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Foreign Automobile Companies in China

A Case Study of Volkswagen and General Motors

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Abstract

The globalisation of the business environment has companies facing several enormous challenges, the most important of which being internationalisation, market maturity and increased customer power.

Developed countries still represent the most important markets for most of the large MNCs. These markets, however, are becoming increasingly mature and saturated. More often, the markets are characterized by over capacity, low margins and lack of growth, as well as shorter product life cycles. This means that the competition is becoming more intense, and companies can grow primarily at the expense of the competitors.

However, since slightly more than 10 years ago, after serious large-scale political changes in the world, new markets, which used to be quite closed for western companies, attracted the attention of the global investors and big multinationals. Eastern European, former Soviet countries' and Chinese economies appeared to be in need of investments and assistance to revive or save their economies.

To some, new opportunities promised benefits, to others, required investments were associated with uncertainty and risk.

China with its population of 1.2 billion looked as an attractive market, but was China able to match with the foreign offer? Doing Business in China is not similar to they way they do it in Western or Eastern Europe, Northern and South America, and not even similar to Japan and other Asia and Pacific countries. Historical and cultural facts playing a most important role in the formation of country's business practices is still a mystery for many western businessmen.

Realising the existence of differences and uncertainty, unpredictability of many factors, risks etc., a number of foreign companies entered this country for business purposes and many of them have succeeded.

In this work we aim to study the foreign companies operating in China. Among other foreigners, automobile companies seem to carry on their business successfully. This sector is one of the most rapidly growing in China, and China is one of the countries keeping stable pace of growth when the other markets decline.

By the case study of Volkswagen and General Motors, we in this work, tried to describe strategies of this companies in China, their position and perspectives, as well as the perspectives of Chinese auto industry. We have raised some questions for further studies and if our work would be useful for the researchers after us, we would consider our work as successful.

Acknowledgements

With this acknowledgement, we would like to express our deepest gratitude to all people who contributed their time and effort in helping us when doing this research.

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List of Abbreviations

ACEA – Association des Constructeurs Européens d' Automobiles
AG – Aktien Geselschaft (Stock Company)
ASEAN – Association of South Eastern Asian Nations
BMW – Bayerische Motoren Werke AG (Bavarian Motor Works Joint Stock Company)
CAIGC – China Auto Industry General Company
CAS – Computer-Aided Styling
CAE – Computer-Aided Engineering
CAD – Computer-Aided Design
CAM – Computer-Aided Manufacture
CKDs or SKDs – Semi-Knocked down Kits
CMC – Combined Management Company
CNAIC – China National Automotive Industry Corporation
Co. – Company
Company Ltd. – Limited Company
EC – European Community
EU – European Union
FAW – First Auto Works
FDI – Foreign Direct Investments
FYP – Five Years Plan

GDP – Gross Domestic Product
GM – General Motors Corporation
GU – Göteborg University
IAS – International Accounting Standard
ISI – Import Substituting Industrialization
ISO – International Standards Organization
VDA 6.1 – Standards of the German Automotive Industrial Association Quality System
JV – Joint Venture
MNCs - Multinational Companies
MNE – Multinational Enterprise

MOFTEC - Ministry of Foreign Trade and Economic Co-operation of China
NAR – North American Region
OECD – Organisation of Economic Cooperation and Development
OICA – Organization Internationale des Constructeurs d'Automobiles (International Organization of Motor Vehicle Manufacturers)
PATAC – Pan Asia Technical Automotive Center
PDC – Parts Distribution Center
R&D – Research and Development
RMB – Chinese Currency (Peoples' Money), same as Yuan
SAIC – Shanghai Automotive Industry Corporation
SAW – Second Auto Works
SEZ – Special Economic Zone
SPC – State Planning Commission
SVW – Shanghai Volkswagen
TMC – Toyota Motor Corporation
TMCI – Toyota Motor (China) Investment Company
VW – Volkswagen AG, or Volkswagen Group
WTO – World Trade Organisation

Chapter 1. Introduction

1.1 Background

In a world that is becoming smaller and smaller, due to the internationalisation and globalisation trends and forces connected to them, international companies compete at an increasingly competitive level. The changes in the business environment occur at an extremely fast pace, so the multinational companies (MNCs) constantly have to upgrade their core competencies, resources and capabilities in order to develop and sustain their competitive advantage (Krznaric, Popovski, 2002).

The main drivers behind the globalisation process are the increased deregulation of world trade, rapid development of new technologies and large privatisation processes worldwide. (Boyd, Walker, Larreche, 1998) Consequently, this has boosted the rise of large international companies with global presence.

The globalisation of the business environment has faced companies with several enormous challenges, the most important of which being internationalisation, market maturity and increased customer power.

Developed countries still represent the most important markets for most of the large MNCs. These markets, however, are becoming increasingly mature and saturated. More often, the markets are characterized by over-capacity, low margins and lack of growth, as well as shorter product life cycles. This means that the competition is becoming more intense, and companies can grow primarily at the expense of the competitors (Krznaric, Popovski, 2002).

The processes of internationalisation and globalisation, and trends mentioned above, are applicable to auto industry probably to a greater extent than many other industries. Companies operate and sell their products far away from their home. Production plants and sales and distribution networks are widely spread

geographically. Companies compete for the share at the existing markets by introducing new products, offering better services and guaranties. They make huge investments in emerging economies and markets, some trying to get higher benefits of being first, the others being more careful and waiting for the proper moment to enter when the situation is more stable.

Processes of globalisation have a significant impact on the automotive industry. International re-location of demand in this industry often reflects in international re- location of manufacturing. The reasons for this are different:

- Models produced and marketed in North America, Europe and Japan do not always fit emerging markets' customers' needs.

- Governments of emerging market countries put constraints and incentives on auto trade and manufacturing in order to hinder imports and favour foreign direct investment from large multinational companies.

- Locating operations nearby the target market represents an advantage in terms of marketing, sales and logistics.

- Cross-boarder cost differentials (especially labour cost), are often so high that they can themselves represent a reason why to locate production abroad

Recent developments in the world automobile industry (which we will discuss more in depth in the next chapters) and our observation of the events indicate the increased interest of car makers in relatively less developed (compared to Europe, North America, Japan, or even some other Asian countries), but also relatively faster growing industries and markets such as China, India etc. China for example is the country, which unlike many others in Asia& Pacific (although the auto industry in some of those countries is a great deal more developed), experiences steady growth of the industry, and companies presented there increase their production and/or sales from year to year. More and more important players of the industry realise the potential of Chinese market with its population of over 1.2 billion. Moreover, given the fact of

cheaper labour force they regard China mainly not as a large sales market for imported cars (which also has an increased meaning since China's accession to WTO, which means that more favourable import and export tariffs and quotas are expected), but as a potentially strong producer and may be even future exporter.

Hereby, briefly stating what inspired us to choose this topic we will further try to give more comprehensive explanations for our choice.

1.2. Research Problem

The European auto market is not currently experiencing its best years, the slight upward trends in 2001 were not kept by the third quarter of 2002. Northern America is still regarded by foreign car makers as a growing market (mainly due to increases in sales in Mexico) and will most likely keep these trend in the next year (as the expectations of the companies are VW). Eastern Europe with its to some extent unpredictable "emerging markets" would have been quite interesting to observe. However, another market – Asia & Pacific, and namely Peoples Republic of China has attracted us more. Realising the uncertainties of this market, our interest in this work is to describe and understand how foreign companies operate in these country. How they established themselves and which strategies they used to enter.

Initially, it was meant to introduce two European car makers, their general and investment strategies, and their strategies towards China. During the course we made a relatively brief study of several automobile companies, including Volkswagen, Daimler Crysler, GM and Toyota. We were also supplied with essential volume of related materials, studies about the automobile companies (VW, Daimler Crysler, Toyota, Renault & Nissan, Volvo, etc.) and industry, conducted at School of Economics and Commercial Law (GU), provided by our supervisor, Thomas Polesie. Thus, we had some basic knowledge about those companies. Taking this into account, as well as the factors, such as availability or non-accessibility of information, willingness and interest of the

companies to assist, the final choice was to focus on three auto-giants: Volkswagen, General Motors and Toyota.

Each of them is the largest in its home market, each of them is global, and each of these companies has at various points in time been the driving innovator in the automobile industry. We are talking about the massive enterprises whose influence spans whole continents – companies that earn and dispense many billions of dollars a year and have a direct impact on the survival of related industries. Among them, they have defined management principles, organizational strategies, and product and marketing concepts that have created new paradigms for their own and other industries. For most of this century, GM has been the personification of the car industry. It was Alfred Sloan of GM, the automotive genius of the 1920s, who devised the concept of car making for every class and purpose. VW rose from the shambles of post World-War II Germany to become the first foreign car company to make a meaningful dent in American market (when the Japanese were not there yet). Beyond that, VW was the first to truly market a reliable, inexpensive small car for the masses. Toyota invented a production system that was so efficient that every auto company has borrowed something from its model. We will not exaggerate when saying that contribution of these three companies has been fundamental to car making (Maryann Keller, 1996).

One might be right by asking "What about Ford?". However, being a prominent and important player (actually No2), as well as establisher of the industry Ford can not be categorised by possessing a leading position in any of the important markets (not even in domestic), and if this is not enough to exclude it from the case stud, Ford could not be named as an innovator in the industry since a long time ago.

1.3. Research Purpose

Coming back to the Choice of China, we would like to once again underline the importance of this market for auto industry. All the companies mentioned are involved in the "Chinese business" and for the next several years China might

be the main battling area for these companies, all of them trying to gain as much market share as possible and establish themselves as a leader. While VW cooperates with Chinese partners for a long time and has not only a good reputation but also half of the market, some other companies are still represented by sales offices only.

This topic will be revealed in the next chapters in more detail, however, with more focus on VW and GM, while regarding Toyota mostly for comparisons and as a challenge for the first two (although, this way might be not quite justified, but hereby we mention that Toyota was included in this work later, to give a more complete picture, and the information gained was not sufficient to make as strong focus on it as on the other two companies).

The importance of our work as we see it, lies in the challenge of the new era for the automobile industry, the challenge of the new century, the challenge of rivalry, which actually started years ago, but currently takes new shape. We are not stating that tomorrow there will be an auto boom there, but we regard China as a potentially increasing auto market, with a lot of opportunities in the future, where in our opinion, everything is still to come. Thus, our purposes in this work are:

- to describe the players' (VW, GM) current positions at Chinese Market
- to show general and investment strategies they used to enter and stay in this market
- to make an attempt to analyse how successful their strategies were
- to address the challenges of the industry and this particular market
- to draw the future scenario development of the Chinese auto industry based on the analysis of the above mentioned.

1.4 Scope and Limitations

We realise how interconnected and interdependent are the events and processes in automobile industry. The success or failure of the company at one particular

market cannot be analysed separately from the trends in industry as a whole (i*n 1980th GM Europe was a successful profitable branch of the group having problems on the domestic market. While increasing its presence in the US, Toyota has faced uncertainties with management in its headquarters. VW expanding globally faced severe competition in Europe from the companies mentioned*). On the other hand, the analysis of the whole industry does not necessarily reflect every player's performance. Essentially contributing to the industry development and growth the biggest companies might still have a number of problems, as the growth in production is not necessarily followed by high profitability. In fact, we sometimes see the top players showing losses. As mentioned, our work is aimed not to give a solution for a specific problem, but rather to understand the trends for the industry in the changing environment and uncertainty of a particular geographical segment. Therefore, the scope and limitations can be stated as following:

- study the specific geographical market – China (general developments and changes, trends in automotive industry)
- study similar companies (similar by size, by domestic and overall position in the industry, by presence at different markets)
- limit the number of the companies by 2+1 (two companies for basic case study and one for better generalisation), which allows us to provide data more relevant for generalisation
- overview in general, but study in particular some of the companies' strategies

Chapter 2. Research Methodology

The purpose of the methodology section is to give an explanation and justification of the methods, strategies, designs and/or approaches used in the research. Below we describe the course of actions that we have used while conducting our study.

2.1 Introduction

Business research is considered, as something different from research in physical sciences, as long as it involves subjects that use language, understands that they are being studied, can be influenced by the results and are extremely situational in their behaviour. Research is defined so as to include what some would call both normal science and major advances (paradigm shifts). In fact, the word research is used to mean a careful, thorough, acceptable collection of convincing evidence which should use observation and measurements whenever possible (Metkalfe, 1996).

According to other opinions, business research can be defined as "an organized, systematic, databased objective, scientific inquiry or investigation into a specific problem undertaken with the purpose of finding answers or solutions to it. In essence, research provides the needed information that guides to further decisions" (Sekaran, 2000).

To a great extent these two definitions are very similar once we get deeper to their meaning. The way we conducted our work might fit both of those statements, as it is impossible to make a research without following those requirements. The way of collecting data and their further processing we have used is described further in the chapter. However, for us it seems that, naturally, the study in its final version should look as a structured, argument-based body with clearly stated purpose, analysis of reasonably collected data, supported or contradicted by theory, and finally, with the clear suggestions or solutions from the authors drawn in the concluding part. In this regard, we

consider that our research in basic terms of performance matches the above-mentioned criteria.

Further, for the support and broadening of our understanding of research we refer to Metkalfe (1996): Research should be perceived as being an argument. This perspective covers research from the level of discussions between learned academics in different universities, to the preparation of a postgraduate thesis. Indeed the word "thesis" can be translated from the Greek as "position" or "argument". Thus, expanding these definitions, we are going to present both our arguments – historical and current development of event related to our topic, supported by other studies and researches, and theory, and our position – our vision, based on empirical evidence and careful analysis.

Research methodology can be conceived as a system of rules and procedures. Such rules and procedures are important in research for the purposes of reasoning i.e. a specific logic to acquire insights; inter-subjectivity i.e. reporting how the researcher has obtained the findings and communication i.e. reporting in manner to enable others to replicate or criticise (Ghauri, Gronhaug, Kristianslund, 1995).

Below we present our main method guidelines, without establishing, however, a detailed set or rules or procedures. In our opinion, one can always change the structure and choose the other, which better fits the topic and facilitates to the work. We think that providing the linkages is more necessary to perceive the paper as a whole than strictly following one or another set of rules. In other words, we base our research on establishing the general structure and use of general methods rather than detailed procedures, which gives us more flexibility in research.

2.2 Research Strategy

The choice of the research strategy depends on the nature of the problem: What does it look like, what can question it, what leads it to the result, and what final result is desirable (Merriam, 1994). According to Yin (1994), there are five different types of research strategies: experiment, survey, archival analysis, history and case study. The choice of strategy depends on several factors, for example, the form of the research questions, the need for control over behavioural events and the degree of focus on contemporary versus historical events. As one could notice from the previous chapter, as a research strategy we have chosen the case study.

"A case study is empirical enquiry that investigates a contemporary phenomenon with in its real-life context, especially when the boundaries between phenomenon and context are not clearly evident" Yin (1994, pg. 13). It is appropriate to use this method when "how" and "why" questions are present and when researchers have a little control over the events (as in our case). In addition, when choosing the case study it is important to have a boundary that limits the study (Merriam, 1994).

There are many advantages of using the case study method. It allows the researcher to retain a holistic view (Merriam, 1994). The case study uses the same techniques as a historical research strategy, but it also uses direct observations and interviews. Further, the case study strategy seems to be suitable for practical problems, as we consider our research problem is. These are some of the arguments we can provide to support our choice of the case study method. On the other hand, we realise also the disadvantages of this method, such as insufficient background for generalisation. To reduce this kind of disadvantages we included a multiple case study in our thesis.

2.3 Research Design

Research design serves as a work plan for the research. It deals with logical problems and serves as a tool that addresses the initial research question. It is

the logical sequence that connects the empirical evidence with initial research question, and finally the conclusions (Yin, 1994). According to the same source (Yin, 1994), there are five components of research design particularly important for case studies:

1. The study's question
2. The propositions
3. The unit(s) of analysis
4. The logic linking the data to the propositions
5. The criteria for interpreting the findings

In order to formulate the suitable model matching our research problem, we have summarized the theories related to investment and market entry strategies. We have already mentioned the study question, however, according to theory we give this formulation: "who" – the companies under study, "where" – in China. "How & why" are the companies operating there, is the most important part, which is the purpose of our study. As defined by Cooper & Schindler, a proposition is a "statement about concepts that may be judged as true or false if it refers to observable phenomena. When a proposition is formulated for empirical testing, we call it a hypothesis." In our work they are used as far as we regard them to be the part of inductive method we have used (see Chp. 2.2). The unit of analysis is linked to the fundamental problem of defining what the "case" under study is. It can be anything from individual units of analysis to whole systems. Hereby, the propositions help to identify what kind of information is needed for the case. The last two components refer to the step-by-step analysis of the data. However, as we mentioned, above, we have not used a specific set of rules, and in this case, we base on our background and vision of the problem, using the data we considered relevant, trying to be neutral in judgement, and explain the findings as we perceive them.

2.4 Research Method

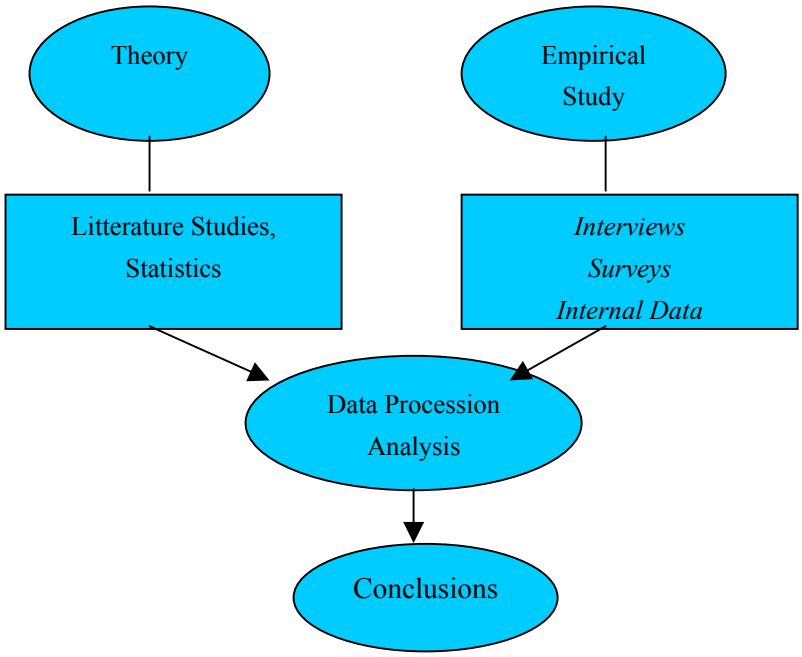
"Good research follows the standards of the scientific methods" (Cooper&Schindler, 1998).

Research can be undertaken for two different purposes: to solve a current problem, demanding a timely solution – applied research, and to generate a body of knowledge by trying to comprehend how certain problems can be solved – the basic research. Thus, research done mainly to enhance the understanding of certain problems and seek methods of solving them, is called basic or fundamental research (Sekaran, 2000).

Many researchers in various industries or academic circles do basic or fundamental research. Thus, more knowledge is generated in particular areas of interest to industries, organizations, and researchers. But the primary purpose of conducting basic research is to generate more knowledge and understanding of phenomena of interest and to build theories on the research results. Such theories subsequently form the foundation of further studies of many aspects of the phenomena (Sekaran, 2000).

Considering our work as a basic research, we do not give a solution to any specific problem, but rather conduct the analysis of the facts, which in their turn give us other facts or assumptions. In our case, the uncertainty of the changes (i.e. political changes in China, etc.) only gives us the possibility to make the analysis of current the situation with a less precise prediction. However, to finalize the work we will draw possible scenarios basing on the above analysis. The figure below explains the basic model we used in this work (Fig.2-1).

Figure 2-1. Basic Mode



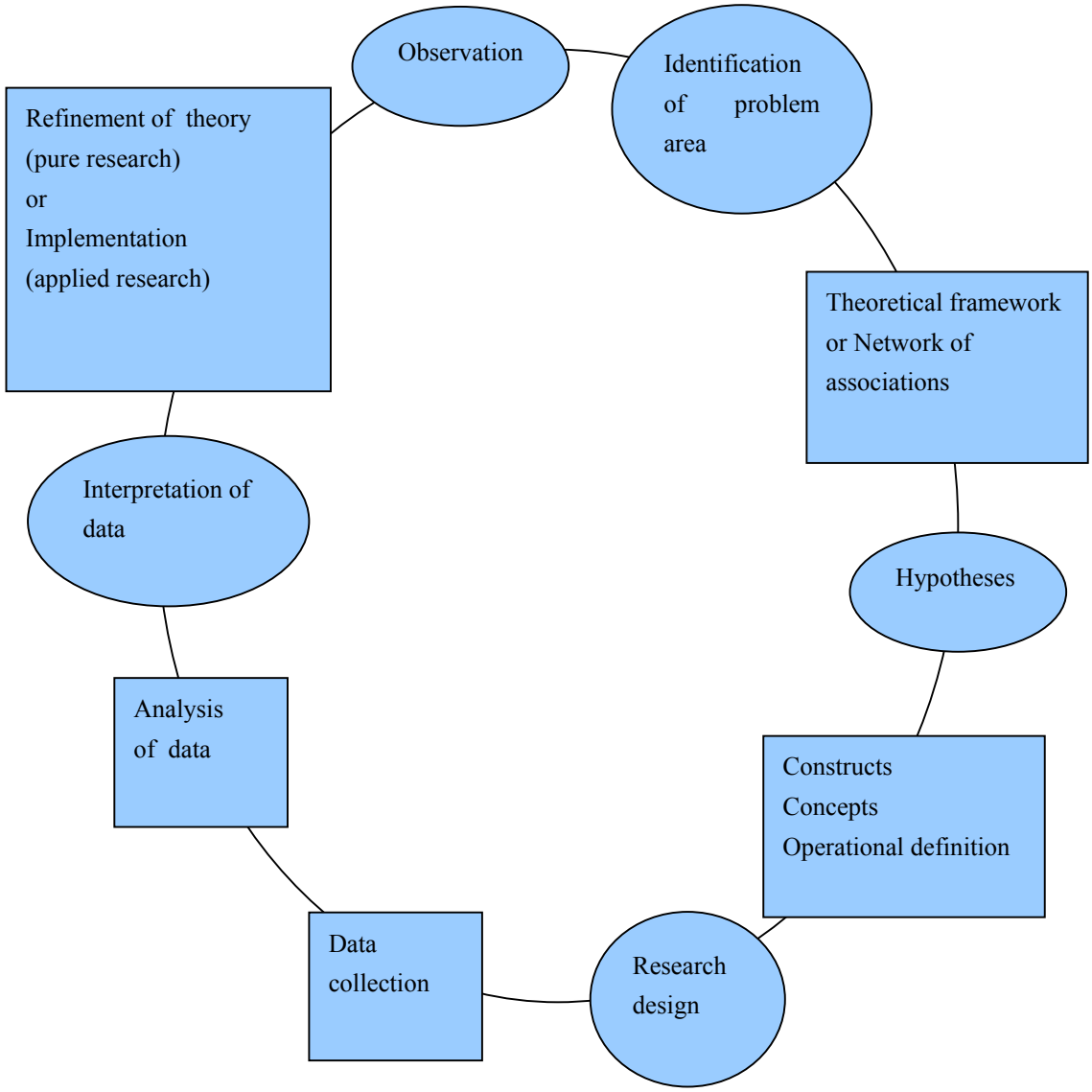
One of the primary methods of scientific investigation is the hypo-deductive method. Answers to the issues can be found either by process of deduction or the process of induction, or by their combination. Deduction is the process by which we arrive at a reasoned conclusion by logically generalizing from a known fact. Induction, on the other hand is a process where we observe certain phenomena and on this basis arrive to conclusions. In other words, in induction we logically establish a general proposition based on observed facts (Sekaran, 2000).

One way or another, we think deduction could have been used as a method for our case, but only in some parts of the paper deduction, when the reasons are said to imply the conclusion and represent a proof, might have been really suitable. The conclusions in deduction must necessarily derive from the reasons given (Cooper&Schindler, 1998). However, in our work we use the induction method as the main method, where there is no such strength of relationship between reasons and conclusions. To induce is to draw conclusion from one or more particular facts or pieces of evidence. The conclusion explains the facts, and the facts support the conclusion. The nature of induction is that the

conclusion is only a hypothesis. It is one explanation, but there could be others that fit the fact just as well (Cooper&Schindler, 1998).

Theories based on deduction and induction help to understand, explain, or predict business phenomena. The building blocks of the scientific inquiry are depicted in Figure 2-2., which includes the process of initially observing phenomena, identifying the problem, constructing a theory as to what might be happening, developing hypotheses, determining aspects of the research design, collecting data, analysing the data, and interpreting results (Sekaran, 2000).

Figure 2-2. Building Blocks of Scientific Inquiry



Source: (Sekaran, 2000 pg. 27)

Descriptive study is undertaken in order to ascertain and be able to describe the characteristics of the variables of interest in a situation (Sekaran, 2000). It is to be mentioned, that in our research, we use the descriptive approach to describe the strategies of the companies under study generally and in China particularly, and on a later stage, to identify the possible future development of the industry in this geographical segment, as well as the role of companies in this development. At the same time, to some extent, we regard it also as the

explanatory study, which tends toward loose structures, which usually has the objective to discover future research tasks (Cooper, Schindler, 1998).

2.5 Data Collection

Collecting data in the case study research often involves several different strategies, such as interviewing and analysing documents (Merriam, 1998).

We agree with the opinion that multiple sources of information should be used if the researcher doubts that a particular single source of information can provide a complete and comprehensive understanding of the research problem. In our study, we have used multiple sources of information. However, different sources were not always available.

Both structured and unstructured interviews, and library search facilitate to the researcher's ability to define the problem more specifically and evolve a theory, delineating possible variables that might influence the problem (Sekaran, 2000). Thereby, in preliminary data collection we included:

1. Background information of the industry;
2. Background information of the companies in case study.

For this reason we used both primary and secondary data collection methods. For both option we mostly used secondary data, library records, company bulletins and publications, other publications and printed editions, company web pages and other on-line sources. Secondary data was most necessary to form our theoretical framework. As a theoretical framework is a conceptual model of how one theorises or makes logical sense of the relationship among the several factors that have been identified as important to the problem (Sekaran, 2000). Secondary data, and hereby we mean mostly the books, articles, and other publications, were also necessary and very useful for understanding the behaviour and background of the industry and companies under study. On the other hand, information provided by company web pages or other online services also essentially contributed to our data collection.

Further, we used primary data collection method, conducting interviews (unfortunately only by phone and e-mails,) and using questionnaires.

While writing the thesis, we have used several different sources when collecting data in order to increase the validity of the collected data, however another problem here is which source to trust. In most cases it was impossible to compare the same data of different sources.

2.6 Validity and Reliability

Here we bring two definitions of Validity and Reliability. In the next part of the chapter we explain how we understand these terms and how they are reflected in our thesis:

"Validity is the term used to express the exemption from 'non-random error' in the application of a measuring instrument. 'Non-random error' (also called 'bias'), refers to a measuring instrument producing a systematic biasing effect on the measured phenomenon" (Drucker-Godard, 2001). In qualitative research, this bias is affected by the methodology used.

The reliability of a measure indicates the extent to which the measure is free from 'random error' and hence offers consistent measurement across time and across the various items in the instrument. In other words, the reliability of a measure indicates the *stability* and *consistency* with which the instrument measures the concept and helps to assess the 'goodness' of a measure (Sekaran, 2000).

2.6.1 Validity

We have used multiple sources of data, as much as it was available and accessible. We have interviewed only two persons in companies, but for our case we consider it as a success, as far as the initially chosen Volvo had not respond at all. Taking into account this fact and the nature of our problem, we consider two interviews, one in each chosen company sufficient from the

validity point of view. Primary source of information about companies were the company reports. As we could observe, online information on official company web pages was practically identical to the same printed source. However, our precept of this information was not as "the only existing reality" and we were fairly critical in processing of information. We were trying to use different sources, and/or consult the interviewed persons where possible. The audited financial results, online historical data (supported by books) and some other online information sources were proved by interviewed persons, while some other information was denied. (For instance: VW London Office confirmed the information about Toyota signing a contract with FAW - the Chinese partner of VW, which we got from information agency Reuters, while the same source denied VW's agreement with Russian partners and intention to build an assembly plant in near Moscow, the data obtained from another information agency). As mentioned in introduction of the work, we studied also a number of similar researches made at School of Economics and Commercial Law (GU). Companies were studied by people from different countries, with different judgement and interpretation of the facts. By adding also a huge volume of other literature (books, articles) of different authors to our data collection, we increase the validity of our work. It is to be mentioned, that in some parts of the study we provide essential volume of information without references. However, this information is based on different sources and views and the shape it has in the work is given by us, by creation of some sort of synthesis of various evidences and our own judgement.

The analysis forms the base for our conclusions. The findings from interviews were combined with the empirical evidence and analysed.

In our opinion, the fact that the research was conducted by two persons, has to some extend decreased the level (risk) of biases in the study, even though we have a rather similar background and education and a rather similar point of view when looking at the business environment. Our advantage, however, might also be the fact that one of the authors of this study is Chinese and his observations and inside knowledge of the facts and processes together with the

outside judgement of the second, creates useful, fairly critical and close to a realistic vision of the problem.

2.6.2 Reliability

In a study with a sufficient reliability, a new study made using the same format as the initial study would generate the same results. In other words, if another researcher follows exactly the same procedures as we did, would he/she get the same findings and conclusions? The goal of reliability is to minimise the errors and biases in a study. Merriam (1998) argues that reliability in the traditional sense does not fit qualitative research. The reliability of a case study like ours can instead be tested in terms of dependability or consistency of the results obtained from the data, for example if the results are consistent with the data we have collected.

To ensure that the results are dependable, researchers can explain the assumptions and theory behind the study, describe in detail how the data that was used to arrive at the results was collected.

CHP 3. Theoretical Framework

3.1 Introduction

This chapter consists of four main parts. In the first part we build the theoretical framework of strategy choosing, and discuss related subjects that need to be further explained. The second part focuses on the entry strategy in international business. In the third part we discuss the importance of global sourcing, localization and optimal distribution system. The final part aims to explain the importance of political environment and the reason for regarding China as their "ready source of money" in the new century by increasing number of multinationals.

3.2 Strategy Choosing in the International Business

"A firm's strategy can be defined as the actions managers take to attain the goals of the firm." (Hill, 2001)

For most of the companies, the fundamental purpose of doing business is to generate profits. To obtain the advantage and stay profitable in today's competitive global environment, a firm must make every effort for both reducing the costs of value creation and to differentiating its product offering. Thus, strategy is often concerned with identifying and taking actions that will lower the costs of value creation and/or will differentiate the firm's product offering through superior design, quality, service, functionality, and the like.

With the accelerating pace of globalisation, multinational enterprises (MNE) have been taking an increasingly important role in today's international economy. To increase profits and sales, global markets frequently offer to companies a more lucrative opportunity than domestic market. Firms that operate internationally are able to:

Earn a greater return from their distinctive skills or core competencies.

Realize location economies by dispersing particular value creation activities to those locations where they can be performed most efficiently.

Realize greater experience curve economies, which reduce the cost of value creation (Hill, 2001).

However, companies' abilities to increase profitability by pursuing these strategies are constrained by the need to customize their product offering, marketing strategy, and business strategy to differing national conditions (Hill, 2001). As a result, global strategy choosing is deemed as a prerequisite for a MNE to win the battle or survive in competitive global business. Before MNEs choose their optimal strategies, they should realize the pressures that they are facing.

3.2.1 Pressures for Cost Reductions and Local Responsiveness

When making the strategic orientations, firms that compete in the global marketplace typically face two types of competitive pressures. They are *pressure for cost reductions* and *pressures to be locally responsive*. These competitive pressures place conflicting demands on a firm (Hill, 2001).

A. Pressures for Cost Reductions

Increasingly, international business faces pressures for cost reductions. Due to this companies have to lower the costs of value creation by mass production of a standardized product at the optimal location in the world. Pressures for the cost reduction can be particularly intense in industries producing commodity products, where price is the main competitive weapon. Mostly this takes place in cases of products that serve universal needs, existing due to the similar tastes and/or preferences of consumers in different countries. Conventional commodity products such as bulk chemicals, petroleum, steel, sugar, and the like is a clear example here (Hill, 2001). Pressures for cost reductions are also intense in the automobile firms, which face low switching costs.

In order to respond to these pressures companies should somehow minimize their production unit costs. To succeed in this task, they often carry out their production activities at the most favourable low-cost location. Also, it may be both necessary and important for a company to offer a standardized product to the global marketplace (Hill, 2001).

In later chapters, we will give examples of how some leading automakers respond to the pressure for cost reduction.

B. Pressures for Local Responsiveness

Pressures for local responsiveness arise from a number of sources including (a) differences in consumer tastes and preferences, (b) differences in infrastructure and traditional practices, (c) differences in distribution channels, and (d) host government demands (Hill, 2001).

Strong pressures for local responsiveness emerge when consumer tastes and preferences differ significantly between countries - as they may for historic or cultural reasons. In the automobile industry, for example, there is a strong demand among North American consumers for pickup trucks, particularly in the south and west where many families have a pickup truck as a second or third car. On the contrary, in European countries, pickup trucks are seen purely as utility vehicles and are purchased primarily by companies or organisations rather than by individuals. As a consequence, the marketing message needs to be tailored to the different nature of demand in North America and Europe (Hill, 2001).

Differences in infrastructure and/or traditional practices between countries are another factor promoting pressures for local responsiveness to emerge (Hill, 2001). A typical example known to everybody is driving on the left side of the road in British Commonwealth Nations, or small island countries (Malta, etc), creating a demand for right-hand drive cars, but in most of other countries, people drive on the right side of the road, creating a demand for left-hand drive cars. Thus, automobiles should be customized to meet this difference in traditional practices.

Company's marketing strategies may need to be responsive also to the differences among the countries' distribution networks (Hill, 2001). Thus, companies often face different requirements and have to use varying marketing approaches.

Finally, economic and political demands imposed by host-country governments may necessitate local responsiveness. In fact, this could be a major problem presenting the threats of protectionism, economic nationalism, and/or local content rules (which require that a certain percentage of a product be manufactured locally etc.). All of those dictate international businesses to manufacture locally (Hill, 2001).

Responding to these pressures requires that a firm keep amending its strategy to accommodate the diverse demands that arise from national differences in consumer tastes and/or preferences, the ways of doing business, distribution channels, competitive conditions, and government policies.

On the other hand it is rather hard to deal with these conflicting and contradictory pressures, mainly because being locally responsive tends to raise costs. Therefore, the company seeking an optimal strategy has to struggle to balance these two pressures.

In the next section we will explain four strategic choices that firms may apply to respond to the pressures we mentioned above.

3.2.2 Strategic Choices

Companies usually use four basic strategies to compete in the international environment: an international strategy, a multidomestic strategy, a global strategy, and a transnational strategy (Bartlett & Ghoshal, 1989). Each strategy has its advantages and disadvantages. The appropriateness of each strategy varies with the extent of the two main pressures we mentioned in the section above.

A. International Strategy

Firms pursuing an international strategy try to create value by transferring valuable skills and products to foreign markets where indigenous competitors experience lack of those skills and/or products. Most international companies tend to centralize product development (e.g., R&D) functions at home, but simultaneously establish manufacturing and marketing functions in each major country where they do business. In most international firms like McDonald's, IBM, Microsoft and Procter & Gamble, the head office retains tight control over marketing and product strategy (Bartlett & Ghoshal, 1989) (Hill, 2001).

An international strategy makes sense if a firm has valuable core competence those indigenous competitors in foreign markets lack, and if the firm faces relatively weak pressures for local responsiveness and cost reductions. However, when pressures for local responsiveness are high, firms pursuing this strategy lose out to the companies that put a greater emphasis and are more successful in customizing the product offering and market strategy to local conditions. This strategy looks inappropriate also in manufacturing industries where cost pressures are high (Bartlett & Ghoshal, 1989) (Hill, 2001).

B. Multidomestic Strategy

Companies following a multidomestic strategy orient themselves toward achieving maximum local responsiveness. Multidomestic firms extensively customize both their product offering and their marketing strategy to match different national conditions. They also tend to establish a complete set of value creation activities - including production, marketing, and R&D in each major national market in which they do business (Bartlett & Ghoshal, 1989) (Hill, 2001).

A multidomestic strategy makes most sense when there are high pressures for local responsiveness and low pressures for cost reductions. The high-cost structure associated with the duplication of production facilities makes this strategy inappropriate in industries where cost pressures are intense, which is the case in the automobile industry (Bartlett & Ghoshal, 1989) (Hill, 2001). We will make further explanations through the case study of GM in chapter 5.

Firms pursuing this strategy will also find it is difficult to have tight control over their national subsidiaries due to the autonomous manner of each subsidiary.

C. Global Strategy

Companies pursuing global strategy concentrate more on increasing profitability by reaping the cost reductions that come from location economies, thus, following a low-cost strategy. The production, marketing, and R&D activities of the companies following this strategy are concentrated in a few favourable locations. Global companies prefer to market a standardized product worldwide in order to get maximal benefit from the economies of scale. Thus, they are able and tend to use their cost advantage to carry out and keep an aggressive pricing in world markets (Bartlett & Ghoshal, 1989) (Hill, 2001).

This strategy is most appropriate under existence of strong pressures for cost reductions and low pressures for local responsiveness. However, these conditions increasingly prevail in many industrial goods industries. For example, global standards have emerged in the semiconductor industry. Accordingly, companies such as Intel, Texas Instruments, and Motorola all pursue a global strategy. However, as we noted earlier, these conditions are not found in many consumer goods markets, where demands for local responsiveness remain high (e.g., audio players, automobiles, processed food products) (Bartlett & Ghoshal, 1989) (Hill, 2001).

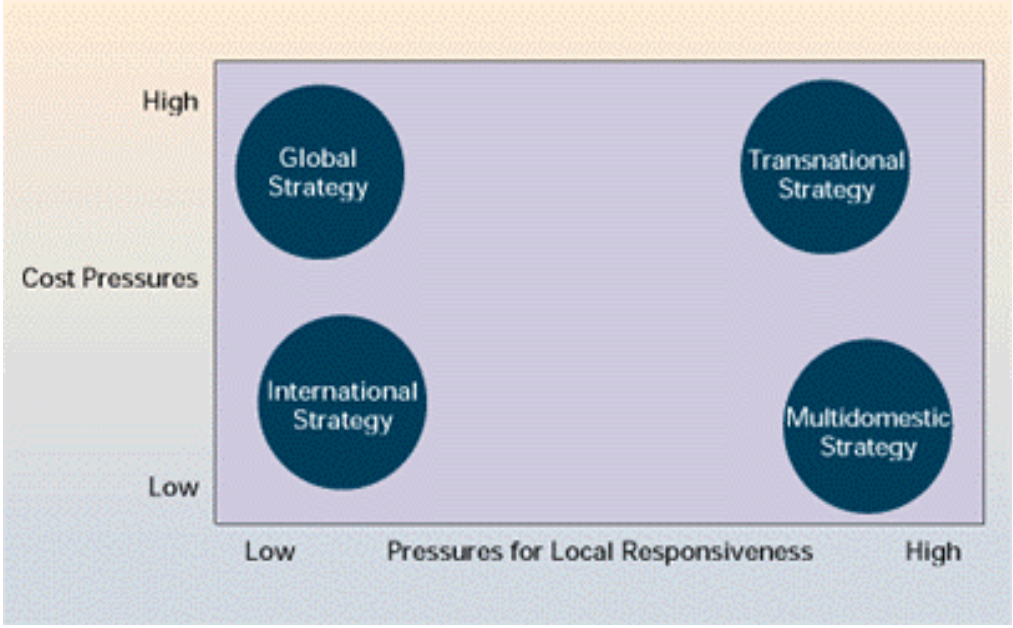
D. Transnational Strategy

In modern multinational enterprises, core competencies do not reside just in the home country. According to Christopher Bartlett and Sumantra Ghoshal, the flow of skills and product offerings should not be all one way, from home firm to foreign subsidiary, as in the case of firms pursuing an international strategy. The flow should also be from foreign subsidiaries to home country, and from foreign subsidiaries to each other - a process referred as global learning. Companies must act in this way while paying attention to pressures for local responsiveness. Bartlett and Ghoshal refer to the strategy pursued by firms that

are trying to achieve low-cost and differentiation advantages simultaneously as a transnational strategy (Bartlett & Ghoshal, 1989) (Hill, 2001).

According to the same sources (Bartlett & Ghoshal, 1989) (Hill, 2001) transnational strategy makes sense when a firm faces high pressures both for cost reductions and local responsiveness. It may sound attractive, but in fact it is not easy to follow this strategy. Pressures for local responsiveness and cost reductions place conflicting demands on a company. Being locally responsive raises costs, making the cost reductions hard to achieve (see Fig. 3-1).

Figure 3-1. Four Basic Strategies



Source: Charles W.L Hill, *"International Business – Competing in the Global Marketplace"*, Third Edition, Pg.392, McGraw-Hill, 2001

General Motors is trying to pursue a similar strategy with its development of common global platforms for some of its vehicles, see the case in chapter 5.

To summarize this part, while a transnational strategy appears to offer the most advantages to multinationals that compete in today's global market, implementing a transnational strategy raises difficult organizational issues. The appropriateness of each strategy actually depends on the relative strength of pressures for cost reductions and pressures for local responsiveness. And the optimal strategies vary from different firms as the different characters of industries they are doing business in.

3.3 Entry Strategy

More and more companies in different industries transform to multinational enterprises for same reasons. These reasons can be generalized as follows:

One is to protect themselves from the risks and uncertainties of the domestic business cycle. This is a form of international diversification. A second reason is to tap the growing world market for goods and services. This is part of the process of globalisation. Firms also become MNEs in response to increased foreign competition and to protect world market shares. A fourth reason to become an MNE is the desire to reduce costs. One more reason is to overcome tariff walls by serving a foreign market "from within". The European Community (EC) provides an excellent example (Rugman & Hodgetts, 2001).

However, when companies decide to expand business world-widely, firstly they have to make deliberate choices of which foreign markets to enter and how to enter. In this part, we will talk about basic entry decisions and the factor of political environment that will affect the decision-making.

3.3.1 Which Markets to Enter. Realizing Location Economies

There are more than 160 nation-states in the world, but they do not all hold the same profit potential for a company contemplating foreign expansion. Ultimately, the choice must be based on an assessment of a nation's long-run profit potential. This potential is a function of several factors including the economic, political, legal, and cultural factors that can either raise or lower the costs of doing business. Given the trade barriers and transportation costs permitting, a firm will benefit by basing each value creation activity it performs at that location where economic, political, and cultural conditions, including relative factor costs, are most conducive to the performance of that activity (Hill, 2001). Here comes out the concept of Location Economies, which is defined as the economies that arise from performing a value creation activity in the optimal location for that activity, wherever in the world that might be (transportation costs and trade barriers permitting). Locating a value creation activity in the optimal location for that activity can have one or two effects. It can lower the costs of value creation and help the firm to achieve a low-cost position, and/or it can enable a firm to differentiate its product offering from that of competitors (Hill, 2001).

It is also noted by Hill that the long-run economic benefits of doing business in a country are a function of factors such as the size of the market (in terms of demographics), the present wealth (purchasing power) of consumers in that market, and the likely future wealth of consumers. However, it is the fact that the potential long-run benefits bear little relationship to a nation's current stage of economic development or political stability. Long-run benefits depend on likely future economic growth rates, and economic growth appears to be a function of a free market system and a country's capacity for growth. This leads one to the conclusion that, other things being equal, the benefit - cost - risk trade-off is likely to be most favourable in politically stable developed and developing nations that have free market systems, and where there is not a dramatic upsurge in either inflation rates or private-sector debt (Hill, 2001). We will explain the importance of political environment in today's global economy and why more and more MNEs regard China as their optimal location for doing business later in this chapter.

3.3.2 Entry Modes

Once a firm decides to enter a foreign market, the question arises as to the best mode of entry. Various modes for serving foreign markets are exporting, licensing or franchising to host-country firms, establishing joint ventures or setting up a wholly owned subsidiary in a host country to serve its market. Each of these options has advantages and disadvantages. The magnitude of the advantages and disadvantages associated with each entry mode are determined by a number of factors, including transport costs, trade barriers, political risks, economic risks, and firm strategy. The optimal entry mode varies from situation to situation depending on these various factors (Hill, 2001).

A. Exporting

Many manufacturing firms begin their global expansion as exporters and only later switch to another mode for serving a foreign market. The most obvious advantage of exporting is that it avoids the substantial costs of establishing manufacturing operations in the host country. Also, by manufacturing the product in a centralized location and exporting it to other national markets, the

firm may realize substantial scale economies from its global sales volume. Exporting has a number of drawbacks. First, exporting from the firm's home base may not be appropriate if there are lower-cost locations for manufacturing the product abroad (i.e., if the firm can realize location economies by moving production elsewhere). Thus, particularly for firms pursuing global or transnational strategies, it may be preferable to manufacture where the mix of factor conditions is most favourable from a value creation perspective and to export to the rest of the world from that location. A second drawback to exporting is that high transport costs can make exporting uneconomical, particularly for bulk products. Another drawback is that tariff barriers can make exporting uneconomical. Similarly, the threat of tariff barriers by the host-country government can make it very risky (Hill, 2001).

B. Licensing and Franchising

In many respects, licensing and franchising are similar entry modes, both of them are arrangements whereby a licensor (franchiser) grants the rights to intangible property to the licensee (franchisee) for a specified period, and in return, the licensor (franchiser) receives a royalty fee from the licensee (franchisee). The franchising tends to involve longer-term commitments than licensing. Intangible property includes patents, inventions, formulas, processes, designs, copyrights, and trademarks (Hill, 2001).

C. Joint Ventures and Wholly Owned Subsidiaries

Joint ventures and wholly owned subsidiaries both belong to the form of foreign direct investment (FDI), which is equity funds invested in other nations (Rugman & Hodgetts, 2001). However, these two entry modes hold different characters and have their own advantages compared to each other.

A joint venture entails establishing a firm that is jointly owned by two or more otherwise independent firms. The most typical joint venture is a 50/50 venture, in which there are two parties, each of which holds a 50 percent ownership stake and contributes a team of managers to share operating control. Some firms, however, have sought joint ventures in which they have a majority share and thus tighter control. Logically, in a wholly owned subsidiary, the firm owns

100 percent of the stock. That can be done either by setting up of a new operation in that country or acquiring an established firm and using that firm to promote its products (Hill, 2001).

Establishing a joint venture with foreign companies has long been a popular mode for entering a new market for the reason of its advantages. First, a firm benefits from a local partner's knowledge of the host country's competitive conditions, culture, language, political systems, and business systems. Second, when the development costs and/or risks of opening a foreign market are high, a firm might gain by sharing these costs and/or risks with a local partner. Third, in many countries, political considerations make joint ventures the only feasible entry mode. Research suggests joint ventures with local partners face a low risk of being subject to nationalization or other forms of government interference (Bradley, 1977). This appears to be because local equity partners, who may have some influence on host-government policy, have a vested interest in speaking out against nationalization or government interference (Hill, 2001).

Despite these advantages, there are several major disadvantages with joint ventures. First, as with licensing, a firm that enters into a joint venture risks giving control of its technology to its partner. A second disadvantage is that a joint venture does not give a firm the tight control over subsidiaries that it might need to realize location economies. Nor does it give the tight control over a foreign subsidiary that the company might need for engaging in coordinated global attacks against its rivals. A third disadvantage with joint ventures is that the shared ownership arrangement can lead to conflicts and battles for control between the investing firms if their goals and objectives change or if they take different views as to what the strategy should be. We will make further explanation of those disadvantages through case studies in Chp. 5.

D. Select Entry Mode

As the preceding discussion demonstrated, there are advantages and disadvantages associated with all the entry modes. Due to these advantages and disadvantages, tradeoffs are inevitable when selecting an entry mode. Despite

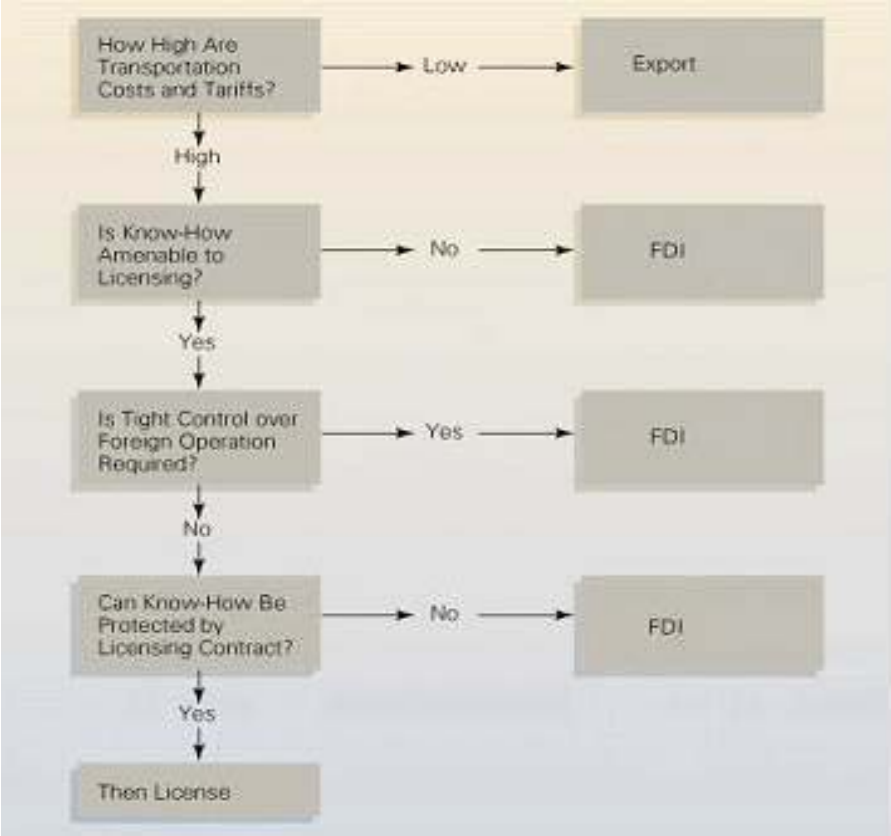
the existence of such tradeoffs, it is possible to make some generalizations about the optimal choice of entry mode (Hill, 2001).

Joint ventures and wholly owned subsidiaries, as two main forms of foreign direct investment (FDI), have seen a marked increase in the past 20 years. Most of multinationals prefer FDI to exporting and licensing (franchising). As mentioned above, exporting is preferable to licensing (franchising) and FDI as long as transport costs are minor and tariff barriers are trivial. However, as transport costs and tariff barriers increase, exporting becomes unprofitable, and then the choice is between FDI and licensing (franchising). A primary advantage of licensing (franchising) is that the firm does not have to bear the development costs and risks associated with opening a foreign market. Licensing (franchising) is very attractive for firms lacking the capital to develop operations overseas. Licensing (franchising) tends to be more common and more profitable in fragmented, low technology industries. A good example is McDonald's global franchising strategy. Since FDI is more costly and more risky than licensing (franchising), given other things being equal, the theory argues that licensing (franchising) is preferable to FDI especially in the countries where FDI is limited by host-government regulations. Other things are seldom equal, however. Although licensing (franchising) may work, it is not an attractive option when one or more of the following conditions exist:
(a) the firm has valuable know-how that cannot be adequately protected by a licensing (franchising) contract, (b) the firm needs tight control over a foreign entity to maximize its market share and earnings in that country, and (c) a firm's skills and know-how are not amenable to licensing (franchising) (Hill, 2001) (Hill & Huwang & Kim, 1990).

To summarize (see Fig. 3-2), when deciding which entry mode to implement, firms should firstly analyse the possible costs of transportation and tariffs, if the costs are at a considerably low level, exporting is theoretically supported to be the optimal choice. Otherwise it should be the last choice to consider. Then firms can make options by looking into their core competencies (e.g. technological and management know-how). In other word, if firms' core competencies are not amenable to being specified in a written contract,

licensing (franchising) is not a good option. And if the risks of losing control over their core competencies are high, firms should avoid licensing (franchising) and joint venture arrangements, on the contrary they should consider setting up a wholly owned subsidiary overseas. Also, when tight control over foreign operations is required, a wholly owned subsidiary is an optimal choice. Of course, entry modes can be used combinedly, especially for those MNEs that are pursuing transnational strategy, they can first make FDI in several countries and then export from one subsidiary to others in which cases the costs of transportation and tariff are low. And those entry modes are suited to different companies in different industries according to their characters as mentioned above.

Figure 3-2. A Decision Framework



Source: Charles W.L Hill, *"International Business – Competing in the Global Marketplace"*, Third Edition, Pg.200, McGraw-Hill, 2001

3.4 Global Sourcing, Localization and Optimal Distribution System

Multinationals' ultimate goal is to pursue maximum profit. To achieve this goal, MNEs have to not only focus on expanding their business overseas, but also efficiently build their strategic frameworks on production, market and management aspects.

3.4.1 Global Sourcing

Most people believe that low cost is the reason that MNEs use global sourcing. If GM wants to be price-competitive in the EC, one strategy is to build and ship cars from Detroit to Europe at a price equal to, or less than, that charged by EC

competitors. Since this is not possible, GM uses overseas suppliers and assembly plants to build much of what it sells in Europe. In deciding who will provide these parts and supplies, the company uses global sourcing, as other MNEs do (Rugman & Hodgetts, 2001). Cost is certainly the most obvious reason that global sourcing has become more and more important. There are many others, however. One is to strengthen the reliability of the supply network. If an MNE dose not has two or more international sources of supply, it can face serious problems if the sole supplier fails to provide the needed materials or parts. A second reason is quality. There are certain areas of the world where suppliers offer the highest quality output. When MNEs need high-quality inputs, they are likely to source them internationally by purchasing from the highest-quality producer. One more reason is penetration of growth markets. A foothold in a promising new market can often be obtained by sourcing in that market (Fagan, 1991) (Davis, 1992).

A successful global sourcing strategy depends on the implementation of a handful of important guidelines. One is a commitment from top management to continually seek the best sources of supply regardless of the geographic distance. A second is not just to examine the costs involved, but also to weigh the quality of the supply source and the dependability of the supplier. A third is to develop the trust and respect of the supplier, and thus promote an ongoing, long-term relationship. A fourth is to use technologies that improve the ability to communicate with the supplier, to keep the individual apprised of company needs, and to work with the supplier to ensure that there is mutual understanding. The last is to be prepared to accept the risk of global sourcing, including the impact of fluctuating foreign currencies and the possibility that political turmoil can result in the loss of a valuable supplier. If an MNE can follow these five guidelines, it stands an excellent chance of developing an effective global sourcing strategy (Fagan, 1991) (Davis, 1992).

3.4.2 Localization of Business Operations

How can MNEs use strategic management to benefit from worldwide economic integration? Localization is deemed to be one effective solution.

"Successful localization efforts typically focus on four areas: products, profits, production and management" (Sugiura, 1990).

Localization of products requires the development, manufacturing and marketing of goods best suited to the needs of the local customer and marketplace. However, this does not suit companies pursuing international strategy and global strategy as mentioned in early part of this chapter. When companies localize products they inevitably increase costs at the same time, consequently it is unfit for companies facing the high pressures for cost reduction.

Localization of profits is the reinvestment of earnings in the local market. MNEs do this by taking their earnings and using them to expand operations, set up new plants and offices, hire more local employees, and make the investment more self-sufficient (Rugman & Hodgetts, 2001).

Localization of production involves the manufacture of goods in the host markets (Protzman, 1994). One strategy for localizing production is by increasing the amount of local content in the product, for example, by producing more and more of the subunits in the host country. The ultimate step, of course, is to produce the entire product locally. Localization of production is often carried out in conjunction with a home country partner, who provides the plant and personnel while the MNE is responsible for the original product and the technology needed in assembling the goods. Sometimes, however, the MNE will own the total operation and depend on local management to help run the organization (Rugman & Hodgetts, 2001).

There is a number of ways in which MNEs localize the management, in attempts to develop host-country-oriented attitudes. One way is by encouraging home office managers to learn the local culture and become part of the community. Another way of localizing management is by delegating authority to host country managers and developing and promoting them wherever possible (Rugman & Hodgetts, 2001).

The localization of business operations helps to create a bond between the host and the home country management. And the strategy is being gradually regarded as a key factor of success to run business overseas. However, it depends on the specific situation of the company and cannot be implemented blindly. For example, it will be inappropriate for those companies that are facing high pressures for cost reduction to customize their products without considering the additional costs it may bring.

3.4.3 Optimal Distribution System

Distribution is the course that differs on a country-by-country basis, and MNEs will spend a considerable amount of time in examining the different systems that are in place, the criteria to use in choosing distributors and channels, and how distribution segmentation will be employed (Rugman & Hodgetts, 2001).

MNEs use a number of criteria in creating the most efficient distribution system. One is to get the best possible distributors to carry his products. A key factor in evaluating potential distributors is the financial strength of the wholesaler or retailer because the multinational wants to know that the distributor will be able to survive the long run. MNEs that sell goods that require periodic maintenance and serving will be interested in business that can keep sufficient inventory on hand. This is particularly important when selling products such as automobiles, computers and electronic equipment (Rugman & Hodgetts, 2001).

In many cases distributors will have competitive products or feel that they do not need to add any new product lines. If the multinational wants to tap into this distribution system, the company will have to formulate an incentive program that is designed to convince the distributor to carry its products. Some of the ways in which this is done include (1) helping to finance local promotion campaigns of the product, (2) providing generous sales incentives, (3) conducting marketing research to identify customer niches and sales forecasts to help the distributor to decide how much inventory to carry (Karel, 1991), (4)

ensuring that unsold or outmoded merchandise can be returned for a full refund (Rugman & Hodgetts, 2001).

Depending on the nature of the market and the competition, the multinational may give exclusive geographic distribution to one local seller or may arrange to have a number of sellers jointly selling the product. For example, automakers will often have more than one dealer in a major metropolis but be willing to give exclusive geographic distribution rights to dealers located in rural areas (Rugman & Hodgetts, 2001). *It is the case of Shanghai Volkswagen that we will show the details in chapter 5-6.*

To choose the best distribution system is one of companies' marketing strategies and is playing a key role in helping MNEs to successfully expand overseas business especially for those in the automobile industry.

3.5 Attractiveness of the Country and Doing Business in China

Countries have different political, economic, and legal systems, which cause international business to be much more complicated than domestic business. Cultural practices can vary dramatically from country to country, as can the education level and/or skills of the population. Moreover, countries are at different stages of economic development. All of these differences have a profound impact on the benefits, costs, and risks associated with doing business in different countries; the way in which operations in different countries should be managed; and the strategy international firms should pursue in different countries. The benefits, costs, and risks associated with doing business in a country are a function of that country's political, economic, and legal systems. (Hill, 2001)

3.5.1 Attractiveness of a Country

The overall attractiveness of a country as a market and/or investment site depends on balancing the likely long-term benefits of doing business in that

country against the likely costs and risks. Below we consider the determinants of benefits, costs, and risks (Hill, 2001).

A. Benefits

As we have already mentioned, in the most general sense, the long-run monetary benefits of doing business in a country is a function of the size of the market, the present wealth (purchasing power) of consumers in that market, and the likely future wealth of consumers (Hill, 2001).

A country's economic system and property rights regime are reasonably good predictors of economic prospects. Countries with free market economies in which property rights are well protected tend to achieve greater economic growth rates than command economies and/or economies where property rights are poorly protected. It follows that a country's economic system and property rights regime, when taken together with market size (in terms of population), probably constitute reasonably good indicators of the potential long-run benefits of doing business in a country (The Economist, 1996, 75).

B. Costs

A number of political, economic, and legal factors determine the costs of doing business in a country. With regard to political factors, the costs of doing business in a country can be increased by a need to pay off the politically powerful in order to be allowed by the government to do business (Hill, 2001).

With regard to economic factors, one of the most important variables is the sophistication of a country's economy. It may be more costly to do business in relatively primitive or undeveloped economies because of the lack of infrastructure and supporting businesses. At the extreme, an international firm may have to provide its own infrastructure and supporting business if it wishes to do business in a country, which obviously raises costs (Hill, 2001).

As for legal factors, it can be more costly to do business in a country where local laws and regulations set strict standards with regard to product safety, safety in the workplace, environmental pollution, and the like (since adhering

to such regulations is costly). In the absence of a well-developed body of business contract law, international firms may find that there is no satisfactory way to resolve contract disputes and, consequently, routinely face large losses from contract violations. Similar situations will happen when local laws fail to adequately protect intellectual property (Hill, 2001).

C. Risks

As with costs, the risks of doing business in a country are determined by a number of political, economic, and legal factors. On the political front, there is the issue of political risk. Political risk has been defined as the likelihood that political forces will cause drastic changes in a country's business environment that adversely affect the profit and other goals of a particular business enterprise (Robock, 1971). So defined, political risk tends to be greater in countries experiencing social unrest and disorder or in countries where the underlying nature of a society increases the likelihood of social unrest. Social unrest typically finds expression in strikes, demonstrations, terrorism, and violent conflict (Hill, 2001).

On the economic front, economic risks arise from economic mismanagement by the government of a country. Economic risks are not independent of political risk. Economic mismanagement may give rise to significant social unrest and hence political risk. One visible indicator of economic mismanagement tends to be a country's inflation rate. Another might to be the level of business and government debt in the country (Hill, 2001).

On the legal front, risks arise when a country's legal system fails to provide adequate safeguards in the case of contract violations or to protect property rights. When legal safeguards are weak, firms are more likely to break contracts and/or steal intellectual property if they perceive it as being in their interests to do so. When legal risks in a country are high, an international business might hesitate entering into a long-term contract or joint venture agreement with a firm in that country (Hill, 2001).

D. Overall Attractiveness

The overall attractiveness of a country as a potential market and/or investment site for an international business depends on balancing the benefits, costs, and risks associated with doing business in that country. Generally, the costs and risks associated with doing business in a foreign country are typically lower in economically advanced and politically stable democratic nations and greater in less developed and politically unstable nations. Economic growth appears to be a function of a free market system and a country's capacity for growth. This leads one to conclude that, other things being equal, the benefit, cost, risk trade-off is likely to be most favourable in the case of politically stable developed and developing nations that have free market systems and no dramatic upsurge in either inflation rates or private-sector debt (Hill, 2001).

3.5.2 Doing Business in China

Over the last decade China has experienced comparative stability and growth. It has overcome inflation and the political strivings of the late 1980s. The return of Hong Kong and Macau was a 'major triumphs'. Gradually economic progress has been achieved followed by relatively higher living standards. Probably one of the most important achievements and another step toward integration into the global community was its accession to the World Trade Organization (WTO) at the end of last year. According to latest statistics released by the Ministry of Foreign Trade and Economic Co-operation (MOFTEC), actual foreign direct investment (FDI) in China reached a new high at US$ 46.85 billion this year, as investors build up confidence in the market following its accession to the WTO.

We analyse the Chinese economic circumstance from the aspects of benefits, costs and risks, which are believed to be three main factors affecting the overall attractiveness of a country.

A. Benefits

The scale of China's economic development has kept steady growth for more then ten years. Respectively, people's purchasing power has been increasing at

an accelerating pace followed by growth of the domestic market. Foreign investors are attracted by the potential of this market and by opportunity of investing and building enterprises there. Because of rapid economic growth, a great number of construction and technological upgrading projects have been undertaken throughout China. On the other hand, another important reason why China is so attractive for multinational investment is its low labour costs.

For a long time China had an image of a country with communist totalitarianism and was censured by many western countries for violation of human rights. However, on the background of transformation from command to market economy the divergence rooted from political system seems to be diluted. Western governments express the belief that changes toward democracy will follow the changes in economic system. Such a vision was an important factor in the US government's 1996 decision to grant China most favoured nation trading status. In the long run, the stable political environment should be the main guarantee for those MNEs doing business in China.

In order to create better investment environment and encourage foreign companies' investments, China has gradually established a relatively complete legal system. In 1979 the National People's Congress issued The Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures. In the next 20 years, the Chinese government has adopted and issued a number of laws and statutes concerning the establishment, operation, termination and liquidation of foreign-invested enterprises. Currently, the Chinese government is re-examining existing laws to meet the framework of the WTO. The Chinese government also levies low taxes on enterprises with foreign investment, and offers preferential tax policies to the sectors and regions where investments are encouraged by the state. With such approaches aimed on improvement of investment environment, China may become a very attractive place for foreign investors.

B. Costs and Risks

Although MNEs will benefit from both economic side and governmental side, doing business with China has never been easy.

For number of western businessmen China remains a mystery: the language, the people, the culture, the customs and the business practices often seem impossible to understand. In fact, from the present point of view, the business environment in China differs essentially from many other Asian-Pacific countries because of its cultural background, historical perspective and its communist government.

On the political front, the costs of doing business in China mainly origin from ethical and cultural reasons. One China expert recently noted the following:

Personal connections play an important role for doing business in China. Companies willing to succeed need to meet the "proper" people and gain their support. This generates additional costs.
The Chinese respect negotiators who have authority to make decisions. They might be upset if the negotiating person has to contact higher managers for directions.

However, negotiators should realise that the Chinese do not make decisions quickly. Chinese are thorough and methodical in their evaluation of a project, therefore determination and patience are important.

Friendship and trust between the parties is considered important and is used to resolve any disputes. Written contracts tend to be shorter than those in the West because the Chinese do not believe that everything must be written down (Tai, 1988) (Borrus, 1993).

We think that the risks from the political side for doing business in China are not really very high. First of all, compared to most developed and developing countries, China has long been one of the most stable countries with regard to violent conflicts like strikes, demonstrations and terrorism since the Tiananmen square massacre in 1989. Also, the possibilities of sudden changes in political or economic system are considerably low, at least in a long period of time from now.

With regard to the costs and risks from the economic perspective, despite its huge population and two decades of rapid growth, China is still a poor country where the average income is around $ 800 per year. The lack of purchasing power results in a limited market for many Western consumer goods from automobiles to household appliances. Another problem is the lack of a well developed transportation infrastructure or distribution system which will possibly force the MNEs to provide its own infrastructure and supporting business and obviously raises costs. There are also problems with some local joint venture partners who are inexperienced.

Despite government's continuous efforts, there are still some problems with the regulations that guarantee the investors' interests in China. Things are especially serious as to the protection of intellectual property. The computer software industry suffers more than most from lax enforcement of intellectual property rights (Hill, 2001). That is the reason that is hampering some high-technology MNEs from making investment in China considering the danger of losing their core competencies.

To conclude, the cultural and political barriers and drawbacks in the legal system can seem discouraging to those businessmen who are planning do business in China. However, companies that have successfully found a way to bridge the gap and deal with these negative effects must have realized that their business ideas can be quite successful in China.

In later chapters, we will talk about the automobile industry and the strategies of some leading MNEs in the industry. Then we will focus on how auto MNEs can successfully do business in the Chinese marketplace.

CHP4. General Circumstances of the Global Auto Market

4.1 Introduction

Being one of the largest, the world automobile industry is one of the first global manufacturing industries, with the major producers assembling and selling cars in all regions. While OECD markets are saturated, emerging markets offer scope for substantial expansion with demand rising in line with general output growth (Richard Jerram, Michael Hodges, Louis Turner, and Richard Kurz, 1997-1998).

The automobile industry is an increasingly international sector. In the 1950s and 60s car manufacturers used to sell their products mainly in domestic markets. National producers often enjoyed government support through subsidies, and very high tariff levels protected markets. Thus producers concentrated on producing cars specifically intended for the domestic markets making international penetration very difficult.

In the late 60s this began to change. Lower tariff levels and pressure from US firms led producers to pursue a more global approach to the industry. Thus, cars converged into a more homogeneous product, which could be sold both in domestic and international markets. Further evidence of globalisation is found in the difficulty in determining the nationality of different companies. Ford set up its first foreign plant in the UK in 1911, while Volkswagen's operations in Brazil began in 1953.

Car markets still stay segmented, thus, the companies still attach a great importance to their home markets. Price difference for the same product is clear evidence of this segmentation. Even within Europe this fact is noticeable: net prices in Denmark are low due to tax pressures, while a market protected from parallel imports by left-hand driving has lead to higher prices in the United Kingdom.

In this chapter, we will show the general circumstance of the global automobile industry from the historical development and the present status perspectives. We believe it is hard to generalize the whole industry to a simple point since different areas have their own background and characters. As a result, we lay out this chapter by showing different auto industries of the "Triad" (K. Ohame, 1985) - the United States, European Unity and Japan.

4.2 U.S. Auto Industry

4.2.1 History

In its first fifteen years the U.S. automobile industry was characterized by a great deal of entry and the number of firms peaked at 272 in 1909. Despite robust growth in the market for automobiles, the industry subsequently sustained a prolonged shakeout in the number of producers and evolved to be an oligopoly dominated by the "Big Threes", namely General Motor, Ford and Chrysler. The industry also evolved to be heavily concentrated around Detroit, Michigan, which not only was home to its top three firms but most of its other leaders. By the late 1910s most of the leading makes of automobiles were produced by Detroit-area firms, and Detroit was home to the three firms that by the 1930s produced over 80% of the industry's output. For most of its history, the automobile industry was characterized by "Fordism" ideas of mass production techniques. This involved using an assembly line to reach a large scale of output of a limited range of products, using fixed techniques, with workers performing specialized tasks. However, such a system was inflexible; although economies of scale could be achieved with large volumes, it was difficult to adapt.

4.2.2 Status of the industry today

Like a number of long-established U.S. industries, the automobile manufacturing industry has gone through wrenching times in the past 10 to 15 years. Nevertheless, the U.S. industry is still home to the two largest vehicle manufacturers in the world, General Motors and Ford, and has been responsible

for 20 to 25 percent of world vehicle production in several years since 1980. Over the past few years, the United States has closed the gap with Japan with respect to the volume of domestically produced passenger cars and overtaken Japan in the increasingly important sector of Trucks, Buses, and Others. In this sector, which includes the popular light trucks, minivans, and utility vehicles, U.S. producers are considered market leaders (Clair, Lafrance, 1996).

The U.S. Big 3 have gained market share in domestic passenger car sales, from 61 percent in 1991 to 64 percent in 1994. Transplants have also increased their share, from 14 percent in 1991 to 17 percent in 1994. Despite these gains—which were made at the expense of imports—the United States is running a well-publicized trade deficit of $ 50 billion (as of 1994) in the motor vehicle sector. The $ 89 billion of production by foreign affiliates of the Big 3 is less well known, and although it does not solve the trade deficit problem, it does put the U.S. industry's position in the world in perspective.

Through the past 15 years, the Big 3 have maintained the confidence of financial markets—their market capitalization has kept pace with the capitalization of Standard & Poor's Industrials. Over the years, the return on assets of the Big 3 has generally been below par in spite of their efforts to increase profitability and efficiency. One of the casualties of these efforts has been employment, which has decreased substantially since the late 1980s. Also, new assembly plants operated by Japanese and German auto manufacturers have been built in the United States, introducing additional competitive challenges for the Big 3. Because of their location, they have also altered the regional distribution of automotive employment. These new "transplant" manufacturing facilities have been accompanied by the arrival of new suppliers from the home markets of these manufacturers. The presence of these new suppliers has benefited both the new assemblers and the Big 3 by introducing additional competition into the supply of automotive parts.

The variety of motor vehicles is expanding and the market is no longer dominated by a handful of very high volume cars. Detroit carmakers have been able to respond much more quickly to this demand for a range of models with

the adoption of lean production. The average time to market or "lead-time" of U.S. carmakers has fallen from about 61 months to about 52 months—below the Japanese average, which actually increased from 45 to 55 months from the late 1980s to the early 1990s. As a result, U.S. companies can now compete with the Japanese in product development. Lead-time may already be significantly faster at Chrysler than at many of the Japanese companies. However, American manufacturers' competitive disadvantage in model mix complexity creates a barrier to their ability to compete in product diversity.

4.3 EU Sector

4.3.1 History and Background

From the day Daimler-Benz first started the European automobile industry with just an idea of an engine, the EU automobiles market is now one of the major markets due to the relatively high average income. About 12,5 million cars are produced annually in the EU standing for one third of world car production.

The European automobile industry started as segmented national markets with many technical regulations that posed as barriers to trade between member states. The segmented markets were seen as limitation for competition. The automobile sector's first supranational organization in Europe was OICA (Organization Internationale des Constructeurs d'Automobiles), which was established in 1955. In 1991 a new unified group was formed – ACEA (Association des Constructeurs Européens d' Automobiles). It extended its membership to include the American and Swedish manufacturers, and adopted a system of majority voting (Laughlin & Maloney, 1999:109-123). The EU took the decision in 1985 to create a single market. In addition, national governments throughout Europe began to follow the UK's lead by adopting deregulation as a move towards a "competition state" model. European integration helps to eliminate the opportunity for price discrimination, and leads to lower costs with respect to testing and adapting cars for different

markets. There seems to be a trend towards lower vertical integration, in spite of the increased requirements for specialised assets in the component industry.

For the EU the automotive sector is extremely important due to its contribution to both employment and GDP. Thus the automotive industry employs more than one million people in the EU, which is approximately 5% of the industrial workforce. At the same time 3 of the 9 largest corporations in the EU are car manufacturers, which furthers the industry's role as a high profile sector. Cars are also a major export commodity for the EU, as total car exports amounted to 37 billion EURO in 1994 (in the same year car imports amounted to 19 billion). The EU's main export market is North America, although the size of this market has decreased due to adverse changes in exchange rates. All in all there can be no doubt as to the sectors importance for the EU economy as a whole.

In the same period the employment in the sector has decreased rapidly. This has happened as a consequence of the major restructuring and rationalization, which has swept through industry during the period in question. At the same time the industry faced declining demand in the early 90s, further hurting employment in the sector. The European automobile industry clearly faced critical challenges in its history, not only from the arrival of the American and Japanese plants but also through the global revolution in manufacturing – lean production. The industry now has the opportunity to restructure and expand its capabilities in order to build a world-class manufacturing and supply base. Europe has an industrial culture based upon engineering and design that is increasingly in demand in the modern world and has a desire and willingness to learn from the "best practices" of its competitors.

4.3.2 Prospects for the Automobile Market

Today, the main problem areas for European manufacturers are:

1. Less financial power than their American and Japanese competitors;
2. Insufficient cooperation and competition among six equally strong manufacturers;

3. Competitive pressure from Japanese production plants in Europe;
4. The rise in the number of new manufacturers in Asia and the Pacific region with considerable export potential, increasing Japanese and American imports into the EU.

It can be assumed that the European Union will remain the world's largest automobile producer and market in the next few years. The sharpest increase in demand is likely to occur in countries where the automobile population is still small (Eastern Europe, Latin America, Africa and Asia, excluding Japan).

Aggregate over-capacity is not spread evenly across manufacturers, countries or plants. Rather, it exposes the vulnerable: the oldest plants, the least efficient plants, or simply those producing an unattractive product. The concern is that high efficiency may not compensate for the structural uncompetitiveness of European vehicle production plants.

It must be noted that both the Japanese coming into the European auto industry and the merger by Daimler and Chrysler helped the European auto industry. They helped in different ways. The Japanization policy seemed to help the industry out of a bad time. The merger of Daimler and Chrysler was a way for the European auto industry to have more global controls and reaches out to face competition.

The immediate goal of the European auto industry must be to establish mutual trust and understanding between the assemblers, suppliers and the governments of Europe in order to re-establish the automotive sector as the main engine for economic growth and prosperity for the twenty-first century. Furthermore, without the efforts to globalise, the industry would soon find itself behind the United States and other prominent automobile manufacturers.

4.4 Japanese Sector

4.4.1 History and Background

In 1917, Japan entered the automobile industry with the Mitsubishi model-A. In 1930, the British helped the Japanese auto industry, but they were unaware of it. Datsun, later known as Nissan, used the British Austin Seven as a model for their first car.

Today, the Japanese are teaching the world about being competitive. A superior product, which is made efficiently, will have two advantages. It will be both better and cheaper. Early manufacturers were driven to make the quickest, quality product.

By the 1960s, Japan was using international styles to add appeal to their automobiles. The Japanese have a history of integrating ideas from the best and the brightest.

The Japanese automobile industry has been playing an important role for the development of the production system. The mass production system called "Fordism" was transformed into a flexible and lean production system. Today, one of the major comparative advantages of the Japanese automobile industry is its production system for maintaining efficiency and quality of production. Another important factor is the strong manufacturer-supplier relationship and the high capability of parts suppliers in Japan. The importance of the strong linkage between auto makers and parts suppliers was globally recognized in recent years as the Japanese production system became highly appreciated. Since the automobile industry became competitive globally, the pressure for productivity increases and cost reduction has been accelerating the reorganization of auto industry on a global scale in recent years. Through technical cooperation and mergers of companies, automobile makers of different countries are adopting new production systems. The Japanese production system, however, cannot be transferred easily. It was developed

under the Japanese management system and social and cultural environment over many years.

4.4.2 Restructuring and Global Strategy of the Japanese Auto Industry

In the 1980s, the Japanese auto industry had a significant impact on the world auto industry as the concept of lean production spread across the globe. The core element of the industry's most recent strategy is restructuring domestic business contents and systems, strengthening overseas production with particular care to ASEAN countries, and establishing a global strategy through the formation of worldwide networks for overseas production and business bases.

The Japanese domestic business plan and global business plan work hand-in-hand. There are, however, different origins between both strategies. Basically, domestic restructuring stemmed from the domestic recession after the burst in the bubble economy, and global restructuring evolved from increasing trade friction, spurred by a radical increase of car exports. Moreover, exports from Japan are becoming more and more expensive and thus are on the decline due to the climbing Yen. Restructuring the domestic policy, therefore, will inherently strengthen global competitiveness.

The global strategy of each Japanese automaker is influenced by different factors, depending on its present position in the market. Toyota, Mitsubishi and Suzuki, for example, do not need to alter their domestic and global strategy, for both are strong because of their effective domestic restructuring. Nissan and Mazda, however, are still pursuing a radical restructuring process to simultaneously reconstructing their domestic strategy and strengthening their global strategy in Asia and in the West. Honda has benefited from its global strategy, especially in the North American market compared with other Japanese companies, and the automaker now wishes to strengthen its Asian strategy and domestic strategy - for the company is in a relatively inferior position locally. Isuzu and Mazda have U.S. automakers as strategic partners. These companies will continue with their global strategy of a partnership for

production and development technology, hoping that this strategy will lead to a stronger and more noticeable presence in their domestic market. Fuji and Daihatsu, who still belong to the Nissan group and the Toyota group respectively, are pursuing an independent strategy. They hope to capture a share of the Asian (especially the Chinese market) and domestic market by offering special car categories, such as four-wheel drives and mini cars.

Japanese automakers will continue to benefit from such restructuring - especially from parts commonization, decreasing number of parts from an early stage of design and development, decreasing the number of development human hours, and total development system preventing after-design change. These aspects of restructuring harmonize with the new CAD CAM software, connecting with the Development, Production and Parts Purchasing stages. The goal is to pursue complete constancy from basic design to production design, and to eliminate cost up elements to check it perfectly from the origin of design stage.

4.4.3 The "ASEAN Strategy"

Japan will place a greater emphasis on restructuring its global strategy due to the continuous fluctuation of Yen. In developed countries, Japanese automakers have advanced their R&D localization and local content of their parts and components, increasing production capacity in these local plants.

To continue to increase local production overseas, Japanese automakers are emphasizing an increase in the plant operational ratio with existing lean production techniques rather than risky big scale investments, because they now have to consider market maturity and recession possibility. As a result, their allocation for overseas investment has shifted to Asia - especially the ASEAN area.

The highest growing auto market next century will be China, with a current population of over 1.2 billion. Japanese automakers obviously have much interest in this market, but they haven't positioned themselves as quickly as

their western counterparts. The Chinese government wants technological collaboration and a network of parts suppliers with the Japanese, but not really investment in Japanese assembly plants. Japan has remained prudent. There are many small-scale technical license agreements and license productions between Japan and China, but the investment is not significant.

Because of the Yen's problem, Japanese assemblers and suppliers are increasing investment in the ASEAN area. Increased investment in this area originated from several reasons, although the raising Yen now has certainly made investment even more attractive. One reason is the booming demand for automobiles in this area. A second reason is that industrialization has lead to an improvement in infrastructure, opening more possibilities for plant locations and physical distribution. A third reason is that, despite industrialization, the wage level is 20% lower than in Japan, and workers are relatively industrious. Now the ASEAN area is producing 1.1 million cars annually, which is third in production volume for Asia, and the production volume has doubled in only five years.

To put it briefly, three strategies now applied by the Japanese automakers are: decreasing some domestic production capacity by continuous restructuring; increasing overseas production in developed countries; and developing an international division of labour system in Asian market with high growth, while preparing a future horizontal division of labour.

4.5 Summary

To summarize, although the automobile industry is one of the oldest global manufacturing industries and the market seems to be saturated, with the rising demand and the internationalised character, automakers in the industry still have large potency to exploit. Companies who can combine cost leadership through the global business networking and establish optimum lean systems to facilitate domestic business restructuring and gain brand premiums simultaneously will be winners in the tough game of business survival.

Ford Motors, for example, is one of the world's largest car manufacturers, and originates from the United States. Today, however, the company has production plants in 38 countries and sales outlets in over 200 countries. Thus Ford, along with a number of other players in the industry, has become a truly transnational corporation with a worldwide network of suppliers, customers and associated companies.

CHP 5. Business Strategies of Leading Auto Companies (Case Studies)

5.1 Strategy at General Motors

5.1.1 Cause and effect of Changing business strategy

General Motors is one of the oldest multinational corporations in the world. Founded in 1908, GM established its first international operations in the 1920s. General Motors is now the world's largest industrial corporation and full-line automobile manufacturer with annual revenues of over $ 100 billion. The company sells 8 million vehicles per year, 3.2 million of which are produced and marketed outside of its North American base. In 1997, GM had a 31 percent share of the North American market and an 8.9 percent share of the market in the rest of the world.

Historically, the bulk of GM's foreign operations have been concentrated in Western Europe. Local brand names, such as Opel, Vauxhall and Saab helped the company to sell 1.7 million vehicles in 1997 and gain an 11.3 percent market share, second only to that of Ford in Western Europe. Although GM has long had a presence in Latin America and Asia, until recently sales there accounted for only a small fraction of the company's total international business. However, GM's plans call for this to change rapidly over the next few years. Sensing that Asia, Latin America, and Eastern Europe may be the automobile industry's growth markets early in the 21st century, GM has embarked on ambitious plans to invest $ 2.2 billion in four new manufacturing facilities in Argentina, Poland, China, and Thailand. This expansion goes hand in hand with a sea change in GM's philosophy toward the management of its international operations.

Traditionally, GM saw the developing world as a dumping ground for obsolete technology and outdated models. GM's Detroit-based executives saw this as a way of squeezing the maximum cash flow from the company's investments in aging technology. GM managers in the developing world, however, took it as

an indication that the center did not view developing world operations as being of great significance. By contrast, GM's European operations were traditionally managed on an arm's-length basis, with the company's national operations often being allowed to design their own cars and manufacturing facilities and to formulate their own marketing strategies. This regional and national autonomy allowed GM's European operations to produce vehicles that were tailored to the needs of local customers. However, it also led to the costly duplication of effort in design and manufacturing operations and to a failure to share valuable technology, skills, and practices across different national subsidiaries. Thus, while General Motors exerted tight control over its operations in the developing world, its control over operations in Europe was perhaps too lax. The result was a company whose international operations lacked overall strategic coherence.

Now GM is trying to change this. GM is switching from its Detroit-centric view of the world to a philosophy that centers on the thought that excellence may reside anywhere in the company's global operations. The company is trying to tap these centers of excellence to provide its global operations with the latest technology. Each is identical, each incorporates state-of-the-art technology, and each has been designed not by Americans, but by a team of Brazilian and German engineers. By building identical plants, GM should be able to mimic Toyota, whose plants are so alike that a change in a car in Japan can be quickly replicated around the world.

To realize scale economies, GM is also trying to design and build vehicles that share a common global platform. Engineering teams in Germany, Detroit, South America, and Australia are designing these common vehicle platforms. Local plants will be allowed to customize certain features of these vehicles to match the tastes and preferences of local customers. At the same time, adhering to a common global platform will enable the company to spread its costs of designing a car over greater volume and to realize scale economies in the manufacture of shared components, which should help GM to lower its overall cost structure. The first fruits of this effort include the 1998 Cadillac Seville, which was designed to be sold in more than 40 countries.

Despite making bold moves in the direction of greater global integration, numerous problems can still be seen on GM's horizon. Compared to Ford, Toyota, or the new Mercedes/Chrysler combination, GM still suffers from high costs, low perceived quality, and a profusion of brands. Moreover, while its aggressive move into emerging markets may be based on the reasonable assumption that demand will be strong in these areas, other automobile companies are also expanding their production facilities in the same markets, raising the specter of global excess capacity and price wars (Blumenstein & Haig Simonian & Howes, 1997-1998).

From a theoretical perspective, General Motors, profiled in the case above, is a good example of a company that has historically functioned as a multidomestic corporation, particularly with regard to its extensive European operations, which are largely self-contained entities. As we mentioned before, the high-cost structure associated with the duplication of production facilities makes this strategy inappropriate in industries where cost pressures are intense, which is the case in the automobile industry, a fact that explains GM's current attempts to change its strategic orientation.

Now GM is recognizing that if it is to compete successfully in emerging markets, it is no longer enough to transfer outdated technology and designs from Detroit. It must build a globally integrated corporation that draws on centers of excellence wherever they may reside in the world to engineer "global" cars and state-of-the-art production systems. In theory, we believe that the company is changing its business strategy from a multidomestic strategy to a transnational strategy.

However, a firm's ability to increase its profitability by pursuing its strategies is constrained by the need to customize its product-offering, marketing strategy, and business strategy to differing national conditions. As we can see from the case above, General Motors is trying to create value by leveraging the production skills developed at its Eisenach plant in Germany to new plants being built in Argentina, Poland, China, and Thailand. But for all its economic benefits, the trend toward greater integration of its global operations is raising

concerns within GM's European units. They fear that an ability to respond to local market needs may be lost in the process.

Even if the process of changing business strategy maybe painful to GM, we still believe that it is an inevitable process for the company to undertake considering the character of the auto industry. So long as it can find the right balance between global integration and local responsiveness after struggle, GM will reap its fruit sooner or later.

5.1.2 Failed Alliance - General Motors and Daewoo

We mentioned in the Chapter 2 that the choices of which foreign markets to enter, the timing and scale of entry, and the entry modes are of great importance to a company. Managers should be extremely careful when making those choices.

Among those choices, the various modes for serving foreign markets are the most crucial key to open the gate of success for managers. These modes are exporting, licensing or franchising to host-country firms, establishing joint ventures with a host-country firm, and setting up a wholly owned subsidiary in a host country to serve its market. Each of these options has advantages and disadvantages. The magnitude of the advantages and disadvantages associated with each entry mode are determined by a number of factors, including transport costs, trade barriers, political risks, economic risks, and firm strategy. The optimal entry mode varies from situation to situation depending on these various factors.

The following case is a typical example of the negative effect brought by malfunction of entry mode.

In June 1984, General Motors and the Daewoo Group of Korea signed an agreement that called for each to invest $ 100 million in a South Korean-based 50/50 joint venture, Daewoo Motor Company that would manufacture a subcompact car, the Pontiac LeMans. At the time, many hailed the alliance as a

smart move for both companies. GM doubted that a small car could be built profitably in the United States because of high labour costs, and it saw enormous advantages in this marriage of German technology and South Korean cheap labour.

Eight years of financial losses later the joint venture collapsed in a blizzard of mutual recriminations between Daewoo and General Motors. From the perspective of GM, things started to go seriously wrong in 1987, South Korea had lurched toward democracy, and workers throughout the country demanded better wages. To calm the labour troubles, Daewoo Motor more than doubled workers' wages. Suddenly it was cheaper to build Opels in Germany than in South Korea. (German wages were still higher, but German productivity was also much higher, which translated into lower labour costs.) Equally problematic was the poor quality of the cars rolling off the Daewoo production line.

However, if General Motors was disappointed in Daewoo, that was nothing compared to Daewoo's frustration with GM. The leadership of Daewoo Group complained publicly that GM executives were arrogant and treated them shabbily. They were angry that GM tried to prohibit them from expanding the market for Daewoo's cars. In late 1988, Mr. Kim negotiated a deal to sell 7,000 of Daewoo Motor's cars in Eastern Europe. GM executives immediately tried to kill the deal, telling Mr. Kim that Europe was the territory of GM's German subsidiary, Opel. Daewoo ultimately agreed to limit the sale to 3,000 cars and never sell again in Eastern Europe. To make matters worse, when Daewoo developed a new sedan car and asked GM to sell it in the US, GM said no. From the late 1988 on, Daewoo was continuously frustrated at having its expansion plans in Eastern Europe and the United States held back by GM. Daewoo's management also believed that the poor sales in the United States were not due to quality problems but to GM's poor marketing efforts.

Finally, Daewoo agreed to buy out GM's stake with $170 million over three years for its 50 percent stake in Daewoo Motor Company to end this failed marriage in November 1992 (Darlin & White, 1992).

The "failed marriage" tells us that although joint venture as a kind of FDI has become a main entry method in today's globalisation economic environment and has its advantages compared to the others as we mentioned in the Chapter 1, it suffers several drawbacks at the same time. We can draw lessons from the case that the shared ownership arrangement can lead to conflicts and battles for control between the investing firms if their goals and objectives change or if they take different views as to what the strategy should be. In this case, their mutual recriminations reveal the fact that both sides of the joint venture does not trust each other. It may be caused by the different cultural and political backgrounds. However, we believe that what the most important is the divergence in their strategic goals, which leads to another disadvantage of joint ventures, a joint venture does not give a firm the tight control over a foreign subsidiary that it might need for engaging in coordinated global attacks against its rivals. In this case, the subsidiary in South Korea has dual strategic meanings to GM, one is to gain the local market share, and the other purpose is to limit the Korean partner's potential possibility of invading GM's global market. In other words, GM was engaging in global strategic coordination. To implement this strategy, GM's subsidiary in Japan had to be prepared to take instructions from the headquarter regarding competitive strategy. Some of those instructions are issued to fulfil GM's global strategic coordination but were negative from the joint venture's perspective. Accordingly, some joint ventures are actually sacrifices for the sakes of their parents' own interests.

We hereby repeatedly emphasize the importance of entry strategies. Managers should carefully make the decisions of which one to enter, when to entry and how to entry. The optimal choices must not only benefit companies' long-term growth and profit, but also benefit the host countries.

5.2. Volkswagen

"A world-class corporation group redefines itself as a 'company that breathes', dedicating its operations worldwide to meeting the needs of the customer. It does so by applying a revolutionary concept which combines total

customer-orientation with a strong focus on value-added processes, supported by skilful change management"

- *Peter Hartz, 1996.*

5.2.1 Company Profile

The "company that breathes" - Volkswagen Group is the largest automobile manufacturer in Europe and the fourth largest in the world. The Volkswagen Group comprises two passenger car brand groups, the Volkswagen Brand Group (Bugatti, Bentley, Volkswagen, Skoda) and the Audi Brand Group (Lamborghini, Audi, Seat). The characteristics of the first brand group focus on classic values; the second on sporty values. In addition the Group includes the Volkswagen Truck Division which is predominantly the light commercial vehicle business plus the Latin American heavy goods vehicle business and the Financial Services Division.

According to official company estimations, Volkswagen Group market share was 12.4 % for the full year 2001. This included an 18.9% market share in Western Europe, a 15.4% market share in Eastern Europe, a 5.1% market share in the USA, a 28.6% market share in Brazil, a 25.8% market share in Mexico and 51.3% market share in China. As China is more to our interest, we have to mention that according to some other sources, during 2002 the company's market share in China decreased slightly.

5.2.2 Global Expansion as a Strategy

Founded as the "Gesellschaft zur Vorbereitung des Deutschen Volkswagens mbH" on 28 May 1937, in Wolfsburg, VW Group made its first step in the process of internationalising the company's operations on 11 September 1952 with the establishment of "Volkswagen Canada Ltd." in Toronto, Ontario. On 23 March 1953, "Volkswagen do Brazil Ltda." is established and converted into a public limited company on 12 July 1955. Volkswagen do Brazil becomes the largest Brazilian car manufacturer in 1959. Following its main strategy "to expand internationally" the company celebrates the production of the

1,000,000th Volkswagen in Wolfsburg in 1955 and continues increasing sales globally.

As we can assume based on the facts from the history of the company, the VW top managers believed in strategy of acquiring the already existing companies and making them profitable. The acquisition of Skoda in 1990, where Volkswagen won the rivalry with Renault by promising higher investments, was a clear proof of this strategy. In this case the brand recognition promised good access to the car markets of Eastern-central and Eastern Europe (as well as it happened before with the Spanish SEAT in 1986. SEAT was a losing state owned car maker, administered by ex-military leaders. Fiat owing the minority interest as well as the other companies refused to invest in SEAT, but within two years VW managed to make a profitable company out of it, however, partly also due to an explosion in car demand in Spain. At the same time due to lower wages in Spain, this deal turned into an opportunity for VW to establish a low-cost production in Europe. SEAT also allowed VW to increase market share in Mexico (M. Keller, 1993)).

To optimise its organizational structures, VOLKSWAGEN AG merges its financial services in March 1991 under the umbrella of "Volkswagen Finanz GmbH", which is transformed into a stock company on 1 January 1994. As a bank, "Volkswagen Financial Services AG" has access to the international financial markets, enabling access to the lowest-cost financing on a worldwide basis.

In order to regionalise its non-European business, the Volkswagen Group bundles its locations in the USA, Canada and Mexico into the "North American Region" (NAR) in 1991, so as to coordinate its activities in production and marketing. In the following year, the "Asia-Pacific" and "South America/Africa" regions are created.

However, at a certain period in time (1980s), expanding internationally showed the need not only of increased production but also broader diversity in products, followed by higher investments in production facilities and R&D. At

a later stage, when the automobile boom was followed by problems with decreased sales and tougher competition, especially with other global players, the increasing need of cost reduction became as sharp as never before. After establishing the small car standard with the "Beetle" and holding a singular edge for the decade, VW was failing on US market, retreating from Japanese invasion. Unlike its predecessor "Beetle", the Golf model faced most fierce rivalry from its Japanese analogues, somehow the inexpensive "peoples car" was priced higher than similar products from other companies. VW was still able to sell cars at the highest price customers were willing to pay, due to good quality reputation of its models and a bit more value added, but it was clear that this situation would not last for long (M. Keller, 1993).

With the appointment of Ferdinand Piech as a new Chairman of the Board of Management of Volkswagen AG on 1 January 1993, the Volkswagen Group counters the slump in its North American business by adopting a comprehensive strategy of restructuring and reorganizing. Following the principle of "quality before quantity" (as stated by company: *The long-term commercial success of the Volkswagen Group is to a large extent determined by the satisfaction and loyalty of its customers. The goal of the quality management function must therefore be to safeguard customer satisfaction. A key element of this strategy is the outstanding quality to which the products of the Volkswagen Group aspire, in order to offer our customers sound value for money.*), the Group's facilities in Puebla are transformed into an efficient manufacturing facility characterized by "lean production" and a high "local content".

However, things went better for VW. The restructuring showed its first results in the USA in 1995. The sales of Volkswagen of America, Inc. increased by about 20 %. After gradually strengthening its competitive position in the North American Region, the Volkswagen Group takes a great step forward, especially in the USA, with its New Beetle, that is introduced in 1997: the retro-model, much as the Beetle 40 years before, sets in motion genuine "Beetlemania". Jetta, Passat and Golf completed the attractive range of models that had a good

response in Mexico, Canada and the USA, placing the Group's North American business on a solid footing.

By acquiring "Rolls-Royce Motor Cars Limited" and "Bentley Motor Cars Limited", VOLKSWAGEN AG expands its range in the luxury class in 1998. The Bugatti and Lamborghini brands round off the Volkswagen Group's commitment to the luxury market.

**Note: With the production start of the Lupo 3L TDI, the first 3-litre per 100 km car produced in series, Volkswagen writes automotive history in July 1999. In Dresden, VOLKSWAGEN AG lays the corner stone for transparent assembly with an "all glass" factory on 27 July 1999. Taking an 18.7% stake in the Swedish truck manufacturer "Scania AB", in April 2000, VOLKSWAGEN AG makes a step toward extending its position on the international commercial vehicle market.*

For achieving its goals and responding challenges, currently, the company states its strategy as given below:

1. clearly define brand positioning;
2. increase coverage of market segments from 75% to 80 % by mid-2003;
3. build upon premium pricing and bring new, higher margin models to the market coinciding with automotive market recovery;
4. achieve the above without increasing capex and R&D by efficiently redeploying resources;
5. continue to enjoy the savings of the platform strategy but to achieve greater flexibility through the module strategy;
6. position VW so that it is able to sustain earnings in a market downturn;
7. as to return on investments, VW targets at 9-11% after tax (AEAA Conference, Paris 26 September 2002).

The other perspective mentioned recently by VW representatives at the Paris motor Show in September 2002 was very much concerned with the issue of selective distribution. In previous chapters we mentioned the role of

distribution in this industry. As described below we can see the company's vision of perspectives, challenges and opportunities set by selective distribution (see Table 5-1):

Table 5-1. Challenges and Opportunities of Selective Distribution

Challenges in Selective Distribution	Strategic Opportunities
•Abolition of geographical protection and defined market area responsibility •Necessity to harmonize prices •Brand exclusivity can no longer be fixed contractually •Authorization- and information-obligation in after sales service •Intensified internal and external competition	•Raise customer satisfaction •Intensify co-operation within the franchised dealer network •Complement the system with direct-sales elements •Active price harmonization in Europe •Optimization of standards as well as margin- and bonus systems •European dealer contract

5.2.3 Ideas for Future

The development of new products in the Volkswagen Group is oriented to the specific goal of enhancing customer benefit. Equal attention is devoted to matters of design and functionality, safety and environmental compatibility. In the financial year 2001 the research and development costs of the Volkswagen Group charged to the income statement in the financial statements to IAS totalled 2,660 million € (– 21.5 %). In vehicle development, Volkswagen

continued to restructure and expand its model range. Developments in that area include the successor models to the Golf and the Transporter, as well as the Phaeton luxury-class saloon. With more new models, such as the Multi-Purpose Vehicle in the Golf class and a Sports Utility Vehicle, the Touareg, developed in collaboration with Porsche, the Group will in future be covering even more segments of the automotive market. Key areas in terms of drive train components were the market launch of the W8 engine in the Passat, the fitting of new power units in the Polo and the successive expansion of the FSI range. With its expanded range of diesel engines conforming to the D4 emissions class, Volkswagen offers its customers a choice, which is as yet unmatched on the world market. Also, the Group is continuing its development of the V10 TDI and W12 units, a new 6-speed gearbox and a new 5-cylinder TDI generation. The company also starts the production of a new “Gol” model, simplified model of “Golf” which we will mention further in Chp 6.

CHP.6 The Chinese Auto Market Introduction

6.1 Introduction

Since the end of last century, the trend of the globalisation of world economy has been affecting the government management of the national economies. Most governments have turned increasingly to global marketplace and retreating from national economies, which were characterized mercantile, commanding and protection-oriented. The People's Republic of China is also in a period of transition from the command economy. It is trying to create market mechanisms to attract foreign investment and establish linkages with the global economy as well. This procedure in the Chinese automobile industry and which is accompanying global linkages have also begun to reorganize the manufacturer-supplier relations in the Chinese auto industry.

China has been keeping transforming from the command economy after the "Reform and Open" began in 1979 and still depends on achieving flexibility of policy making by breaking up the center-periphery relations. In many cases, however, these adjustments cannot be totally autarkic so long as China's national economy is increasingly being linked with the global economy.

All mentioned above implies that the Chinese national economic boundary is no longer impermeable to the global linkages. In the automobile sector, especially, China has witnessed the gradually vanishing of the economic boundaries thanks to the extensive linkages it has established with the global economy. Although more or less reluctantly, the Chinese auto makers have to rely on the global linkages to develop the industry despite their preference for having a national industry. The government wants to grow the industry into a national "pillar industry", an industry that will represent the maturing of the Chinese industrial revolution in the near future.

In this chapter, we will firstly make an overview of the Chinese automobile industry by analysing the developing trend of the industry including effects

from governmental policies. Then we will focus on the investment strategies of several auto multinationals in China. In the last part of this chapter we will generalize some differentiation of the Chinese auto industry and gain some experience for the coming investors.

6.2 Overview of the Chinese Auto Industry and Effects of Governmental Policies

6.2.1 Overview of the Chinese Auto Industry

A. Opening up of the Industry, 1979-1985

Until the mid-1980s, auto manufacturing in China remained dependent on a "comprehensive" or fully vertically integrated system of production. And it was under the supervision of the central industrial ministries or local governments. The "big and comprehensive" plants started by imitating the Ford system of the 1930s, copied from the former Soviet Union during the 1950s (Yang, 1994). This kind of "fixed relationship" between the manufacturers and their matching suppliers which the government had established to make sure entry, balance demand and 80% of the inputs supplies needed by the enterprises in the national supplies system were responsible for maintaining and spreading it. By 1979, numerous small and medium size comprehensive auto makers which the local governments had established to support the development of the local industries had contributed to a total number of about 130 assemblers that built 185,700 vehicles for the year, mostly trucks and truck chassis. Also, they had matching relations with more than 2,000 direct suppliers whose number almost doubled in the mid 1980s.

The Chinese enterprises tried to develop jointly after assuming "self-management" and a renewed profit retention scheme in the early 1980s, with the objective of expanding market, developing new products, concentrating the industry, rationalizing production as well as securing the certainty and improving the quality of the inputs supplies. Some auto assemblers, component suppliers and a number of defence factories interested in entering automobile business formed "combined management companies" (CMCs) - a sort of

divisionalized conglomerates (Yang, 1994). Within a conglomerate, usually there is a largest and most technologically advanced assembler called the "core" enterprise. The core company coordinated production as well as managed procurement and marketing across cities and provinces where the group members were located, so as to achieve a degree of specialization and division of labour within a CMC.

After the "Reform and Open" policy was implemented in 1979, the central government had in the legislation for "Special Economic Zones" (SEZs) and gradually removed the principle of "self-reliance" from national economic development. And at the moment, the policy was further adjusted from relying on SEZs towards using large and medium-sized state enterprises, which are main industrial base of the country, transferring the type of technologies needed in order to upgrade the overall technological capabilities of the country.

During the period of 1979 to mid-1980s, a variety of western advanced technologies were transferred to the Chinese auto industry. Initially, the projects on technology imports and assembly joint ventures were limited in scale and accompanying in nature for China's auto industry, the local governments that had tight control over the local supplies did not want to give up the administrative style of managing the automobile business. Neither did they show much interest on the possible benefit of such policy on the foreign partners of the joint ventures. It was not easy to upgrade those subordinate enterprises engaged in parts and components production, including both numerous assemblers themselves and the suppliers which had fixed matching relations with them, the administrative style of management had been proved effective for a long time. However, this protectionism approach to management made it impermeable for the joint venture assemblers to enter the Chinese auto industry.

Another problem was low reactivity of some enterprises in the materials industries, in other word, the unmet of demand of the auto assemblers and parts makers that had modernized their products and equipped with foreign technology. The boom of auto technologies imports in the mid-1980s and

subsequent rush in auto production result in 40% of the steel products, 23% of the iron and from 30% to 60% of the non-ferrous metals needed by automotive industry went unmet at that time.

Finally the problem centred on how to find an optimal scheme to switch imported assembling to exports. At the first step, it was necessary for those assemblers with various types of foreign linkages to make their products more value-added rather than merely assembling the imported supplies. To achieve this goal, they must not only link up with the foreign partners, but also the domestic parts and components makers. This in turn required that the Chinese suppliers improve product quality to meet the procurement requirements of the assemblers instead of continuing to rely on the protectionism of the local authorities. At the same time, however, it is necessary for the local governments turn to support the subordinate enterprises in competition for product quality instead of shielding them from the challenge in the marketplace.

This means that instead of merely employing foreign technologies and partnership to overcome the technological bottlenecks or upgrade skills and facilities for each enterprise individually, China had to connect the foreign aid with resolving the fundamental constraints on the auto enterprises' performance, namely, the inter-firm organizational relationship that continued to be controlled by the administrative commands of the local governments.

China had thus faced a crossroad by the mid-1980s. It could conservatively put a halt to the fragmented development in the auto industry by returning to central control. But this would sever its linkage with the world economy, which it had made efforts to establish for developing its auto industry in the first place. Alternatively, it could go further with globalisation, turning to rely on the market forces to manage the development of the auto industry. When adopting the principle of market competition, however, it necessitated government's concession on restructuring the manufacturer-supplier relations, particularly the concession from the local governments that have been gaining increasing control over the transactions in the inter-region inputs market.

B. From Administrative to Market-Based Management, 1986-1993

From the 7th "Five Years Plan" (FYP) period (1986-1990) onwards, China has increased reliance on joint ventures in the development of auto manufacturing, with auto assembly spearheading the trend. In both assembly and parts and components supplies, foreign linkages have proliferated after 1986 in response to growing competitive pressure faced by the Chinese auto industry (Yang, 1994). There came out "Three Bigs" joint ventures which taking the lead of the whole auto industry during this period: "Second Auto Works" (SAW) - Citroen; "First Auto Works" (FAW) - Volkswagen and Shanghai-Volkswagen. So named not only because they are much larger in scale than other joint ventures in assembly but also because SAW and FAW have traditionally been the two largest auto builders in China whereas Shanghai-Volkswagen aims to match them in future capacity. FAW and SAW acted as pioneers in this trend of increasing joint ventures because, as two heads of the traditional Chinese auto industry, they must shoulder the main burden for developing the auto industry into a "pillar" industry for the national economy.

Despite their tradition of reverse engineering both products and production processes, the conversion of SAW and FAW to joint ventures surely proved China's commitment to rely on the global linkages to develop its auto industry. As we mentioned in the theoretical framework, joint ventures allow them to take advantage of the relatively advanced technologies in the world. Since FAW and SAW are able to convince the automakers and their banks in the "Triad" to leverage some of the products, facilities and technologies whose life cycles have already ended in the advanced economies for a stake in the formers' projects, they can also obtain a discount in the fixed capital expenditure. Above all, FAW and SAW can learn from the foreign partners how to maintain the reputation of their brand names. This may prove useful not only for upgrading the technological learning along with restructuring the linkages with the domestic suppliers, but also for competing for market shares in the domestic market in the future. All mentioned above prove the advantages of joint venture, as a main entry strategy, will benefit not only the investing companies but also the host countries themselves.

At that moment, however, the first to benefit from the large-scale joint ventures in car assembly are the global linkages in the supplies sector, both joint ventures and other types of tie-ups that may not be involved in foreign equity investment. The industry had to rely greatly on foreign suppliers at that moment in order to meet the demands of the joint venture assemblers' for quality parts and components, with whose standards its domestic suppliers have not yet learned to deliver. China has become integrated with two tiers of foreign auto suppliers by entering large-scale car assembly with joint ventures. The first tier consists of those from the "Triad" who may have started the linkages with China through supplying the knockdown kits. And it is expected that China's ties with the suppliers in the "Triad" is going to expand continuously, as it deepens the development of auto production. The second involves a growing number of the companies from those newly industrialized countries and regions, particularly Hong Kong, followed by Taiwan and South Korea, with whom the Chinese suppliers begin to establish joint investment partnerships. Because these linkages are used to upgrade their skills and technology as well as to develop an ability to attend to the assemblers' sensitivity to quality, those suppliers with foreign connections stand to receive favourable consideration from the joint venture assemblers in the latter's drive to restructure the supplier linkages in China on the basis of the competitiveness in product quality.

We noticed that the central authorities have kept themselves being involved in some of the technology sharing projects, perhaps to approve a project when the total sum of a deal has exceeded an official cap or to strengthen the bargaining position of the subordinate enterprises compared to the technologically and financially powerful foreign peers. This implies that the central government has made an effort to maintain an influence on the direction and scale of the Sino-foreign partnerships without causing the enterprises lose most of their decision-making autonomy. Indeed, the government's attempt to adjust the policies in the auto industry seems to be more related to the changes in the general conditions such as the resource availability in the economy than to a deliberate retreat from the foreign linkages. On the contrary, the rising number of the multinational partnerships seems to be an indication of Chinese effort to extend

the global linkages with the auto suppliers all over the world. These linkages also confirm the continuity of decentralization in China by virtue of the diversity of the jurisdictional affiliation of the Chinese parties involved. Indeed, the partners of these linkages include not only some local parts makers, certain defense enterprises, major assemblers like FAW and SAW and some key national suppliers, but also some upstream suppliers like provincial iron and steel enterprises.

6.2.2 Effects from Governmental Policies

To attract investment and other types of technical aids from multinational corporations, China had to improve the terms relating to foreign investment. As it began to amend its legislation, China had also to incorporate the lessons of Sino-foreign joint ventures learned in SEZs (Yang, 1994). In the 1983 provision to the joint venture laws, for example, it lengthened the period of partnerships in order to give foreign investors enough time to recover their initial investment. It made conditional concessions on inputs sourcing requirements to enable the foreign partners to supervise product quality in line with the reputation of their brand names. Similarly, the 1983 provision opened up China's market conditionally to allow them to broaden product sales. It also laid out a basis for resolving the problem of the shortages in foreign exchange that might plague a joint venture if it depended on the imported knockdown parts and materials for production.

To assure foreign investors of the autonomy of their Chinese partners, the People's Congress further enacted the General Principles of the Civil Law in 1986 to empower the management of a limited number of enterprises with the authority to sign contracts directly with foreign technology suppliers, subject to prior approval of the Ministry of Foreign Economic Relations and Trade. This was coupled with the promulgation of the provision of the State Council for the Encouragement of Foreign Investment that reaffirmed joint ventures autonomy in management, including that for marketing and procurement (Yang, 1994).

Since it continued to rely on the joint ventures for developing auto manufacturing into a pillar industry, it necessitated China to adopt the rules of the international market in its effort to raise the domestic content of the auto assembly. Both the central and local governments had to expand the joint ventures' access to the domestic market and remove the administrative barriers that hinder the competitive ability of their business. In an unprecedented decision in the latter half of the 1980s, the State Planning Commission (SPC) relieved SAW and FAW, the Chinese partners of the two largest joint venture assemblers, from the supervision of China National Automotive Industry Corporation (CNAIC), the successor of China Auto Industry General Co. (CAIGC) or the top agency supervising the development of China's auto industry. Instead, SPC placed them under its direct care (Murray, 1993). The decision has certainly given the Chinese auto enterprises greater autonomy in setting the quality of technology transfer as well as the conditions of purchasing. It has also been intended to more effectively pave the way for quality inputs supplies to the joint ventures.

To encourage the joint venture assemblers to rebuild the linkages with the Chinese auto suppliers, CNAIC has further announced its plan to establish fifty "auto-parts manufacturing groups" by 1995. This is in addition to the 60% domestic content rule, which China has already adopted to support the domestic sourcing programs of the individual joint ventures (Karp, 1992) (Takayama, 1991). It hopes that the "cooperation, regrouping and merging" to be launched among the Chinese parts makers would reduce their number, consolidate their scale and rationalize their development in a manner compatible with the competitive advantages of each, with each able to meet the tough demands of the joint venture assemblers (Xinhua General Overseas News Service, 29 February 1993).

While the central authorities are making it easier for the foreign investors to access the Chinese market, the local authorities are expanding the Sino-foreign linkages in the areas under their own geographical control. They are beginning to support the modernization efforts in the subordinate suppliers to help them to upgrade the business relations with the joint venture assemblers on the basis of

competitive performance. For instance, the Beijing government reportedly has allocated much of its own funds to help some 100 parts makers to develop the capability to source the inputs for Beijing Jeep's Cherokees (Xinhua General Overseas News Service, 20 February 1993).

This means that the local governments are breaking their own jurisdictional barriers after raised them in the first half of the 1980s. One explanation to this change is that the auto joint ventures have demonstrated their bargaining power to the superior administrative authorities. As the latter has found out, those joint ventures do not have to make concessions on matching supplies like the state owned assemblers in China. They can always overcome the lack in quality inputs with imports. In fact, they would rather close down production to protect the reputation of their foreign partners' products than keeping the operation going with inferior parts, as Beijing Jeep's experience suggests. If the local governments insisted on forcing the joint venture assemblers to localize sourcing with the governmental directed suppliers only, they would have driven the foreign partners away. On the other hand, the new approach of management promises to broaden the sources of investment capital while giving the local enterprises an opportunity to restructure themselves.

All of the above mentioned shows that the investment environment for foreign investors has been much improved in China since the government has realized the inevitable trend to be globally linked. Only by relying on the western advanced technology, management methods and ample capital can the Chinese develop their auto industry to become the state's "pillar industry".

According to the country's initial program, China was supposed to have three domestic plants for large car production, three for small cars, and two producing mini-cars. Having clearly divided tasks, they were not much in competition. However, the new round of rushing for automobile joint venture projects, marked by the entry into China of GM in 1998, is now in place. The manufactures started to produce vehicles of different types targeting different groups of customers. As the situation progresses, their competition for customers will become more and more intensified.

6.2.3 Differentiation of the Chinese Auto Industry

To summarize this part, we generalize some differences of the Chinese auto industry compared to the global auto industry.

Although more and more auto MNEs hold confidence in the Chinese auto industry and accelerate the pace of investment there, the Chinese auto industry is still an industry that is in lack of competitiveness in the global market compared to other industries in China. The auto industry, as a kind of manufacturing industry, has a strict demand for scale economy. However, the Chinese auto structure is still at a level of decentralization, small production scale, unordered management and out-moded technology. It is crucial for automakers to enlarge the production scale and make the competition more intense in the domestic market, which will finally increase the overall competitiveness of the whole auto industry in the global market.

The entrance into WTO might have more significant impact on the Chinese auto industry than on any industry else. Imported autos will grab a lot of market share from domestic products. Those automakers that are lacking enough production scale and advanced technology will eventually be eliminated. It can be foreseen that the thorough restructure and lots of mergers and acquisitions will happen in the near future, and only several superpowers will finally dominate the whole industry instead of the messy structure at the present stage.

The potential of the Chinese auto market is huge considering the existing and potential advantages compared to other areas. First, with the rapid economic growth and well-improved living condition, the purchasing power of the Chinese will increase accordingly. The average growth rate of the global auto market has been fluctuating around 4-5% for the past few years, however, the growth rate in the Chinese auto market is over 10%. The demand for sedans is particularly increasing at an amazing speed as a result of declining prices and rising personal incomes. Second, the volume of the Chinese auto market is also huge so that it creates enough competitive space for many leading auto superpowers to enter the market simultaneously. The third advantage is low

labour cost. The average wage level of the Chinese autoworkers is only one tenth to one twentieth to those of the workers in developed countries. And the wage level of senior autoworkers or engineers is also very poor compared to those of the workers in developed countries. The advantage of labour cost in China is so obvious not only compared to developed countries but also to some developing countries. The low labour cost combined with advanced technologies will create a beneficial condition for auto MNEs to do business in China successfully. Another advantage results from the overall advantage of manufacturing industries in China, especially those material industries relating to auto manufacturing. For example, the outputs of steel and mechanical products of China are ranked no.1 all over the world. And the manufacturing scales of some auto material are also in a leading position. We have every confidence that with those advantages, the Chinese auto industry will have a bright future.

After looking deeply inside the Chinese auto industry, we will take some examples of how auto MNEs do business in China by focusing their investment strategies.

6.3 Investment Strategies of Foreign Auto Companies in China

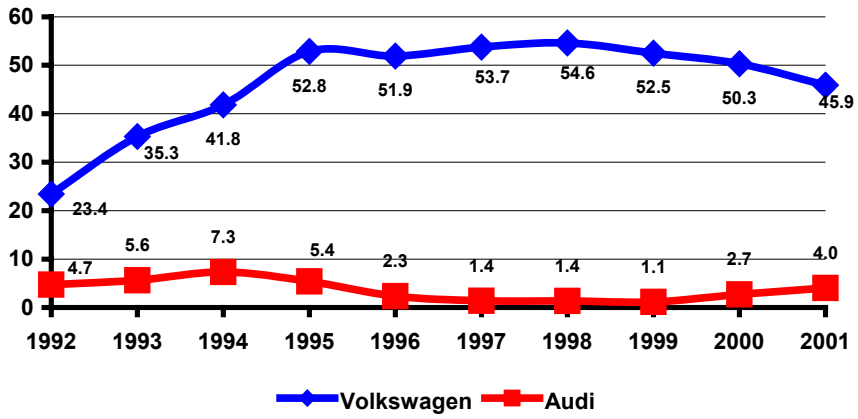
6.3.1 VW - The Best in China

6.3.1.1 General Overview/Historical Highlights

The first negotiations between VW authorities and Chinese government started in 1978. A trial assembly contract with the "Shanghai Tractor & Automobile Corporation" in 1982 is the start of the Volkswagen Group's commitment to the People's Republic of China. A number of years of negotiation lead to the foundation of the "Shanghai-Volkswagen Automotive Company, Ltd.", which currently enrols over 10 000 employees. On 20th April 1985 Volkswagen AG holds 50 % of the shares in the Chinese-German joint venture, which, as its capacity increases, develops into the largest and most modern passenger motor car factory in China.

On 6 February 1991, Volkswagen AG set up a second operation in China. Arising out of the cooperation with the "First Automobile Works" beginning in 1988, the joint venture "FAW-Volkswagen Automotive Company, Ltd." is created in Changchun, in which Volkswagen AG holds 40 %. The Volkswagen Group uses this joint venture to strengthen the Group's position in China, so as to assure its market leadership in the long term and to build up a low-cost production facility in Asia. 2001 Volkswagen Transmission Co. is established in Shanghai. The chart below shows the developing of the market share in China, by VW and Audi brands respectively: (see Chart 6-1)

Chart 6-1. Market Share in China (by Volkswagen and Audi)



Source: http://www.vw.com (2002-11-19)

As we can see VW has not started by building new plants in China (as we previously talked about choice of the entry), but followed its long-last strategy, or shall we say main strategic quid line, which does not change essentially from region to region: acquiring the existing company and making it profitable. Based on the facts and figures we think it is more than fair to say that in this case the strategy has worked – VW is the car maker number one in China with the market share of 51.3% and sales of 358,879 units (both figures as of the end of 2001, + 6.9% comparing to year 2000), and the way the company established itself on this market in our opinion was the best and maybe the only possible alternative by that time. However, we can see the differences: VW does not wholly own its Chinese operations but in joint ventures. As a matter of

fact the participation of VW in Chinese auto industry looks as given in Table 6-1:

Table 6-1. Participation of VW in Chinese JVs

SVW/Shanghai (1985)		**FAW-VW/Changchun (1991)**	
VW AG	50%	First Auto Works	60%
Shanghai Auto Ind. Corp.	25%	VW AG	30%
Bank of China	15%	AUDI AG	10%
China National Auto Ind. Co.	10%		
SHANGHAI SAIC -VOLKSWAGEN SALES CO. (2000)		**FAW-VOLKSWAGEN SALES CO. (1997)**	
		FAW-VW	85%
SAIC	50%	FAW	15%
VW	30%		
SVW	20%		

Source: AEAA Conference, Paris 26 September 2002

As we see VW Group owns 30% of Shanghai SAIC -Volkswagen Sales Co., which is 20% owned by SVW where VW AG has 50%. Similar situation is with FAW-VW Sales. Thus, VW is cooperating with Chinese partners not only in manufacturing of the cars, but to a great extent also in creation of distribution networks (Table 6-2). There is a saying “Local dog hunts local rabbit better than the outside dog” (approximate translation from Georgian), in this case joint efforts and resources may play essential role, taking into account the differences in cultures, management or negotiation styles. Taking the best of German carmakers global experience and Chinese sales methods gives the possibility of creation of some kind of symbiosis more appropriated to Chinese market and customers. However, mentioning the structure of VW in China, another factor more essential for VW than to its partners might be the attempt to get more control over new enterprises, establishing them trough joint investments from the group as a whole and the subsidiaries. In other words, VW owns something together with somebody VW already owned. If we consider the possibilities of disagreement, VW could have an advantage in

decision-making by directly holding part of the shares of the enterprise and holding another part indirectly through the JV.

Table 6-2. Distribution System Structure of the Joint Ventures

SVW Sales Company	FAW-VW Sales Company
• Network Size: 858 • Total Dealers: 572 of which 3-in-1: 71 • Service Centers 415 (only service: 286) • REGIONAL ORGANIZATION 22 REGIONAL DISTRIBUTION CENTERS	• Exclusive Dealers: 456 (only sales 59) of which 3-in-1: 242 • Service Centers: 397 (exklusive:155) Bora DLS: 117 • REGIONAL ORGANIZATION 8 REGIONAL OFFICES

Source: AEAA Conference, Paris 26 September 2002

As partly mentioned above, in relation with China, VW initially chose FDI being in a JV with a local partner as this was the only allowable way into the Chinese market with a modicum of control over operations. Since accession to WTO, VW now also exports in China certain models that are not made there. At the same time it is planned that VW will soon start production of its small "Gol" car for the Chinese market - a simpler version of the VW Golf, which would be built in China at VW sites in Changchun and Shanghai. The car is already sold in Brazil.

As planned for the future, the investments in China will be Capex, to a large degree. R&D will be minimal, as the cars are global, where local modifications are not needed. (However, confidentiality does not allow disclosing relevant exact figures at this stage.) At the same time there are no acquisitions planned in nearest future.

The main expansion areas of VW for the following years according to company's plans will be Asia, Eastern Europe and North America. As seen in the company, North America is still a relative growth market. For instance the

company intends to more than double Audi sales in the US from about 80,000 in 2001 to 200,000 in the medium term as there is a good market for premium automobiles.

VW CEO stated that a healthy car company should maintain Capex at about 6.5% of sales and R&D at 4%. VW intends to maintain or improve quality levels where possible and where the customer is willing to pay for it (A.Hunger).

6.3.1.2 Business Development

Before analyzing the strength and potential of the company at Chinese market we would like to present some figures and facts of VW activities here. As one of the main goals of the company is still stated as a "global expansion" (A.Hunger), we would describe the performance of VW in China in order to see how the results match the target. However, we will not make deep analysis of rations etc., as the expansion on market does not necessarily lead to high profits and efficiency in production. On the other hand, we have to mention that at this particular market VW looks good enough, holding the leading position and being able to balance the losses it generated in markets other than Asia &Pacific (and China in particular).

Sales of the Group on the Chinese market in year 2000 underwent pleasing development in collaboration with the two joint venture partners in Shanghai and Changchun. The total of 335,708 deliveries to customers surpassed the previous year's figure by 6.5 %, primarily owing to successful new model launches (the Passat and Audi A6) and to the sustained high demand for the Jetta. The Group's 53.2 (53.8) % share of the passenger car market demonstrates its outstanding position of strength on the Chinese automobile market.

Hereby, it is worthy to mention that Passat and especially Audi A6 are quite fuel-consuming and in no way cheap cars. Given the fact of the demand existing for these cars we probably can assume that there is some class of

people who could afford them. In other words, we can assume that Chinese consumers purchasing power has to some extend increased (although the price for the same model in EU or US compared to China, in our opinion is a great deal higher if we consider higher labour costs etc.).

The importance of the Asia-Pacific Region to the Volkswagen Group increased further in the year 2000. As from the company reports: In China, Volkswagen and Audi maintained their market leadership with a 53 % share (however, this figure is higher than according to other sources, which we mention in the last chapter). Since the Volkswagen Group's initial commitment to China, a total of over 2 million Volkswagen and Audi vehicles have been manufactured. In order to exploit the market potential more effectively, a joint venture company was established with the partner company Shanghai Automotive Industry Corporation, which had previously been the exclusive distributor in the country.

Further facts and figures from the report are as follows: In the Asia-Pacific Region the Volkswagen Group sold 394 thousand vehicles, 7.5 % more than in the previous year. Substantial increases in sales were recorded by the Volkswagen New Beetle, Jetta and Passat models and by the Audi A6. Production volumes at VW Chinese joint venture company rose by 5.8 % from 314 thousand to 332 thousand units. Part of those volumes involved production by the FAW-Volkswagen Automotive Company Ltd. of the Jetta and also of the Audi A6, which was successfully launched onto the market in a stretched version at the beginning of the year. In spring, the Shanghai-Volkswagen Automotive Company Ltd. also started production of a stretched Chinese version of the Passat, with an initial production volume of 30,000 units. By December 31, 2000, the workforce of the Volkswagen Group in the Asia-Pacific Region had increased by 6.7 % over the previous year-end figure, and totaled 17.0 thousand people. Of those, 16.3 thousand people (+ 6.2 %) were employed in China.

In 2001 the Volkswagen Group achieved a new selling record in the Asia-Pacific Region. Sales totaled 439 thousand units, up 11.4 %. The successful model range in China was expanded to include the Bora and – by the end of the

year – the Polo. Japan saw the launches of the Lupo and the new Passat as well as of the Audi A4 (see Table 6-3).

Table 6-3. VW Performance in China

	2001	2000	%
Vehicle Sales	439,000	394,000	+ 11.4
Production	364,000	332,000	+ 9.6
Workforce at Dec.31	17,600	17, 000	+ 3.4
Sales Revenue million €	5,075	4,297	+ 18.1
Operating Results million €	545	393	+ 38.7
-as % of Sales Revenue	10.7	9.1	X

Source: http://ir.Volkswagen-ir.de/english/default.asp (2002-11-19)

Volkswagen AG holds 60 % of the new Volkswagen Transmission (Shanghai) Company Ltd. and its Chinese partners Shanghai Automotive Industry Corporation and FAW Car Company each hold 20 % respectively. The investment volume for the new plant totals some 104 Based on the increase in unit sales, sales revenue increased by 18.1 % to 5,075 million € (pro rata). The positive sales development resulted in a substantial increase in pro rata operating profit to 545 million € (+ 38.7 %). The companies in China, in particular, made a major contribution to this improvement in performance. The region thus developed into a further key profit earner within the Group.

Contrary to the previous year, the upward trend was not sustained in the third quarter of 2002. In 2002 on a cumulative basis, worldwide sales of Volkswagen Group vehicles fell against the prior year comparable period by 3.6 % to 3,756,837 units (interim annual report 2002). As such the upward trend seen in the second quarter was carried over into the third. The Volkswagen Group

participated only to a moderate extent in the incentive programmes that have become commonplace in the automotive industry and was, nonetheless, able to achieve an increase in sales of 0.3 % in the third quarter versus the prior year. This was in keeping with the Volkswagen strategy of maintaining the value of its products. The Company's share of total new vehicle registrations worldwide was 11.9 (12.4) %.

However, in the Asia-Pacific Region, the Volkswagen Group again increased its sales by a substantial 28.5 %, to a total of 449,711 units, in the first nine months of the year. In China, especially, Volkswagen maintained its clear lead over the competition, selling a total of 368,789 vehicles (+ 34.9 %). The Japanese import market has grown slightly over the year to date (+ 1.2 %). The Group increased its sales in Japan by 2.6 %. Comparing to the other areas, we can see that China for VW is one of the fastest growing markets. It would be interesting to compare it for example with India, the country with also high number of population and resources. Unfortunately, no figures and reports give such emphasis on VW's other Asian markets as on China. However, we have already mentioned the future main expansion areas for the company.

6.3.1.3 Successful Investment Strategies of SVW

The term of the original joint venture contract concluded in 1985 was 25 years. On April 12, 2002, however, the Chinese and German shareholders signed the amended and restated joint venture contract giving the joint venture an extension of 20 years. The event marked a new round of development of SVW. As the largest joint car-making venture, SVW has enjoyed strong support from China's central government as well as from the local government of Shanghai.

By the end of 2001, SVW had manufactured and sold 1.9 million cars, with a market share of 38.73% and a sales revenue of over RMB 220.7 billion. The company was listed on the top of the 500 enterprises with foreign investment in China for 7 consecutive years and won the award of "10 National Excellent Joint Ventures" for 8 consecutive years.

The successful story of SVW results from a series of successful investment strategies.

First of all, 50%-50% joint venture was the wisest choice under the background of high tariff costs and the mysterious Chinese business environment at that time. Before they decided to invest in this unexplored land, the managers of Volkswagen had made deliberate assessments of the benefits and risks that would possibly be brought after entering the Chinese marketplace. When Volkswagen initially signed the contract of cooperation with the Chinese partner, they were not only attracted by the low product costs, but also the huge potential of the Chinese market and the large scale of manufacturing capability. As a result of many years' development SVW now boasts 5 production areas, including 3 car plants and 2 engine plants, with an annual capacity of 300,000 cars and engines. SVW has extensively adopted the most advanced manufacturing techniques and equipment, and its manufacturing capability has reached world level.

Secondly, according to the response to our questionnaire, VWAG is using a global matrix structure to cope with a transnational strategy (A. Hunger). In the structure, the Volkswagen Group is organized geographically:

- Europe
- North America
- South America/South Africa
- Asia Pacific

And the group is also organized into two Brand Groups:

- Classic: Volkswagen, Skoda, Bentley and Bugatti
- Sporty: Audi, Lamborghini and Seat

SVW is on the point of dual decision-making responsibility of Asia Pacific area and the Volkswagen brand. SVW is now taking the role of the manufacturing and marketing center of the Volkswagen sedan in the whole Asia Pacific area. Now SVW's product variety includes dozens of versions out of the four series of Santana B2, Santana 2000, Passat and POLO, the products are not only sold in Chinese market but also exported to different countries.

The relatively low price compared to the imported cars is another key factor, however, low price does not equal low quality. SVW has always put product quality above everything else. The company has introduced and improved the latest quality management concept and measures, thus ensuring a stable improvement of the product quality. In Nov. 1995, SVW became the first carmaker in China to obtain the ISO 9001 quality certificate. In 2001, the company again passed inspections against the VDA 6.1 (the Quality System of the German Automotive Industrial Association) and the ISO 9001 standards (version of the year 2000). The quality assessment of Shanghai Passat indicated that the car had reached the advanced level of the same class of cars made within the VW-Group. In 2001 Passat was twice ranked first among the cars of the same class. At its start of production, POLO had reached a high quality level of the same class as well. In 2001 SVW attained the honour of "National Customer Satisfaction Enterprise", and won the "National Quality Management Award" issued for the first time by the State, thus becoming the only enterprise to gain such an honour in China's automotive industry. The comprehensive adaptation and measuring room which SVW's quality control center boasts is of the largest scale and the most advanced technology in China, and its measuring and calibrating methods have been modernized or digitised.

Furthermore, SVW has been making effort to improve its vehicle development capability to approach the world level. In order to raise the capability for independent vehicle development, SVW has made a huge investment in the establishment of a large-scale technical center equipped with advanced facilities that can basically meet the needs of independent bodywork development and adaptation of engine to the chassis. Some of the laboratories are of the first class in the world and technically well ahead of other carmakers in China, and because of this the product development can be carried out on the same technology as that of VW AG. SVW's proving ground, in which a total investment of RMB one billion has been made, is the only one that has ever been built in China for car testing. Designed in accordance with VW standards, it has installed all the necessary facilities and test roads for testing purposes, such as the high-speed oval, the hill, the road section for acoustic testing and roads with typical Chinese conditions, etc. SVW's technical specialists also

participated in the development of "Santana 2000" and POLO. The start of production of Polo especially signals that SVW is now able to develop, plan, manufacture and launch on the market the latest product simultaneously with the advanced carmakers in the world. All the facts show that VW AG regards SVM as its favourable location of not only concentrated production, marketing, but also the technology center.

Finally, localization and a good distribution system are also significant factors for success. After years of efforts at the localization of Santana, SVW has established a rather mature parts supply system. By the end of 2001, 93% parts of Santana B2, 86% of Santana 2000 and 72% of Passat had been manufactured in China. At the start of production of SVW's latest model POLO, 40% of its parts and components came from the local sources. So far SVW has 387 local suppliers, from which RMB 16 billion Yuan's worth of parts and components are purchased every year. Besides, SVW has also established sales and service networks all over China. Up till now, SVW has authorized over 500 service stations and more than 700 dealers. This has enabled SVW users to enjoy a full, fast and convenient service of a high standard.

Today, when you come to Shanghai, you will definitely be astonished that 7-8 out of 10 cars running on the streets are made by SVM. And almost all of the taxis in Shanghai are Santana. The Chinese have gradually regarded "Da Zhong" (Chinese name of Volkswagen) their own cars. SVM is undoubtedly one of the most successful cases since the Chinese government decided to make reforms and open its market in the end of 1970s. Both the Chinese and the German parts have made promise to keep improving the cooperation. "The Chinese market is very important to us due to the growth of the market and our nearly 50% market share there. And our investments in China in the next years will reach € 2.5 Billion Euros" (A. Hunger). SVW has set up an example for all the joint ventures and we believe that the success is originated from the right investment strategies of the company.

6.3.1.4 Toyota – A Newly Born Competitor in the Chinese Marketplace

On the web page of Toyota Motor Company one can read the interview of Fujio Cho the president of the company. The president states "Since the Asian currency crisis in 1997, sales in the region have been recovering steadily. In major countries such as Thailand and Indonesia, we will work to maintain a high market share of more than 20%. In addition, looking ahead to the development of free trade in the region, we will work to construct comprehensive, Asian-wide operations by reorganizing our business infrastructure, covering manufacturing centres, procurement channels, and sales channels. In China, full-scale operations are beginning to take shape. In 2000, Toyota began manufacturing its mid-size bus, the Coaster, in Sichuan and the Company will start joint production of small passenger cars in Tianjin in the fall of 2002. We will continue to follow the progress of deregulatory measures in this market, while expanding our manufacturing and sales base in China. Including distribution channels and purchasing networks, we will lay the foundations necessary for an expansion of our market from China's coastal regions to areas further inland."

Japanese were the last to come to the North American market but they succeeded a lot, putting local companies in troubles. The share of Toyota in Chinese market is not essential comparing to VW, and Toyota is not as well established as the latter. Even among its main Asian markets Toyota (excluding Japan) does not mention China. Is there a threat that the Japanese will repeat what they did in Northern America and Europe? Their overseas plants were and still are putting a lot of pressure on the other global players like GM, Ford, VW, Daimler Crysler. How dangerous are they for the global company established there a quarter of a century ago, the pioneer and the leader of the industry on that market, possessing plants and distribution networks?

A. The Challenge

Tokyo - TOYOTA MOTOR CORPORATION (TMC) announced today that on July 25, after having received approval from the Tianjin Agency for Industry and Commerce, it established Toyota Motor (China) Investment Co., Ltd.

(TMCI) in the Chinese city of Tianjin to provide marketing support for Toyota vehicles in China.

TMC has been actively developing businesses in the Chinese market by starting production of the Coaster small bus in Sichuan last year and establishing a joint venture passenger car production company in Tianjin. TMCI will compliment these efforts by investing in Toyota vehicle production companies in China and by providing necessary marketing services, such as advertising, sales and public relations. TMCI also plans to engage in the education and training of sales and service center employees.

TMCI is capitalized at 30 million U.S. dollars with 100% equity participation by TMC. It will employ about 60 people. Former TMC China Division General Manager Hiroshige Nagoya will serve as TMCI President.

Source: Reuters, Aug 30 2002, "Toyota set to challenge VW's dominance in China", By Tiffany Wu

Shanghai, Aug 30 (Reuters) - Germany's Volkswagen AG faces a fierce challenge to its almost 20-year rule over China's auto market after Toyota Motor Corp announced plans to launch its first China-made car in October.

The new rivalry for Volkswagen, which sells one in two of the country's cars, comes after Toyota agreed on Thursday with China's top auto firm, FAW, to build 300,000 to 400,000 cars by 2010. "Toyota will definitely put pressure on Volkswagen, General Motors Corp and other foreign car makers," said Zhang Xin, analyst at Guotai Junan Securities. "Foreign manufacturers will have to seriously consider strategies and new models going forward."

Toyota, the world's third largest car maker, has strong brand recognition because of its popular car imports. The FAW deal will introduce vehicles ranging from luxury sedans to compacts to sports-utility vehicles.

While Toyota may chip away at Volkswagen's leading market share in the near term, some analysts said it would not be able to seriously challenge the German giant's supremacy for now.

Volkswagen is a veteran in the industry, becoming the first foreign firm to make cars in China in 1982. It sold 380,000 sedans last year and expects that to rise to at least 430,000 in 2002. "Whenever a new player came, the market was growing. So we don't think it will affect us in the short term," said Volkswagen's China spokesman Michael Wilkes. "But overall, Toyota is a very strong player in the automotive industry, so of course we take it very seriously."

B. Comments

According to some analysts, Toyota's main strengths are plans to roll out a wide spectrum of vehicles and an already excellent distribution network for its imports. The firm gives its sales agents a good profit margin, which cultivates loyalty. They have a good product and the key thing is they are trying to rebuild their import distribution model for their local products.

In recent years, global car makers have all set their sights on China's 1.3 billion people and competition has heated up. General Motors, Honda Motor Corp and PSA Peugeot, for instance, all have plants in China.

"It is an excellent opportunity for Toyota. They have taken a slow approach to China, but that is because the company has been waiting for the right time. They have laid good foundations"- said Takaki Nakanishi, auto analyst at Merrill Lynch.

Further analysts state that China's steady economic growth will benefit all manufacturers with strong brands by supporting booming demand. Car sales are estimated to hit one million for the first time this year and total vehicle sales to rise to three million. They don't see much risk of oversupply glutting the market, as it did four to five years ago when the industry was operating at only 50 percent capacity. "The competition will always be there, but because the overall pie is growing bigger, everyone can have their share," said Yale Zhang, analyst at Automotive Resources Asia.

But analysts doubted Volkswagen would be able to maintain its 50 percent market share in the long run. That ratio has already dipped to 45 percent in the first half of 2002 due to discounts offered by competitors, although Volkswagen's representative, Wilkes said that recent strong sales growth suggest that the share would rise back to 50 percent by the end of the year (and it most probably did rise if we judge by sales increase). "We will continue to be number one by introducing at least one new model a year. Growth comes from a strong base," he said.

Other analysts think that the competitive landscape has changed rapidly. According to them a 20-30 percent market share will be reasonable for Volkswagen in the next five years. But in the longer term, Japanese cars will take away their market share.

Having heard the views and predictions of experts, we leave this discussion for a while but we will come back to it in the concluding chapter in order give our opinion and vision of the problem.

6.3.2 GM in China

The General Motors-China relationship dates back more than eight decades. GM Export's first Far Eastern branch office opened in Manila in 1920 and moved to Shanghai in 1922. In 1926, GM China was established with headquarters in Shanghai China in 1926.

Nowadays, GM's mission in China is to leverage the company's extensive global resources to provide transportation products and services that deliver the best combination of technology and customer care innovation.

Manufacturing, sales, marketing and after-sales Services are key functions of GM China. Cadillac, Opel and Saab products imported from GM facilities worldwide are marketed in China. GM China also supports a network of authorized service centers and parts distributors across China. Today, GM cooperates with Chinese partners in different areas and through different

methods. Among them, Shanghai GM, Jinbei GM and The Pan Asia Technical Automotive Center (PATAC) are the most successful businesses and are of great value to both GM and the Chinese auto industry as well.

6.3.2.1 Shanghai GM

Shanghai General Motors Co. Ltd. (Shanghai GM) is a $1.52 billion, 50-50 joint venture with Shanghai Automotive Industry (Group) Corporation (SAIC), the leading passenger car manufacturer in China. As one of the largest automobile joint ventures in China, Shanghai GM was formed in June 1997. It manufactures a family of Buick products, as well as engines and transmissions.

With its customer focus philosophy, Shanghai GM has led the Chinese automobile industry in the introduction of new products. In April 1999, Shanghai GM began regular production of three models of midsize luxury Buick sedans: the Xin Shi Ji (New Century), GLX and GL, the company delivered 19,850 Buick sedans by year end, exceeding internal forecast by 75%. In May 2000, Shanghai GM launched the driver-oriented Buick GS sedan and the first executive wagon made in China, the Buick GL8. In August 2000, a sedan with a smaller engine - the Buick G - was added to the portfolio. Shanghai GM's first small car, the Buick Sail, came off the production line on December 12, 2000. Deliveries will begin in June 2001. All Shanghai GM vehicles include the latest technology, comfort and safety features.

Manufacturing at Shanghai GM is powered by world-class technology and world-class facilities. All five shops - general assembly, powertrain, press, body and paint - are situated in the 240,000-square-meter state-of-the-art facility, which is the most advanced of its kind in China. Shanghai GM has adopted advanced industry processes such as flexible tooling and lean manufacturing. This allows it to build two distinct models on the same production line. Shanghai GM has been designed to be environmentally friendly. It incorporates some of the industry's most advanced pollution-control equipment and procedures, including emissions and wastewater treatment technology.

Shanghai GM is fully supported by a comprehensive network of sales, after sales and parts centers created to deliver a world-class ownership experience. It has implemented a pull system whereby product volume is determined by market demand. Shanghai GM has pioneered a one-tier distribution system and a unified pricing strategy nationwide to guarantee value for customers.

The stringent quality control process adopted by Shanghai GM extends to its suppliers. At its inception, the facility had a local sourcing level of 40 percent, a level never before achieved by a joint venture automaker in China in year one. Local suppliers are selected based on quality, service, technology and price and judged according to the global QS-9000 standard. Shanghai GM's Quality Department has in-line inspection teams at all levels. The goal is to ensure the same high level of quality of parts and components in China as those produced elsewhere in the world.

6.3.2.2 Jinbei GM

Jinbei General Motors Automotive Co. Ltd. (Jinbei GM) is a $ 230 million 50-50 joint venture. Located in Shenyang, Liaoning province. Jinbei GM manufactures two of GM's most popular trucks: the Chevrolet Blazer sport-utility vehicle and the Chevrolet S-10 crew cab pickup. The first truck came off the production line on December 15, 2000. Regular production commenced in May 2001. Jinbei GM will have an annual manufacturing capacity of 30,000 vehicles during the first phase of production. During the second phase of production, capacity will increase to 50,000 units per year. Three models of the Blazer and one model of the S-10 crew cab pickup are believed to suit the needs of a variety of users in urban and rural areas of China.

Jinbei GM has set up a nationwide network of sales and after sales outlets. The products are supposed to be sold at a series of retailers across China. The first group of retailers began opening in April 2001. After sales service centers have started opening once vehicle deliveries commence in July 2001.

Some of the latest industry management systems and process controls such as lean manufacturing have been brought to Jinbei GM. All four Jinbei GM models have a parts localization rate surpassing 40 percent. Suppliers have been recruited from across China based on GM's Worldwide Purchasing standards of quality, service, technology and price. All suppliers are required to be QS-9000 certified by the start of regular production.

6.3.2.3 PATAC

Pan Asia Technical Automotive Center (PATAC) is a $50 million, 50-50 joint venture between General Motors and SAIC. PATAC is situated in the Pudong New Area of Shanghai and opened on June 12, 1997. It provides automotive engineering services including design, development, testing and validation of components and vehicles for automotive companies in China and the Asia Pacific region on a commercial basis. Among its achievements is the re-engineering of the Buick Sail for Shanghai GM.

The center combines GM's expertise in advanced technology and equipment with SAIC's knowledge and experience in the local market. However, as the first independent joint venture automotive engineering and design center in the Asia Pacific region, it functions separately from its parent companies. This permits PATAC to provide its services to all automotive companies across China and the region.

PATAC is one of 10 centers authorized by the State Environmental Protection Administration to carry out emissions testing. In addition, PATAC is the only center in southern China authorized to conduct automobile emission tests for new vehicles. In 1999, it received ISO-9001 certification.

The 12,500-square-meter PATAC facilities are fully computer-oriented. They utilize some of the automotive industry's most sophisticated software for computer-aided styling (CAS), computer-aided engineering (CAE), computer-aided design (CAD) and computer-aided manufacture (CAM). Much of this technology is being used in China for the first time.

6.3.2.4 Investment Strategy

By observing GM's business in China, we found the evidence of the company's transition from multidomestic strategy to transnational strategy, what we have analysed in the previous chapters. The company is trying to leverage the production skills developed at its Eisenach plant in Germany to new plants including those in China. All three companies enumerated above are not purely assembly plants but production, marketing, distribution and R&D centers equipped with world-class technology and world-class facilities.

GM also successfully dealt with the pressures for local responsiveness by customizing its products to suit the special needs of Chinese customers. The most typical example is Shanghai GM's first small car, the Buick Sail. With the increasing number of sedans, the traffic problem is becoming more and more serious. As a result, GM plans to enter for the first time the "low-medium" family sedan segment of the market within a year to compete against the aging Santana from Volkswagen AG , the new VW Jetta and the Citroen Elysee and the Peugeot 307 from French automaker PSA Peugeot Citroen. The new Sail version is believed to be another Santana miracle in the 21st century.

As mentioned in SVW's case, the 50-50 joint venture is believed to be the most ideal mode for auto MNEs to enter the Chinese marketplace in the first stage. We found that most of GM's investments in China are through this entry mode. It is also the mode that is enjoying the governmental and legal support in China. GM takes the advantage of low-labour-cost, huge-market-potential and host partners' knowledge and experience in the local market when doing business in China. On the other hand, Chinese automakers can keep the pace with their world-leading-peers by learning the world class technologies and management methods, and by absorbing foreign direct investment which can help them develop the auto industry.

With the entrance of WTO, tariff on imported cars will be reduced dramatically in the near future, as a result, GM targeted the Chinese market for its Cadillac, Opel and Saab products considering the huge potential of the market. We

believe that the combined mode of exporting and joint venture will have a bright future in the post-WTO automobile market in China.

Like SVW, high localization rate of its production and an efficient distribution system are also key factors of success for GM to do business in China. As mentioned above, the local sourcing rate over 40 percent is a level never before achieved by a joint venture automaker in China in year one. And the high localization rate helps GM to achieve low-cost advantage. Besides, GM invested $ 3.2 million for its first wholly owned subsidiary in China, GM Warehousing and Trading (Shanghai) Co., Ltd. in 1999. The parts distribution center (PDC) was established to ensure the quick delivery of genuine GM parts to customers in mainland China. The PDC features a fully computerized management and inventory control system and stocks about 15,000 parts. It serves as a bridge between GM and the China's domestic market, providing professional commercial and trade warehousing services for GM and its Chinese joint ventures.

GM expects to export more vehicles from its joint venture plants in China, but China will not serve as a major base for the sale of new cars and trucks to the rest of the world. GM currently exports about 100 a month of its Shanghai-made Buick GL8 minivans to the Philippines where it is sold under the Chevrolet name. GM is considering exporting its left-hand drive GL8 minivan to Japan to sell in low volumes and is also in discussions with Taiwan to open its market to Chinese-made vehicles. But GM's highly-profitable GM China unit has no plans to export vehicles to Europe or North America, Phil Murtaugh, chief executive officer of GM China, said in the response to our questionnaire "The opportunities in the domestic market are going to be more than adequate to keep us busy for a long time."

Moreover, for the sake of making GM China the new R&D center, GM Jiaotong Powertrain Technology Institute and GM-Tsinghua Technology Institute were established successively by GM together with Shanghai Jiaotong University and Beijing's Tsinghua University. They focus on technical training and joint R&D, and science and technology collaboration as well.

In general, GM adheres to its five principles for doing business in China:

- A commitment to a long-term relationship with China that benefits GM, China and the Chinese people;
- Involvement in the production, distribution, design and testing of vehicles and components;
- Active engagement in technology exchange programs and an obligation to keeping technology current;
- A commitment to fostering the managerial and professional skills of its Chinese employees;
- The integration of GM's operations in China with its regional and global operations to ensure the highest quality services and products for the Chinese market;

These principles guarantee the success of the cooperation between GM and its Chinese partners, and ensure both sides' considerable benefits.

6.3.3 Other Players

Since the Chinese government decided to absorb foreign direct investment to help develop its auto industry in 1981, more than 600 auto JVs have successively been established. Today, almost all leading auto MNEs from more than 20 countries and regions have their business in China and the total amount of investment has reached 20 billion US$. The products vary from middle-low class sedans to high-class sporties, from jeeps to vans, from buses to trucks, among them, the most successful Sinos are Shanghai – Volkswagen, Shanghai – GM, FAW – Volkwagen, SAW – Citroen, Guangzhou – Peugeot, Guangzhou – Honda, BeijingJeep – Daimler Chrysler, Changan – Suzuki, Changan – Ford, Jiangling – Ford, Tianjin – Toyota, and the newly established Shanghai – Volvo and Xi'an – Volvo, etc.

The reason why auto joint ventures are popular in China is the combined impact from low costs, high tariff on imported autos and the supporting policies

from government. Before China entered WTO, high tariff made imported cars not affordable to most Chinese. However, the lack of technology and the poor quality make domestic automakers unable to meet the needs from customers. Auto MNEs who have keen discernment grasped this opportunity and benefited a lot from the cooperation with Chinese.

Furthermore, high-class and luxury autos will become acceptable following the reduction on tariff which will result in the prices of imported autos dropping dramatically. Consequently, more and more auto MNEs target China as their main exporting market in the near future.

We believe that in the new century, the trend towards globalization in the auto industry is irresistible. As a result, China can no longer be regarded by automobile MNEs purely as their assembly base. On the contrary, the smart automakers have already made the Chinese marketplace their new production, marketing, exporting and R&D center considering its comprehensive advantages compared to other areas. Moreover, the entry strategy of doing business in China should no longer be confined to joint venture although it suits most to the Chinese circumstances, with the post-WTO impacts on the Chinese auto industry and a strengthened legal system, it is wiser for auto MNEs to implement a combined entry mode instead of a single one.

Chapter 7. Conclusions and Future Prospect of the Chinese Auto Industry

7.1 Surveys

The results of a recent survey conducted by the People's Bank of China on 22,800 people in 57 cities across the country shows a bright future for the Chinese auto market. According to the survey, demand of house and other large consumption automobiles will likely slow down while that for cars will increase. More than one-tenth said they have plans for cars. Nearly 30 percent of people said they will use loans to buy houses, while half said they will take loans to buy cars. A little more than one-tenth of the people surveyed already owns cars. Of these people, one third said the cars are for daily transport, another one-third stated they are for better life quality and the rest said cars are for business (Shanghai Daily news, January 14, 2002).

Another survey by Jiefang Daily found eight family cars popular in Shanghai. Over all, Shanghai drivers like General Motors Corp. Sail sedan as a family car. The Sail obtained most votes for the best family sedan in the survey. Besides the Sail, Shanghai residents' favourite family cars are the Honda Guangzhou, Santana2000 (VW), Ford, Oryx, Buick(GM), Aeolus and Passat (VW) (Shanghai Daily news, January 14, 2002).

7.2 Growth

"We just saw explosive growth, the growth has been huge and sustainable."
Phil Murtaugh, chief executive officer of GM China

In Table 7-1, we can find out that despite the depressing state of the global auto industry, the growth rate of the Chinese auto industry is keeping accelerating. It is forecasted that this year China auto overall demand will still keep a soaring trend by double-digit figures.

Table 7-1. Overview of Sale and Production of 2001 China Auto Industry

	Produce (Unit)	Increase (%) Compared to 2000	Sale (Unit)	Increase (%) Compared to 2000
Car	703,521	12.81	610,138	13.29
Passenger Vehicles	828,566		823,769	
Truck	802,353		818,433	
Total	2,334,440		2,252,340	

Source: www.chinacars.com (2002-02-26)

The figure of production will looking forward to reach 3.15 million units by the end of 2002, while the cars will be the most growing vehicles with 900 thousand units, a increase of 20 percent versus last year. At the same time, 2002 will undergo the largest tariffs cut for overseas vehicles. Beyond 150 thousand overseas vehicles will come to China, and the cars will hit 100 thousand record (Shanghai Daily news, May 16).

According to the statistics by China National Automotive Industry Corporation (CNAIC), from January to October this year, the total amount of produce in China auto industry is 2.63 million, increased 34.85% compared to the same period of last year. And the total amount of sale is 2.67 million with an increase of 35.55%. Judging by these figures, the total outputs of autos in China is forecasted to be at rank of No.5 or 6 leaped from No.8 in 2001.

China is even boldly predicted to become the fourth largest car market in the world in 2002, according to the International Organization of Motor Vehicle Manufacturers (OICA). OICA said the world car sales are expected to decline this year, while it is estimated that China will enjoy above 15 % growth. The main car exporters including North America, Japan and Germany are suffering from sales decline. The car output in China rose by 13 % last year. The output of heavy vans experienced a sharp decline in North America and Europe last year while that of China, whose output ranked the third around the world, enjoyed 92 % yield increase. The car output of the Asia Pacific region outpaced

that of North America last year. As Japan and South Korea both suffered from output declines, China is expected to take the lead.

Phil Murtaugh, chief executive officer of GM China said that China will become the world's second largest vehicle market, surpassing Japan, by 2010, and could pass the United States by 2025. He also mentioned that although China as a whole is not temporarily going to be a major exporter to North America and Europe (it is simply because of domestic demand), he said that the opportunities in the domestic market are going to be more than adequate to keep them busy for a long time. And so long as the domestic market is well satisfied with increasing outputs, China will become the export base of GM sooner or later (Global Auto Systems).

7.3 Reactions of Automakers

Chinese car market, a "lucrative cake", has garnered attentions of numerous foreign automarkers. Starting this year, they are gradually increasing market presence in China.

This year marks the first year of China's entry to the WTO, as policies on auto sector are relaxed, many international well-known auto firms set up their bases in China one by one to attract consumers, some domestic auto makers also seek ways to grab the market by joint venture.

Mercedes-Benz lately announced its sedan sales volume in China for the first quarter of 2002, both mainland and Hong Kong's sales volume exceeded 2000, the best record in history. Sales volume of Benz's S class increased by a 2-fold over the same period of last year since tariffs were cut on January 1 this year, S class has been always on the top among luxurious cars. Benz firm also plans to introduce its E class at the coming auto car exhibition in June.

BMW's first quarter sales volume increased greatly in Asia with volume up by 8.2 percent, its China (including Hong Kong) volume rose by 41 percent to

reach 1915. BMW will launch its mini car in the latter half of this year following its successful sale of the 200 new 7 series.

GM earned 7 million US dollars in the Asia Pacific Region in the first quarter, it also made good performance in China, as the four types of Opel have been introduced to China, it also plans to promote its newest type to China within the year. In order to help China keep pace with the international market, GM is to bring its mature auto credit service to China.

Renault also makes an ambitious plan this year after several types made debut in China, it hopes to sell another 2000 cars to China this year.

Volvo hopes to increase its sales volume to 10000 within the coming five years, it is going to make the debut with the XC90, which was exhibited in Geneva recently besides the S802.9T6, being sold on Chinese market. Volvo aims to have a better performance both in market development and sales volume. It targets to realize a large growth rate in sales volume and become one of China's most popular cars.

Honda Motor Co. Ltd. announced in July a joint venture to build the first export-only car assembly plant in China. Beginning in 2004, Honda plans to initially export about 50,000 cars a year to Asia and Europe from a new plant in Guangzhou.

Auto consumption becomes more and more popular in China, as both global and domestic carmakers are sharing the "big cake", the Chinese car market will become more attractive and mature.

7.4 Possible Future Scenarios

7.4.1 Scenario 1 (Import Scenario, Experts Forecast)

As a significant effect after entrancing the World Trade Organization (WTO) in the end of 2001, China's import tariffs for cars in 2002 will drop dramatically.

Import tariffs for automobiles of 3L or above will be slashed to 50.7% from last year's 80%, a decrease of 29.3 percentage points; for those smaller than 3L, the rate will be reduced to 43.85% from 70% of 2001, down by 26.15 percentage points. Therefore, reduced tariffs will contribute about 10% - 15% to the drop of prices for imported cars in 2002.

China imported a total of US$ 4.05 billion worth of automobiles and auto parts and components in 2001, but under the Chinese government's WTO commitments, the quota for imports of automobiles and auto parts and components will be raised to US$ 7.94 billion. The quota will go up by an annual 15% until being fully scrapped in 2005. As quotas and licenses have been one of the main measures restricting car imports, quotas become high-priced commodities thanks to their rarity, and the expense eventually is translated in to the prices of imported cars. However, in 2002, the prices for quotas will inevitably drop as China raises the quotas dramatically, hence the drop in the prices of imported cars.

In addition, as the volume of car imports goes up, demand and supply will move closer to balance, which is another factor that would push down prices for imported cars.

Our comment is: Prices for import are not dictated by increase in imports volume, as stated above, but rather by tariff level and thus, profitability of imports. If tariffs allow essential cut down in prices on imports that does not necessarily mean that they will be competitive with domestic prices. All in all, a relative protection of the market by tariffs most likely allowed domestically operated companies to keep highest possible prices, which probably they could also decrease. It might be profitable for Toyota or other Japanese or Korean company with production facilities located nearby, to increase imports in China, but not for VW. Higher production cost plus transportation expenses and tariffs for Polo or Audi A6 produced in Germany or elsewhere, cannot compete in price with the same models produced by VW in China. Moreover that the company targets 500 000 unit sales by the end of 2002 and intends to double this number over next 5 years.

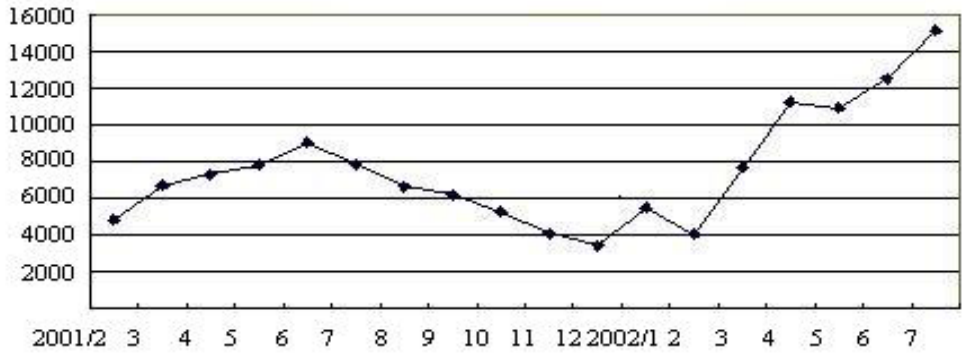
Prices for domestically produced cars will also drop, partly because the increase in supply surpasses that of demand and the gap between supply and demand becomes wider, leading to fiercer competition and eventual price cuts. The reduced cost of production also makes it possible for domestic car producers to cut prices. As demand for automobiles goes up, more car manufacturers have improved economy of scale and cut cost of production. The slashes in the prices of imported auto parts and components and the progress in global procurement will further push down the costs of production for domestic car manufacturers.

**Note: This part of the experts opinion we consider to be a more realistic judgement compared to the first 'too import-oriented' and optimistic part.*

Thanks to major tariff cuts and quota increases, and the domestic customers' preference for imports, the number of imported cars will increase significantly, at a pace faster than that of domestic ones. The share of imports in the country's automobile market is expected to reach 5% - 6% in 2002 from the previous year's 3.23%, and the amount of imported cars will likely be at 100,000 -150,000.

In the face of major tariff cuts and quota increases, and a drop of 1% - 15% in prices for imported cars in 2002, producers of medium and top-end domestic cars will have to take steps in pricing if they want to maintain their competitive advantage. As China produces automobiles in each of the price brackets, price cuts in medium and top-end automobiles will surely lead to a chain reaction that would impact on prices of cheaper cars (see Table 7-2).

Table 7-2. Trend of Imported Automobiles in China



Source: **http://www.qiche.com.cn** (2002-10-27)

Our Comments: Again, with the VW's sales of about 500,000 vehicles in 2002, assuming that majority of them are passenger cars, and the company holds 40-45% of market share, total production must be around 1,250 thousand units. Increasing imports to 100 – 150 thousand makes it go up to 1,350-1,400 thousand cars. It is fair to question, if the companies target further growth (in domestic production) and the volume of imports will increase according to experts' forecasts, how realistic does this scenario look in future? Is the purchasing power of Chinese customers increasing so rapidly that the doubled output of the industry+imports matches the demand? If the purchasing power is so high, why is the number of privately owned cars in the country with highest population (over 1.2 bln) in the world so low? Why from around 50 mln vehicles annually produced all over the world China consumes only about 2 mln.

Hereby, we gave our brief comments concerning the opinion of the part of experts. In the following scenario we will bring our own arguments and interpretation of facts and events.

7.4.2 Scenario 2 (Fact Analysis)

The total length of roads (which reached the technical standard and with the width over 4.5 meters) in China is 1.698 million kilometres by the end of 2001,

and among them there are 19,437 kilometres of highway, which ranked No.2 all over the world. However, compared to the whole territory of 9.6 million Kilometres Square, the traffic condition is still not encouraging. As a result, the Chinese government decided to increase the investment of 35.5 billion Chinese yuan (Chinese currency, 1US $ ≈ 8.3 Chinese yuan) with the increase rate of 15.3% this year to improve the road condition.

Figure 7-1. **Per Capita Annual Net Income of Rural and Urban households**

Year	**Disposable Income**	
	Rural Households **(yuan)**	Urban Households **(yuan)**
1978	134	343
1980	191	478
1990	686	1510
2001	2,366 (about 282 USD)	6,860 (about 830 USD)

Source: Chinese National Statistics Bureau

As we see in Figure 7-1, there is a significant difference between income level of rural and urban population. Let us consider the best situation. The number of urban population in China is about 480.64 million, the average unemployment rate in urban region is 3.6% in 2001. About 68% of population is in the age range of 15-64 years, and 10% of population is under poverty level. However, even if we consider only employed urban population as if this was a total population of the country, we still have a high number of people, which means there is a basis for a solid demand. On the other hand, we have the annual income of these people somewhat close to the price of a small cheep car. In this situation, it is appropriate to ask: can an average Chinese citizen afford a car? And we wonder what is there behind the growing car production and sales.

Further, we made some rough estimations: given the price, we assumed that in average each vehicle covers 20 km per day; the fuel consumption figure is assumed to fit the average of small cars and sedans, which is 3-9 litres for

gasoline; for other sorts of fuel we also made approximation closed to real. As a result we have got the following numbers for fuel consumption (see Table 7-3).

According to this result, we will have annual spending for per car operating on gasoline, liquid petroleum and natural gas 1,007; 712; and 95 yuan (about 121.6; 85.9; 11.5 US$) respectively. However, there are also other car maintenance costs.

Table 7-3. Fuel Consumption Per day (Cars)

Type of Fuel	Kilometres covered Per car Per day	Price Per unit (yuan)	Fuel consumption unit/100km	Fuel consumption Per car Per day
Gasoline	20	2.3yuan/L	6.0L	2.76 yuan
Liquid Petroleum Gas	20	1.5yuan/L	6.5.L	1.95 yuan
Natural Gas	20	1.4yuan/M3	0.91M3	0.26 yuan

In the beginning of this chapter we brought the results of surveys, which in our view also look rather optimistic. However, we can not doubt the truth of these results as the number of peoples under survey might reflect the average opinion in Luxemburg or Cyprus, but is not enough to express the intention and possibility of the average Chinese citizen.

The total amount of privately owned automobiles has reached 7.71 million by the end of 2001, which is over 40% of the whole amount of vehicles in China. And this sector is believed to be the most potential in the future and the percentage is predicted to reach 50% this year. At this stage however, given the number of privately owned vehicles and 1.2 bln of population, approximately, only every 156th Chinese citizens enjoys the advantages of owning a car.

Table 7-4. Top 10 Cities by Privately Owned Autos/unit: 10,000 (by the end of 2001)

Beijing	624,081
Guangzhou	235,456
Chendu	233,119
Tianjin	232,086
Shengzheng	144,597
Shanghai	87,168
Chongqin	82,410
Shenyang	67,593
Hangzhou	58,587
Nanjing	39,119
TOTAL	**1,804,216**

Sourced: Chinese National Statistics Bureau

With regard to the costs and risks from the economic perspective, despite its huge population and two decades of rapid growth, China is still a poor country where the average income is around $ 800 per year. The lack of purchasing power results in a limited market for many Western consumer goods from automobiles to household appliances. Another problem is the lack of a well-developed transportation infrastructure or distribution system which will possibly force an MNE to provide its own infrastructure and supporting business and obviously raises costs. There are also problems with some of local joint ventures partners who are inexperienced

With this in mind, the import oriented scenario and the “higher growth of imports comparing to domestic production” looks rather ambiguous to us. To summarise, we do not argue that imports will not increase, but given the social conditions of the majority of population, we rather see the development of the automotive sector and the companies involved as a gradual process within the overall industrial growth of the country. The prerequisite of relatively fast development of auto industry, as we mentioned in Chp 6, was determined

mainly by the investments of foreign companies and will of Chinese government, but this process would not have been so successful without other industries, such as steel or fuel exploring and processing industries being ready to be the part of the process. Now, by only emphasising on automotive industry China will not grow rapidly as a market but rather as a future auto exporter.

7.5. Conclusions

Several automobile multinationals have basically completed their strategic set-up in China and are now moving deeper in their China operations. Some of them are stepping up its efforts to enter the automobile arena with financial capital, and some from other sectors are also moving into the auto industry. All these will intensify competition in this industry, competition that will eventually spill over to the scramble for customers on the market. As a result of the loosening up of government policies, the mutual infiltration of various kinds of automobile manufacturers and among producers of different auto products is gaining steam. According to initial statistics, 12 light and mini-type automobile producers have started to or are preparing to manufacture sedans; there are also cargo vehicle producer's moving to passenger cars as well as medium to heavy-duty vehicle producers moving to light vehicles.

The industry we have chosen is not easily predictable. Overall, the companies we have analysed (as well as Toyota) are at the top of the industry. We do not go deep into their problems or analysis of their success or failure in the rest of the world, where all of them have advantages and disadvantages, better or worse positions in different markets, higher or lower profitability in certain countries or by products. The main point of including them into our research was that these companies have the greatest ambitions and resources in today's automobile industry and they all regard China as a relatively new opportunity. In our work we described the current situation of the Chinese auto industry and in Chapter 6 we also brought some brief comments of analysts and experts concerning further development of this industry in China and market distribution. We believe that it would be harder to draw better pictures without presenting these particular companies. Chinese economy, and in our case

automotive industry, is not strong enough to grow rapidly by its own sources. If China is interested in further developing the industry, the foreign companies, are interested in expansion and new markets. As we have shown in our work, both the industry and presence of foreign car makers experience growth and if the Chinese authorities keep the pace of economic transformation as well as legislative improvements and political stability, China has many chances to realize the best predictions.

On the other hand, being fairly critical we showed the possible scenarios of development. The optimistic forecasts are necessary to make people and society believe in an idea. Today all the players (including Chinese authorities) are interested in attraction of investments and technologies to China. However, based on our scenarios and facts, and identifying the influencing factors (overall economic situation, development level of related industries, resources, purchasing power of customers, etc.) we are not that excessively optimistic as to blindly agree with all the experts views, nor radically critical, and consider that it will take years, a lot of efforts, investments, and hard work of the both sides to bring Chinese automobile industry to those optimistic standards.

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Appendix

Appendix1. Key Figures of Chinese Economy and Population

	1997	1998	1999	2000	2001
FDI (net inflows Bop current US$ in billion)	44.2	43.8	38.8	38.4	46.8
GDP (current US$ in billion)	898.2	946.3	991.4	1,079.9	1,159.0
GDP growth (annual %)	8.6	7.8	7.1	8.0	7.3
Population growth (annual %)	1.0	1.0	0.9	0.9	0.8
Population Total (in million)	1,230	1,242	1,253	1,262	1,272

Source: http://www.worldbank.com (2002-11-08)

Appendix 2. 2001/2000 Total Auto Outputs Ranking List: The First 15 Countries

Rank	Country	2001 Produce （Unit）	2000 Produce (Unit)	Growth (Annual %)
1	U.S.A	11425061	12810140	-10.81
2	Japan	9777191	10144847	-3.62
3	Germany	5691700	5197685	9.50
4	France	3628410	3351929	8.25
5	South Korea	2946329	3114998	-5.41
6	Spain	2849888	3032874	-6.03
7	Canada	2535471	2345882	8.08
8	China	2334400	2069320	12.81
9	Mexico	1865270	1918807	-2.79
10	Brazil	1798472	1671093	7.62
11	U.K.	1685010	1817059	-7.27
12	Italy	1579638	1738315	-9.13
13	Russia	1249582	1202589	3.91
14	Belgium	1187257	1033294	14.9
15	India	853919	796185	7.25
Global Total Outputs		55770001	57539713	-3.08

Source: http://www.cacauto.com (2002-11-09)

Appendix 3. Sale and Market Share of Main Sedans in the Chinese Auto Market (First six months of 2002)

Style (Producer)	Sale (first six months of 2002, unit)	Growth Rate (compared to the same period of last year, %)	Market Share (first six months of 2002, %)
Passat (Shanghai VW)	28088	-24.4	6.43
Santana2000 (Shanghai VW)	29653	-12.4	16.28
Santana (Shanghai VW)	41390	3.25	
Polo (Shanghai VW)	8817	NA	NA
Buick (Shanghai GM)	14060	53.5	4.58
BuickGL8 (Shanghai GM)	5912	46.6	
Sail (Shanghai GM)	12285	357	6.07
SailS-RV (Shanghai GM)	14220	NA	
Jetta (FAW VW)	57848	14.7	13.25
Bora 1.8 (FAW VW)	17264	NA	3.96
Audi (FAW VW)	15053	5.05	3.45
Yage (Honda Guangzhou)	25364	-0.35	5.81

Source: China Automobile Newspaper 2002-07-16, and Shanghai Auto News (2002-07-21)