

The “New Normal” in China’s Auto Industry

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While China has established a position for itself as the world’s largest automobile factory and market, the government has now shifted to the development of new energy vehicles in recognition of China’s status as a “manufacturing giant” as opposed to a “leading manufacturing power”. With the government planning to introduce new regulations in 2018, next year could mark a major turning point for China’s auto industry as it enters a stage of “new normal”. The “new normal” is expected to trigger a shift in strategy for not only auto manufacturers but their suppliers.

China’s auto market: an overview

It has been many years since China emerged as the world’s largest auto market. In 2016, this largest market broke a record with vehicle sales topping 28 million thanks in part to the tax incentives for buyers of low emission vehicles, which have helped to spur demand. This tax cut was originally set to expire in December 2016, but it has been extended the term to the end of 2017 through narrowing the scale of the tax incentive. Whilst the smaller tax break is expected to slow the pace of growth in new vehicle sales in 2017, few are anticipating major decline in sales.

China’s market for electric vehicles, plug-in hybrid electric vehicles and other new energy vehicles continues to grow at a healthy clip, with sales topping 500,000 units last year. New energy vehicles currently represent just 2 percent of total vehicle market demand, but the Society of Automotive Engineers of China (SAE China)¹ has released a roadmap for new energy vehicles², which targets a 7-percent market share (equivalent to 2.1 million units) by 2020 and 15 percent (5.25 million units) by 2025. China’s market for new energy vehicles, already the world’s largest, is expected to expand even further (Figure 1).

¹ An national academic organization of Chinese auto engineers

² This roadmap was drafted by the Strategic Guidance Committee on the Technology Roadmap for Energy Saving and New Energy Vehicles and SAE China under commission from the National Manufacturing Strategy Advisory Committee (NMSAC) and the Ministry of Industry and Information Technology

Fig. 1: Roadmap for the Popularization of New Energy Vehicles

	2016 (Actual)	Targets		
		By 2020	2025	2030
China production and sales (million Unit vehicle)	28.03	30	35	38
Percentage of new energy vehicles	2%	7%	15%	40%
Size of new energy vehicle market (million Unit vehicle)	0.51	2.1	5.25	15.2

Source: Prepared by Mizuho Industry Research Department from China Association of Automobile Manufacturers (CAAM) data and the Technology Roadmap for Energy Saving and New Energy Vehicles

Changes in China's Auto Industry Policy

In terms of manufacturing scale, China has long established a position for itself as the world's largest automobile factory. On the level of individual manufacturers, however, Chinese manufacturers still lack international competitiveness. China exported less than 5 percent of locally produced automobiles and vehicle exports have been declining for the past two years³, suggesting that China is failing to put its excess production capacity to practical use through exports. Chinese auto manufacturers have also failed to make their presence in other major auto markets. It means that China has failed to achieve the goals of its plan to promote the auto industry⁴, which proposed consolidating domestic auto manufacturers into "four big, four small" companies and nurturing leading Chinese manufacturers capable of competing in the global auto market.

Announced by the Chinese government in 2015, the "Made in China 2025" initiative summarizes China's current situation as follows: "China is still in the process of industrialization and there remain gaps between China and developed countries. Chinese manufacturing sector is large but not yet strong. The capability for independent innovation is weak and China is highly dependent on the outside world for the key technology and advanced equipment. Enterprise-led manufacturing innovation is yet to be perfected. Product quality is not high and China has few world-famous brands." These statements suggest that the government should be aware of the limitations of cultivating and/or bolstering domestic enterprises under an auto industry policy that is weighted towards scale expansion.

Added to which, the exponential increase in vehicle numbers has intensified China's environmental challenges, and this has further prompted a shift in the government's policy for the auto industry towards "new energy vehicles and energy-saving vehicles" in recent years. These are positioned as one of the

³ Customs data indicate positive growth in auto export last year, but a CAAM press release shows negative year-on-year growth. This gap is attributed to the inclusion of low-speed electric vehicles in the customs statistics. Since low-speed electric vehicles are not normally included in auto industry statistics, the figure used in the CAAM press release was referenced for this report.

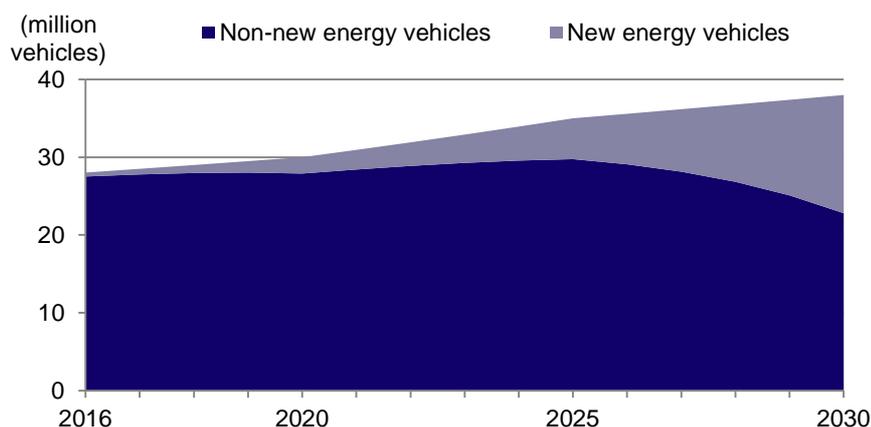
⁴ Announced in March 2009, the "Program for the Adjustment and Rejuvenation of the Auto Industry" made reference to promoting the consolidation of the auto industry focusing on FAW Group Corporation, SAIC Motor Corporation Ltd., Dongfeng Motor Corporation, Changan Automobile Co., Ltd, Beijing Automotive Group Co., Ltd, Guangzhou Automobile Group Co., Ltd., Chery Automobile Co., Ltd, and China National Heavy Duty Truck Group Co., Ltd. (Sino Truck).

ten priority sectors in the aforementioned “Made in China 2025” plan. In particular, new energy vehicles are rapidly becoming increasingly critical to China’s auto industry with domestic players including new entrants investing aggressively in the sector against a backdrop of tighter regulation and generous government subsidies. Recently, untraditional players, such as LeEco, a Chinese IT company, partnered by an electric vehicle venture and Wanxiang Group, a major Chinese parts supplier that has obtained a license to manufacture electric vehicles, have started to see this shift in the government’s auto industry policy as a golden opportunity to enter the auto market and are investing heavily in electric vehicles.

New regulations for new energy vehicles set to mark a turning point

Amongst the various policies unveiled for China’s new energy vehicle industry, the “Measures for New Energy Vehicles Carbon Quota Implementation” (the “NEV regulation” hereunder) has the potential to affect a seismic shift in the industry. The new regulation obligates the production of new energy vehicles by auto manufacturers, and according to the draft rules that were released for public consultation; it is slated for introduction next year⁵. The enforcement of the NEV regulation is projected to trigger a rapid increase in new energy vehicle production and lead to an increase in this sector’s share of China’s auto market (Figure 2). When looked at from a different perspective, the new regulation is expected to precipitate a slowdown in cars with internal combustion engines (primarily gas-powered vehicles), which currently have the largest share of total auto market demand, and further a contraction in the market for such vehicles in the coming years.

Fig. 2: Trends in the Markets for New Energy and Non-New Energy Vehicles identified in the SAE China Roadmap



Notes:

1. The chart shows compound annual growth rates for 2016-20, 2020-25 and 2025-30, which are calculated on the basis of the targets given in the SAE China Roadmap.
2. Based on Chinese classifications, electric vehicles, plug-in hybrid electric vehicles and fuel cell vehicles are classified as new energy vehicles and all other vehicles as non-new energy vehicles.

Source: As for Figure 1

⁵ For an overview of the NEV regulation, readers are referred to “The Five-Year Attack Plan: Business Strategy Scenarios for China, Structural Changes in Twenty Major Industries and How Japanese Companies Should Respond To Them”, edited by Mizuho Industry Research Division, Mizuho Research Institute and published (in Japanese) by The Nikkei.

Moreover, as there are huge differences between the component parts and underlying technologies used to manufacture new energy vehicles and those for cars with internal combustion engines, such influence will likely spread in the whole auto industry throughout the supply chain. The regulation will not only have great impact on its directly targeted auto manufacturers, but the repercussions for China's entire auto industry cannot be neglected as well.

The “new normal” in China's auto industry

In requiring, with very little buildup, auto manufacturers to produce and/or import new energy vehicles in numbers that substantially exceed current levels, the NEV regulation is expected to trigger a rapid, large-scale shift to electric vehicles and will necessitate a shift in strategy for all players in China's auto industry.

China's auto industry is thus expected to move out of its current scale-oriented phase centering on cars with internal combustion engines and enter a stage of “new normal”. The NEV regulation and other new rules are expected to spur competition, and lead China to being the market driver of the global charge in the development of new energy vehicles.

Whilst there has been no official announcement on the enforcement of the NEV regulations to date (as of March 31, 2017), local auto manufacturers and the various other players in China's auto market have begun preparing for the advent of this “new normal” in the industry.

Strategies required of Japanese suppliers

Should China's auto market enter a “new normal”, Japanese suppliers will also be under pressure to rethink their business strategies for China⁶.

Currently, domestic auto manufacturers have been investing aggressively in China's new energy vehicle sector. By contrast, given the obscurity surrounding the policy maneuvers of the Chinese government⁷, the direction of which is unreadable though possibly attributable to its ulterior goal of nurturing domestic enterprises, Japanese players have been taking a cautious stance towards new investment. If the situation remains unchanged, there is a risk that Japan's auto manufacturers could fall behind the curve in China's expanding market for new energy vehicles.

How, then, are Japanese suppliers to utilize the technologies and expertise accumulated in developed markets so as to reap the benefits of China's expanding new energy vehicle market whilst simultaneously avoiding – as far as possible – the risks posed by the lack of clarity surrounding the government's policy maneuvers?

⁶ See previous reference for further details of the changes to the business strategies of auto manufacturers.

⁷ For example, the ongoing lack of clarity on the relationship between industry standards for electric vehicle batteries (industry guidelines) and the types of vehicles that are eligible for new energy vehicle subsidies resulted in a subsidy application for an electric vehicle equipped with a Korean-made battery being rejected.

Forming a strategic alliance with Chinese auto manufacturers offers a powerful option. This would facilitate the acquisition of business with players already active in China's new energy vehicle market and make it easier to pick up on policy trends by going through the Chinese partner, which enjoys a closer relationship with the government. At the same time, several domestic auto manufactures have begun introducing luxury brands and making inroads into developed markets, in moves that demonstrate a determination to improve the quality and performance of their products way above current levels, and they have high expectations of foreign suppliers, particularly in areas such as electrification, self-driving car technology and other emerging technologies.

For Japanese suppliers, interest in Chinese auto manufacturers has fluctuated between the appeal of quantitative growth in China's auto market and the risks posed by a possible deterioration in the relations between Japan and China over the nationalization of the Senkaku islands. Recently, however, the growth in China's market for new energy vehicles shows signs of encouraging Japan's suppliers to view Chinese auto manufacturers in a different light. With forecasts pointing to further expansion in this market, already there is evidence of new partnerships being formed between Japanese suppliers and Chinese auto manufacturers. The joint venture formed last year between Yasukawa Electric Corporation and Chery Automobile Company to develop a drive system for electric vehicles is a good example of this.

Changes bring in opportunities. It is hoped that Japan's car parts manufacturers will see the changes in China's auto industry, including the introduction of new regulations, as an opportunity to rethink their business strategies for China in order to successfully maximize their strengths and leverage their competitive advantages even as the Chinese auto market enters a "new normal".

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