Domestic carmakers: too many, too slack

Auto analyst Jochen Siebert surveys the realm of domestic automakers and concludes that the industry has too much idled capacity, a dearth of innovative ideas and a lazy capital investment for the future. Something's got to give.

Jochen Siebert
Managing Director, JSC Automotive

In 10 years' time, the local governments can either decide to exit the car market or invest significantly, maybe by acquiring a foreign carmaker.

There are currently too many domestic original equipment manufacturers in China. The central government has been talking about consolidation for more than 10 years, but the number of Chinese carmakers has actually increased. One reason is that local governments want their carmakers to thrive and support them in many ways. In this regard, the automotive industry is similar to other industries in China.

The average capacity utilization across all industries stood at 57 percent in 2013, while the car industry's capacity utilization stood at 65 percent, including the performance of joint ventures. Without the joint ventures, the average capacity utilization of the Chinese carmakers would be only 38 percent, not significantly better than that of solar panel makers. The average capacity utilization of joint ventures stands at 89 percent, well above the 80 percent needed to make money sustainably.

Being state-owned doesn't seem to help. The biggest three Chinese passenger car companies in 2013 were the privately owned Great Wall, Geely and BYD. We don't include minivans in these numbers because they yield only very low margins, if any at all.

Including pick-up trucks, Great Wall made about 750,000 vehicles last year, which, of course, pales in comparison with Toyota's 10 million vehicles in the same period. Great Wall is trying to increase its average sales price of 98,000 yuan (US$16,000) to close the gap with the 178,000 yuan average price of joint ventures. Great Wall seems to be struggling with that, though. The Haval H8 has been delayed due to problems with which owners of a vehicle that cost more than 200,000 yuan would take issue. Great Wall probably doesn't have the financial resources at this time to reach that high and will have to approach that price level over a longer period. It remains to be seen whether the market will give Great Wall enough time to do that.

The average capacity utilization stands at 58 percent, which means Great Wall must increase the number of profitable vehicles sold soon if it doesn't want to run out of cash. Being stuck in the lower ranks also means making less money on every car, which leads to less financial firepower to develop more expensive vehicles that can be more profitable. It's a long struggle that always takes decades.

After the private companies, the largest Chinese passenger carmakers are state-owned enterprises like FAW, Chery and Chang'an, with appalling capacity utilizations of 28 percent, 29 percent and 34 percent, respectively. Both FAW and Chery seem to be incompetent at making vehicles with any other attraction than price. These two carmakers represent two different failed plans for building up significant Chinese carmakers.

FAW stands for a growth approach, based on the assumption that foreign carmakers are willing to share technology know-how with their Chinese partners. Thirty years after the introduction of the joint-venture model, the Chinese partners are still not even close to becoming competitive carmakers. The large state-owned companies like SAIC, FAW and Chang'an all have very profitable joint ventures. It's only rational that the management of these SOEs is not trying hard enough to become better carmakers on their own terms as long as there is a reliable income stream from the joint ventures.

Chery stands for the approach of throwing tons of money at a company and hoping for the best. Over the years, Chery has become less competitive. One problem was that Chery was unable to absorb the knowledge of international executives.

'Third idea'

Chery's Qoros joint venture with Israel Corp actually represents the third idea of developing a successful carmaker. This time the money is thrown at a team of international executives, who are to build a team that would include many Chinese employees as well. Its first car managed to get the highest rating in the Euro-NCAP and seems to be on par with any European car in that price range. Qoros is trying to build the brand and hasn't taken shortcuts in terms of quality. However, this approach means that Qoros will take many years before high numbers of cars will be built. It has to make sure the shareholders don't lose their patience on the way.

Geely is an example of a fourth approach. Rather than trying to just grow organically, Geely bought Volvo to get access to know-how. Geely will struggle to get Volvo in a position where it can be sustainably profitable. Three different local governments supported the acquisition, which explains why there will be two small car plants 3,000 kilometers apart with an engine plant in between, rather than all combined into one larger facility.

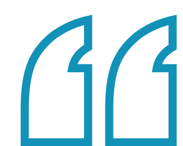
Export is also not a solution for the Chinese carmakers as long as the original equipment manufacturers are not ready for sophisticated markets like Western Europe or the US. The last major original equipment manufacturer to join the global ranks of sophistication was Hyundai. However, from the first Hyundai Pony in 1975, it took almost 30 years for the automaker to be taken seriously in the US and Europe. Hyundai managed to become a successful exporter only after it secured a dominant market share in its home market South Korea. None of the Chinese original equipment manufacturers has what it takes to secure a large market share at home.

If China manages to rebalance the economy, less money will end up in the hands of local governments. Since land sales also will be curbed in future, local governments will have to find new income sources. Selling shares in joint ventures would be significant. Local governments will be more than willing to support the end of the joint-venture rule. We assume that the buy-out of the Chinese partners would happen over 10 years or so. In that time, the governments can either decide to exit the car market or invest significantly, maybe by acquiring a foreign carmaker.

License limits could throttle car industry

Wilson Liu
PwC China Automotive Leader

Sophie Shen
Lead China Analyst of PwC Autofacts



Municipalities and original equipment manufacturers can use this opportunity to develop a more eco-minded way of balancing the needs for mobility amid burgeoning population growth.

FOLLOWING Shanghai, Beijing and Guangzhou, the port of Tianjin has become the fourth city in China to impose a quota on the number of new car license plates. The new policy takes effect this month and is aimed at curbing both traffic congestion and air pollution by capping the number of new licenses issued at 100,000 a year.

The licenses will be granted by lottery and auction, with 60,000 going by lottery and 40,000 by auction. There are additional quota-like measures that would limit use of vehicles— based on odd or even license plate numbers — during peak congestion periods. This practice is already in place in Beijing, and other cities may follow suit.

When the policy was announced in Tianjin in December, citizens flocked to dealer lots to buy cars before the measure came into effect. That added to a sales surge at the year end. Overall, the Chinese auto market saw another year of strong growth, outperforming tempered expectations for 2013 with 14.2 percent growth from 2012.

An additional eight large cities are rumored to be ready to follow suit with similar car-restriction policies in the coming months, prompting potential buyers to expedite purchases. According to the China Passenger Car Association, retail sales volume reached 1.7 million in December 2013, an 11 percent increase over November and up 20 percent year on year.

As rising levels of air pollution and growing traffic congestion plague large cities, slowing the expansion of vehicle use is an obvious and immediate solution. In the long term, there are implications that may leave the market in a precarious situation. Any overarching policy, such as registration limitations, is seen as a disruptive change that could result in shifts in supply and demand.

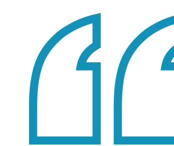
The stimulus programs of 2009 boosted the car market by more than 10 percent that year, and, in our estimation, the impact of additional cities imposing limits could lead to a 15 percent decline in the mid-to-long term. Moreover, the rising cost of new license plates, increasing the overall cost of car ownership, may change buyer preferences. Buyers may splurge on higher-priced models because the license is seen less as a commodity and more as a privilege. Conversely, buyers may downgrade their choices to offset the increased burden. Either way, the growth of entry-level vehicles is expected to be curbed because eventually buyers will prefer a decent car within their capability.

There is little doubt that the four cities that have enacted license limitations benefited in terms of pollution and congestion to some extent. The situation would have become more intolerable if vehicles were released to the road without limitations. It should be noted, though, that the problems Chinese cities have are not much different from the growing pains experienced by other metropolises in recent history. Tokyo faced a similar situation in the 1960s, as vehicle penetration grew from under 500,000 units in 1965 to 1.2 million by 1970. The city's rapid urbanization eventually led to a stronger public transportation network, and what was once a city riddled with air pollution and traffic congestion is now one of the more efficient megacities of the world. Statistics shows that in today's Tokyo, merely 11.6 percent people use a car to go to work or school. Most people use metro or railway (38 percent), auto bikes and bikes (16.5 percent) and the other measures.

There is no silver bullet to address the multifaceted issues of the rapidly growing cities and the corresponding impact on the auto market. Despite looming concerns, we remain optimistic about growth within the country. Municipalities and original equipment manufacturers can use this opportunity to develop a more eco-minded way of balancing the needs for mobility amid burgeoning population growth.

Among global automakers, Volkswagen, General Motors Co and Ford Motor Co are likely to benefit most from a second year of relatively strong growth in the Chinese mainland market. — Zhang Suoqing

Hyper-growth auto sales may be gone, but China market 'still the place to be'



We believe clearly for anybody working in the automobile industry, if there's one place to be, it's China.
Hubertus Troska
Head of Daimler AG's China operations

The world's biggest auto market will likely sustain the momentum it regained in 2013, helped by an anticipated array of economic stimulus measures and robust demand for cars in smaller cities of China's interior regions, according to industry executives and analysts.

The new year should mark a second year of double-digit growth for China after sales expansion rates slumped in 2011 and 2012 to 2.45 percent and 4.33 percent, respectively. In the previous 10 years, auto demand in China often surged 30 to 40 percent annually. Those hyper growth days are over, but last year the Chinese market rebounded convincingly. In 2013, sales in China rose 13.9 percent to 21.98 million vehicles, according to the China Association of Automobile Manufacturers (CAAM).

"We believe clearly for anybody working in the automobile industry, if there's one place to be, it's China," said Hubertus Troska, head of Daimler AG's China operations that include Mercedes-Benz.

"If things continue well, there's a good chance that the automobile market in China will grow again double-digit this year," said Troska, who is also a member of Daimler's management board.

The revived strength of China's auto market is a relief to global automakers whose business is still impaired by sluggish demand in Europe and an anticipated slowdown in growth in the United States this year.

Volkswagen AG, for example, had forecast vehicle demand in China to grow at annual rates of between 5 and 7 percent over the next five years. Jochem Heizmann, head of Volkswagen's China operations, said he believes the German automaker might have been too conservative.

As demand appears poised to expand much faster, "we could sell more (cars) if we have more capacity," Heizmann said.

LMC Automotive forecasts an increase of 11 percent this year in China's overall automobile market for passenger cars and commercial vehicles — a forecast echoed by Shanghai-based consulting firm Automotive Foresight. IHS Automotive, another consulting firm, predicts demand to grow 9 percent. CAAM said China's overall demand for automobiles will likely grow 8 to 10 percent this year.

What's driving demand

The main support for auto sales, experts say, will likely come from continued strong economic growth in China's interior provinces, as opposed to the previous decade and a half when the bulk of growth was generated in the country's coastal provinces.

Another supportive factor is a series of fresh stimulus measures seen likely to be implemented this year by China's new leadership under President Xi Jinping.

Those factors, combined with steady personal income growth backed up by falling vehicle prices, will help ensure a second straight year of double-digit growth, according to Yale Zhang, head of Automotive Foresight.

The Chinese market should be able to comfortably overcome demand-sapping pressures such as auto sales restrictions now being implemented in a growing number of big cities, Zhang and others said. Those sales caps in cities including Shanghai and Beijing are aimed at cutting air pollution and congestion.

Among global automakers, Volkswagen, General Motors Co and Ford Motor Co are likely to benefit most from a second year of relatively strong growth. Volkswagen, GM and Ford market some of China's best-selling cars, such as the Volkswagen Lavida, the Buick Excelle, and the Ford Focus.

The future for Japanese automakers in China, by contrast, remains clouded. Japanese brands led by Nissan Motor Co Ltd, Toyota Motor Corp and Honda Motor Co Ltd are seen unlikely to benefit fully from China's renewed strength because of lingering political tensions.

Sales on a month-by-month basis recovered to pre-crisis levels for many Japanese brands toward the end of last year. Toyota for instance forecast 20 percent growth in China sales to about 1.1 million vehicles this year, compared with year-on-year growth of 9 percent in 2013. Still, some industry executives and analysts doubt a convincing reversal of fortunes for Japanese automakers. The main source of worry comes from Japanese Prime Minister Shinzo Abe's visit last month to the Yasukuni war shrine that is seen by critics as a symbol of Japan's wartime aggression.

Already, the collective Japanese share of China's passenger car market fell to 16.6 percent in 2013 from 23 percent in 2011, according to LMC Automotive, following the flare-up of anti-Japanese sentiment triggered by the territorial dispute in late 2012. That year, Japan's share fell to 19.2 percent.

(Reuters)