JOHANNES EISELE/AFP/GETTY IMAGES

2016 R&D spending

$1.3 billion
SAIC Motor Corp.

$3.6 billion
Fiat Chrysler Automobiles

$9.1 billion
Toyota Motor Corp.

All figures in U.S. dollars

SOURCE: COMPANY FILINGS

China partners with foreign automakers on EVs

Beijing's joint-venture policy has borne little fruit for domestic producers

By Fan Yu
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Foreign automakers are going back for a second helping.

Decades after foreign automakers created joint ventures with local Chinese domestic car manufacturers—trading technical know-how for market access—a slew of new partnerships to jointly develop electric vehicles (EVs) have sprung up in recent weeks.

On Aug. 29, Renault-Nissan Alliance announced a new joint venture with longtime Chinese partner Dongfeng Motor Corp. to research and build EVs in China. The venture, to be called eGT New Energy Automotive Co., will be 50 percent owned by Dongfeng and 25 percent each owned by Renault and Nissan, both led by CEO Carlos Ghosn.

The announcement follows a string of recent foreign-Chinese partnerships to develop and sell EVs in the China domestic market—the biggest automobile market in the world today.

Also in late August, Ford Motor Co. announced plans to partner with Anhui Zotye Automobile Co., to manufacture EVs "under an indigenous brand" instead of using the Ford nameplate, the company said in a statement. Zotye is one of the early market leaders in developing EV technologies in China. Ford expects the Chinese EV market to reach 4 million units per year by 2025.

Volkswagen earlier this year also received approval from Beijing to set up an EV joint venture with Anhui Jianghuai Automobile Group.

Setting up joint ventures is the only viable option for foreign automakers to access the world's largest automobile market. China imposes a high tariff on imported cars, and joint ventures give foreign automakers the right to sell cars in China in exchange for manufacturing and management expertise.

EV development is one of 10 key sectors Beijing authorities want to expand to elevate the country's international competitiveness, as part of the Made in China 2025 initiative to modernize its manufacturing sector. China previously limited automakers to two joint ventures in the country but has lifted the cap for partnerships developing EVs. Ford, for instance, already operates two Chinese joint ventures with Changan Automobile Co. and Jiangling Motors Corp.

To jump-start research and development of EVs, China is turning to the joint venture model that has been in place since 1984, when the now-defunct American Motors Corp.—then owner of the Jeep marque—set up the very first foreign-China automobile joint venture with Beijing Automobile Industry Corp.

While the mandatory joint-venture model has been criticized by economists and some automakers as inherently unfair, in practice it has arguably benefited foreign automakers more than domestic Chinese producers.

China is the world's fastest-growing automobile market. And in recent years, the market has helped foreign automakers offset sagging sales in North America and Europe.

Over the last several years, China has become equally important to the United States for General Motors. The company delivered 852,000 vehicles in China during second quarter 2017–almost 18 percent higher than the 725,000 units delivered in the United States in the same period. In 2016, GM sold 3.9 million vehicles in China, accounting for more than a third of its global deliveries.

Ford, which discloses earnings figures from its China joint venture, said second-quarter net income was US$195 million with a 10.7 percent operating margin. Its China operating margin is higher than the 9 percent margin from its North America business in the same period. For the full year 2016, Ford earned $1.4 billion from its China joint venture with a 14.6 percent margin, compared to a 9.7 percent margin for North America.

> The creation of joint ventures appears to have instead created complacency.

Complacency

Despite decades of learning foreign manufacturing and management methods, which theoretically levels the playing field for local manufacturers, evidence suggests that the Chinese local partners haven't been able to take advantage of such knowledge.

A good case study on the foreign-domestic joint venture is the SAIC-GM partnership headquartered in Shanghai, which manufactures and sells Chevrolet-, Buick-, and Cadillac-branded cars in the Chinese domestic market. While each of the partners has full visibility into the production, marketing, and sales of existing vehicles, each company still maintains separate R&D departments apart from the joint venture that do not have to be contributed into the partnership.

With regard to Chinese domestics manufacturers, "there is probably more innovation in going to market and in thinking about new business opportunities than there is in technical innovation," former GM China leader Kevin Wale told McKinsey back in 2012.

The creation of joint ventures appears to have instead created complacency, with domestic producers happily cashing the large cheques from their 50 percent joint-venture ownership and relying more on government subsidies such as tax breaks and easy financing to support their domestic-branded vehicles. For example, annual R&D spending for SAIC Motor Corp. topped $1.3 billion in 2016, a fraction of the spending at Fiat Chrysler Automobiles ($3.6 billion) and Toyota Motor Corp. ($9.1 billion) during the same period.

SAIC has used its funds to purchase assets, acquiring Nanjing Automobile Group, which holds certain assets of bankrupt British automaker MG Rover. Certain MG Rover platforms and technologies were used to create SAIC's Roewe sub-brand in China.

But cars bearing foreign nameplates remain far and above the biggest sellers in China. And Chinese sales of luxury cars is a market where domestic brands have virtually zero market share.

In 2016, seven out of the 10 most popular locally produced cars in China, by sales volume, bear foreign marques. Volkswagen, Buick, Honda, Hyundai, Toyota, Nissan, and Ford all rank in the top 10 in sales among domestically produced vehicles, according to sales figures compiled by CarSalesBase.com. Changan (No. 4), Haval, and Geely are the only domestic marques in the rankings, with Haval and Geely—two non-state-owned automakers—coming in at Nos. 9 and 10. The data underscores the popularity of foreign brands in China, especially considering that the figures exclude imported vehicles.

Outside of China—especially in developed markets—Chinese brands have even less presence.

Nonetheless, technology transfer remains a sensitive issue for joint EV development. The EU Chamber of Commerce in Beijing issued a report in March cautioning against the negative repercussions of the Made in China 2025 initiative. "European business is facing intense pressure to turn over advanced technology in exchange for near-term market access," the report said, in regard to electric vehicles.

But more recently, Beijing appears to have softened its stance. Miao Wei, minister of industry and information technology, told the press in March that the belief that foreign companies have to hand over technology was a "misunderstanding," and that such transfers are "not mandatory for foreign-funded enterprises," according to a Financial Times report.

If prevailing practices hold, obtaining foreign EV technology will also fail to yield much benefit for Chinese automakers.

Perhaps that's one reason why a Chinese automaker, Great Wall Motor Co., signalled in late August that it was interested in buying Fiat Chrysler Automobiles. If you can't beat them, join them.

2016 TOP CAR BRANDS BY SALES IN CHINA (LOCALLY PRODUCED ONLY)

1. Volkswagen
2. Buick
3. Honda
4. Changan
5. Hyundai
6. Toyota
7. Nissan
8. Ford
9. Haval (Great Wall)
10. Geely