



## **Outsourcing Automotive Parts in China**

### **April, 2004**

When China opened up to the world twenty years ago, it was heralded for being a huge market of more than 1.2 billion consumers, attractive to the world's largest retailers and manufacturers. China has become the world's factory making products to be sold all over the world. China has become to the 21<sup>st</sup> Century what England was to the 19<sup>th</sup>. With China's entry into the World Trade Organization (WTO) in 2001, China keeps getting better. Today, China is competitive in many advanced technologies and is challenging the exporting prowess of other emerging markets around the world. Today China produces more than 50% of the world's cameras, 30% of the air conditioners and televisions, 25% of washing machines and close to 23% of refrigerators.

China is also making great efforts to develop its auto industry into a pillar industry by 2010. According to the China Automobile Industry Association, in 2002 China's automobile industry has hit a ten-year record high for vehicle production. By 2005, the annual automobile production volume will reach 3.3 million vehicles of which 1.1 million will be passenger cars. For the last two years, China's total vehicles output has been growing at roughly 36.5% over past year. The ratio of diesel engine vehicles will be increased to 35% by 2005. By 2005 the quality and standard of automobiles and key spare parts should be close to international standards.

With China's accession to the WTO, it will have a great impact on its automobile industry in terms of foreign competition in China. By 2006, tariffs on all imported automobiles will be reduced to 25%. More importantly, the tariffs on imported automobile parts and components will be reduced to 10%. American and other foreign companies will have the right to distribute automobile parts to any part of China by 2005. Due to the vast market size of China, this article will focus on the most important economic areas in Southwest China, Sichuan Province and Chongqing Municipality, as they have become the key production bases for automobiles, auto parts and components. More and more foreign companies are exporting business opportunities in these areas.

### **Summary of Sichuan Province Market Profile**

Sichuan Province is the largest province in Southwest China with a population of 85 million. Sichuan's economy ranks among the tops in China, and the auto industry is a key sector of the machinery industry in Sichuan. Sichuan has over 180 enterprises involved in the automobile industry of which there were 35 State approved auto manufacturers and re-manufacturers, 18 farm vehicles, 4 motorcycle companies and over 120 auto parts and component producers. The majority of the manufacturing companies are located in the following four cities, Chengdu, Mianyang, Nanchong and Luzhou. The total output value was RMB 9.19 billion (USD 1.11 billion) of which RMB 3 billion (USD 362 million) came from the auto parts and components sector.

The number of motor vehicles on the road in Sichuan was 1.1 million by the end of 2002. Chengdu alone has over 800,000 vehicles on the road, ranking third in car ownership in China after Beijing and Shanghai and number two, on a per capita basis, after Shanghai. Chengdu is one of the few popular cities in China that takes a lead in introducing new life styles. The local government's favorable policies also stimulate automobile purchases. According to the Chengdu Transportation Administrative Bureau, more than 300 new vehicles are registered every day.

In recent years, Chengdu has established a super transportation network with the newly established 3<sup>rd</sup> Ring Road, with a total investment of USD\$790 million, connecting other cities in Sichuan and Chongqing. Growing car consumption has promoted the development of the auto maintenance and repair business sector. Presently there are 20,000 automobile maintenance and repair shops in Sichuan. Chengdu alone has over 4,000 of them. Although there are numerous auto repair and maintenance shops in Chengdu, their competitiveness is not strong due to low skilled labor, a lack of funds, outdated equipment, fake parts and above all, poor management. In general, there is good market potential for aftermarket automotive products and services for U.S. companies.

**Table One: Auto Parts Markets in Sichuan Province (in USD million)**

|                  | 2000   | 2001   | 2002   | Est. Growth<br>(2002-2003) |
|------------------|--------|--------|--------|----------------------------|
| Import Market    | 0.44   | 22.42  | 23.98  | 7%                         |
| Local Production | 362.75 | 411.12 | 468.67 | 14%                        |
| Exports          | 5.77   | 4.97   | 5.24   | 6%                         |
| Total Market     | 357.42 | 428.57 | 487.41 | 14%                        |

Source: Chengdu Customs Information

The following tables demonstrate the growing auto market in China. According to Chinese Customs statistics, China is undergoing a rapid increase in the import and export of automotive products in the first five months of 2003.

**Table Two: China's Automotive Imports and Exports (First Five Months of 2003)  
(in USD Million)**

|   | Vehicles including<br>Complete Sets of Parts | Key Parts | Spare Parts and<br>Accessories |
|---|--|-----------|--------------------------------|
| Imports                                 | 1968   | 1028      | 2424                           |
| Growth Rate over the<br>Previous period | 82.6%  | 144.5%    | 117.2%                         |
| Export                                  | 137  | 239       | 1422                           |

**Table Three: China's Automobile Imports and Exports (First Five Months of 2003, in Units)**

|         | Total  | Sedans | SUVs   | Mini<br>Buses | Buses | Trucks | Special<br>Vehicles |
|---------|--------|--------|--------|---------------|-------|--------|---------------------|
| Imports | 72,399 | 40,724 | 20,289 | 4,659         | 1,663 | 3,594  | 1,467               |
| Exports | 30,820 | n/a    | n/a    | n/a           | n/a   | 8,014  | 19,725              |

Source: China Auto News, June 2003

## **Best Business Opportunities in Automobile Aftermarket**

By 2006, International automotive companies will have full distribution rights for vehicles and parts. It will certainly put much pressure on China's domestic automotive industry. Besides, automotive aftermarket services will also face major challenges from foreign companies.

Over the years, China's auto maintenance and repair industry has been an unsophisticated and inferior business. As more and more electronic devices and modular systems are used in vehicles, many small and medium-size repair firms have lagged behind in maintenance testing equipment, management skills and information technology. Thus it creates opportunities for foreign and American companies.

### **Engine Category:**

- Air filters, oil filters and spark plugs
- Inlet and outlet valves
- Car cylinder head blank, inlet pipes
- Fuel injection systems
- Automatic gear case, aluminum alloy die-castings

- Automatic gear case gears and bearings

#### **Chassis and drive train parts category:**

- Clutch disks, facings, pads, brake hoses
- Shock absorbers
- Aluminum alloy wheels
- ABS systems (antilock brake systems)
- Aluminum radiators

#### **Body Parts Category:**

- Wiper blades
- Auto Lighting and bulbs
- Rear mirrors

#### **Other products:**

- Electrical/electronic parts – non-durable and sporty accessories
- Auto care chemicals such as wax and rust-proofing solutions
- Tires

#### **Testing products for body shops:**

- Computerized four wheel locators
- Emission testers
- Black jackets
- Tire removers

## **Competitive Analysis with both Domestic Production and Other Imports**

The auto parts manufacturing industry in China is a highly fragmented with many small players. Most of the domestic manufacturers cannot be financially viable over the long term. In terms of foreign investment, China has about 240 auto parts joint ventures. Four percent of the companies invested over USD\$10 million and Seventy-four percent invested between USD\$1-10 million. Few have reached full-scale capacity and most of them are scattered. In general, most auto parts companies in China are very weak in research and development and their products are not very reliable due to inefficient testing instruments and a lack of quality control. Besides, the products can barely meet dynamic market demands and it will create many opportunities for other most sophisticated foreign companies.

Japanese companies are very ambitious on China's auto parts industry. Today there are more than 140 Japanese joint venture auto parts manufacturers in China. Some prestigious Japanese companies such as NGK Spark Plug Corporation and Seiko Epson Corporation are planning to set up shops in China soon.

European firms have made great progress too. Bosch Co. (Germany) has established 150 auto maintenance and repair stores in major cities. It also plans to set up 320 gasoline engine and 100 diesel engine maintenance and repair shops by the end of 2004. By 2010, Bosch plans to have over 1,000 auto repair stores in China, offering their great services to Chinese customers.

American firms like Delphi and Visteon, are also growing in China. Delphi has set up 11 joint ventures auto parts companies manufacturing over 40 types of parts and components in China. It supplies both the major OEM in China and exports to International market. Delphi's main products such as coil clusters and life span batteries have a 24% market share in China. The company is also a leader in the development and production of EMS (Engine Management Systems) in China. Visteon has five joint ventures auto parts companies in China. Even though American firms face strong competition from Japanese companies, there are still a lot of opportunities for new entrants.

## Overview of Chinese Customers' Frustrations

As auto parts are marketed by OEMs, their affiliated companies and auto parts trading firms, it is very difficult for Chinese customers to distinguish one from the other. As a result, customers are very frustrated when trying to identify reliable repair shops where they can get a fair price.

Another problem for end-users is the quality of the auto parts and services. The qualities are very inconsistent among the auto maintenance/repair sector and some repair shops often use fake products. The customer may pay a high price but cannot be guaranteed quality of service.

Today there are not many imported American cars in Chengdu. However, in the next five to ten years, when the import tax reductions brought in by WTO and local people's growing purchasing power, the demand of American cars will increase tremendously. As a result, there will be a higher demand for U.S. auto parts and components.

## Market Opportunity and Access

In compliance with the WTO, tariffs will be reduced to 43% for 3-liters vehicles and to 38.2% for vehicles lower than 3-liters. Quota for automobile imports will be USD\$9.13 billion. The reduction in tariffs will make it much cheaper for foreign firms to export finished vehicles to China. The State Ministry of Transportation announced that effective December, 2002, foreign companies can cooperate with Chinese companies to set up joint ventures in shipping, forwarding, warehousing and maintenance/repair. Foreign investment in these sectors will be permitted to reach 75% of the total investment.

Another important milestone is non-bank financial institutions will be permitted to engage in automobile financing. This will allow Chinese citizens to apply for loans from cars manufacturers or credit institutions and pay for their cars on installment basis. Currently, most buyers with significant personal savings pay for cars in cash. Auto financing is available only through the major Chinese banks: the Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB), the Agricultural Bank of China (ABC) and the Bank of China (BOC). Today only 10-15% of purchasers in China have auto loans. The recent announcement of American Express issuing credit cards with ICBC will further fuel the growth of automobile purchases in China.

Currently there are three ways for U.S. companies to enter China's market. First, you can find a qualified agent or distributor who has built up a vast network in a certain area of the country. Second, you could set up a representative office to assist local distributors with product promotion and thirdly, establish a joint or solely funded venture. A good way to enter the market is to work with experienced parts trading companies that have established a regional sales network with a good business reputation. Agents and distributors are geographically distributed since the China market can be divided into six regions: the South (Guangdong), the East (Shanghai), the Beijing-Tianjian region, Central China, the Northeast (Shenyang) and the Southwest (Chengdu). American companies may need to find several agents for different regions. Another alternative method of entry is OEM sales to a Chinese auto manufacturer. Whatever the course you choose, U.S firms are advised to take normal business precautions when choosing Chinese partners.