

Managing the Dragon Blog Post

Tesla, China and Trump

By: Jack Perkowski | December 16, 2016

After nearly quadrupling in 2015, sales of New Energy Vehicles (NEV's), which includes plug-in hybrids ("PHEV's") and pure electric vehicles ("EV's"), surged by 82.2 percent to 337 thousand units in China during the first ten months of 2016. This does not include the 700 thousand low speed electric vehicles which were sold during the same period and which are popular in China's Tier 2 and Tier 3 cities.

Despite the rapid growth of NEV's in China, and the country's emergence as the leading NEV market in the world, Tesla (NasdaqGS:TSLA), America's EV darling, has struggled in the country. In February 2015, Chief Executive Elon Musk [predicted](#) that China sales would rival those in the United States in that year. Yet, sluggish sales in China forced Tesla to slash its 10,000 unit forecast for 2016, and China is expected to [account](#) for only 6,000 of the 80,000 cars that Tesla expects to sell this year.

Management turnover, customer complaints about service and the fact that, as an importer, Tesla does not qualify for Chinese government subsidies have all contributed to lower than expected sales. However, the problem may be that expectations for China by Mr. Musk were too high in the first place. After all, Porsche, a well-recognized brand which is priced at approximately the same level as Tesla, imported just over 58,000 cars into China last year. Considering that Porsche has been building its brand for over seventy years, has a long history in China and is selling cars with an internal combustion engine, which still account for almost 98 percent of all car sales in China, Tesla's sales of EV's are not that bad in comparison.

With respect to China's rapidly growing NEV market, the fact is that Chinese brands, led by BYD and Chery, account for 98.5 percent of EV sales in China, while foreign EV's like Nissan Leaf and Tesla [divvy](#) up the remaining 1.5 percent. Tesla's choice is simple. Either it continues to export cars and live with a small share of the China market, or it decides to manufacture its cars in the country.

Over the years, one international company after another has discovered that the only way to truly penetrate China's vast market is to manufacture its products in China. According to existing regulations, a foreign company cannot own more than 50 percent of a car assembly factory in China, so Tesla would need to partner with a local company, just as General Motors, Ford, Volkswagen and other international car companies have already done. Working with a partner in China is no easy task, so Tesla must think hard about going the joint venture route.

In considering its options, and the many operational and strategic issues which each alternative poses, Tesla must now take into account what impact, if any, the election of Donald Trump will have on Sino-American relations. Because President-elect Trump took a congratulatory phone call from Taiwan President Tsai Ing-wen several weeks ago, and then called into question the long-standing one China policy in a subsequent interview, many fear that China may retaliate against U.S. companies doing business in the country. The consumer backlash against Japanese car companies as a result of China's dispute with Japan over ownership of three islands in the East China Sea in 2012 is often cited as an example of what might happen to American companies trying to penetrate the China market.

If Tesla decides to continue an export only strategy, Trump's election will have little impact on Tesla's plans. China has repeatedly stated that the government's NEV subsidies are only available to cars that are manufactured in the country, and this policy is unlikely to change, no matter who occupies the White House. In fact, government subsidies for all NEV's are likely to be phased out in the coming years.

If Tesla decides to go the joint venture route, the question is whether the Chinese government will withhold its approval as a result of Mr. Trump's actions. This also is unlikely. China and Chinese car companies want to gain access to new technologies, particularly in NEV's, and Tesla would be a desirable partner for many local companies. Moreover, if Tesla chooses a strong local partner, its Chinese partner would guide the company through the joint venture approval process.

Apart from what the Chinese government may or may not do, is it possible that the reaction of Chinese consumers against American companies as a result of a Trump presidency might be so bad that Tesla's car sales in China will be adversely impacted, just as those of the Japanese car companies were affected in 2012? Again, this is very unlikely, because Chinese attitudes towards Japan and The U.S.A are fundamentally different. The reaction against the products of Japanese companies several years ago tapped into a long standing, deep seated antagonism towards Japan as a result of Japan's aggressions towards China in the 1930's and 1940's.

With respect to the United States, the Chinese have always distinguished between the actions of the U.S. government and the actions of the American people. One only has to see the long lines of Chinese seeking visas at the U.S. embassy in Beijing to appreciate how positively the Chinese view the United States. More than two-thirds of the four million Chinese students who have received an education outside China since 1978 have studied at American institutions. The Chinese consumer's admiration of everything American is why American products are held in such high regard in the country.

Over the past thirty years, the Sino-American relationship has survived disputes over human rights in the 1990's; NATO's bombing of China's embassy in Yugoslavia in 1999; and the mid-air collision between a United States Navy aircraft and a People's Liberation Army Navy fighter jet in 2001 which resulted in the death of the Chinese pilot. As the two largest economies in the world, China and the United States simply have too much to lose if they cannot find a way to cooperate.

Moreover, the appointment of Iowa Governor Terry Branstad, who enjoys a thirty year relationship with President Xi Jinping of China, as the new ambassador to China may prove to be an ace in the hole for the Sino-American relationship. In 1985, on what's believed to have been President Xi's first trip outside of China, Xi led an animal-feed delegation to Muscatine, Iowa, where he toured farms and visited rotary clubs for two weeks. During Xi's visit, Governor Branstad formed a friendship with Xi, and in fact, helped organize Xi's second visit to Iowa in 2012. That kind of one-on-one relationship made an impression. "When you get the opportunity to meet somebody in their home or in a private setting, you get to know them differently than at a state dinner," [remarked](#) the editor of the Muscatine Journal. China's Foreign Ministry called Mr. Branstad an "old friend of the Chinese people."

President-elect Trump has promised to take a tougher stand towards China on a wide range of issues, and China is braced for a series of tough negotiations ahead. In the end, though, Tesla's fortunes, and those of all American companies operating in China, will be determined by the acceptance of the company's products by the Chinese consumer, not by any actions that may or may not be taken by the government.

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