Managing the Dragon Blog Post

Where Have All The Start-Ups Gone?

By: Jack Perkowski | December 12, 2017

When Google announced in May 2014 that it planned to build driverless cars, two of the largest industries in the world—the internet and the auto----began to converge. Even when Apple, the other American internet giant, followed with its own plans to build cars, the reaction was somewhat measured in the U.S. After all, what did these companies know about building cars?

The reaction to these developments was much more dramatic in China, however. In the eighteen months following Google's announcement, over twenty new companies embracing connectivity and new energy vehicles were formed in the country. Some were pure start-ups; many involved combinations of Chinese automakers with China's leading internet companies such as Alibaba, Baidu, Tencent and LeEco; and virtually all seemed to have little problem attracting large amounts of private capital.

How have these new startups fared, and where are they today? Before addressing these questions, it's important to understand why China has become such a prolific breeding ground for new energy vehicle start-ups, particularly since China's auto industry is already a crowded field with hundreds of companies making trucks, buses and passenger cars.

The reasons are threefold. First, ever since China entered the World Trade Organization in late 2001, autos have become one of China's major growth industries. From 2002 to 2016, annual vehicle sales grew fourteen fold from approximately 2 million units to over 28 million. Secondly, with over 750 million internet users, China is now also the world's largest internet economy, virtually insuring that China would play a key role in any convergence of the internet with autos. And finally, China's incredible growth over the past twenty years has resulted in a vast accumulation of capital which is sitting on the sidelines, waiting to invest in the next big thing.

As might be expected with so many new entries, many were founded with fatal flaws. Some had the wrong partners; others the wrong products; and still others the wrong strategy. It's not the place here to review all of the new companies, but a few examples will illustrate the point. Pateo Smart Car was a proposed joint venture between Chery and either Qoros or Fisker to build smart cars. However, Chery has had problems in its core business; the company's troubled joint venture with Qoros, an Israeli company, has never gotten off the ground; and Fisker closed its doors and was acquired by another Chinese company. As its name implies, CIIDS (China Institute for Innovation & Development Strategy) has close ties to China's Central Government, but its strategy of combining gas turbine range extenders with electric vehicles is a bit off the mark with the country's strategic development. Finally, Golden Tiger, a joint effort between Tencent and Foxconn, has strong partners and an ambitious business plan, but little has been heard about the venture in over a year.

Of all of the new ventures, Faraday Future seemed to have it all---a charismatic, visionary founder in Jia Yueting; a connection to China's multitude of internet users through LeEco, the "NetFlix" of China; and sufficient funding by Jia and a host of his Chinese billionaire friends. When Faraday unveiled a 1,000-horsepower prototype at the Consumer Electronics Show in Las Vegas in 2016 and announced plans for a $1 billion production plant in Nevada, the company seemed well positioned to be a formidable challenger to Tesla. However, it's been all downhill since. Faraday's funding dried up due to over expansion at LeEco; Jia stepped down from his position at the company; and the company's plans for the Nevada plant have been tabled. At last report, Faraday has $100 million of unpaid bills and is struggling to raise even a portion of a planned $500 million Series A funding.

Of all of the new energy vehicle companies founded just two years ago, Nio, formerly NextEV, is one of the more notable survivors. Although NIO's plans are every bit as ambitious as those announced by other start-ups, NIO has a powerful and well-balanced set of backers that includes well regarded founders of important Chinese companies; several of China's largest technology giants; as well as prominent Chinese and Western financial institutions. NIO's list of shareholders reads like a "Who's Who" of Chinese and global leaders. The list includes the founders of Bitauto, JD.com, Autohome.com and Xiaomi. In addition, Tencent, Baidu and Lenovo are important shareholders, as are Hillhouse Capital, Temasek, GIC, TPG, Sequoia and Warburg Pincus.

Led by Tencent, Nio reportedly raised more than $1 billion in its latest fundraising round at a valuation of approximately $5 billion. In its recent report on NIO, Bernstein, a leading research firm that follows the global and Chinese auto industry closely, quoted Automotive News: "bright ideas and can-do attitudes are not what make automotive ventures succeed. What makes them succeed is…money."

Apart from money, though, NIO has other things going for it. First of all, it has a solid management team with substantial auto experience. Secondly, the company has carefully built its brand image and street creds. It was the inaugural winner in the 2014/2015 season of the Formula E Championship, and its EP9 supercar clocked the fastest time ever for a road-legal vehicle at Nürburgring Nordschleife in 2017. Third, the ES8 full-size SUV, which will begin production in early 2018, targets the highly profitable premium segment. Finally, an asset light business model that outsources manufacturing to an established auto company significantly reduces risk and capital costs.

Will NIO, in fact, be China's answer to Tesla? Only time will tell, but the company has certainly survived the first round in the new energy vehicle sweepstakes and appears to be well-positioned for Round 2.

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