



How to be Competitive in Chinese Automobile Industry

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Abstract

Chinese market has a great demand for foreign cars, and a great many foreign automobile companies are competing for their market shares here. The most representative ones are Volkswagen and Honda, they adopted different market strategies and they both suffered some success and failures. With so many competitions, the future of Chinese automobile industry is hard to predict.

Keywords: Market structure, Industry structure, External challenges, Three joys, Source and supply chain

1. History background

After the reform and open policy, China's economy has been increased rapidly, and there was a great demand for cars. But the domestic automobile industry was not that developed at that time and could not meet with such a great demand. So in the 1980s, Chinese automobile industry started to join hands with the foreign companies and improve the technology.

Among all the foreign companies, the most typical and successful ones are Volkswagen and Honda.

The Volkswagen Company started to enter the Chinese market in 1984 with production base in Shanghai. It is one of the earliest manufactures set up business in China. And it set up another joint venture in Changchun in 1990. Until today, the company owns 14 enterprises in the whole mainland of China.

The Honda Company entered Chinese market in 1994, but their early business was manufacturing some car components. Not until 1998, did the company set up its first production base in making cars in Guangzhou, China.

From the statistics of market shares in 2006, we can see that both companies have achieved great success.

1949-1980

1956: The first modern automobile factory First Automobile Works began production.

March 10, 1958: The first 2½ tones light duty truck (NJ130), which was based on the Russian GAZ (GAZ-51?), was produced in Nanjing. Named 'Guerin' brand by China's First Ministry of Industrial Machinery.

June 1958: Nanjing Automobile Work, which previously was a unit in the Third Field Army, was established. The truck production continued until the last truck (NJ134) rolled off the assembly line on July 9, 1987. Cumulative production was 161,988 (Includes versions like: NJ130, 230, 135 and 134).

late 1950s to 1960s: Several automobile factories were set up in Nanjing (today is Nanjing Automobile (Group) Corporation, Shanghai (today is Shanghai Automotive Industry Corporation), Jinan (evolving into China National Heavy Duty Truck Group), and Beijing (today is Beijing Automotive Industry Holding Corporation).

1968: The Second Automobile Works (later Dongfeng Motor Corporation) was founded.

1980s

Three big joint-ventures and three small joint-ventures:

Shanghai Automotive Industry Corporation - Volkswagen: Santana mid-size/compact car.

First Automobile Works - Volkswagen: Volkswagen Jetta compact car.

Dongfeng Motor Corporation - Citroën: Citroën Fukang compact car.

Beijing Automotive Industry - DaimlerChrysler: Jeep Cherokee.

Guangzhou Automobile Industry Group - Peugeot : Peugeot 504 (subsequently defunct). (However, in the 90s, Honda replaced Peugeot as the partner of Guangzhou Auto, and producing the Accord and the Fit with huge success. And in 2006, it started to manufacture Toyota Camry, with huge success also. Making Guangdong province the center of Japanese makes auto manufacturing in China now.)

Tianjin Automotive Industry - Daihatsu : Daihatsu Charade (merged with FAW/Toyota joint-venture).

After 1990

Several enterprises entered the automobile industry since 1994. Some of them are originated from defense industry, such as Chang'an Motors, Changhe, and Hafei Motor; some were developed from old state-owned companies, such as Brilliance China Auto, BYD Auto, Chery Automobile, and Changfeng Automobile. Others are private-owned companies, such as Geely Automobile, Great Wall Motors.

Insert Table 1 Here

2. The Chinese automobile market

By a first look on the growth rates of the Chinese car market you can only be impressed. In 2007 the car market increases dramatically. 37 % more cars were sold than the year before while the European car market was growing slowly and the US car market has had a growth rate near to 0 %.

Additionally impressive is the number of car builders in China. More than 80 Chinese companies are producing cars at the moment. This huge amount of competitors needs a form of organisation so that they can be successful not only in China but in the whole world. Up to now the majority of these companies are quit unknown abroad and so the Shanghai Automotive Industries Corporation (SAIC) and Nanjing Automobile decided to develop standards in design, the production process and the sales management of these companies in order to raise the export rate of Chinese cars.

The potential of the Chinese car market is gigantic. At the moment there are about 30 million cars in China. If China would have the same cars-per-person-rate like the European Union 870 million would have been to be sold there additionally. More than 70 % of all Chinese are saving money in order to buy an own car.

In face of these figures and prospects also a lot of foreign car builders try to enter the Chinese market in the hope to participate from the high demand for cars. Many of them thought that just being on the market will lead to high sale-rates and economic success. Toyota from Japan, GM from the USA, Volkswagen, Daimler and Audi expected that they could sell even more cars on the Chinese market than on in their country of origin. They used different strategies that lead only in some cases to high sales. The different strategies on selling cars of German Volkswagen and the Chinese car company Honda will be discussed later. But even now it can be said that only by offering cars that hit the Chinese requirements and wishes a car builder can be successful on this growing market.

By having a closer look on the sales figures Volkswagen is very successful in selling their cars in China. In 2008 it is expected that Volkswagen sells more cars on the Chinese market than on its home market in Germany. A reason is that the demand for practical, daily use cars is very high. Volkswagen also has a very good reputation by being one of the cheapest German car builders. In contrast to that the German premium car builders like Daimler and Audi are in concurrence with other foreign companies like Lexus (Toyota), Volvo and Infiniti (Nissan). Even these premium brands have high growth rates although the prices of their cars are extremely high compared to the average Chinese salary. An additional problem for these companies is local regulations that for instance forbid driving cars with strong engines in big cities like Beijing.

Another question that has to be answered is: Do the Chinese prefer foreign cars to cars from China and why? First of all it has to be said that in China cars are like nearly everywhere in the world status symbols. For example driving an Audi A8 is closely connected to having a good job and being successful in life. At the moment there do not exist many Chinese luxury cars. To a certain degree the Chinese do not have the choice if they want to buy a premium car with good reputation they have to buy a foreign car. On the other hand the Chinese car builders develop and grow very fast. Probably it would be big mistake to underestimate their potential. Especially the history shows that in the first year none of the old "Western" car builders expected Toyota from Japan as being a real competitor. Nowadays Toyota is famous for being innovative (e.g. hybrid car) and successful all over the world.

Moreover I think as a country of economic importance China will try to establish an own strong car brand that represent their technical progress.

3. 'Olympic Program' - The Strategic View of Volkswagen in China

Volkswagen was the first company entering the Chinese automobile industry. Faced by a satisfied home market the company had to expand its business and therefore the growing economy of China was their next choice.

The Volkswagen Beetle, the first car produced for the Chinese market, was a real success. After several years competitors, mainly from the Japanese market like Honda, started to enter the Chinese market very aggressively and due to that Volkswagen had to face the challenge to maintain its market leader position and therefore adopt the corporate strategy.

As a consequence Volkswagen China introduced its 'Olympic Program' strategic plan in 2005. The program is called 'Olympic' since its aim is to reach the strategic goals set by the end of the Olympic year 2008.

In the following we will analyze the strategic plans of Volkswagen and set them in context to the strategic behaviour of the Japanese competitor Honda.

3.1 Marketing

Volkswagen announced to focus more on differentiation. This is due to the existence of two joint ventures and the planned positioning of the Skoda products. By offering a large product variety the group aims to serve as many different target customer groups as possible.

In opposition to previous product designs the new cars offered by Volkswagen will be adapted to Chinese taste in order to increase the brand's popularity. The former Volkswagen products were designed for the European market but since Japanese car manufacturers fit better to the Asian taste the company had to react. The Volkswagen products in China compete on quality but to maintain the company's leading position it is unremitting to produce cars that are both fashionable and qualitative.

3.2 Sales

Sales relationships are going to be restructured and there will be more interaction between the two joint ventures FAW VW and VWS. These strategic interactions are another way to increase the company's customer orientation and thereby the attractiveness of the brand. Dealerships will be tailored to the newly-defined customer group's segmentation of the two joint ventures respectively. Vehicles of the Volkswagen brand will be distributed through two dealer network channels. By this, Volkswagen aims at its strategic goal to maintain its leading position by serving different customer groups.

3.3 Research and Development

The company focuses more on in-house developments within the Volkswagen joint ventures in China to save costs. Ten to twelve new models developed in China for the Chinese market should be launched by the end of 2008.

3.4 Sourcing and Supply Chain

Historically the two joint ventures VW Shanghai FAW VW in Changchun sourced separately but within the last decade sourcing became more challenging for the company: the cars are becoming more sophisticated and therefore the components have to fulfil higher expectations, the technical expertise of the supplier is getting more important and it is difficult for Volkswagen to find suppliers which meet their requirements, lack of availability of certain raw materials (e.g. specific kinds of steel) cause sourcing difficulties.

As a reaction Volkswagen is trying to introduce a common sourcing process for the global group and bundle the purchasing volume in China to create economies of scale. Thereby the target is to find one supplier for each platform part and carry these parts to China.

3.5 Manufacturing

In order to decrease production costs the board decided to introduce so called 'product cost workshops' within the manufacturing departments to communicate cost targets and 'produce to costs'. Also large parts of the manufacturing process will be done in China and localization in China are planned to be increased to make use of the cheaper labour wages in China. Besides all plans to reduce production costs Volkswagen tries not to compromise its high engineering quality and manufacturing standards since this is a very important success factor for the company.

4. Honda strategy in China

Honda advocates the spirit of three joys.

Because of their belief in the value of each individual, Honda believes that each person working in, or coming in touch with their company, directly or through their products, should share a sense of joy through that experience. This feeling is expressed in what they call "The Three Joys". Their goal is to provide Joy: for those who buy their products and produce their products. In that regard, their main concern is for people.

First, there is "The Joy of Buying" for every customer who buys a Honda

This Joy is a step beyond customer satisfaction. As they define it, there are four steps to successfully creating The Joy of Buying. The customer must first understand the product and its fundamental concept. Second, the customer should accept the product and make the decision to buy the product. Third, the customer must be completely satisfied with the product. Finally, the customer will experience The Joy of Buying if the company can provide products and services that exceed their customers' expectations.

Second, there is "The Joy of Selling". To achieve The Joy of Selling, what is important is not just the relationship between the customer and their products. Their products provide the opportunity for a human

Those who sell and service Honda's products seek to respond sincerely to customers' needs and desires. When the quality and performance of the products are excellent, those who are engaged in selling and servicing the products are proud to represent Honda to the customer. When their sales and service network

Especially Honda's dealers and distributors, experience that pride and a positive relationship with our customers, they feel The Joy of Selling.

Third, there is "The Joy of Producing". At Honda, the Joy of Producing

Including manufacturing, production engineering, research and development, and Honda suppliers, by producing quality products that exceed the expectations of our dealers and our customers, we can experience pride in a job well done.

When we realize The Three Joys, we should also be creating joy for society as a whole. Because of the industry we are in, we affect society in many ways. Some are positive – such as personal mobility, the pride of owning a spirited and valued product and the provision of employment opportunities. Some are negative – such as the environmental impact of our product. Social issues, especially safety and environmental concerns, are among the most pressing needs of our society.

We also pick up another 4 strategy of Guangzhou Honda in China. Firstly, large scales of purchasing; Honda uses their economies of scale by working with their parts suppliers to order raw materials in large quantities.

Secondly, suppliers' localization, more than 160 component suppliers around Guangzhou Honda to manufacture some supports component for automobiles. For example, the glass seat and engine. These parts are supplied not only for Guangzhou Honda but also sometimes for exporting. What's more, setting up manufacturing base for transmission in Guangzhou really makes a record, because this is the first time for foreign-funded automobiles enterprises to set up transmission manufacturing base in China. And this investment of Honda makes the supplier localization especially the suppliers for core parts.

Thirdly, optimizing logistics process. They use logistics management software from USA. The logistics department of Guangzhou Honda was demanded to operate according to the pattern in Japanese Logistics Company. They emphasize importing the service quality in logistics, decreasing logistics cost enlarge market share and competitiveness and import new technology and methods in logistics from USA.

Fourthly, making supply chain perfect. The Honda setting up a local transmission manufacturing base in Guangzhou makes transmissions no longer popular in importing and components industrial chain in China will develop to perfect. the newly set-up base will provide transmissions to three Honda companies in China (Guangzhou Honda, Dongfeng Honda and China Honda). In this pattern, the most crucial part of automobile---engine production has been promoted a lot.

In the influence of transmission localization. The biggest supplier of clutch in Japan set up a factory in 5 years with the total investment---54million dollars in Nanhai District in Guangzhou and it manufacture clutch for Guangzhou Honda directly.

With the localization of supplier of transmission and clutch the supply chain of Guangzhou Honda has developed into nearly perfect.

Honda's strategy in supply chain can considerably decrease the cost which gives Guangzhou Honda more profits.

Then we move on to the comparison of the marketing between Volkswagen and Honda. Firstly, for Honda they launch a new car later in China compared with in Japan. For example, the Accord in 2008 was launched half a year later in China than in Japan. But for Volkswagen, a new car will have a same launching agenda all over the world; it means same time promoting same time marketing.

Secondly, Honda adjusts the price to the situation of market nearly every season. Demand fluctuation, price fluctuation. The flexible price strategy is different from Volkswagen's steady price strategy which perhaps gives consumers more reliability.

Thirdly, Honda fight for market share and Volkswagen emphasize brand reputation in long term, Honda target consumers which means flexible strategy will be much easier for company to survive and succeed. While for Volkswagen, more luxury and exclusive element allow Volkswagen to offer more credence for consumers in order to gain reputation in long term.

5. The future of Chinese automotive industry

The future of the automotive industry in China can be said to be depending on certain factors: the market structure; the industry structure and external challenges.

5.1 Future market structure

There are two different pictures among Chinese industrial leaders about how the market will develop. Either they suggest steady growth or they suggest exponential growth. With steady growth China will be competing with the USA about being the largest market by 2015. When GDP per capita increase the vehicle sales do the same thing. With the assumption that there is a crucial point in the GDP per capita where the households regards their income as enough for affording a car, there could be a possibility for a dramatic increase in the automotive sales. The potential of the Chinese

automobile market is big; a figure from 2005 says that on average 1000 Chinese people own 24 vehicles, which could be compared to the global average that at the same time was 120 vehicles per 1000 people. A steady growth instead of an exponential might though have the positive implication that it will give the Chinese government time to develop better circumstances for the industry. It might as well give time for the manufacturers, suppliers and dealers to grow in a healthy speed, with a better potential to sustain in the long run. The long run sustainability may be threatened if the industry has to react too quickly to a sudden market growth since the time will be too less to develop a good knowledge base as well as capital resources.

An important issue in the future market structure is the potential to develop new financing alternatives for car buyers. Special vehicle loans may trigger the demand for new cars, while the necessity of paying a very big part of the car in cash may lead people rather to choose to buy a used car or a less expensive new car. That the financial companies create a trust among consumers is therefore important and it will make it easier for people to make decisions about buying not only cars but also accessories, insurance and service to the cars.

5.2 Industry Structure

The development of the automotive industry is very depending on the industry structure. Since China does not have an old tradition in making good quality cars, as several other countries, knowledge must either be imported or developed by the Chinese automotive companies. As an own development of a knowledge base and technology may be costly both in the form of time and money, the import of these features may in many cases be preferable. A way of making this import can be via mergers and acquisitions of companies from outside of China, who has got the demanded knowledge and technological skills. Another way of taking advantage of international development is by joint ventures between Chinese and foreign companies. Something that is very important for getting the best result out of the joint venture is that the two companies develop a way of trusting on each other. In other words they have to overcome the fear that the other company will steal the competences, using them by themselves in later stages. For a positive development to take place in terms of mergers, acquisitions and joint ventures, the government can play a key role by deregulating the market and setting policies encouraging these activities. Of course the market competition may also push companies to consolidate.

5.3 External challenges

Regarding the external challenges, the infrastructure plays an important role. The possibilities of using a car may of course influence the decision of buying a car or not. Today there are still big development possibilities concerning the traffic system in China. The connections between cities in urban and rural China still need improvement. Additionally the whole traffic management, concerning traffic planning, traffic-flow and congestion may need enhancement. The gas stations need also to be more spread out and the number of parking spaces in the cities should be increased. All these factors are essential for the Chinese automobile market to extend.

Another factor that must be taken seriously is the effect on the air of an increase of the Chinese motor vehicle population. Also an even bigger augmentation in the demand for oil may be an important feature for the future car industry in China. This can in fact have a big impact on the global oil supply. These aspects will raise the question of making cars with smaller consumption and alternative fuel cars. That incentives are given for the car manufacturers to develop and produce these cars are therefore important. Here the government plays a central role, as it can stimulate the demand for these kinds of cars, something that may be essential for the Chinese automotive industry in the long term.

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Table 1. Auto. Sales by Leading Manufacturers in 2006

Rank	Firms	Sales (1000 Units)	Shares(%)
1	Shanghai Automotive Industry Corporation (Group)	1224	20.22
2	China FAW Group Corporation	1165.7	19.26
3	Dongfeng Motor Corporation	932.3	15.40
4	ChangAn Automobile (Group) Liability Co.,Ltd	708.7	11.71
5	Beijing Automotive Industry Group Corporation	685.1	11.32
6	Guangzhou Automobile Group Co.,Ltd	352.3	5.82
7	Chery Automobile Co.,Ltd	302.5	5.00
8	Harbin Hafei Automobile Industry Group Co.,Ltd	266.8	4.41
9	Huachen Automotive Holding	210.2	3.47