China's Booming Auto Market: Opportunity or Threat?

China's automotive market is booming, with exponential growth expected year after year. Is this an opportunity or a threat for Canada?

Last year, China produced 4.44 million vehicles, catapulting it into the position of being the fourth largest auto manufacturer in the world. China is expected to produce more than 7 million vehicles by 2010, which would make it the world's second largest auto manufacturer, behind the United States. Some have even predicted that if China maintains a GDP growth rate of 8 per cent, its demand for automobiles could reach 20 million by 2020. As a result, many foreign auto and parts companies are rushing into China or are aggressively expanding their operations there. U.S. automakers will not repeat the mistakes they made in Japan decades ago when they missed the opportunity to partner with, and become the controlling force behind, Toyota and Nissan.

During the 15 years of the General Agreement on Tariffs and Trade (GATT)/World Trade Organization (WTO) accession negotiations, nobody predicted that the Chinese auto industry would one day be booming. However, China's carefully crafted auto policies and the rapid expansion of its foreign auto and parts companies have transformed this formerly uncompetitive sector. This turnaround leads some to believe that China will become the main driver of the global auto market in the next 20 years and that, therefore, international companies should expand their Chinese operations in order to reap the market potential. Others have cautioned that China's auto market is overheated and that its expanded production capacities will inevitably lead to an oversupply and price competition in both China and the rest of the world.

Will cars be the next Chinese export to North America? Experts seem to agree that short-term demand in the Chinese market will delay the export of Chinese autos to North America in the next few years. But the flood of western investment to the auto industry may create excess capacity and precipitate auto exports to North America within 10 years, especially in smaller low-end cars.

Should Canadians be pleased or worried about the Chinese auto market's success? The answer depends on how Canadian companies position themselves. Canadian automakers can find a niche in the supply chain in this market by making machine tools, using tools to make components or turning components into finished sections. As tariffs come down and quotas are removed after China's WTO accession, opportunities may arise for Canadian and other foreign companies to export advanced parts and components and a small number of vehicles to China because local suppliers might not yet be able to meet the standards or increased demands.

For those Canadian companies currently operating in China, the next few years represent a window of opportunity for them to make considerable gains. Currently, GM Canada and Magna are in China, and more Canadian auto parts companies are contemplating the same move. If they choose to do so, they should go soon, as the window to enter the Chinese market will not remain open for much longer. China has demonstrated again and again that it is able to pick up foreign technical know-how from its foreign partners very quickly, and it will doubtlessly be able to consolidate its auto industry and to export vehicles and parts to North America and Europe. Chinese auto and parts makers could soon become potential rivals to Canadian and foreign manufacturers of autos and parts. In fact, the price war has already started. Due to fierce competition, some Chinese companies have lowered the prices of small cars to less than $5,000 U.S. and others have already begun to export made-in-China autos and parts to foreign markets.

Given the booming Chinese auto market, how can Canadian companies grasp the opportunities and minimize the risks? The Canadian Automobile Manufacturing Association recently visited China and offers the following advice:

- China will become the next automotive powerhouse. The booming Chinese auto market will inevitably have an impact on all Canadian auto industry suppliers in one way or another. They will have to cut their prices or lose contracts to Chinese competitors. The opportunity and the threat for Canadian suppliers are real and present. Canadian companies should act now and, at the very least, develop a China strategy.
- Canadian companies currently operating in China or ready to enter the Chinese market are in a good position. They are expected to make handsome profits in the short term, and although margins will narrow due to fierce competition, they will be better positioned to compete with the threat of low-cost vehicles later on.
- Canadian companies should be careful in selecting the right local partners to ensure the success of the joint ventures in the Chinese marketplace.
- Canadian companies should maintain the advantage of technology innovation and R&D, and aggressively pursue protection of intellectual property rights in China.