

Foreign Investment:

The Automotive Market in China

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Introduction

Why have foreign corporations invested so heavily in the Chinese automotive industry? How has this inflow of products, supplies, technology and financial support affected the Chinese car market? Without the foreign investment that accompanied the Opening Up, would China's economy resemble its current state?

In just over 50 years, China has been able to turn its once weak and slowly-expanding automotive industry into an important and powerful global giant. Currently, the Chinese car market is the largest automotive market in the world. Its annual sales and growth rates are extraordinarily high, even with the most recent slowdown in production growth. What could this be attributed to? The decade of the 1990s was arguably the most influential time period for this market due to several factors. The implementation of the dual-track system and the country's requirement that all foreign automakers selling vehicles in China create joint ventures with domestic automakers both granted the state the ability to control much of this market. With this power, the state controlled the production rates of state-owned enterprises and, in turn, invested accordingly in infrastructure, thus expanding the market further. In 2001, China joined the World

Trade Organization, and subsequently allowed foreign corporations access to its market without necessarily partaking in a joint venture, thus increasing foreign investment incentives.

On the other end of the spectrum, Chinese customers responded positively to domestic car manufacturers that had ties with foreign brands, especially brands such as BMW, Volkswagen, and Mercedes-Benz. BMW, for example, partnered with Brilliance Auto Group, a state-owned automaker, in order to sell their newest BMW models in China, including the first new energy vehicle produced in China by a premium car maker. Foreign companies must also take into consideration the importance of incorporating and addressing Chinese culture in their products and advertising. For example, the Chinese population has the consistent desire to improve their social status, mainly through purchasing a ‘brandname’ car. The consumer base in China also is not only demanding more and more cars, but the wealthier population is demanding specific changes in design that foreign auto manufacturers must pay attention to.

Through analyzing the development of China’s car market together with political, economic, and cultural ramifications of foreign investment, this paper will express the significant influences of foreign support. Supporting information will be both culturally and data-oriented to present arguments from both perspectives. Overall, historical facts and quantitative information will coalesce to validate the idea that foreign investment heavily affected the growth of the Chinese automotive market.

Part I: The History of China’s Automotive Market and Changes in the Industry

The Chinese automotive industry began its slow rise to power with the formation of First Automobile Works (第一汽车集团), Shanghai Automotive (SAIC, 上海汽车集团股份有限公司) and Nanjing Automobile (南京汽车集团有限公司) in the mid to late 1950s, a period known

as the Great Leap Forward. Since its inception, the domestic automotive industry required significant foreign assistance. Initially, Soviet Russia lent a hand to numerous state-owned auto manufacturers, including the enterprises noted above, while also providing crucial guidance on China's industrialization up until the 1960s.

The Chinese state started out by establishing and then subsidizing car manufacturers that focused on producing heavy duty trucks, vans, and various military vehicles, forming a significant demand for production vehicles. The passenger vehicle sector, however, was severely lacking in demand. Not only were they not largely available, but the majority of Chinese citizens between the 1950s and the late 1980s simply could not afford purchasing a vehicle. The government, recognizing the sector's potential growth and growth sustainability, began increasing the production of passenger cars in hopes of creating a strong and profitable automotive industry.¹

After the Soviet Union severed ties with the Chinese government during the 1960s, Chinese auto manufacturers had no choice but to rely solely on the country's resources and to continue growing the industry. First Automobile Works was expected to use its employees, funds, and supplies to construct Second Automobile Works, now known as Dongfeng Motor (东风汽车有限公司).² During this time period, foreign involvement in the automotive state-owned enterprises existed, however, there was a high level of distrust between the government and foreign suppliers. Surprisingly, "foreign suppliers did not even know where their equipment was located

¹ Nick Oliver, Matthias Holweg and Jianxi Luo, "The past, present and future of China's automotive industry: a value chain perspective," *International Journal of Technological Learning, Innovation and Development*, vol 2, no.1-2, 2009, <http://www.research.ed.ac.uk/portal/files/7765689/Oliver.pdf>, 76-118.

² *Ibid.*, 6.

until China opened its doors in 1978.”³ China struggled to expand their automotive industry throughout the central control and planning era of 1949–1979, mainly due to the lack of demand, foreign financial support, and political unease.⁴

During the proliferation phase of 1979–1994, the opening-up of China greatly influenced the flow of foreign investment into the nation, especially in the automotive industry, and can certainly be associated with the modernization of the car market. The “transition from a planned economy to the market economy”⁵ was also a significant factor in the expansion of China’s passenger vehicle market. The implementation of the dual-track system, a system where the government eased the planned economy into a free market economy by allowing the sale of surplus goods by companies that had already met the required production quotas, created competition between automotive manufacturers.⁶ This gave way to the lowering of prices and boosted the competitive drive between companies. Capitalism was beginning to take form in China. This ‘relaxation’ in government policies and change in the economic system led to “an increase in the volume of output, and an increase in the range of products.”⁷ More and more people were able to afford purchasing vehicles and so demand rapidly rose. In response, “The number of automobile factories increased from 55 in 1979 to 114 in 1985.”⁸ In an effort to advertise the ease of purchasing a car, the Communist Party embellished the story of a chicken

³ *Ibid.*, 6.

⁴ *Ibid.*, 4.

⁵ *Ibid.*, 6.

⁶ "1981: Dual-track Price System -- China.org.cn," *china.org.cn*, September 16, 2009, accessed December 10, 2014, http://www.china.org.cn/features/60years/2009-09/16/content_18534471.htm.

⁷ Oliver, Holweg and Luo, “The past, present and future of China's automotive industry: a value chain perspective,” 6.

⁸ *Ibid.*, 6.

farmer's first purchase of a vehicle and spread the word through newspapers in the 1980s. "Chicken farmer Sun Guiying and her family plunked down 9,300 yuan - \$4,650 - in cash recently and became the first ordinary family in Peking to buy a car. The local Communist Party newspaper heralded the purchases as a major event. 'Happy purchase of Toyota for Sun Guiying, the best chicken farmer in the country,' read the headline in Tuesday's Peking Daily...many peasants are now able to afford vehicles because they have increased their income under the Communists' relaxed economic policies that permit private enterprise."⁹

During the phase of concentration that lasted between 1994 and 2004, the government began contemplating the advantages of joining the World Trade Organization and eventually chose to become a member. Up until 2002, foreign investment was increasing drastically due to expected future profitability of the Chinese market, yet was limited by the state's strict policies. Before China had become a member of the WTO, "30,000 vehicles a year were allowed from foreign carmakers."¹⁰ After joining in 2002, China's quota "increased by 20% a year and was phased out by 2006."¹¹ Not only did this provide yet another extreme incentive for foreign automakers to enter the Chinese market, the drastic change in foreign sales policies also designated the car industry as one of China's "Pillar Industries," an industry chosen to "drive the national economy."¹² Automotive Industry Policy of 1994 was used "to force sophisticated and complete transfers of car technology, and to push the national industry from a preliminary phase

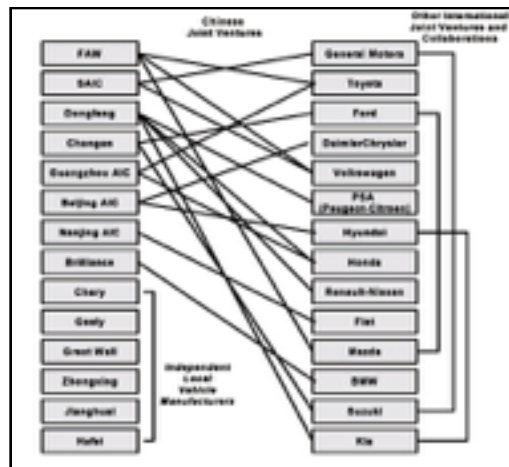
⁹ "Chinese Chicken Farmer Buys a Car," *The Spokesman-Review*, April 4, 1984, accessed December 11, 2014, <http://news.google.com/newspapers?id=7VdWAAAAIIBAJ&sjid=7-4DAAAAIIBAJ&pg=7094,2255299>.

¹⁰ P. Gao, "A tune-up for China's Auto Industry," *McKinsey Quarterly* Vol. 1, 2002, 144–155.

¹¹ *Ibid.*, 144–155.

¹² *Ibid.*, 144–155.

of auto modernization in the 1980s to a more advanced stage of modernization in the 1990s.”¹³ As a part of this policy, foreign entities originally were “limited to wholesaling through joint ventures and were prohibited from consolidating sales organizations of imports and joint ventures. By 2006, they were allowed to own vehicle wholesales, retail organizations, and integrated sales organizations.”¹⁴ The aftermath of these ‘relaxed’ policies is obvious when looking at the top five automotive manufacturers of 2011 in China. Based on the volume of sales, Shanghai General Motors Company Ltd. reigned supreme, followed respectively by Shanghai Volkswagen Automotive Co. Ltd., FAW-Volkswagen Automobile Co. Ltd., Dongfeng Nissan Chinese Automotive Joint Ventures¹⁵ Passenger Vehicle Co. Ltd., and Beijing Hyundai Motor Company.¹⁶ Each company listed is a very large corporation with significant foreign joint-ventures.



¹³ Gregory Chin, *China's Automotive Modernization: The Party-state and Multinational Corporations* (Basingstoke: Palgrave Macmillan, 2010).

¹⁴ Gao, “A tune-up for China’s Auto Industry,” 144–155.

¹⁵ Oliver, Holweg and Luo, “The past, present and future of China's automotive industry: a value chain perspective,” 18.

¹⁶ Lu Na, “Top 10 Automakers in China 2011,” *china.org.cn*, February 10, 2012, accessed December 10, 2014, http://www.china.org.cn/top10/2012-02/10/content_24604448_6.htm.

Due to the unprecedented production growth and the increase of foreign investments, China felt it was necessary to slow down growth and deter investment. The New Automotive Industry Policy of 2004 attempted to do just that. After the policy's implementation, the industry became more transparent, left room for future growth, and referred to market forces instead of government regulations.¹⁷ Today, the growth has been slowing, however this could well be a sign that the market is stabilizing and becoming more mature. Nearly every government decision and policy made concerning the Chinese car market has either been influenced by or was made to influence foreign investment, thus proving the significance of investment by foreign automotive corporations.

Part II: The Effect of Foreign Investment in the Automotive Industry on Chinese Culture

Beginning in the 1990s, the drastic increase in automotive manufacturing has both pleased and concerned the Chinese government. State-led restrictions, relaxations, and then a round of policy tightening has shown that this specific market is very difficult to control. Making the transition from a planned economy to a market economy is a rare case that requires careful guidance and monitoring of production, prices, and foreign-domestic joint ventures. An industry as large as the automotive industry with foreign influence must be closely overseen.

The Chinese consumers, on the contrary, are now eagerly watching this market's development and some hope to participate in its growth. A car is the main symbol of status, wealth, and prosperity. However, it also has notably caused envy and displeasure in the portion of the population that still cannot afford to purchase a vehicle or that cannot stand polluted air and roads blocked by traffic jams. The author of American Wheels, Chinese Roads: The Story Of

¹⁷ Runckel & Associates, "China's New Automobile Policy," *China's New Automobile Policy*, January 1, 2004, accessed December 11, 2014, http://www.business-in-asia.com/china_auto.html.

General Motors In China, Michael Dunne, has mentioned something that foreign auto manufacturers must be wary of in regards to culture. What is present in China is not present worldwide; the nation possesses a “car culture with Chinese characteristics. In China, it's more about social status: look at me, look at my new car. It's much more about the thrill you get from pulling up in front of your hotel or golf club or workplace and being seen and recognized.”¹⁸ Not only has the car infiltrated the culture of China, but it has become a prominent milestone in achieving the ‘Chinese Dream.’ “In China, the car represents a private space, a proprietorial extension of the home,” and so it has deeply impacted the personal lifestyle.¹⁹

The population, while either openly or secretly wanting a car, presents contradictory opinions. Owning a car will increase one’s status and prove that the owner is successful, however it can also encourage less fortunate citizens to question the moral values and materialistic nature of the purchaser, thus undermining his or her reputation. In particular, a woman on the dating show called *If You Are The One* told her admirer “I would rather cry in the back of a BMW than laugh on the back of a bicycle (宁在宝马车里哭，也不在自行车上笑).”²⁰

Nevertheless, the automotive market has expanded so drastically due to cultural incentives that foreign corporations now heavily rely on sales in China. Dunne agrees that “there is no way to overstate how much foreign companies have become reliant on sustaining success in the Chinese market. For GM, Hyundai, Nissan, Volkswagen, Audi, it's already the number one

¹⁸ Tania Branigan, “China and Cars: A Love Story,” *The Guardian*, December 14, 2012, accessed December 10, 2014, <http://www.theguardian.com/world/2012/dec/14/china-worlds-biggest-new-car-market>.

¹⁹ Sheung Wan, “Key to Ignition,” *Island 6*, December 11, 2014, accessed December 12, 2014, http://www.island6.org/downloads/KeyToIgnition_PressRelease.pdf.

²⁰ Branigan, “China and Cars: A Love Story.”

car market in the world. Take China out of their portfolio and their fortunes would reverse."²¹ In order to appeal to this market and generate more sales specifically in China, corporations chose to create special edition vehicles based on Chinese traditions. In 2012, Rolls-Royce chose to celebrate the year of the dragon by selling a Special Edition Year of the Dragon Phantom, complete with red leather seats, golden accents and real gold inserts (inspired by the Forbidden City). At \$1.2 million each, amazingly, it just took 2 months for the car to sell out.²² At the 2014 Beijing Auto Show, BMW followed suit with a 7-series Horse Edition to celebrate the year of the horse. The car itself isn't much different than the regular 7-series, however the trim is slightly different, it has an emblem that specifies it is indeed a Special Edition car, and its seats are embroidered with the traditional Chinese character for horse (Mǎ - 馬).²³ The famous Italian designer Gucci even partnered with Fiat to sell a Gucci vehicle specifically targeting Chinese consumers.²⁴ Developing special edition vehicles is no small task which proves how heavily invested foreign automakers are in this market.

Conclusion

The Chinese automotive industry attributes its successes and unprecedented growth not only to capitalist policies but also to the entrance of foreign investment. The Chinese auto sector would not have flourished had the state not transitioned the nation's economy into a market economy which prompted foreign investors to fully provide their financial, intellectual and

²¹ *Ibid.*

²² Timothy Coghlan, "Car Culture in China," *Maosuit*, July 3, 2012, accessed December 10, 2014, <http://maosuit.com/fashion/china-fashion-history/car-culture-in-china/>.

²³ Alexander Stoklosa, "BMW 7-series Horse Edition Celebrates China's Year of the Equine [2014 Beijing Auto Show]," *Car and Driver*, April 8, 2014, accessed December 13, 2014, <http://blog.caranddriver.com/bmw-7-series-horse-edition-celebrates-chinas-year-of-the-equine-2014-beijing-auto-show/>.

²⁴ Coghlan, "Car Culture in China."

technological support to the industry. Similarly, the global foreign investment sector also would not have experienced such growth had it not partnered with China in one of its largest industries. On the other end of the spectrum, increased purchasing power of Chinese consumers and their willingness to embrace foreign brands, albeit adjusted for local and cultural preferences, also influenced foreign investment and provided a fertile ground for a dramatic rise of the Chinese auto industry.

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