



TURKISH INDUSTRY AND BUSINESS ASSOCIATION

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``Report on Chinese Automotive Industry``

The overview of automotive industry in China

The status of Chinese automotive industry in 2008

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The Overview of Automotive Industry in China

In 2008, global financial crisis hastened the economic recession worldwide and the economic situation of China also underwent big changes. Under the impacts of a series of factors including macro-regulation, Series of natural disasters, Global financial crisis and implementation of national emission standards III, the production and sales of automobiles in China shown the tendency of “going down” and the momentum of high-speed growth in recent years was finished. The growth rate of economic benefits of the industry obviously slowed down and the increase of export was considerably restricted.

Thanks to China's 4 trillion stimulus package, the automotive industry has been included into "Top Ten Revival Industries" in 2009. The prospect of China's automotive industry is quite extensive. According to the experts' forecast, the vehicle production in 2009 is expected to reach 12.737mn units and will continue to maintain growing in 2010 and 2011 with the expected growth rate around 19% to 20%. By the end of 2009, China will become the first automobile-producing country in the world and will account for 12% of the total automotive consumption all around the world. In 2015, China is expected to be the largest automotive consumer market surpassing the United States. By 2020, China's domestic automotive output will reach 20mn, of which 20% will enter the international market.

This report tries to make an analysis of the current status of China's automotive industry and its development prospects, thereby reducing the investment risk.

Status of China's Automotive Industry in 2008

➤ **Automobile production and sales**

The production and sales of automobiles of China reached 9.3451mn and 9.3605mn respectively in 2008, up by 5.21% and 6.70% respectively year-on-year, while the growth rate of production and sales dropped by 16.81% and 15.14% respectively year-on-year, which was the first time for the annual growth rates below than 10% since 1999.¹

➤ **Market share of automobile brands**

The sales of local branded sedans amounted to 1.3082mn in 2008, accounting for 25.92% of the total sales,

a drop of 0.43% year-on-year concerning market share. Among foreign brands, Japanese brands had relatively good performances and the sales of vehicles reaches 1.556mn, accounting for 30.83% of the total sales of sedans with the market share increasing by 1.92% year-on-year. The sales of German and South Korean brands increased to 1.0265mn and 361,700 respectively, accounting for 20.34% and 7.17% of the total sales of sedans respectively, with the market share growing by 0.38% and 1.25% respectively. The sales of the US and French brands fell slightly to 615,300 and 178,100, accounting for 12.19% and 3.53% of the total sales of sedans, with the market share dropping by 1.96% and 0.85%.²

¹ From China Association of Automobile Manufacture:
<http://www.caam.org.cn/zhengche/2009/37/093714912A24234EGDCIEJIHJ39BB.html>

² From China Auto Industry Consultancy:
[http://www.auto-sinomind.cn/\(S\(lcds0x45yzuhsy55edbzaiz2f\)\)/NewsCon](http://www.auto-sinomind.cn/(S(lcds0x45yzuhsy55edbzaiz2f))/NewsCon)

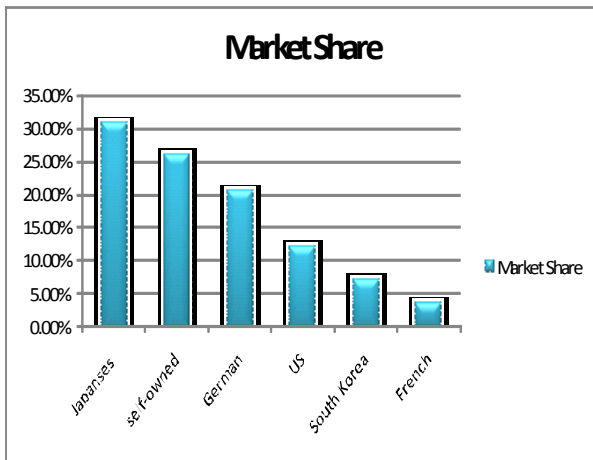


Figure 1: Market Share of Automotive Brands 2008

➤ Automobile export and import volume

With regards to export, the export of complete vehicles was largely affected by international environment in 2008. In the first half of the year, the fast growth trend was maintained as a whole, while since the third quarter, the growth rate obviously fell, particularly, the year-on-year drop every month for five consecutive months since Aug. quickened the trend of fall of export growth rate on year-on-year basis in 2008. By the end of 2008, the export of automobiles totalled 680,700, up by 11.10% year-on-year, with the growth rate falling by 67.85% year-on-year. The amount of export reached USD9.633bn, up by 31.75%, with the growth rate falling by 101.44% year-on-year.

With regards to import, 410,100 automobiles were imported in 2008, up by 30.53% year-on-year. The accumulative amount of import reached USD15.128bn, up by 41.65% year-on-year with the same growth rate of the previous year. As far as the import of automobiles was considered, the situation in the first half of the year was relatively good, while import slowed down since July. After the fourth

quarter, the import grew month by month, better than export at the same time.³

➤ Investment on automotive industry

According to the statistics of MOFCOM, 521 foreign investment projects in Automotive industry were newly set up in 2008, 321 less than that of the same period in the last year, and the amount of the actual utilized foreign capital reached USD 2.66711bn up by 48.09 % year-on-year. The number of newly established foreign invested enterprises and the amount of the actual utilized foreign capital accounted for 1.89 % and 2.89% of the national total number or amount of foreign capital absorption in the Automotive industry during the same period.

Calculated by the amount of the actual utilized foreign capital, in 2008, countries or regions: Hong Kong, Japan, Korea Rep, United States, Br. Virgin Is, ranked No.1 to No. 5 in the automotive industry regarding the amount of FDI, accounting for 24.9%, 14.64%, 14.02%, 13.86%, 7.53% of the total amount of the actual utilized foreign capital of the industry separately.

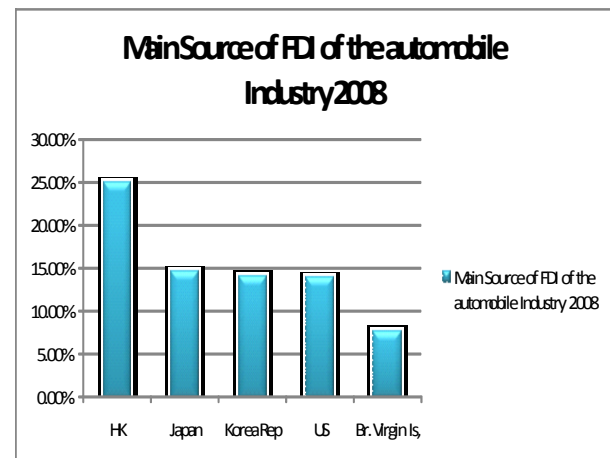


Figure 2: Main Source of FDI of the automotive Industry 2008



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In 2008 automotive industry, ten (10) Asian countries/regions (Hong Kong, Macau, Taiwan, Japan, Philippines, Thailand, Malaysia, Singapore, Indonesia and Korea) newly set up 359 enterprises in China, with the actual utilized foreign capital of USD 1.52435bn down by 35.43 % and up by 50.71 % separately year-on-year. The number of the newly established enterprises and the actual utilized foreign capital accounted for 68.91 % and 57.15 % of the national total number or amount of foreign capital absorption in the same period.

The EU set up 61 new enterprises in China, down by 26.51 % when compared with that of the same period last year; the actual utilized foreign capital reached USD 205.05mn down by 8.12 % year-on-year. The number of the newly established enterprises and the amount of the actual utilized capital accounted for 11.71 % and 7.69 % of the national total number or amount of foreign capital absorption in the same period.

The US set up 47 new enterprises in China, down by 42.68 % year-on-year; the actual utilized foreign capital reached USD 369.6mn up by 139.77 % year-on-year. The number of the newly established enterprises and the amount of the actual utilized capital accounted for 9.02 % and 13.86 % of the national total number or amount of foreign capital absorption in the same period.

437 foreign-invested automotive enterprises were newly set up in the Eastern area, with actual utilized foreign capital of USD 2.1698bn accounting for 83.88 % and 81.35 % of the national total number or amount of foreign capital absorption in the same period. In the Eastern area, Jiangsu Province, Guangdong Province and Zhejiang Province ranked among the tops with respect to actual utilized foreign capital, had 146, 42 and 89 newly established foreign-invested enterprises separately,

with the actual utilized foreign capital of USD 661.47mn, USD 362.49mn and USD 297.91mn, accounting for 24.8 %, 13.59 % and 11.17 % of the total amount of the actual utilized capital of the industry in the Eastern area separately.

73 foreign-invested automotive enterprises were newly set up in the Central region, with actual utilized foreign capital of USD 386.97mn, accounting for 14.01 % and 14.51 % of the national total number or amount of foreign capital absorption in the same period. In the Central region, Anhui Province, Jilin Province and Hubei Province ranked among the tops with respect to actual utilized foreign capital, had 14, 5 and 15 newly established foreign-invested enterprises separately, with the actual utilized foreign capital of USD 239.62mn, USD 48.26mn and USD 47.27mn, accounting for 8.98 %, 1.81 % and 1.77 % of the total amount of the actual utilized capital of the industry in the Central region separately.

11 foreign-invested automotive enterprises were newly set up in the Western area, with actual utilized foreign capital of USD 110.34mn, accounting for 2.11 % and 4.14 % of the national total number or amount of foreign capital absorption in the same period. Guangxi Zhuang Autonomous Region, Chongqing and Inner Mongolia Autonomous Region ranked among the top with respect to actual utilized foreign capital, with the actual utilized foreign capital of USD 56.72mn, USD 50.72mn and USD 1.66mn, accounting for 2.13 %, 1.9 % and 0.06 % of the total amount of the actual utilized capital of the industry in the Western area separately. Among them, Guangxi Zhuang Autonomous Region, Chongqing and Inner Mongolia Autonomous Region had 1, 1 and 1 newly established foreign-invested enterprises separately.

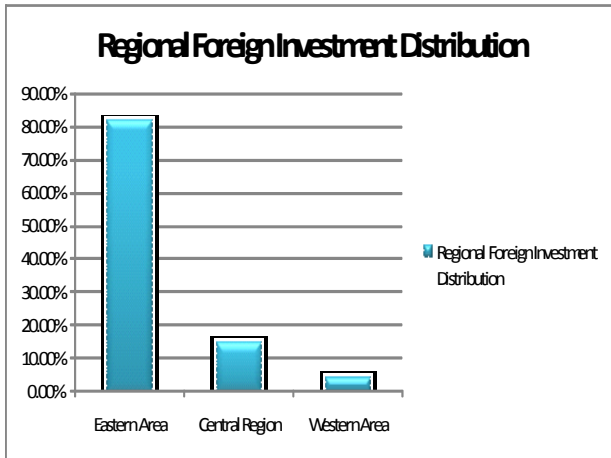


Figure 3: Regional Foreign Investment Distribution (by Regional FDI Inflow) of the automotive Industry 2008

in 2008, there were 116 Chinese-foreign equity joint venture projects, 393 wholly foreign-invested projects, 10 Chinese-foreign contractual joint venture projects, which newly established in the automotive industry. In 2008, in the automotive industry, the amount of the actual utilized foreign capital in the Chinese-foreign equity joint venture projects reached USD916.37mn; wholly foreign-invested projects reached USD1.66053bn; Chinese-foreign contractual joint venture projects reached USD4.79mn.⁴

China and Turkey's Trade/Investment Relationship on Automotive Industry

Chinese automotive enterprises begin to enter Turkish market in recent years. According to CAAM (China Association of Automotive Manufacturers), at present, the export volume of automobile from China to Turkey is small. During first 8 months of 2009, the automobile export volume from China to Turkey amounted to just more than USD168mn, down by 30.46% when compared with the same period of last year. However, as Turkey is the springboard for enterprises which

intend to enter European market, most automobile manufactures begin to invest more in Turkey including Chinese manufactures.

Before Chinese automobile manufactures investing in Turkey, they have to confirm that whether they can produce the cars in line with EU regulations and standards as EU regulations and standards are applicable in Turkey.⁵

Prospect of Chinese Automotive Industry

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

➤ Market structure

There are two different pictures on how the market will develop: either steady growth or 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 will 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 automotive 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 will also have a 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

⁴ For more detailed info, please refer to <2009 Annual Report on China Automotive Industry Development >

⁵ From <China Automotive News>2009-12-01



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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. Thus 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.

➤ **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.

➤ **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 automotive market to extend.

Another factor that must be taken seriously is the environmental effect on the 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. The 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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Prominent Challenges

➤ Limitation to Investment

For a foreign automobile manufactures wanting to invest in China, the only permissible business structure is a joint venture with a Chinese partner. The foreign investors' maximum share is limited to 50%. In addition, a foreign investor is limited to setting up no more than two such Sino-foreign JV for the production of passenger cars, and two for commercial vehicles. ("2+2")

➤ Type Approval/Homologation Standards

The China Compulsory Certification system in effect since 2002 has become more onerous for manufacturers over the years. Accretions to the CCC homologation procedure may reduce the chances that China may soon adhere to global harmonised standards and testing methods under the UN/ECE 1958 Geneva Agreement.

➤ Fuel quality

Fuel quality (gasoline and diesel) and emission standards do not equate, and improvements in fuel quality lag behind the introduction of emission standards for cars and trucks. Consequently, the air quality will not improve as intended; and the substantial investments made by vehicles makers to upgrade their technology will not generate the social benefit that should have justified such investments in the first place.

➤ Publishing vehicle licensing data

As of now, the vehicle industry is only able to publish and market data through the China Association of Automobile Manufactures and the National Union of Passenger Vehicles. However, being the industry's benchmark, the vehicle licensing data has been controlled by the Ministry of Public Security (MPS) and is not readily available to the public. For years, the industry has been lobbying for the publication of the data, yet manufactures may only purchase such data through various agencies and are therefore unsure on the validity of the data provided.

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