



The Coming China Car Boom

by Jack Perkowski



IN 2005, CHERY, one of the fastest growing Chinese carmakers, made a startling announcement: In partnership with Malcolm Bricklin's Visionary Vehicles, it would begin exporting passenger cars to the United States by 2007. At this year's international auto show held in January in Detroit, another Chinese carmaker, Geely, stole the limelight when it showcased its "China Dragon," along with other models it plans to export to the United States beginning in 2008. Chery plans to sell a \$30,000 car for \$20,000 in the U.S., while Geely's goal is to land a basic model in dealer showrooms for \$7,500.

Industry experts are pondering, is this merely hubris on the part of over-ambitious Chinese carmakers? What are the real prospects for the export of complete vehicles from China to developed markets like North America and Europe? And can the two carmakers possibly meet 2007 and

2008 timelines? As with all things China, opinions vary widely.

Quite understandably, many question whether Chinese car companies can achieve the high levels of quality required in more mature markets, and more fundamentally whether the Chinese have the ability to create, rather than merely copy, designs. The accusation by General Motors that Chery copied the design of its Spark model to make the QQ provides plenty of fodder for those making this argument. Previous failed attempts to import cars from low cost countries into the U.S., Yugo being the classic example, are also cited as arguments that Chinese cars will fare no better.

On the other side, many point to the experience of the Japanese car companies, which in the 1970s were making inferior

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for modern passenger cars. Because the industry lacked the ability to make the sophisticated parts required by the latest generation of vehicles now in demand, imports of components increased to \$11.3 billion in 2004 from \$3.4 billion in 2002. While all the talk was about the export of components from China, imports actually exceeded exports in 2002, 2003 and 2004.

In 2005, however, this trend was reversed. Despite a 14% increase in vehicle sales, imports of components actually declined to \$10.4 billion, and exports of components surged to \$15.8 billion from \$10.6 billion, both statistics suggesting that the "technology gap" between China's components industry and the global industry is beginning to close. This gap will completely close within the next four to five years, as companies with technology conclude that they can no longer ignore the China market. Concerns about losing technology to intellectual property violations will give way to the realization that not being in China when the country becomes the second largest automotive market in the world—most likely by 2010—poses a much greater threat.

Aggressive China sourcing plans by companies such as General Motors, Ford, PSA and Volkswagen for their global operations, as well as the emphasis on the localization of components by all assemblers with operations in China, are attracting technology to China and improving the quality of the China supply base. Ford, for example, now has 15 Q1 suppliers in China, and expects to award Q1 status to additional suppliers in 2006. Ironically, efforts by the global assemblers to develop the

China supply base is hastening the day when China can produce export world-class vehicles to developed markets.

A third important factor is that stricter emissions regulations in China are driving vehicle technology in China toward export-suitable models. Apart from quality, one of the key hurdles for Chinese carmakers is that China has been behind developed markets in emissions regulations, with most countries at Euro III or Euro IV levels. In a surprise move, however, Beijing announced in late December that it would implement Guo III emission standards (equivalent to Euro III) for all new registered vehicles in Beijing, effective December 31, 2005, one year earlier than previously planned. It is expected that Guangzhou will follow suit at the end of 2006, and Shanghai by 2008, when the entire nation will be required to adopt Guo III standards. Guo IV goes into effect nationwide in 2010. As China tightens its emission regulations, Chinese carmakers will upgrade their engines and fuel systems to comply, making their models compatible with global standards in the process.

ASIMCO is currently supplying products to both Chery and Geely and we are familiar with both organizations. I have met both Malcolm Bricklin and his key executives at Visionary Vehicles, as well as John Wilmer, COO of Geely North America. While Mr. Bricklin has a reputation for being controversial, one should not underestimate the work that is being done by his organization, which includes a number of experienced automotive executives. They are telling Chery exactly what is required to sell into the U.S. market, and from what

we can see, the Chery executives are listening.

Li Shufu, the Chairman of Geely, is a forceful Chinese entrepreneur who has already brought Geely a long way from its origins as an assembler of motorcycles. He wants to sell into the United States for all the right reasons. He believes that if Geely can compete in the U.S., it can compete anywhere. John Wilmer, the individual who has been selected to lead Geely's effort in North America, is a serious individual who, despite having no prior experience in the auto industry, has strong credentials in both business and government. His job is to tell Chairman Li what is required to achieve his vision. In addition to exhibiting vehicles in Detroit, Geely is conducting consumer surveys, benchmarking Geely's vehicles against U.S. standards, and conducting a test-marketing exercise in Puerto Rico.

For the reasons given above, I believe it is inevitable that Chinese carmakers will break into developed markets in the coming years. Having said that, whether Chery enters the U.S. market in 2007, or Geely in 2008, is not the real point. In my view, the impact of China on the global automotive industry is likely to be much more dramatic than is currently imagined.

That is because fundamental forces are already at work which may cause the center of gravity for technological innovation to shift to China. When combined with its cost and market advantages, a technologically driven China auto industry will cause a fundamental change in the way in which the global industry operates.

As the Chinese auto market approaches the size and scale of the United States, which most experts predict will occur by 2020, China's challenge will be to make transportation more affordable and readily available to its entire population. With relatively small energy reserves and faced with the large environmental costs of adding another 100 million vehicles to its highways, the industry in China will be under enormous pressure to design vehicles which are more affordable, more fuel efficient and more environmentally friendly.

In this context, China will become an early adopter and developer of new technologies. While these same pressures exist in developed markets, making transportation available to the masses will be a matter of economic life and death for China. Moreover, China need not be concerned about obsolescing existing infrastructure. Just as China went from no phones to cell phones in telecommunications, I believe it will also leap ahead to the latest technologies in transportation, skipping over whole generations of technology in the process. As these newer technologies gain scale in an increasingly large China market, they could then set the standard for the global auto industry.

While technological solutions to most problems faced by the global automotive industry are within sight, they must also meet the affordability standard to gain traction in China. As a result, China's greatest contribution may be in developing more affordable solutions, not only for the Chinese consumer, but also for consumers around the world. ■

products compared to those of their Western counterparts. Thirty years later, Japanese assemblers are gaining market share in nearly every part of the world and have long ago stopped competing on price. Instead, they are now known for their quality, design and innovation.

More recently, South Korean assemblers have made great strides in terms of quality and are expanding globally. Hyundai's rise is all the more significant because it has penetrated developed markets even more quickly than the Japanese assemblers. If the Japanese and the Koreans have been able to successfully climb the wall of quality, design and technology, the argument goes, why can't the Chinese?

Against this backdrop, a closer look at the facts is in order. First, there is no question that exports of vehicles from China are growing. In fact, 2005 was the first year in which exports of vehicles from China exceeded imports, with exports climbing to almost 170,000 units, more than twice the number in 2004. Admittedly, trucks accounted for over 60%, and most units went to countries in the Middle East, Southeast Asia and Africa. However, experience gained exporting to less developed countries provides excellent training for sales to more developed markets.

Though passenger car exports accounted for only 39,000 units last year, this represented almost a four-fold increase from 2004. Included were 9,700 cars which Honda shipped to customers in Western Europe from its plant in Guangzhou. In exchange for being permitted to own 65% of an assembly joint venture in Guangzhou (the only exception to the rule against ma-

jority ownership by foreigners), Honda agreed to export its entire production. As a result, Honda may be a special case. But its experience nonetheless demonstrates that vehicles suitable for use in developed markets can be manufactured successfully in China.

Second, while more progress is needed, China's components industry is showing signs that it is gaining the technology and expertise necessary to manufacture components for modern passenger cars, brought about in large part by changes in the market caused by China's entrance into the World Trade Organization in December 2001. WTO accession was the spark which reignited the growth of China's automobile industry. With more liberal regulations and pent-up consumer demand, the number of models assembled in China increased to over 100 in 2005 from less than 20 in 2001, and sales of all types of vehicles increased to almost six million from approximately two million vehicles during the same period. With more competition, Chinese consumers are no longer content with older models. They now want the latest models and technology available from developed markets.

China's components industry was ill-prepared for the increased sophistication of the market brought about by WTO. Despite favorable policies that, for example, have allowed majority foreign ownership in Chinese components companies since 1993, overseas suppliers have been slow to bring their latest technologies to China. Meanwhile, local components makers have lacked the development capability to design the parts, modules and systems required