



## Are Chinese Cars Ready for the Prime Time?\*

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'There is nothing I can do with this bone,' mumbled Cao Cao in the classic 14<sup>th</sup> century Chinese novel *Romance of the Three Kingdoms*, while chewing on a bare bone. 'But,' he continued, 'it would be a waste to throw it away!' One could easily draw an analogy with the Chinese auto industry.

A lot of excitement has stirred up lately about the prospect Chinese cars being sold in the United States. After China's rapid emergence as a global manufacturing center, this is not very surprising. Many Americans are naturally beginning to wonder how long it will take for China to realize its goal of becoming, by 2010, the world's leading automaker.

China's automotive industry has grown at a phenomenal clip over the past decade. As late as 1990, it produced only 42,000 cars. By 2004, the number exceeded 2.3 million. Next year, China is expected to make over 6 million cars and trucks, surpassing Germany to become the third-largest vehicle manufacturer in the world. Chinese cars, once regarded as poorly built—many are still assembled by hand using low cost labor—continue to improve in quality. Chinese automakers are improving by aggressively acquiring advanced technology, mainly through foreign joint-ventures—a strategic move that has already shortened their learning curve by a quarter-century.

But should the American market be bracing for a sudden rush of unexpected competition like the one from Japan that started 30 years ago? It took Japanese automakers some 20 years to get a strong foothold in the American market.

It took the Koreans 10 years. Can the Chinese do it in less than five as some expect?

Over the past few years, I have seen many auto parts factories in China and recently visited about ten Chinese car companies. My observations have led me to a simple conclusion, which can be summed up by a Chinese adage: 'If you get on the train today, you'll overpay your fare. If you don't, you'll be left behind in the dust.' How ironic this is!

Chinese-branded vehicles are still several years away from entering the US market. They are not as cheap to build as they are generally thought to be. Also, their quality is still below that of their Asian counterparts. Perhaps more importantly, though, most (if not all) Chinese-branded vehicles have not yet met US safety standards.

Looking at China's auto industry, a number of problems stand out:

- The industry is structurally fragmented and inefficient. There are just too many car factories in China. I have seen, for instance, at least three factories making the same version of an outdated, 20-year old Toyota van (under different brand names), using the same production-line layouts. This makes little economic sense because it counteracts economies of scale.
- There is a lack of a common platform in car design. Some Chinese automakers produce sport-utility-vehicles only,

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while others make sedans only. During my last trip, I did not see any factories offering a full line.

- Despite continual improvements in quality, many companies struggle to maintain consistent quality standards. They show concern for quality but do not always adhere to their standards. A lack of project-management experience further complicates the quality-control process. For various cultural and economic reasons, they lack the experience and knowledge to put into place effective systems to select, inspect, and manage their suppliers. Historically, most factories have been vertically integrated.
- Although many Chinese carmakers are aware of safety issues, such concerns are superseded by intense competition and price pressure. Safety regulations are still weakly grasped and poorly enforced by a culture that encourages drivers and pedestrians to be more adventurous in nature than their counterparts in the West. One of China's big car manufacturers recently cited rigorous scrutiny by US regulators as its reason for having no intention to export to the United States— despite one American car dealer who claims to have already signed a deal to import its cars!
- A lack of marketing skill hampers the ability of Chinese companies to sell their products competitively overseas. Marketing abroad has long been a major sticking point. How many, for instance, remember LG's former name: Lucky Goldstar? How many Americans can pronounce the names of many Chinese car factories such as Zhong Hua? Without being able to build stronger brand awareness and image outside China, obscure-sounding Chinese carmakers will face a major obstacle to entering foreign markets at a time when

global branding has never been so vital.

- The lagging pace of research and development, coupled with weak innovativeness, are sealing China's automobile sector in a time capsule. By the time that Chinese automakers figure out how to manufacture more efficiently, attain consistent quality and safety standards, and market their cars in America, the models they currently produce will be obsolete. At the moment, nearly all newly designed sport-utility-vehicles in China resemble the BMW X5, but how long will this appeal to consumers?

Consolidation in China's auto industry will necessarily occur over time, helping to resolve many of these issues, if properly guided by sound government policy and continued liberalization of China's economy. This does not necessarily mean, though, that Chinese automakers will suddenly overwhelm the US market. One must keep in mind that it took Japanese automakers some 20 years to get a strong foothold in American.

In the meantime, American car dealers face a major dilemma: should they spend money now to get involved with the Chinese auto industry or risk being left behind in a cloud of dust? Many see little economic rationale for positioning themselves to one day ship over boatloads of Chinese-made cars and set up distribution networks, long and costly processes. They are skeptical of Chinese imports and inclined to toss away what they think is a bare-bone opportunity.

But should they? Any shrewd observer who has visited auto plants in China during the past few years, and who has seen the changes shaping up, from Harbin all the way down to Guangzhou, will say no. They will probably tell you, with a hint of irony, that getting involved with Chinese automakers now is costly, but if you do not get involved now, you will likely miss out on the opportunity.