Managing the Dragon Blog Post

China's Crowded Auto Industry

By: Jack Perkowski | November 28, 2016

By any measure, China's auto industry is crowded. The China Association of Automobile Manufacturers ("CAAM") lists 79 original equipment manufacturers ("OEM's) of passenger cars, trucks and buses in the country. However, CAAM's list understates the actual number of OEM's by a wide margin. For example, Shanghai Automobile Industry Corporation, along with its joint ventures with General Motors and Volkswagen, are counted as only one entity by CAAM, when in fact they are three separate companies. When counted separately, there are 86 different companies making passenger cars in China alone. When truck and bus manufacturers are added, the number of OEM's is well in excess of 150.

Because 27 million vehicles will be produced in China this year, it may seem reasonable that the world's largest auto industry would have a large number of participants. However, even when China based auto makers were making far fewer cars and trucks, the field was crowded. According to a report by the China State Economic and Trade Commission, China had 118 vehicle OEM's in 1999, a year when China produced less than two million vehicles.

The truth of the matter is that most industries in China have many more players than the same industries in more developed economies. The combination of a large and fast growing economy that enables new companies to achieve global scale quickly; unbridled entrepreneurialism on the part of China's citizens; and the desire of local government officials to share in the tax receipts generated by new companies breeds competition in every industry. As a result, it is the rare industry in China that doesn't end up with far too many competitors.

Over the years, there have been repeated calls for the consolidation of China's auto industry by government officials and auto experts alike—all to no avail. It has not been for lack of trying, though. In the mid-1990's, China announced its plan to consolidate the auto industry to just eight companies: "Three Big: Three Small: and Two Mini." That policy was never implemented, and few remember that it was ever even announced as a goal. Despite the failed consolidation attempts of the past, industry executives and experts are in disbelief at the number of auto companies in China and continue to predict that the industry will consolidate. "By 2020, at least more than 20 percent of Chinese auto makers will be gone," Xu Heyi, Chairman of the BAIC Group, one of China's top automobile makers said at the 2015 Global Auto Forum held in Chongqing.

Chairman Xu's prediction seems even more unlikely today given the rapid growth of the electric vehicle ("EV") industry over the past eighteen months, and the proliferation of new companies being formed to serve the growing EV market. After nearly quadrupling in 2015, sales of New Energy Vehicles ("NEV's"), including all-electric and plug-in hybrid models, have increased a further 82 percent to 337,000 units during the first ten months of this year. Although fast growing, NEV sales are admittedly small relative to China's auto industry as a whole. However, strong government support, the introduction of connectivity into the automobile and the allure of technological innovations such as autonomous driving have stirred the imaginations of China's entrepreneurs, and billions of dollars are flooding into the industry.

It is estimated that 200-plus companies, many backed by large, well-known companies and a number of China's billionaires, have been formed recently and are busily working on developing 4,000 new models of electric vehicles. Alarmed by the number of new companies entering the market, many of which it is feared do not have the necessary technological backgrounds, industry officials are calling for limits on the number of new manufacturing licenses that may be issued. The Ministry of Industry and Information Technology is considering restricting the number of startup EV makers to a maximum of 10, said Dong Yang, Executive Vice Chairman of CAAM. This does not include the traditional carmakers that are also developing NEV's, because the new models under development are covered by existing manufacturing licenses.

So far in 2016, five new EV manufacturing licenses have been approved by China's National Development and Reform Commission ("NDRC"). BAIC New Energy, a company owned by Beijing Auto and a group of investors, received the first license in March. Changjiang Passenger Vehicle Co., based in Hangzhou, received the second, and Chery New Energy received the third. Within the past two months, CH Auto, whose Chairman and President both worked in the engineering department of Beijing Jeep in the 1980's, and Minth Group (HKG 0425), a highly profitable manufacturer of exterior auto parts, were approved for licenses.

Despite the threat of further government restrictions, however, many of the most prominent EV startups have not even bothered to apply to the NDRC for a license. For example, LeEco, which has announced a $1.8 billion investment in a new plant in Hangzhou to manufacture EV's, as well as Foxconn and Tencent, have not yet applied. Gone also are the days when it was all but impossible to raise capital for a business in China if the proper government approvals were not in place. NextEV, backed by Tencent and Hillhouse Capital, will apply for a license, but only after it makes its first car. Meanwhile it is delaying investing directly in manufacturing and instead teaming up with a traditional automaker that already has a license and manufacturing facilities.

The casual attitude being taken by Chinese entrepreneurs and investors towards obtaining approvals suggests that the government will have no more success controlling the number of new entrants than it has had in the past. The individuals and companies backing the new wave of auto companies are well heeled; are investing billions of dollars; know China well and are well connected.

China's auto industry is about to become even more crowded.

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