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Too Many Chinese Cars, Too Few Chinese Buyers. So Far

By KEITH BRADSHER

TAIZHOU, China — China is passing Japan as the world's second-largest vehicle market this year, with sales soaring for cars of every size and shape. But the Chinese market still may not be big enough to support all the homegrown manufacturers as well as the foreign automakers trying to do business here.

China has more car brands now than the United States, as companies like Fiat and PSA Peugeot Citroën compete with General Motors, Ford, DaimlerChrysler, Toyota and Nissan in joint ventures with Chinese companies. But while car sales have climbed 38 percent in the first three quarters of this year, automakers have increased their output even faster, causing fierce competition and a slow erosion in prices, with further price cuts this autumn for top-selling models like the Buick Excelle and Hyundai Elantra.

As top executives of the world's multinational automakers fly to Beijing for the auto show that will open there on Nov. 19, they are particularly watching the growing competitiveness of Chinese manufacturers, who have been steadily gaining market share over the last several years and are expected to continue doing so. Some of the biggest winners in the Chinese market have been little-known Chinese automakers that have grown up in even lesser-known Chinese cities, like Geely here in Taizhou, Chery in Wuhu and Hafei in Harbin.

These low-cost Chinese automakers do not yet have the marketing muscle, brand names and global distribution to compete on their own in the United States and other industrialized countries. They are only starting to form international alliances to do so. Geely, for example, has just set up a joint venture with a British company to make the famous boxy London taxis in Shanghai for markets around the world, while Chery is working out the details of a deal with DaimlerChrysler to make subcompacts in Wuhu for the American market.

But in their home market, Chinese automakers are proving increasingly formidable competitors. After practically disappearing before an onslaught of foreign-dominated joint ventures in the 1990s, Chinese brands have recovered and now hold 26.3 percent of their domestic market.

To gain market share, Chinese automakers have become masters at controlling costs and holding down prices. Some of the savings, particularly in the 1990s, have come by imitating and even copying Western designs, resulting in a series of lawsuits, but most of

the savings have come from inexpensive labor at every stage in the production process. Cost controls have become increasingly important as the original heart of the Chinese market — selling luxury sedans to state-owned companies and wealthy families — has been far surpassed by the sale of affordable compacts and subcompacts, with no sign this trend will stop.

“The demand will tend to shift toward fuel-efficient and middle-class vehicles,” said Xu Ping, the chairman of Dongfeng Motor, a large Chinese automaker.

The overall Chinese vehicle market is on course to reach 6.8 million vehicles this year, more than the Japanese market, although a larger share of the Chinese market consists of small commercial trucks. Automotive Resources Asia, acquired this autumn by J. D. Power & Associates, says that sales of cars, minivans and sport utility vehicles will reach \$74 billion this year, up from \$55 billion last year. It forecast that sales of these vehicles in China will roar past such sales in Japan next year.

By comparison, the United States is on track for sales of almost 16.7 million cars and light trucks this year, and total sales in the 18 countries of Western and Central Europe are, coincidentally, expected to be 16.7 million.

Offering inexpensive deals is crucial in China’s burgeoning market because brand loyalty is rare. J. D. Power recently found that 80 percent of Chinese car buyers were purchasing their first vehicle, compared with under 15 percent in the United States, Europe and Japan.

Before China entered the World Trade Organization in November 2001, China had some of the world’s highest car prices. Domestic automakers and joint ventures hid behind steep tariffs that nearly doubled the price of imported cars.

Falling tariffs and a plethora of new models and new car factories in China have brought prices down to international levels for well-known, globally traded models like the Honda Accord. Domestic Chinese brands sell even cheaper models, including \$6,000 subcompacts and \$15,000 midsize cars — still too costly for the large majority of China’s 1.3 billion people, but affordable for the rapidly growing middle class.

Some of the best examples of Chinese cost efficiencies can be found at Geely (pronounced JEE-lee), the only large Chinese automaker that is not partly owned by a government agency and has not gotten its start with the benefit of lavish loans from state-owned banks.

“We do not belong to any government,” said Li Shufu, the company’s chairman and controlling shareholder. “This may not be bad. We had to fight on our own, and we became the most competitive in China.”

Geely, with 5 percent of the fast-growing Chinese market, is the country’s second-largest home-grown automaker, trailing Chery, a state-owned company with 7 percent.

Volkswagen, General Motors, Honda and Hyundai are ahead of both of them, and Toyota has 6 percent of the market.

Geely's cost advantage over multinationals starts with developing new vehicles. Freshly hired from universities, the company's engineers earn \$4,600 to \$7,600 a year, with few costly benefits.

Even if Geely sets up an overseas factory someday to be closer to customers, "the research and development will still be done here and costs less," said Yu Xueliang, Geely's vice president for domestic manufacturing.

The next advantage lies in labor costs — not just at the assembly plant but at nearby parts factories as well. For starters, most of the workers are in their early 20s. They are young enough to be the children of the typical Big Three worker in the United States, and with low medical costs to match.

Wages are low, but so are living costs here in this port in southeastern China, where the Geely factory sits near the base of a steep-sided hill topped by several temples. Zhang Jiahong, 22, earns \$250 a month as a quality-control inspector and repairman at the end of the assembly line here. But his 320-square-foot studio apartment in town costs \$20 a month, a common price for a spartan home in a Chinese city far from costlier metropolises like Shanghai or Beijing.

He eats two large meals a day at the factory canteen for \$40 to \$55 a month. The company gave him a free Motorola phone with a built-in color camera and charges him \$2.50 a month for basic service. "I've loved cars since I was very young — there was a car factory near where I grew up and I played there as a boy," he said.

Geely has also adopted Japanese and Western techniques for controlling inventory costs. Auto parts are delivered regularly in small, plastic bins and few backlogs were visible during recent visits to the company's factories in Taizhou and Ningbo, a three-hour drive to the north.

By contrast, huge loans from state-owned banks have left many state-owned automakers with less incentive to be efficient. Periodic shortages and price increases for steel and other raw materials give automakers an incentive to hoard parts.

But the result is that large inventories of spare parts are common in many state-owned Chinese auto factories. The extra parts not only take up costly floor space but also hurt quality — when a problem is discovered in a part, it may take a long time before improved parts are ordered as replacements.

Despite being firmly in the private sector, Geely goes to considerable lengths to stay on good terms with the Communist Party. The most productive workers are invited to join the party, including Mr. Zhang, and have a red flag with a yellow hammer and sickle flying above their work stations on the assembly line here.

Trade barriers among provinces within China have hobbled Geely's efficiency and cost controls to some extent, however. Mr. Li, the entrepreneurial son of a Taizhou farmer, said that a few years ago, when a taxi company in Tianjin bought Geely cars instead of Xiali cars produced in that city, local officials were so angry that they ordered an investigation into who had approved the purchase and barred taxi companies in the city from buying any more Geelys.

The taxi market is so large in China — many people still cannot afford their own cars — that Geely is now building three small assembly plants in locations as remote as Lanzhou in western China's Gansu Province. The goal is to make sure that local taxi companies will be allowed to buy Geely products. But scattering assembly plants across wide areas tends to drive up costs.

Many Chinese automakers are soaking up a lot of technical know-how through joint ventures and some are buying technology outright, like Nanjing Automobile. But many Chinese executives complain that Western companies do not transfer their latest designs, and the Chinese are starting to step up their own research and development spending.

“If you want to get the best technology,” Mr. Li said, “DaimlerChrysler and BMW won't sell it to you, you have to do it from scratch.”