



OBSERVATIONS

Dennis DesRosiers

Thoughts on the Chinese Vehicle Market

In recent months, one of the auto sector's big stories has been the official signing of a deal between Chrysler and Chery Motors to develop a lineup of entry level vehicles for export from China. These vehicles will initially be sold in Europe but, by the end of the decade, will likely be available through Chrysler stores in North America. Details of the forthcoming vehicles are presently unavailable (aside from their expected "B" size).

China has been a hot topic for a number of years and indeed it is hard to attend a seminar or conference in the automotive sector without someone discussing it - and rightfully so. China's burgeoning automotive industry arguably represents one of the most exciting opportunities faced by the vehicle companies in the last 50 years. For many OEMs, China has become one of the top two or three global markets, and it is certainly the fastest growing market for a number of automakers. For instance, GM now ranks China (877,000 GM sales in 2006) as their number two customer-base behind only the United States. China is twice the size of GM's number three customer, which happens to be Canada at 421 thousand units.

China is the fastest growing automotive market in the world. Last year, light vehicle

sales hit 7.42 million units with passenger car sales up 32.8 percent and light truck sales up 17.1 percent. The market is forecast by local analysts to grow to 11.3 million units over the next five years. As a fellow forecaster, I am always sceptical of any "blue sky" forecast, so I looked back several years and reviewed the history of Chinese market forecasts. In 2000, the local analysts were forecasting the market to grow to 5 million units by 2006. The market came in 2.4 million units above this level, so an 11.3 million unit forecast for 2011 is definitely possible and may actually underestimate the market's potential.

The other reason that China is considered "hot" is that it is viewed as a major threat to the traditional OEMs in North America. The theory is that China will dump millions of low cost units into North America, putting even more pressure on GM, Ford, and Chrysler. In addition, original equipment parts built in China for export to North America are growing at a rate of over 30 percent per year, threatening the health of many OE parts suppliers.

On a recent trip to the Shanghai Motor Show, I came away with a different view of China's ability to export vehicles to North America. Most analysts believe they are

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coming in a very big way with vehicles in the near future. I disagree. Yes, we will see some Chinese-built vehicles within a year or two, with the Chrysler-Chery deal likely representative of the first product assault. I suspect other OEMs will have a Chinese-built vehicle in their showrooms within five years. However, I also believe it may be a decade or more before we see a Chinese-branded vehicle in North America like we have seen with the Korean and Japanese brands over the last few decades. The Chinese products I saw at the Shanghai Motor show are presently inappropriate for the North American market, and it will be

several years before a suitable state of readiness is achieved.

Our industry has a long history of fingering 'scapegoats' for the issues of the day. I remember Korean-built vehicles being the big threat in the early-to-mid 1980s. The Korean experience may be a very good case study of what may develop with China. Hyundai was the first Korean-built brand in North America. They began selling ultra-cheap vehicles in Canada in 1983 and in the US in 1986, so they have been in the North American market for over two decades. Last year, Hyundai together with Kia sold just under 800,000 units in North America,

or less than five percent of the market. Of that total, 200,000 were built at their new plant in the U.S. Clearly, the 'threat' of

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Korean manufacturers selling millions of vehicles in North America and putting thousands of autoworkers out of their jobs never materialized. It took Hyundai more than a decade to fix their quality issues and they still do not have a full lineup of products covering all segments of the market.

As much as I respect China and its economic might, I just don't see it as a looming threat to the established OEMs in North America. I suspect it will be at least ten years before we see any significant volume (more than 500,000 units) and more likely a longer timeframe.

On the OE parts side of the equation, the threat is more imminent. US imports of automotive parts from China have grown by 30-plus percent per year. In 1997, China exported about \$300 million in automotive parts to the U.S. market. This year, their exports are tracking at well

TOTAL LIGHT VEHICLE MARKET IN CANADA & THE U.S.

Year	Total Market	Korean Sourced	Market Share
1981	11,331,549	-	0.0%
1982	11,165,576	-	0.0%
1983	13,090,937	19	0.0%
1984	15,519,116	25,123	0.2%
1985	17,028,551	79,072	0.5%
1986	17,620,066	238,906	1.4%
1987	16,417,196	314,256	1.9%
1988	17,027,907	295,295	1.7%
1989	15,986,165	211,959	1.3%
1990	15,186,688	159,980	1.1%
1991	13,654,281	139,641	1.0%
1992	14,113,709	127,469	0.9%
1993	15,110,114	129,774	0.9%
1994	16,343,862	158,440	1.0%
1995	15,859,442	150,542	0.9%
1996	16,268,341	161,918	1.0%
1997	16,508,057	187,301	1.1%
1998	16,933,321	196,246	1.2%
1999	18,507,951	329,717	1.8%
2000	18,898,864	449,036	2.4%
2001	18,692,978	636,801	3.4%
2002	18,519,614	690,046	3.7%
2003	18,232,545	714,480	3.9%
2004	18,364,700	756,621	4.1%
2005	18,527,783	807,612	4.4%
2006	18,114,988	786,842	4.3%
2006/2005	-2.2%	-2.6%	

Source: DesRosiers Automotive Consultants Inc., AIAMC, CVMA, and Ward's Automotive Reports

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over \$5 billion per year. Even with automotive parts, China's explosive growth has to be taken in context. Yes, they have grown by over 30 percent per year but they still represent only 2.1 percent of the U.S. demand for OE and aftermarket parts. Japan, Mexico, and Canada all have significantly higher penetration into the U.S. market.

It is my view that the real opportunity lies in the domestic Chinese market, not the North American market - at least for the next ten years. The Chinese market today (and looking

forward into the foreseeable future) is very different from its historical roots. In the past, the light vehicle market was comprised of two broad segments. The most important (and, by a wide margin, the largest) segment was that of small vehicles entirely dedicated to commercial use. One would not have found any personal-use light trucks in China like you find in North America. The second market was for personal-use vehicles, but virtually all of these were midsize and larger chauffeur-driven cars. Traditionally, the personal-use owner rode in the

back seat and was not the driver, so an institutional preference for larger vehicles

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was born. Indeed, most of the North American and European passenger cars sold in China were re-engineered for the Chinese market to lengthen wheelbases and stretch rear compartments. Brands like Brock have enjoyed huge

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US Original Equipment and Aftermarket Parts Market (\$US Billions)

Year	Size of the Total U.S. Parts Market	Imports of Parts from all Countries	Imports of Parts from Canada	Imports of Parts from Mexico	Imports of Parts from Mexico and Canada	Imports of Parts from Germany	Imports of Parts from Japan	Imports of Parts from China	Imports of Parts from all Other Countries
1997	\$188.8	\$39.4	\$11.4	\$10.2	\$21.7	\$2.1	\$9.9	\$0.3	\$5.3
1998	\$204.4	\$41.6	\$12.2	\$10.9	\$23.1	\$2.6	\$9.6	\$0.4	\$5.9
1999	\$232.0	\$47.7	\$14.3	\$12.5	\$26.8	\$2.9	\$10.3	\$0.6	\$7.0
2000	\$220.5	\$51.7	\$14.7	\$13.8	\$28.5	\$3.2	\$12.0	\$0.8	\$7.1
2001	\$207.9	\$48.3	\$13.1	\$13.2	\$26.3	\$3.1	\$11.1	\$1.0	\$6.9
2002	\$213.3	\$53.7	\$14.5	\$15.2	\$29.7	\$3.5	\$11.3	\$1.3	\$7.9
2003	\$237.6	\$58.0	\$15.7	\$16.0	\$31.8	\$4.3	\$11.4	\$1.7	\$8.9
2004	\$241.4	\$65.0	\$17.0	\$17.9	\$34.9	\$4.7	\$13.1	\$2.4	\$10.0
2005	\$245.0	\$71.1	\$18.1	\$19.4	\$37.5	\$4.9	\$13.8	\$3.2	\$11.7
2006	\$237.7	\$72.8	\$16.9	\$20.8	\$37.8	\$4.8	\$12.8	\$4.3	\$13.1
Change	-3.0%	2.4%	-6.2%	7.4%	0.8%	-0.9%	-7.3%	32.4%	12.1%
Jan- April 06	\$80.0	\$24.4	\$5.9	\$7.0	\$12.8	\$1.6	\$4.3	\$1.3	\$4.3
Jan- April 07	\$81.0	\$25.5	\$5.8	\$7.4	\$13.2	\$1.9	\$4.2	\$1.7	\$4.5
Change	1.3%	4.7%	-1.2%	6.8%	3.1%	13.1%	-3.7%	31.0%	6.7%
Percent of Total OE and Aftermarket Parts Market									
1997		20.8%	6.0%	5.4%	11.5%	1.1%	5.2%	0.2%	2.8%
1998		20.3%	6.0%	5.3%	11.3%	1.3%	4.7%	0.2%	2.9%
1999		20.5%	6.2%	5.4%	11.5%	1.3%	4.4%	0.3%	3.0%
2000		23.4%	6.7%	6.3%	12.9%	1.5%	5.4%	0.4%	3.2%
2001		23.2%	6.3%	6.3%	12.6%	1.5%	5.3%	0.5%	3.3%
2002		25.2%	6.8%	7.1%	13.9%	1.6%	5.3%	0.6%	3.7%
2003		24.4%	6.6%	6.7%	13.4%	1.8%	4.8%	0.7%	3.7%
2004		26.9%	7.1%	7.4%	14.5%	1.9%	5.4%	1.0%	4.1%
2005		29.0%	7.4%	7.9%	15.3%	2.0%	5.7%	1.3%	4.8%
2006		30.6%	7.1%	8.8%	15.9%	2.0%	5.4%	1.8%	5.5%
Jan- April 06		30.4%	7.3%	8.7%	16.0%	2.0%	5.4%	1.6%	5.3%
Jan- April 07		31.5%	7.2%	9.2%	16.3%	2.3%	5.2%	2.1%	5.6%

Source: DesRosiers Automotive Consultants Inc. and U.S. Department of Commerce

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success by catering to these sorts of conversion requirements.

The growth experienced in the Chinese market over the last 10 years has been very different. The segments that have led the pack are small "A" and "B" sized vehicles purchased exclusively for personal use. On my recent trip to China, one local official told me that over 5.0 million of the 7.4 million vehicle sales last year were to first-time buyers. If you think about it, this is the equivalent of giving a million teenagers a set of car keys and telling them to go have a good time. Scary!

Indeed this is one of the most significant observations I came away with from my trip. I call it the ying and the yang of the Chinese market. The personal vehicle represents the antithesis of a true communist society, since cars - by their very nature - stand for freedom of choice, mobility, the ability of consumers to differentiate themselves from one another, and relative freedom from locational or temporal constraints. These are not values typically allowed to flourish in communist societies, yet most of the Chinese market's growth has come from the ordinary consumer embracing the vehicle as their means of transportation. China's embrace of the

automotive sector represents an in-your-face recognition of the power of capitalism. From

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an outsider's point-of-view, it appears that the Chinese authorities have recognized that the economic benefits of the automotive sector (in terms of jobs and wealth generation) outweigh the societal impact of personal transportation.

If the Chinese government eventually moves away from its communist roots, historians may look back and identify the automotive sector as a primary instrument of change.

I also find it interesting to see how GM has emerged as the biggest and most successful company in China. They first invested in China in 1995 and most analysts thought they were making a serious strategic error. How wrong they were. We have become numb to the barrage of articles, books and analyses of the GM we know in North America - a GM that has lost a full 25 points of market share. Everyone is GM's critic.

But China provides different insights into the "real" GM and

reveals the true power of this company. Give GM a growing market and allow them to shed the "shackles of history" that so impede their ability to compete in North America and in less than a decade they emerge as the biggest, most profitable and strongest player in China. China represents an excellent case study of what GM can achieve when one of its hands is no longer tied behind its back. They are able to lever massive strategic capabilities and employ them very effectively. One wonders what GM could do if they were ever able to shed the handcuffs that constrain them in North America. **DAR**