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An Analysis on Transnational Investment of China's Automobile Industry under the Financial Crisis

Lei Du
School of Business, Nanjing University
Nanjing 210093, China
E-mail: dulei99@gmail.com

Abstract

This paper gives a detailed analysis on Chinese automobile industry under the condition of financial crisis and then conducts a research of the motivations of transnational investment of Chinese automobile industry and the challenges it is facing in depth, coming to the conclusion that it is advisable for them to push forward transnational investment. However, because of many restraining factors, there are a lot of challenges in the transnational investment of Chinese automobile industry. According to the analysis, the paper puts forward some suggestions.

Keywords: Automobile industry, Financial crisis, Transnational merger and acquisition, Brand strategy, Cluster strategy

1. Introduction

With the increasingly tense financial crisis, international automobile industry seems to have stepped into depression. Due to the crisis, three major Detroit automobile manufactures are facing the most severe impact ever since. In the United States, President Obama has officially announced the bankruptcy of Chrysler and it will be taken over by Fiat and the American Government. General and Ford are also considering selling their superior assets to overcome financing problems caused by their lower credit rating. Although U.S. Congress has recently issued a proposal to provide $25 billion's low-interest loans to their automobile industry, which is a rare rescue, it will only temporarily and partly help their automobile manufactures alter their factories and update their facilities, unable to relieve these enterprises' pressure in financing. As a result, consumption of new cars is on the decline due to lost confidence, even influencing Japanese automobile industry which mainly relies on the American Market. Even Toyota has taken the cue of Detroit to attract consumers with zero-interest loans. In Japan, Germany and other auto manufacture powers, their domestic consumption has suffered from a serious decline. While in China, in spite of the lower growth this year, the financial crisis has exerted less impact on its automobile manufactures. With the rapid development in the recent years, a complete product series and production layout have been formed in China's automobile industry with some large-scale enterprises such as No.1 Automobile Corporation, Dongfeng Automobile Corporation, Shanghai Automobile Industry Corporation and so on. Domestic automobiles have taken up over 95% of China's automobile market. Currently, with china's domestic market getting increasingly saturated and lower sales growth, it seems urgent for China's automobile industry to get out of its domestic market.

2. Current Situation and Analysis on China's Automobile Industry

It is shown in the statistics of automobile import and export provided by China General Administration of the Customs that the export of automobiles was influenced greatly by the international environment in 2008. To be more specific, in the first half year, a general rapid-growth tendency was shown, but there was an obvious decline in growth from the third quarter, especially a five-month decline since August compared with the same periods of the previous year has worsen the general lower growth in automobile export in China. By the end of 2008, 680700 automobiles had been exported, a 11.10% increase compared with that of the same period in the previous year; compared with that of the first half year, the growth rate had been lowered by 48.27%; compared with that of the same period in the previous year, it had been lowered by 67.85%. In addition, the $9.633 billion's export had been an 31.75% increase compared with that of the same period in the previous year; compared with that of the first half year, the growth rate had been lowered by 53.09%; compared with that of the same period in the previous year, it had been lowered by 101.44%. All these are shown in the following figure.

Insert Figure 1 here

It can be revealed that the export of China's automobile industry is restrained greatly by the financial crisis. Because of that, there has been a sharp decrease in the manufacturing and sales of automobiles in some major global markets such as Europe, North America and so on, which has dragged some newly-born markets including Russia and Latin America into depression. Besides, some other factors, such as the changed RMB exchange rate, the higher cost for production and sales and commercial barriers have also restrained the export of China's automobiles to some degree. According to the statistics issued by General Administrative of the Customs, from January to July in 2008 China had a sales-output ratio of 98.6% with its output of 593.2 automobiles and sales of 584.9%. In spite of the relative sales-output balance, China's automobile market still suffers from overcapacity. Due to few independent patented technologies and poor brand competitiveness, China's automobile industry has serious problems in itself in addition to the inferior external environment. However, some improved objective conditions in China, such as higher demands for small cars, the issuance of fuel tax as well as the lower price of finished oil, have stimulated China's sluggish automobile market. It is shown in the latest data that China replaced America to be No.1 automobile sales country in January 2009. Therefore, it is safe to say that China's automobile industry has huge potential in the future.

The financial crisis can be both an opportunity and a challenge for China's automobile industry. On one hand, China has taken a place in the formerly fierce automobile market while those large-scale manufacturers are dealing with their lower sales and even bankruptcy risks. China's automobile manufacturers can make use of their favorable objective environment and national financial support to open up their new markets for investment abroad as well as to facilitate their product innovation. On the other hand, due to the dominance of FDI investment pattern in China's automobile industry, we face great risks as well as opportunities. Lacking in relevant experience in international investment and M&A, they will suffer from even greater challenges after M&A. Therefore, they should remain calm when dealing with all these.

3. Investment Motivations of China's Automobile Enterprises under the Financial Crisis

On 10th Feb, 2009, Chana Automobile Corporation took an opposite measure to others to establish their plants in North America and signed an joint-venture agreement with Autopark in Mexico to produce and sell Beni, Joice and other products in the whole American Market including U.S.. With their success, this will be the 6th oversea factory of Chana Corporation. Meanwhile, Chery Corporation is having a negotiation with South America in which Chery Socma S.A. invested by China, Argentina and Uruguay plans to establish a new automobile assembly plant in Chaco, Argentina with the total investment of 450 to 500 million dollars. Conducted over a 4-year period, this investment plan is expected to create an annual output of 100,000 automobiles, most of which will be exported to Brazil. In addition, some domestic automobile manufacturers such as Chery have declared their plans to obtain technologies and sales networks through international M&A in order to further exert the advantage of China's low labor cost.

Against the background of 2008 financial crisis, China's automobile manufacturers' investment in spite of the current situation is really confusing. Due to the exterior environment and this industry's capacity structure as well as industrial structure, international automobile industry has stepped into depression. Currently, there are two diverse countermeasures to it: first is to pursue assistance from their nations' governments and seek for some potential clients to offer loan services, such as General and Chrysler; the other is to invest a large amount of capital to stimulate consumers' passion and to put forward environmental-friendly hybrid-power automobiles or electric ones to meet the market's demands, such as Ford and Toyota. Therefore, China's large investment in FDI and M&A seems quite irregular. What motivations do they have? And what influences will it exert on China's automobile manufacturers?

According to some relevant knowledge of international investment, there are four main aspects in international investment motivations generally: production internationalization, lower production cost, scattered and reduced enterprise risks and the realization of enterprises' global development strategy. However, China has three motivations according to its previous investment experience (with the case of the 6 overseas plants set up by Chana)

3.1 Seeking for Market Advantages

Here, market advantages refer to those factors attracting investment in the host nation's market, including market scale, potential, market consumption pattern, market competition, basic conditions of market and permission for a third country to enter the host nation' market and the like. Accordingly, Chinese automobile enterprises exert their direct overseas investment to seek for their market advantages mainly with the intention to open up new overseas markets based on their former one according to Kozima Kiyosi's theory of "the Expansion of Inter-enterprises", in order to seek for a way out from China's saturated domestic products, to pursue high-consumption market and to switch its technological advantages. In Kozima Kiyosi's opinion, with commercial barriers, if enterprises of direct investment stick to their transnational direct investment along Rybczynski Line, they will realize their complete replacement in commerce with relatively optimized efficiency and lowest cost in switching production elements. For instance, Chana's investment in Iran, Ukraine and Mexico is mainly intended to open up the potential markets in Middle East, East Europe, Latin America and so on. Because of their developing economy, they need these cheap automobiles produced by China, hence creating a wide market for Chinese automobile manufacturers.

3.2 Seeking for Resource Advantages

Here resource advantages cover a wide range, including not only the natural resources in the host nation, but science and technology, information, labor force, capital, social relations and so on. Accordingly, Chana establishes its joint ventures in U.S. just in order to take advantage of American manufacturers' advanced technologies, management methods and latest industrial information, those established in Malaysia and Vietnam are intended to use their low-price labor force.

3.3 Seeking for Environmental Advantages

Here environmental advantages cover a narrow range, mainly including the host nation's superior political environment, legal environment, economic environment as well as cultural environment and so on. Investors seek for preferential policies, industrial clusters and profit-oriented investment here in order to make use of different host nations' relative advantages and achieve their minimized cost and maximized profit. For instance, the plants set up by China in Vietnam are encouraged by Vietnamese Government due to their propelling force in its economy. And as well, convenient transportation can be turned to due to the short distance between Vietnam and China's southeastern costal area.

All these mentioned above are the basic factors considered by China's automobile enterprises when making their investment. In the special period of financial crisis, some new characteristics emerge.

First, seen from the economic environment and resource advantages of the invested nations, Chinese enterprises are attracted by the advantageous resources in those nations, which include plenty of production materials (labor or capital), advanced technology and management patterns, open local markets, convenient transportation, preferential taxation policies and so on. Overall, compared with domestic investment, these advantages will help to cut down the investors' cost for production and operation and encourage them to transfer part of their capital or conduct M&A. therefore, under the circumstances of financial crisis, the economic environment should be closely related to the host nation to predict the future trends for development based on the current situation and to maximize the long-term investment profit.

Second, the financial crisis makes it possible for Chinese automobiles' global expansion. The current serious economic situation has dragged a large number of foreign automobile enterprises into depression, in which the bankruptcy of banks and the large-scale shrinking of sales have confronted them with capital shortage and overstocked products. In this situation, China's automobile manufacturers can help those enterprises out of depression with their abundant financial resources as well as buy the stock of foreign enterprises or have their M&A with unbelievably low prices.

Third, the financial crisis has also make trade protectionism emerge again, hence worsening China's pressure in export. As a result, they are eager to open up new markets. For example, in order to protect its domestic automobile industry, Russia decided to collect a 15% tariff which cannot be lower than € 5000 per car on imported automobiles in November 2008 and even raised that to 30% for second-hand cars with no more than 3 years' use and 35% for those used for 3 to 5 years from January to September 2009. Due to the important role of Russia in China's small automobile export, this series of measures have really exerted serious impact on the sales of Chinese automobiles in Russia. Therefore, it is one of the most significant tasks for China's automobile export to open up new markets especially those in developing countries.

To sum up, the investment made by China's automobile manufacturers in the current environment is a timely global expansion strategy which is favorable to their long-term automobile enterprises.

4. Challenges for Chinese Automobile Enterprises in Foreign Investment

Seen from the history of international M&A, a majority of large-scale M&A cases ended up with failure, which makes it critical to have a second thought before making any decision. American scholar Bruno analyzed thousands of M&A cases over the world with 137 survey reports, only to produce disappointing results:

- 17% M&A projects bring substantial benefits
- 33% M&A projects bring no benefits
- 20% M&A projects cause losses
- 30% M&A projects cause serious losses in possession

With such results, inexperienced Chinese investors should be cautious instead of being fickle and crazy because the financial crisis provides challenges other than opportunities. They should be reminded of Japan's painful lessons in crazy transnational M&A in 1980s. I totally agree with Professor Wu Qihong in that it is a long journey for Chinese enterprises to step into the international market and a lot of adjustments should be made with plenty of time. Just as what Darwin says in this book *Origin of Species*, not the most giant species or the most intelligent ones, but the most adaptable ones can survive. It is the biggest challenge confronting Chinese enterprise whether they can be adapted to changes under the current financial crisis. This will involve a conversion from Chinese thought to global thought and from isolated thought to open thought. Let's analyze the investment risks in the financial crisis from the perspective of

Chinese enterprises themselves.

First, many cases reveal that it is quite risky due to possible indigestion in spite of the positive effect in Chinese automobiles' influence power to merge the loss-suffering enterprises in developed countries. Tata Corporation in India bought Land Rover and Jaguar, only to be restricted by America in many aspects and suffer from a loss in 2008 due to their huge debts in the financial crisis. Shanghai Automobile-controlled SsangYong, who was once regarded as an example in transnational M&A, is now stuck into depression influenced by the financial crisis, resistance of the trade union as well as strikes. As is shown in the series of cases, it is a long and tough task for developing countries to conduct transnational M&A.

Second, under the negative current economic environment, all counties are protecting their different industries' domestic markets, causing Chinese automobile enterprises' rapidly-shrinking overseas sales. A customs report is as follows:

Insert Table 1 here

It is shown in this table that there is an overall reduction in the export to every country on the list in 2008, especially to Russia, mainly due to its much higher tariff in order to protect their domestic automobiles.

Third, China's automobile enterprises plan to achieve economic profits as well as brand reputation with their overseas investment but have to struggle their way due to their unfavorable conditions. First comes their product image. Chinese automobile enterprises mainly focus their attention to those nations with poorly-development automobile industry or those nonprofit regions, hence having relatively weak competition. Although they will gain part of the market in a short term with their cheap automobiles, it won't be the choice for the mainstream consumers. Therefore, they must take Japan's cue in 1960s and 1970s to conduct brand strategies, to create their middle to high end brands and therefore change the previous impression Chinese automobiles leave on consumers. Besides, lacking in experience, China's automobile enterprises tend to fail to predict and prevent some potential difficulties, hence suffering from passive situations, such as the case of Shanghai Automobile Corporation's merger of Ssangyong. Third are development strategies. Currently, the main advantage for China's automobiles, cheap ones are only fit for those low-class people, who tend to be most unstable in demands. Therefore, our current sales strategy seems not a good one on the long run. Fourth, our after-sale service drags Chinese automobiles backwards in overseas competition. In the current depression period, it has become the most powerful guarantee for any enterprise. However, the imperfect after-sale service system of Chinese automobile enterprises has caused serious problems in their competition with those foreign ones.

5. Conclusion and Suggestions

Financial crisis has brought about both challenges and opportunities to china's automobile industry. As is mentioned above, we should be optimistic about transnational M&A which is really a precious opportunity for us. However, sufficient preparation should be made in case of possible risks, because China's automobile industry will be faced with four major obstacles in their taking over the whole operation system of some automobile brands enjoying world reputation: deteriorating global sales, powerful overseas trade unions, the merged corporations' debts and great investment risks.

In order to solve the above problems, first of all, we should buy some capital selectively from those bankrupting companies instead of their whole companies, such as their technologies and brand logos. Although it will protect the merged companies' reputation and brand value and help to lessen the negative influences after merger to conduct M&A before bankruptcy and take relevant risks and debts, we must be cautious when pricing some invisible assets such as technologies, brands an so on.

Second, more experience from other nations' automobile enterprises, such as Japan, Korea, should be learned in China's foreign investment. More effects should be made to maintain equal communication, common ground while reserving differences, mutual respect, friendly cooperation, democracy and harmony with trade unions.

Third, some strategic unions led by government and made up of powerful enterprises should be established to tackle with risks in investment and enhance their anti-risk capacity.

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Table 1. China's automobile export to major export markets in 2008

Market	2008		2007	
	Export (in ten thousand)	Year-on-year percentage (%)	Export (in ten thousand)	Year-on-year percentage (%)
Total	64.4	9.4	58.8	85.7
Africa	14.0	17.4	11.9	92.5
Latin America	9.7	26.9	7.6	144.8
Russia	7.7	-27.0	10.6	180.4
ASEAN	6.4	57.6	4.1	36.4
EU	6.4	10.5	5.8	81.6