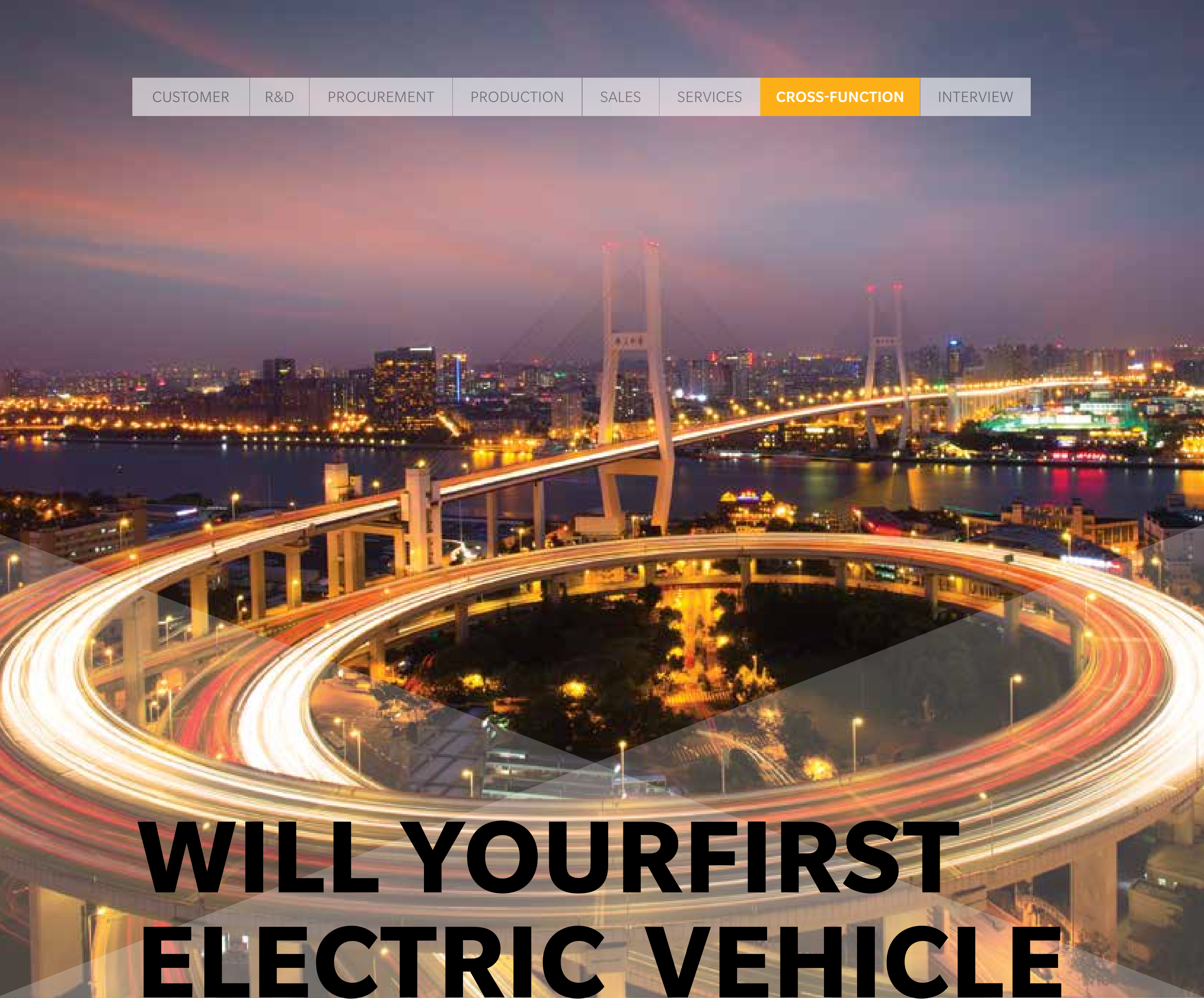


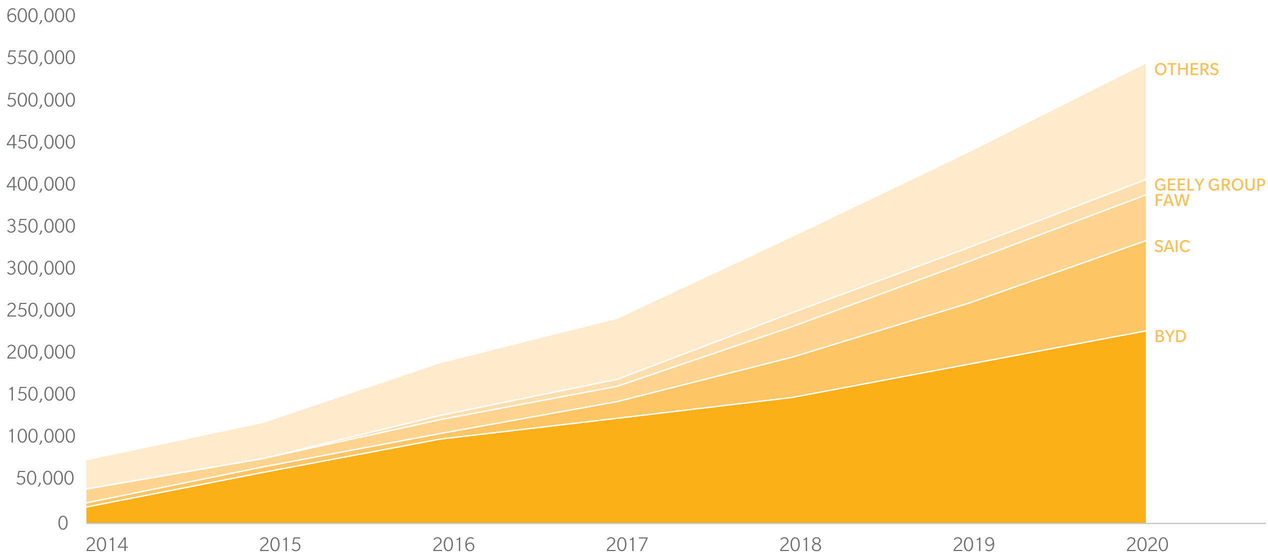
WILL YOUR FIRST ELECTRIC VEHICLE BE MADE IN CHINA?

Fifty years ago, motorists in Western markets would have laughed if told they would soon be driving Japanese vehicles, but sure enough the Toyota Camry has been the best-selling passenger-car in the U.S. for the better part of two decades. Thirty years ago, when Hyundai debuted its first car in America, few expected Korean brands to gain significant share. Today, many Americans and Europeans would scoff at the idea of driving a vehicle from a Chinese brand and would struggle to name one. That, however, may soon change.

HUNTER WILLIAMS

CHARGING AHEAD

China's domestic automakers are forecast to boost light electric vehicles production by 2020[1,2]



[1] Includes hybrids and fuel cell vehicles [2] Includes Chinese-foreign joint ventures

Source: LMCA Q4/2015, Oliver Wyman

China's domestic automotive industry is becoming more challenging for a variety of reasons. The market remains highly fragmented, with the top four players accounting for just 40 percent of the market (vs. 60 percent in the U.S.). Chinese policymakers are getting serious about tackling both pollution and congestion. Beijing has restricted driving temporarily to help cut pollution, while Shanghai has reduced the appeal of car ownership by raising the price for a license plate to more than €8,000, which has spawned a secondary market for used vehicles.

Car-hailing apps, such as Uber and its much larger domestic rival, Didi Chuxing, are attaining widespread usage. At the same time, multi-year investments in public transportation infrastructure are coming online. For instance, Shanghai opened 27 new subway stations last December. As a result, vehicle sales growth has slowed to single digits from the double-digit gains common in the past. Local brands, which account for a fifth of the market, are losing share to foreign marques. Where are the Chinese players likely to look for their future growth? It's possible they will pursue sales outside China much faster than many think and may find a competitive advantage in a surprising niche.

LEARNING CURVE

Chinese automakers are increasingly capable of producing vehicles that are good enough to be sold globally. SAIC Motor's joint venture with Volkswagen is 30 years old, and its JV with General Motors is nearly 20, providing China's largest domestic automaker with world-class expertise. Chinese automakers also have imported know-how as illustrated by Zhejiang Geely Holding's 2010 purchase of Volvo and Dongfeng Motor's 2014 investment in PSA Group. Today, China's leading carmakers are increasingly debuting quality vehicles under their own marques. The expected consolidation of China's domestic players only will improve competitiveness.

GOING GREEN

Chinese automakers may have a surprising ace up their sleeve. China surpassed the U.S. as the world's largest auto market in 2009, but more quietly it became the largest market for electric vehicles (EV) last year. In addition, China has seen an exponential increase in the local production of EV since 2014. Output is forecast to grow by 35 percent by 2020. While sales of battery EVs remain subsidy-driven and highly protected, hybrids are becoming economically competitive as they win share in fleets. Shanghai commuters using Uber or Didi Chuxing frequently find themselves riding in a BYD or Roewe hybrid.

Globally, automakers are recognizing that they are in the business of helping people get from point A to point B. Rather than focusing solely on making vehicles with internal combustion engines, they are investing in their EV and mobility business models to avoid having to play catch-up when the next unforeseen spike in oil prices triggers a widespread shift.

35%

BY 2020

GROWTH FORECAST FOR
CHINA'S EV PRODUCTION

SEEING GREEN ABROAD

It's no secret that Chinese automakers are looking at export opportunities beyond the Mideast and Southeast Asia, where inroads have already been made. Developed Western markets will prove tougher to crack, however. The first wave of competitors will arrive under familiar marques. Volvo announced in early 2015 that Chinese-made long-wheelbase versions of the S60 would be sold in the U.S. Meanwhile, General Motors plans to sell "made in China" Buicks in the U.S. market starting this year. Also, the recently revived Borgward brand, which is owned by Chinese truck manufacturer Beiqi Foton, intends to export its China-made vehicles to Germany in next few years.

Already, Great Wall Motor's Haval SUV is sold in Italy, while Lifan is among the top 20 brands in Russia, where it outsold Audi, BMW, and Land Rover last year. But what would convince U.S. or European customers to buy a vehicle from a Chinese marque? The niche they may end up filling could be low-cost EVs. Low oil prices make it even harder to produce cost-effective EVs. If there's one thing China is good at, however, it's low-cost manufacturing at scale.

How hard is it to imagine Roewe or BYD introducing a low-cost EV in Western markets? This car could undercut the Nissan Leaf, Chevrolet Bolt, and Tesla Model 3 on price. While low oil prices are bad for the EV sector in general, they favor the lowest cost producers. Western consumers may not be used to buying Chinese vehicles – yet – but they are accustomed to buying expensive, Chinese-assembled electronics that run on lithium-ion batteries. EVs just happen to have wheels.

BARRIERS

Of course, barriers abound. A shake-up in the domestic market could be delayed, oil prices could continue sinking, or a proprietary "breakthrough" in battery technology could take place.

What is certain is that Chinese automakers should be considering how to best enter overseas markets, where they have a potential to carve out a competitive advantage and take pole position when oil prices rise again.

Likewise, non-Chinese automakers should prepare for the day when their partners in the world's largest market become their newest rivals at home. Before long, the competition will be as global as the supply chain. The Chinese are coming, and they are poised to arrive with a more sophisticated offer than most people might have expected.