Managing the Dragon Blog Post

Coming To America

By: Jack Perkowski | April 7, 2018

Late last year, GAC Motor Company ("GAC Motor"), a subsidiary of Guangzhou Automobile Corporation ("GAC"), announced that it plans to begin selling its cars in the United States by late 2019. If successful, GAC Motor will be the first Chinese automaker to penetrate the U.S. market, following in the footsteps of German, Japanese and Korean carmakers that have made the jump from their home markets to the world's most demanding auto market over the past seventy years. GAC's success is not guaranteed, however, particularly given that several previous attempts by Chinese original equipment manufacturers ("OEM's) to sell cars in the United States never got off the ground.

In the mid-1950s, the U.S. auto market was a much simpler place. General Motors, Ford and Chrysler—the so-called "Big Three"—dominated the industry, manufacturing 94 percent of the seven or eight million cars and trucks that were produced every year. Tiny American Motors and the troubled Studebaker-Packard Corporation accounted for most of the balance, and imports were virtually non-existent. The only imported car being sold in the United States at the time was the Volkswagen "Beetle," which got off to a slow start when it was first introduced in 1949, but began to gain traction with American consumers in the 1960s. As the Big Three struggled with quality issues in the late 1970s, the Japanese car companies began to make headway, and in 1986, Hyundai came to America.

Through a great deal of hard work and attention to service and quality, the newcomers have been able to overcome their initial reputations for low cost and low quality to the point where many are considered quality leaders today. The attention to quality has paid off in increased sales and market share. From its high point in the Fifties, the Big Three's market share has declined to just under 45 percent and is now neck and neck with the combined market shares of the Korean and Japanese assemblers. Volkswagen, Daimler and a handful of European OEM's account for the balance. Despite the size of China's auto market, which is now nearly twice as large as that in the United States, no Chinese OEM is represented----but it is not for a lack of trying.

In 2005, Chery Automobile Co., Ltd. ("Chery") made the startling announcement that it would begin importing and selling 250,000 Chinese made sport utilities vehicles, sedans, and sports coupes in the United States. "Audacious, gutsy, and maybe a little nutty" was how this announcement was described by industry observers. After all, Chery had no brand value with U.S. consumers, and everyone doubted Chery's ability to meet the emissions, safety and quality requirements of sophisticated American consumers.

Zhejiang Geely Holding Group ("Geely") was the next Chinese car company to dream the American dream. In 2006, Geely announced that it planned to export cars to the United States beginning in 2008, and to land a basic model in dealer showrooms for $7,500. Like Chery, Geely's efforts were unsuccessful.

A great deal has changed over the last ten years, however, and the experiences of Chery and Geely in 2005 and 2006 may not be very useful in predicting whether GAC's efforts to enter the American market in 2019 will meet the same fate. China's auto industry is much larger today than it was a decade ago; Chinese OEM's like GAC have learned a great deal from their international partners; and GAC is a much more mature and substantial company than either Chery or Geely were when they announced their plans for the United States.

In 2005, less than six million vehicles were produced in China. That number has grown to 29 million today, with 40 percent of the vehicles manufactured by local companies that did not exist at the turn of the century. The Chinese OEMs have benefitted from that growth, and have been able to access the capital needed to buy state of the art equipment. Moreover, in order to survive in the fast growing, but very competitive, China market, the local car makers have had to up their game substantially and significantly increase the quality of their cars. As a result, the quality gap between cars made by the international car companies and those made by local assemblers is rapidly closing, and may have already closed at some companies.

When Chery and Geely decided to enter the American market, neither company had a formal relationship with an international auto company. Unlike most of their local competitors, neither Chery nor Geely had a *(next page)*

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joint venture in China with a global OEM. Geely did not acquire Volvo until several years later in 2010.

By comparison, GAC has formal working relationships with five international auto companies, the most of any Chinese company. GAC did a joint venture with Honda in 1999 to make cars for the China market, and a year later, concluded a cooperation with ISUZU to make buses. In 2004, GAC did a joint venture with Toyota, a company well-known for its high quality, and in 2010, GAC FIAT was formed. Finally, a joint venture between GAC and Mitsubishi became operational in 2012. Over the past eighteen years, GAC has been able to benefit by adopting the best practices from leading players in the global auto industry.

Finally, GAC is a much more substantial company than either Chery or Geely were when they announced plans to crack the American market. When Chery announced its plans to sell a quarter of a million vehicles in the United States, it had only made 80,000 cars the year before and was struggling in the China market. Geely was a bit larger when it decided to come to America, but was still only producing 218,000 cars when it announced its plans.

GAC is much further along in its development. Through joint ventures and its own operations, GAC produced 2.0 million vehicles in 2017 and ranked sixth in China's auto industry. The company had sales of $11.4 billion last year, and earned $1.7 billion in Net Income. GAC Motor, which was formed in 2008 to develop a line of GAC branded cars, is one of the fastest growing car companies in China. In 2017, GAC Motor sold 508,600 cars, a 37.2 percent increase over 2016.

Cracking the American auto market is a challenge for any company, no matter how strong. Meeting the strict emissions and safety requirements of U.S. regulators; developing a national dealer and service network; and overcoming the quality concerns of consumers are all daunting challenges by themselves. Taking together, they are a tough package, to say nothing of any potential difficulties caused by the trade tensions that now exist in the Sino-American relationship. Nonetheless, GAC's experience may be the first real test as to whether a Chinese car company can succeed in selling its cars in the United States.

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