

Managing the Dragon Blog Post

Automakers Respond To China's Changing EV Rules

By: Jack Perkowski | March 13, 2018

Last September, China [announced](#) that automakers selling over 30,000 vehicles annually in the country would be required to produce fleets with a corporate average fuel economy of 42 miles per gallon (“mpg”) by 2020, and 54.5 mpg by 2025. The combination of credits and disincentives in the new regulations are designed to improve the fuel efficiency of traditional-fuel vehicles, as well as to promote the deployment of New Energy Vehicles (“NEVs”), which include both Battery Electric Vehicles (“BEVs”) and Plug In Hybrid Electric Vehicles (“PHEVs”). Failure to meet Beijing’s guidelines could result in production cutbacks of an automaker’s vehicles powered by less fuel efficient internal combustion engines (“ICE”).

At the same time, China made known its intention to phase out subsidies paid to buyers of NEVs by 2021. Currently, China’s central and local governments pay subsidies of up to \$10,000 toward the purchase of an NEV, depending on the range of the vehicle. The government’s generous subsidy policy has been one of the reasons why China leads the world in the production and sale of NEVs.

While China wants cleaner air and has aggressive targets for NEV adoption, paying subsidies is an expensive way for the government to achieve its objectives. Although battery costs have declined in recent years, they are still significantly higher than the cost of an ICE. Therefore, in order to encourage individuals to buy NEVs, either the government has to subsidize their purchases, or automakers have to make NEVs available at a price that is competitive with an ICE vehicle, never mind the losses the automakers might incur in doing so. The effect of China’s two recent policy changes is to shift the burden of closing the cost gap from the Chinese government to the automakers.

In any other country in the world, except for perhaps the United States, such a dramatic change in NEV policy would encourage automakers to look to other markets. China, however, accounts for almost one-third of the 100 million vehicles produced globally every year, and is the major source of growth for the industry. For almost every international assembler, China is now one of its most profitable markets. No automaker can afford to be shut out of the country.

As a result, assemblers have taken China’s policy changes to heart and have reacted in two ways. First, virtually

every automaker has taken another look at its NEV strategy and has announced aggressive new targets for NEV sales, in China as well as globally. Secondly, many have formed new alliances, many with unlikely partners, to insure their ability to meet China’s new guidelines.

Volvo led the way as far as NEV targets when it announced that all of its cars would be [electrified](#) by 2019. Meanwhile, Geely, Volvo’s parent, is [targeting](#) for 90 percent of its total sales of 1.8 million units to be BEV or PHEV by 2020. Changan, one of China’s largest local assemblers, became the first Chinese automaker to [announce](#) that it would stop the sale of all ICE vehicles by 2025, while BAIC, SAIC and Chery have also announced aggressive EV sales targets.

The international assemblers are also adjusting their EV strategies. Nissan is [targeting](#) for EVs and PHEVs to reach 50 percent of total company car sales by 2020, while Toyota says it will offer 10 BEV models by the early 2020s. By 2025, BMW has [said](#) that EVs will reach 15 to 25 percent of sales; Daimler 25 percent and Audi [30 percent](#). Volkswagen is [targeting](#) EV sales of from 2 to 3 million units by then, while Ford has [said](#) that 70 percent of total company car sales in China in 2025 will be EV.

In order to meet such aggressive targets, new alliances are being formed, many with unlikely partners. In November, Ford, an industry giant, [announced](#) that it was teaming up with Zoyte, a relative newcomer to the industry founded in 2005, to produce a China-only EV brand. The two companies plan to invest over \$800 million in a joint venture to provide a range of small EVs to the China market.

Similarly, Volkswagen is [joining](#) forces with Chinese automotive firm JAC to create an entirely new range of cars under a specially created brand. The two companies are investing RMB 5 billion (\$726 million) and pooling their research and development and production capabilities in a joint venture to build Chinese cars that meet or better current European reliability and quality standards.

In another surprise development, BMW and China’s Great Wall [announced](#) in January that they have signed a letter of intent to jointly produce electric mini vehicles in China. BMW would be the first foreign manufacturing partner for Great Wall, and the joint venture would represent the first mini assembly site outside of Europe for BMW, the minority partner in the venture. (*next page*)

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Always the innovator, Li Shufu, Chairman of Geely, has [teamed up](#) with Kandi Technologies, a NASDAQ-listed company, to set up a joint venture for building and promoting small, short-range electric cars. The new company, which is a 50:50 joint venture between the two companies, has a mission of providing cities with affordable EVs that are convenient to use. Based in Hangzhou, Geely's hometown, the joint venture aims to become a leader in the market of low-speed and short-range EVs by applying what it calls the "Hangzhou Model" of EV promotion to other Chinese cities.

China's entry into the World Trade Organization in late 2001 triggered an explosion of growth in China's auto industry, causing auto assemblers around the world to re-examine their global strategies and to make substantial new capital commitments in China. In much the same way, China's changes in EV regulations are causing automakers to re-think their approach to EVs, even though such a re-direction threatens to obsolete the massive investments that have been made in recent years in plants producing ICE vehicles.

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