

University of Economics, Prague

Master's Thesis

University of Economics, Prague
Faculty of Business Administration
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Title of the Master's Thesis:

Rise of the Auto Industry in China and it's Impact on the Auto Industry in Europe

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Declaration of Authenticity

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Prague, August 28th, 2012

Signature

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Abstract:

This thesis deals with the internationalisation strategies of Chinese car manufacturers towards the European car market in the period 2012-2025. It starts by introducing the internationalisation framework on a theoretical level with special regards to the automotive industry. In the second part then the major characteristics of the Chinese and European car markets are identified. The conclusions from this analysis then create the base for a subsequent analysis of capabilities of Chinese car manufacturers with respect to the target European market. In the last part of the paper the identified information is used for coming up with potential entry strategies of Chinese carmakers in Europe in the specified time period as well as identifying the most probable consequences of this market entry for the current market players.

Key words:

China, Automotive, Entry strategy, Internationalisation, Europe

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List of Abbreviations

ACEA	European Automobile Manufacturers' Association
ADAC	Allgemeiner Deutscher Automobil Club
bn	Billion
BRIC	Brazil, Russia, India, China
ca.	Approximately
CEE	Central and Eastern Europe
CAGR	Compound annual growth rate
CAPEX	Capital expenditures
CKD	Completely knocked down
CNG	Compressed natural gas
CO ₂	Carbon dioxide
DPF	Diesel particulate filter
DVD	Digital video disc
EC	European Commission
e.g.	Exempli gratia
EGR	Exhaust gas recirculation
EMC	Export Management Company
ESP	Electronic stability control
etc.	Et cetera
EU	European Union
Euro-NCAP	European New Car Assessment Programme
EV	Electric vehicle
FEV	Full electric vehicle
FIFA	International Federation of Association Football
FTA	Free Trade Agreement
GDP	Gross domestic product
HC	Hydrocarbons
ICE	Internal combustion engine
ICT	Information and communications technology
IMF	International Monetary Fund
IPMI	Implementation Policy of the Motor Industry
JV	Joint venture
LCV	Light commercial vehicle
LED	Light emitting diode
LPG	Liquefied petroleum gas
m	Million
max.	Maximum
M&A	Mergers and acquisitions
NO _x	Nitrogen oxides
NOIPR	National Office for Protection of Intellectual Property Rights
OEM	Original equipment manufacturer

OECD	Organisation for Economic Co-operation and Development
PEV	Plug-in electric vehicle
PHEV	Plug-in hybrid electric vehicle
PHV	Plug-in hybrid vehicle
PC	Personal computer
R&D	Research and Development
SEE	South-Eastern Europe
SKD	Semi knocked down
SME	Small and medium enterprises
SUV	Sport utility vehicle
Triad	USA, European Union, Japan
TV	Television
UEFA	Union of European Football Associations
UK	United Kingdom
USA	United States of America
USP	Unique selling proposition
vs.	Versus
WE	Western Europe
WTO	World Trade Organisation

1 Introduction

The global auto industry belongs to the most traditional ones, but more than that it creates a significant part of GDP of many countries in the world. The influential impact of auto industry on many developed countries could have been observed during the financial crisis, where the auto industry was one of a few ones that obtained an intensive governmental support. Not only do the major manufacturers such as Ford, General Motors, Toyota or Volkswagen employ hundreds of thousands of people, but it is expected that just in the European Union more than 12 million work in the entire automotive value chain. This is around 6% of the EU-27 employment.¹

In the past ten years, the global car market has experienced a drastically changing environment. Whereas for the past 30 years, the US market had been considered as the most important one, followed by Japan or Germany as other strong demand markets for cars, nowadays they all have been replaced by the largest country worldwide – China.

China has been living a daydream in this century. From a poor country “infamous” for their cheap clothes, it has become one of the world’s most rapidly growing economies. Moreover, currently being the world’s number 2, China is expected to become within 5-8 years the biggest economy in the world.² This strong and fast boom, which is a result of both well-prepared economy plans and cheap labour, has had a significant impact also on the performance of many global industries. Even only in the auto market, almost all global brands are currently present in China, selling there millions cars a year. For instance for the traditional Czech car maker Skoda, China has become the number one market after only three years of the brand’s presence. In 2011 Skoda sold nearly 880 000 cars worldwide, from which every fourth one was sold in China. The total sales of Skoda in China equal the combined sales in Germany, the Czech Republic and the United Kingdom.

The Chinese car industry boom has also its other viewpoint. Along with the growing sales of European and US-based carmakers, many China-originated car manufacturers have become financially very strong and they are starting to expand their activities behind the Chinese borders. Even though the situation is not imminent, it is more a question of when than if they will sooner or later actively enter the traditional European car market. Similar to the entry of Japanese car makers in the 1990s and South-Korean car makers a decade later, the period 2015-2025 may be known for a massive entry of Chinese car makers to Europe.

¹ See ACEA (2012)

² See Economist Intelligence Unit (2012)

1.1 Motivation, relevance and problem

Such a rapid growth of the automotive industry attracts researchers as well as journalists, who have strived to analyse this phenomenon. However, most of such papers focus only on the problem from a limited perspective, not allowing them to create a complete picture. Moreover, little of the research has been conducted with respect to the influence of such automotive boom on the situation on a different market and if so, then on a global level.

There have been two analyses identified that touch the field of entry of Chinese carmakers into Europe. In 2006 in cooperation with Hoegh Autoliners, Kristiansen, Garaas, Halvorsen and Utengen have issued a paper focusing on the future export strategies of selected Chinese carmakers.³ This study provides an in-depth analysis of the Chinese automotive industry and the potential entry into Europe. However, due to its publication date in 2006, the factors of the recent global crisis were not taken into account. In reality, for many Chinese carmakers the global crisis has been a trigger for their internationalisation activities and this was completely omitted in this paper. Roland Berger Strategy Consultants (2012) published a short study dealing with the influence of globalizing Chinese carmakers onto the CEE region in April this year.⁴ This study took the advantage of the most recent data available, but due to the scope of the study little conclusions were actually available to the readers.

This thesis aims at providing a top-line analysis while filling the missing gap from both abovementioned papers at the same time. This will be achieved by a thorough analysis of the domestic Chinese automotive market as well as the target European market from several perspectives, completed by analysing the internal capabilities of both the Chinese carmakers and the current players on the European car market. The analysis will be based on frameworks that are used for decades for research of internationalising activities of Triad companies. Little, though, is known about specifics of internationalisation of Korean or Chinese companies despite their increasing influence on the Triad economy.

This thesis' objective is to answer the following questions:

- Despite the rapid growth of the Chinese automotive market, will there be reasons for the Chinese carmakers to initiate their internationalisation process towards Europe?

³ See Kristiansen, D., Garaas, H., Halvorsen, V., Utengen, A. (2006)

⁴ See Roland Berger (2012)

- After failing in the first phase in mid 2000s, are they now capable of succeeding on the highly competitive European market?
- Which strategy are they likely to opt for during their market entry?
- What will be the consequences of their entry for the current market players?

1.2 Methodology

This thesis can be virtually split into two main parts. The first one provides with a detailed overview of theoretical approaches towards internationalisation with special regards to the ones relevant for the subsequent analysis of the Chinese automotive industry in Europe. This part is solely based on a secondary research from literature as well as relevant electronic sources that were used to supplement the literature.

The practical chapters that follow the initial theoretical overview then are done with a mixed secondary-primary research approach. The principal data are obtained through publicly available secondary data, such as institutional reports, consulting companies' studies, newspaper and magazine articles as well as websites, analyses and reports from relevant automotive market players.

In cases when the secondary data did not suffice to provide a clear partial conclusion, the issue was discussed in person with industrial experts who deal with the automotive industry. This approach was purely non-structured and the objective was merely to understand some data or discuss a framework that was planned to be used in the individual sections. Therefore, no official records from these discussions were made.

1.3 Thesis structure

The thesis is divided into seven main chapters. After this introduction chapter the key theoretical internationalisation frameworks are outlined and in appropriate situations set in perspective with examples from the automotive industry. In other cases the frameworks remain without a clear relation to a region, company or time period. These frameworks aim at providing with a base for the subsequent practical analyses in the latter parts of the thesis.

The chapters three and four then deal with the analysed environment, covering the two relevant regions. First, the Chinese automotive market and industry is analysed to understand the main drivers and future trends that will influence the behaviour of the locally originated carmakers. Then a similar analysis is conducted for the target European automotive market. Besides, two case studies are outlined in this chapter, discussing the recent success of Japanese and Korean carmakers that could serve as role models for the Chinese internationalisation strategies.

Chapter five then discusses whether the Chinese carmakers are already competent for a near-future mass-market entry into Europe. First, a brief overview of the recent Chinese activities in the European car market will be carried out covering both the first and second phase of their European internationalisation history. This is then followed by an in-depth analysis of their internal capabilities as well as a comparative analysis of how both market player groups, the current ones and the entering Chinese carmakers, are able to fulfil the identified success factors.

In the sixth chapter, these conclusions are utilized for creation the most likely internationalisation strategy of the Chinese carmakers in Europe in a short- and medium-term outlook. This is done in line with the theoretical strategic frameworks from the chapter two. In the latter part of the chapter, several major implications of such a Chinese market entry are identified that will affect both the position of current players as well as the structure and characteristics of the overall automotive market in Europe.

The last chapter then summarizes the key points from the research and outlines several topics for a further expert investigation and research.

1.4 Research limitations

The scope of the thesis does not allow analysing all factors influencing the internationalisation process. Therefore, only the key ones are used in a shortened version. Besides, in terms of the regional scope, the thesis aims to cover the entire European region, however, the main emphasis is laid on the developed Western European markets from the former EU-15. The CEE region is mainly covered in the strategic part when discussing the potential production plant locations for the Chinese carmakers. Russia is then completely omitted during the analysis.

Because of little internal data available to the author, the strategic analysis is based on publicly available information and figures. Due to various sources used for the analysis, in a few cases the statistical data from two sources might not offer identical results. However, the most was done to diminish these statistical errors with the goal to decrease the deviation to tenth of percent.

2 Internationalisation strategy

Starting international business activities requires companies to set a new direction of development that significantly differs from the previous way of doing business on a local basis. Internationalisation decision requires the management to implement strategic changes. Therefore, to successfully enter other market, companies should first thoroughly define their strategies. Chandler (1962) defined the strategy as a determination of the basic long-term goals and objectives of an enterprise and the adoption of the courses of action and the allocation of resources necessary for carrying out this goal.⁵ Andrews (1986) added to Chandler's definition the factor of policies and plans that the company needs to make in order to formulate its strategy.⁶ Horáková (2003) emphasizes the role of top management in creating and managing strategic actions within companies.⁷ Nevertheless, in the process of internationalisation two major steps need to be considered – the situational analysis, followed then by selecting the right strategy. But first, a theoretical insight should be made to better understand the internationalisation process.

2.1 Theory of internationalisation

In the face of increasing level of globalization many companies attempt to increase their footprint through expansion into other markets than the country of origin. Through internationalisation the companies can achieve numerous goals. Boučková (2003) mentions the following ones: Companies can geographically diversify the demand and face the seasonal demand changes, extend the lifecycle of a product, improve the competitiveness on the domestic market, stabilize the labour situation, stimulate the local economy or take the advantage of various financial subsidies that are not available on the domestic market. Moreover, the companies can make use of the economies of scale and increase their competitiveness by cooperation with a strong foreign company. Also, through internationalisation the companies can gain access to modern technologies that are not available on domestic markets.⁸ Albaum (2008) adds other motives for internationalisation: managerial urge, small and saturated domestic market, overproduction and proximity to international customers.⁹ Berndt (2007) completes this list by adding a significant importance of image that can be built through international activities.¹⁰

⁵ See Chandler, A.D. (1962), pp. 13

⁶ See Andrews, K.R. (1986), pp. 28

⁷ See Horáková, H. (2003), pp. 11

⁸ See Boučková, J. (2003), pp. 247

⁹ See Albaum, G., Duerr, E. (2008), pp. 76

¹⁰ See Berndt, R., Altobelli, C.F., Sander, M. (2007), pp. 13

These goals can have two different characters according to Berndt (2007) – reactive and proactive. Proactive internationalisation occurs when companies have competitive advantages to operate abroad and these can be used to achieve higher profits. Reactive reasons occur when the operation abroad serves to stabilizing the threatened domestic production.¹¹ Czinkota and Ronkainen (2002) phrased these characters in the quote: *“Proactive firms go international because they want to, while reactive ones because they have to”*.¹²

2.1.1 Definition of internationalisation

The term “internationalisation” has not a single, commonly acknowledged definition. The definition differs depending on point of views of their authors. Penrose (1959) focused in his definition mainly on the firm’s core competencies and opportunities in the foreign environment.¹³ Welch and Luostarinen (1988) defined internationalisation as a process in which the companies increase their involvements in international operations.¹⁴ Calof and Beamish (1995) adjusted the previous definition as a process of adapting firms operations to international environments.¹⁵ Boučková (2003) mainly focuses on the production point of view with her definition of internationalisation as an international business with goods produced within national economies. Hollensen (2007) focuses on the business viewpoint and defines internationalisation as doing business in many countries of the world, but often limited to a certain region (e.g. Europe). Albaum (2008) on the other hand does not attempt to find a clear definition of internationalisation, but observes internationalisation three different ways as: (1) a process, (2) an end result, and/or (3) a way of thinking.¹⁶ This is not in a contradiction with definitions of other scholars, but rather brings a different viewpoint.

2.1.2 Internationalisation models

Internationalisation process of companies worldwide can be analysed through theoretical models and approaches. However, there is not a single model explaining the process of internalization. Some of the models, though, can be used together, complementing one another. The early-stage models originated from classical marketing theories. Later on, the focus was on selecting between foreign direct investments (FDI) and exporting. Currently, the emphasis is laid on models preferring the networks and relationships built between all stakeholders.¹⁷ The following part of

¹¹ See Berndt, R., Altobelli, C.F., Sander, M. (2007), pp. 13

¹² See Czinkota, M.R., Ronkainen, I.A. (2003), pp. 227

¹³ See Penrose, E. (1959)

¹⁴ See Welch, L.S., Loustarinen R.K. (1988), pp. 34

¹⁵ See Calof, J.L., Beamish, P.W. (1995), pp. 116

¹⁶ See Albaum, G., Duerr, E. (2008), pp. 13

¹⁷ See Hollensen, S. (2007), pp. 61

the thesis deals with the major approaches of internationalisation. Most of them are based on an assumption that companies move in certain steps when internationalizing. Initially, they have to become strong in the domestic market to gain enough knowledge and resources to move abroad. However, Lopez (2009) disrupts this commonly acknowledged concept with his theory of “born-global” companies that start internationally since their establishment.¹⁸

Traditional marketing approach

This model is based on the traditional approach by Penrose (1959), who compared the company’s core competences with opportunities that emerged through foreign environment. The cost-oriented view of this approach deals with the opinion that in order to succeed on a foreign market the initial costs have to be overcome by a significant compensating advantage. The result of this approach was a focus on marketing and technology as main success factors of internationalisation.¹⁹

Life-cycle theory of trade and direct investment

This model is based on a sequential internationalisation approach similar to a product life cycle, where a company starts its foreign operations through an exporting phase and after gaining sufficient experience switches to market-seeking FDI, eventually to cost-oriented FDI.²⁰ The theory assumes that companies first start their operations in advanced countries because of the proximity to the business origin later followed by launch in less developed markets. With increasing demand standardization comes into play, driven mainly by economies of scale. When reaching a certain level of standardization, less developed countries might offer a better production environment and the facilities move to a different country.²¹ In the final stage as the product has a decreasing level of demand and prices the production remains only in the developing countries and developed countries import the good.²²

Uppsala School model

This model was developed in the 1970s and is used as a standard model for all modern internationalisation approaches. Also called U-model, it was developed by Swedish researchers Jan Johanson, Finn Wiedersheim-Paul and Jan-Erik Vahlne at Uppsala University as a model observing Swedish manufacturing companies when going abroad.

¹⁸ See Lopez, L.E. (2009), pp. 1228

¹⁹ See Hollensen, S. (2007), pp. 61

²⁰ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 18

²¹ See Hollensen, S. (2007), pp. 61

²² See Machková, H., Král, P., Lhotáková, M. (2010), pp. 19

The basic assumptions of the model are that companies try to achieve growing profits in the long term with increasing international business experience.²³ The model also assumes that the internationalisation process is influenced by opportunities and risks that vice-versa influence the decisions about the current and future operations.²⁴ Besides, the process is assumed to include many steps, one following another.

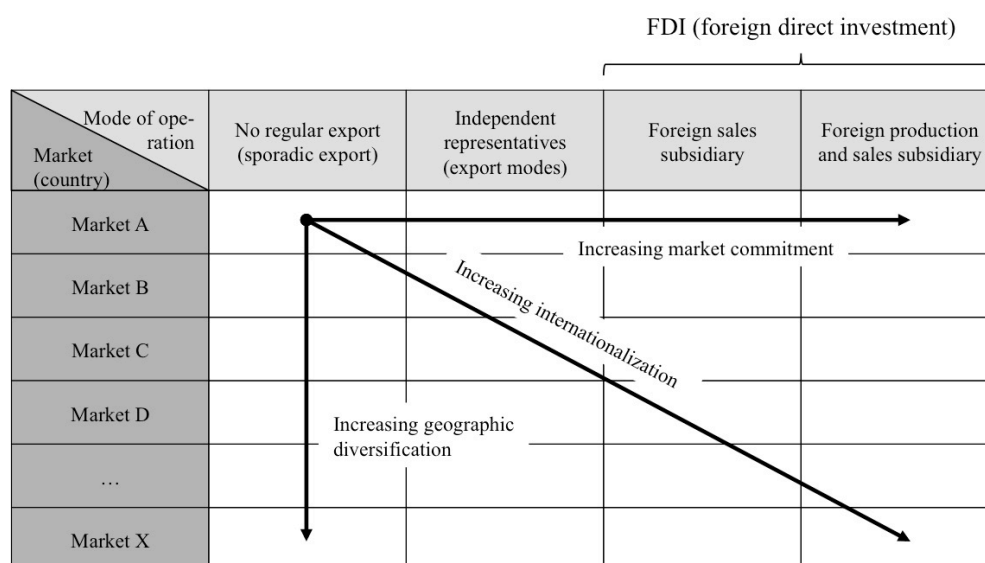
The first observations noted that the companies appeared to begin their operations on the Swedish domestic market. Speaking of operations abroad, first in the near markets and then the companies penetrated other, further located markets. This is a result of continuously gained knowledge about operating abroad. Based on this, the researches identified four main stages of entering an international market, where the later phases represent a higher level of foreign operations. The stages are illustrated in the Figure 1.

- **Stage 1 – No regular export activities (sporadic export).** The non-regular export activities are typical for companies that do not possess any previous relationship with the new market, do not have sufficient information about the market or are risk-averse. As a result, the companies will rather export into near-located markets or markets that are business-wise similar to their domestic market.²⁵
- **Stage 2 – Export via independent representatives (export models).** In this stage, the companies create information and distribution relations with the foreign market through cooperation with local independent agents. These agents are a valuable source of information about situation on the foreign market and are also favourable in terms of the financial demandingness. In this stage the companies also set up exporting departments that are in charge of establishing and maintaining relationships with the foreign agents.
- **Stage 3 – Establishment of a foreign sales subsidiary.** This stage is usually a result of the increased need of higher control of the activities on a foreign market as well as a result of growing sales. Within this stage the company establishes own information channels that enable the parent company to manage the type and amount of information flowing between both parties – the foreign market and the company. Therefore, the company can actively control the factors influencing the level of sales on a foreign market.
- **Stage 4 – Foreign production/manufacturing units.** In this stage the company establishes its production/manufacturing activities directly in the foreign market. This is the highest level of internationalisation.

²³ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 20

²⁴ See Johanson, J., Vahlne, J.E. (1977), pp. 23-31

²⁵ See Zapletalová, Š. (2011), pp. 2



Source: Adapted from Hollensen, S. (2007), pp. 64

Figure 1: Internationalisation stages of Uppsala model

Figure 1 implies that the increasing commitment on a market will be made in small incremental steps in both dimensions – market commitment level and geographic level. The company does not however experience all the steps of the framework, because the company might skip some levels because for instance insufficient market potential or high level of know-how from other markets.

Authors describe the geographic dimension from Figure 1 as the mental distance.²⁶ The mental distance is an overall description of all factors that prevent from ideal communication between the company and the foreign market. To these factors the authors count differences in culture, language, political systems, level of education or economic development. The existence of the mental distance results in the aforementioned assumption that the companies first enter markets similar to their domestic one.²⁷

Internalization / Transaction cost analysis

The transaction cost analysis was developed by R.H. Coase (1937). The model is based on the theory that the firm will try to expand until the costs of organizing an extra transaction within the firm will become equal to the cost of carrying out the same transaction by means of an exchange on an open market.²⁸ The theory assumes that a company will keep within those activities that can be undertaken at lower costs than when purchasing externally. On the other hand, the company will use the market

²⁶ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 20

²⁷ See Hollensen, S. (2007), pp. 66

²⁸ See Coase, R.H. (1937), pp. 395

opportunities to externally source those activities that would not be cost-effective to produce internally.

The transaction costs that occur between the buyer and seller consist of two main particles – ex ante costs and ex post costs. The ex ante costs have two components – search costs and contracting costs, whereas the ex post costs consist of monitoring costs and enforcement costs. Companies attempt to minimize their transaction costs by analysing and monitoring each of the components mentioned above.

The Eclectic model

This model was made by Dunning (1988) and is also called the OLI paradigm. It is based on Coase's internalization theory and explains different forms of international production and how companies choose the right country for expansion.

According to the author, the decision whether to internalize or externalize depends on three main factors – advantages. The first one, ownership advantage (O), is company specific and relates to accumulation of intangible assets, technological capabilities and product innovation. When companies operate on foreign markets, they take the advantage of these competences to outperform their competitors. The second aspect, location advantage (L), is related to specific geographical locations and their production and institutional factors, such as cheap labour costs, raw materials, low transportation costs, etc. Location advantages are usually country-specific. Thirdly, the internationalisation advantages (I) depend on the company's capabilities of managing the activities through its value chain, thus ideally creating more added value than its competitors. When managing the internal activities efficiently, costs associated with external markets can be eliminated and the company gains competitive advantage through cost saving.²⁹

The Dunning's eclectic paradigm attempts to integrate existing theories into one approach. The theory also answers the question of how to operate internationally. If there are potential advantages, companies should explore their assets through international production, as opposed to other ways such as exporting, licensing or franchising. According to Dicken (2007), the paradigm also emphasizes the critical role of geographical location in understanding the complex nature of behaviour of transnational companies.³⁰

The internationalisation network approach

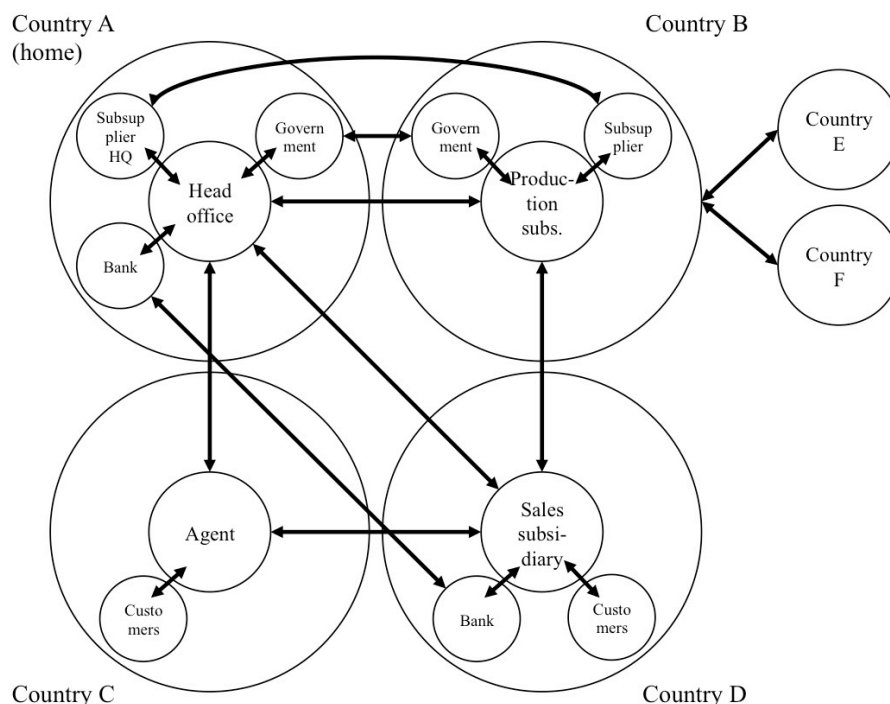
This model was developed by J. Johansen and J.E. Vahlne (1990) as a revision of their Uppsala approach. The basic assumption of this model is that an international

²⁹ Dunning, J.H. (1980), pp. 9-31

³⁰ Dicken, P. (2007), pp.108

company is not an isolated subject but is part of a greater environment that has to be considered. Therefore, the company is also dependent on resources controlled by others and should invest into relations with them. These relationships can be viewed as networks, which are flexible and can change rapidly according to changes in the environment. The factors keeping the network together can be technical, personal, economic or legal.³¹

The authors suggest that when a company goes international, it depends more on its position in the network than on the cultural aspects of the international markets. The entry into the market is thus a result of continuous interaction of parties within the network. During the internationalisation process companies create, develop and maintain relations with the commercial partners in the target country. These partners can be customers, distributors, competitors or local authorities. The internationalisation strategy then is characterized by the need to minimize the development of new knowledge, the need to minimize the adjustment to new realities and the need to explore the firm's position in established networks.³² Therefore, companies make use of networks where they are active in and these network are the key driver of the internationalisation processes. An example of such a network is described in the Figure 2.



Source: Adapted from Hollensen, S. (2007)

Figure 2: Internationalisation networks

³¹ See Johanson, J., Vahlne, J.E. (1990), pp. 111-124

³² See Johanson J., Vahlne, J.E. (1990), pp. 111-124

2.1.3 Internationalisation barriers

Scholars and institutions have identified several key factors hindering a successful internationalisation. Some of them affect mainly the export initiation; others are come across during the exporting process. The main factors are according to OECD (2009) the following:³³

- **Shortage of working capital to finance export** – This is considered as one of the major limitations of internationalisation. Without sufficient level of finances it is basically impossible to initiate any internationalisation activities.
- **Inability to identify foreign business opportunities** – A lack of skills and resources to extensively seek potential international opportunities creates a barrier for many current companies.
- **Limited information to locate/analyse markets** – Inadequate knowledge of foreign markets remains a critical limitation for companies that strive to expand their activities abroad.
- **Inability to contact potential customers abroad** – This point is interconnected with previous two barriers to a certain extent. Not only are companies unable to analyse foreign markets, but also even then it remains problematic for them to initiate active communication with potential clients.
- **Difficulties obtaining reliable foreign representation** – Many companies have struggled creating reliable relationships with agents in foreign countries, hindering them from successful and long-term profitable foreign presence.
- **Lack of managerial time to deal with internationalisation** – Even though the company itself might be ready for going abroad, the management can be identified as a barrier. Insufficient knowledge of managers in a better case prevent from starting any internationalisation activities, in a worse case causing significant losses to the company.
- **Inadequate quantity of and/or untrained personnel for internationalisation** – This aspect correlates with the previous barrier, but rather focuses on the employees who might not have enough skills to deal with day-to-day international business.
- **Difficulty in matching competitor's prices** – Even though the company might have a dominant position on the domestic market in terms of pricing strategy, abroad it might face stronger competitors that could prevent the company from successful establishment of a foreign subsidiary.
- **Lack of home government assistance/incentives** – Companies that are financially supported on domestic markets will have substantial problems when going abroad as they will miss a part of their usual incomes

³³ See OECD (2009), pp. 8

- **Excessive transportation costs** – Further located markets can significantly influence the profitability by high transportation costs that are needed to supply the market with the products.
- **Difficulty developing new products for foreign markets** – Many markets in the world need specific country-related adaptations of the products or even totally new products to be developed. Companies that are unable to meet this changed demand can't succeed on the new market.
- **Unfamiliar foreign business processes** – Different cultural issues, habits or business processes can hinder companies from being successful on a new market. Therefore it is important to bear in mind even soft factors.
- **Unfamiliar exporting procedures/paperwork** – Many countries demand specific procedures and paperwork when exporting products to them. If companies are not aware of these additional barriers, the entire internationalisation process might fail.
- **Meeting export product quality/standards/specifications** – Last but not least, different markets have different standards, legislations and quality requirements. Companies that are not capable of fulfilling the quality standards with their products can't succeed.

2.1.4 Degree of internationalisation

According to the internationalisation theories, companies doing business abroad can differ according to their commitment to international activities and their level of integration. The degree of internationalisation can also describe the level of interconnectivity in a sector or industry. Hollensen (2007) divides companies into four main groups of internationalisation. Two aspects characterize them – level of internationalisation of the firm and level of internationalisation of the market (the production network):³⁴

- **The early starter** – In this stage the parties in domestic markets don't have any significant connections to other countries.
- **The lonely international** – In this stage there are certain interconnectivities and relations with other parties abroad. Companies possess some level of knowledge how to communicate with international parties and it helps them to integrate the company into an international network. Company being in the position of a lonely international helps other domestic companies to set up basic international networks.
- **The late starter** – When a significant part of the market is already members of an international network, it is assumed that it will force the other domestic companies to join. The little internationalized company can be "pulled" into the international environment by for instance its customers, suppliers or other

³⁴ See Hollensen, S. (2007), pp. 72

network members. The process can however cause some difficulties for large companies, as it is not easy for such a domestic company to find a niche on an international market. Also, the linkages in the international network are tight between the current members and new companies might have troubles establishing a valuable position within the network.

- **The international among others** – In this stage the companies have a strong international position and use it to create other connection within the net or with another networks. The urge to coordinate activities in many countries along the value chain drives the companies to make use of economies of scale and specialization of certain facilities to concrete part of the value chain.

The degree of internationalisation has a significant effect on the way of how a company makes its business internationally and whether it even is capable of going international. When a company identifies itself in one of the international stages and realizes the conditions for going abroad are favourable, it should formulate its international strategy.

2.2 Situational analysis

The analysis should help systematically identify and evaluate all crucial factors that can influence the internationalisation process and that should be considered when formulating and selecting the strategy.³⁵ With help of the situational analysis companies can fully understand the playfield that they are attempting to enter and succeed in. Not only should companies understand this environment, but they should also maximize the effort to leverage the positive factors and eliminate, or at least minimize the negative ones.

The company's playfield, also called environment, can be divided into three main parts. First, global conditions set the general environment for all companies that are present on a market. Second, the industry and competitiveness create a framework for analysis of the industry structure, potential competitors as well as the suppliers and customers. These two groups formulate the external environment for a company. Beside the external factors, it is important to analyse also the company's internal factors such as the management objectives or financial background. Each of the group is discussed below.

2.2.1 Internal factors

The internal factors are important determinants of company's business success. They consist of variables that are not usually within a short-run control of the top

³⁵ See Hanzelková, A. (2009), pp. 91

management.³⁶ The internal environment consists of material, financial and human resources, the quality of company's management and other employees, the organizational structure, company culture, relationships between the employees as well as ethics.³⁷ The analysis of internal resources and capabilities aims at identifying the strategic capabilities that a company needs to possess in order to successfully react on constantly changing external environment as well as new opportunities emerging from the changes.³⁸

In terms of the internationalisation process, four key drivers can be identified as main factors influencing potential foreign business success – management objectives, management experience and resources, production capacity and financial capacity.³⁹

- **Management objectives** – They analyse the reasons for going international, whether the company management is dedicated to operate internationally as well as management's mid-term and long-term plans that can possibly affect the future international operations.
- **Management experience and resources** – They analyse the internal capabilities of conducting international business successfully. First, it is especially important to have sufficient in-house expertise such as experienced sales staff or language knowledge. Second, the company should be able to set up a dedicated team or employee who will be responsible for international operations, regardless of the size of this team. Also, the success of internationalisation depends on enough senior management resources and a right organizational structure that does not hinder flexible operation and straightforward communication.
- **Production capacity** – Within a company the current production facilities should be analysed in order to find out whether the company is even capable of fulfilling additional demand from foreign business activities. Besides, as identified in the internationalisation barriers part, the company should analyse whether any modifications of current products are needed in order to succeed on the target market as well as what will be the costs of additional production either at the domestic facilities or abroad in case of FDI. Also, any potential negative effects of international sales on domestic operations should be taken into account.
- **Financial capacity** – Especially for SMEs, it is important to analyse the financial requirements that are needed for establishing successful foreign operations. Underestimating the needed financial resources can have a fatal impact on the future existence of the company.

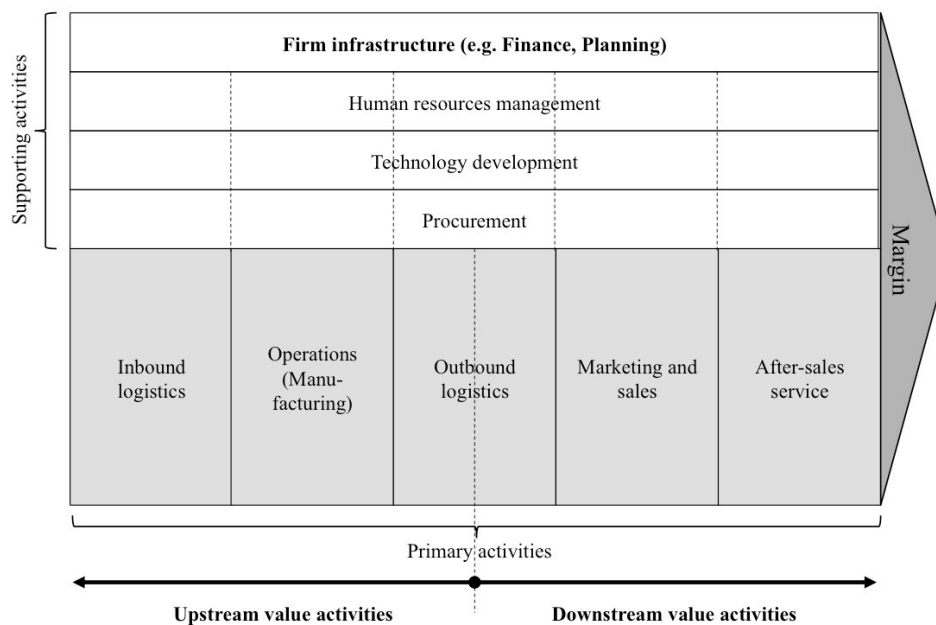
³⁶ See Thenmozhi, M. (2012)

³⁷ See Jakubíková, D. (2008), pp. 88

³⁸ See Synek, M. (2002), pp. 160

³⁹ See U.S. Department of Commerce (1998)

A useful way of graphically describing the internal processes and their importance in creating value for companies is the value chain. It is based on the transaction cost analysis of Coase, and was specified by Porter.⁴⁰ With help of the analysis the company can identify its main strengths and weaknesses as parts of the value chain that contribute to buyer's value. Although Porter uses the model primarily to identify company competitive advantages through optimizing the chain to outperform the competitors, the model can also be used to evaluate the current internal processes and identify those that can be beneficially externalized. The Porter's value chain is described in Figure 3.



Source: Adapted from Porter, M.E. (1998), pp.41

Figure 3: The value chain according to Porter

As the figure shows, the chain consists of two main types of activities – primary and support activities. Primary activities are activities involved in a physical creation of a product, its sale and delivery to the customer, as well as consequent aftersales activities. Porter identified five primary activities – inbound logistics, operations, outbound logistics, marketing and sales and service. The supporting activities – procurement, technology development, human resource management and company infrastructure – play a significant role in assisting the primary ones and each other by provision of technology, purchased inputs, employees and other valuable functions. The dotted line through the majority of supporting activities signalizes the fact that these activities can be associated with specific tasks of the primary activities. The infrastructure, though, serves the entire value chain.

⁴⁰ See Porter, M.E. (1998), pp. 40-41

Porter's value chain belongs to the traditional frameworks that are used for strategic analyses. However, due to its specific scope covering the entire process it will be used only partially as part of other frameworks in this thesis, where applicable. Nevertheless, because of its importance in the strategic analyses of companies it is vital to include it to the theoretical part of this thesis.

2.2.2 External factors

Synek (2002) defined the external environment, also called macro environment, as everything that is beyond the company border as social-economic and technical system and what influences the company and potentially vice versa, what a company can influence.⁴¹ These forces usually do not affect company short-term activities but might have a substantial impact on its long-term decisions. Also, the impact of external factors is usually strong but the possibility of the company to influence its environment is limited. Synek identified the following external factors – geographic, social, political, legal, economic, ecological, technological, ethical and cultural-historic.⁴² Many of these factors are tangible and easy to identify, many however are intangible or difficult to assess. The analysis of external environment of a country plays a significant role when deciding into which countries to expand and which country should rather be business-wise avoided.

A generally accepted method of analysing the macro environment is known as the PEST analysis. Although there are various forms of this analysis – PEST, PESTE (STEPP) or PESTEL, all of them include four major factors that should be taken into account when doing an external analysis:⁴³

- **Political, legal and regulatory factors** – The political-legal factors represent the general conditions for international business.⁴⁴ These factors allocate power and provide laws and regulation that may either protect or limit the business operations. The factors analyse the local political system, its stability and the risk connected with the current political situation. Factors such as level of corruption, importance of lobbying, structure of taxes and ease of establishment of new companies are also important parts of the political analysis.
- **Economic factors** – The economic environment provides a useful overview of the economic situation of a country. The economic factors influence the purchasing power of customers and the structure of their expenditures. Not only is it important to analyse the “hard” indicators, such as market size, foreign trade policy and macroeconomic stability, but also the “soft” factors,

⁴¹ See Synek, M. (2002), pp. 13

⁴² See Synek, M. (2002), pp. 13

⁴³ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 22

⁴⁴ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 22

e.g. level of education, innovativeness and technological readiness. Moreover, a special attention should be paid to the main trends that provide a useful estimation of the future market situation. An important part of the economic analysis is the level of competitiveness between countries. There are three basic stages of competitiveness. The “factor-driven economies” attract the potential investors mainly through basic factors such as infrastructure, macroeconomic stability or structure of primary education. “Efficiency-driven economies” possess significant strengths in level of higher education, sophisticated financial markets and technological readiness as well as efficiency of labour and goods markets. The uppermost stage, “innovation-driven economies” attract investors on their technological advancement and level of innovation in the country.⁴⁵

- **Social factors** – These factors are divided into demographic and cultural factors.⁴⁶ Demography deals with the basic indicators than characterise the country as whole, such as the number of inhabitants, population density, class structure, age structure or occupational trends. The cultural factors, on the other hand, focus on cultural and social differences between cultures. Several approaches and models are used to analysing cultures – Hofstede’s dimensions, GLOBE dimensions, 7d model and others.⁴⁷
- **Technological factors** – The analysis of technological environment focuses both on technological indicators (internet penetration, technological advancement, level of infrastructure) and level of investments into R&D as key drivers of modern business.

The amount of factors that can be identified and analysed is virtually unlimited. Therefore, companies need to prioritize and focus on factors that have an important position in their industry or in the country they are analysing. Nonetheless, forecasting the future trends and situations in the mid- and long term might be found impossible. As a result, companies often simulate various scenarios to eliminate negative downturns.

2.2.3 Analysis of industry and competition

Industry and competition are crucial factors of the company environment. Without broad knowledge about the industry the company operates in and knowledge of direct and indirect competitors, a company would struggle not only competing on the market, but also constituting a company strategy in the first place.

⁴⁵ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 28

⁴⁶ See Boučková, J. (2003), pp. 85

⁴⁷ Jakl, M.L. (2010)

An industry (product or service oriented) is a group of competitors producing products or services that compete with each other.⁴⁸ Thenmozhi identifies seven key factors determining the analysis of an industry:⁴⁹

- **General features and basic conditions of the industry** – These conditions include determinants such as industry size, product categories and subcategories, the volume that is sold in each category as well as recent performance development of the industry
- **Industry environment** – Industries can be classified according to their environment. Besides, their level of maturity plays a significant role during the environmental analysis.
- **Industry structure** – The structure of an industry means the underlying fundamental economic and technical forces that are part of an industry. Each industry has its main indicators such as its size on the market, number of active players, their relative market shares, the nature of the competition, costs structure as well as the behaviour of players on the market. These features determine the strength of the competition in an industry.
- **Industry attractiveness** – The key factors of the industry attractiveness are the industry potential, development and profitability, current and future industry barriers and forces influencing the level of competitiveness on the market.
- **Industry performance** – The main factors of performance analysis are the level of production, sales, profitability and technological development.
- **Industry practices** – The practices signalize the effort and intentions of main market players in terms of their distribution, pricing, promotion activities, method of selling, aftersales support, R&D as well as legal tactics.
- **Emerging trends and likely future** – These aspects observe and analyse the plausible future outlook of an industry with respect to factors such as product life cycle, current and future stage on the industry, growth rates, process and product innovations, potential entry of new players and exit of unsuccessful ones and any potential governmental and regulatory changes. Also changes in the behaviour of value chain members are analysed.

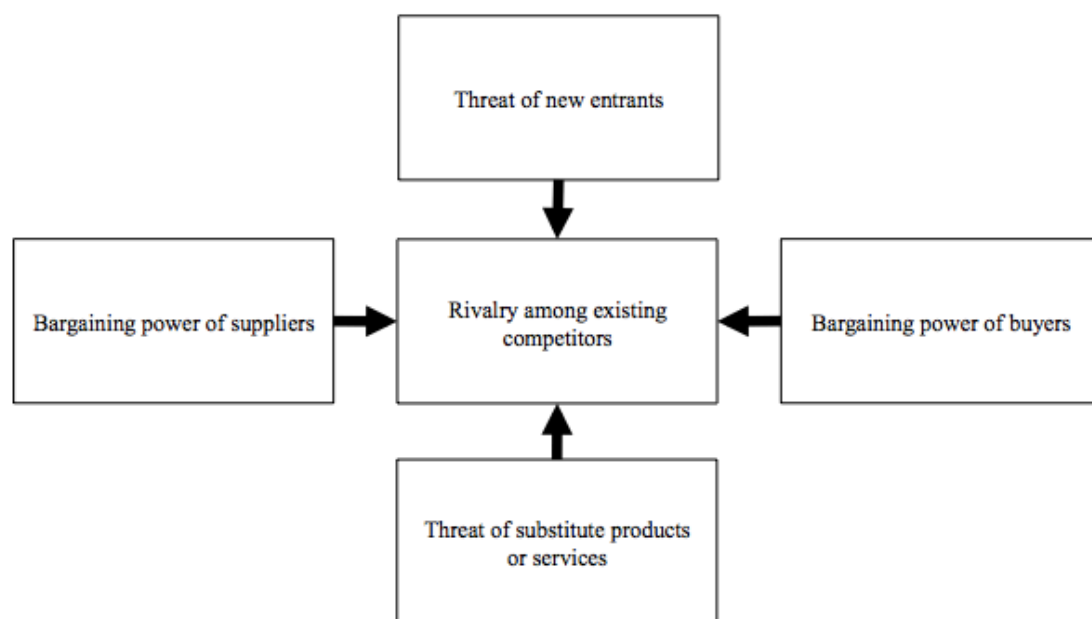
In order to create a successful strategy within an industry, companies need to analyse thoroughly their current as well as potential competitors. According to Porter (1998) the nature of competition as a significant driver of the market profitability is determined by five competitive forces: (1) threat of new entrants, (2) threat of substitute products or services, (3) bargaining power of suppliers, (4) bargaining power of buyers, and (5) rivalry among the existing competitors. These factors are illustrated in Porter's Five Forces in Figure 4. The strength of these forces differ from industry to industry and determine the industry's long-term profitability because the

⁴⁸ See Porter, M.E. (1998), pp. 33

⁴⁹ See Thenmozhi, M. (2012)

factors shape the prices companies can charge for their products or services, the costs they have to bear for producing on the market, and the investments that are required in order to remain competitive. The threat of new competitors entering the market limits significantly the profitability of the industry as their entry pushes the margins down and decreases the profits of current players. A strong bargaining power of suppliers has a negative effect on profitability of companies in the next step of the value chain since the suppliers strive to keep a large portion of the profits for themselves. A fierce competition among current players drives the costs up, because the companies need higher expenditures on R&D as well as advertising. An existence of close substitutes limits the profitability because the producers can't increase the prices too high due to possibly losing the customers to other producers.⁵⁰

This framework offers an around-the-clock approach towards the industry analysis covering all influential factors. However, since its introduction many other models, such as the one introduced by Thenmozhi, have been introduced covering the issue from a more detailed point of view, which is more favourable for the analysis of the Chinese carmakers' internationalisation to Europe.



Source: Adapted from Porter, M.E. (1998), pp.35

Figure 4: Five competitive forces determining industry competition

2.2.4 SWOT analysis

SWOT analysis is a useful method to systematically analyse the overall outputs of individual analyses such as Porter's five forces, PEST model and others. It aims to identify the extent to which the current company strategy and its strengths and

⁵⁰ See Porter, M.E. (1998), pp. 34-36

weaknesses are relevant and capable of coping with the environmental changes and trends.⁵¹ The analysis originates from two separated methods – SW and OT methods. The OT analysis focuses on the factors influencing the company from outside, both macro-factors (political-legal, economic, social-cultural and technological aspects) as well as micro-factors (customers, suppliers, competition and public). The OT analysis is then followed by the SW part, where the key factors of the internal environment are analysed (goals, systems, procurement, resources, company culture, relationships within the company, organizational structure, management quality and others).

The strengths summarize all factors that are beneficial for both the company and its customers. Weaknesses are all activities that the company is not good at or activities where competitors have significant competitive advantage. Opportunities identify all factors that can increase the demand for company products or services or through which the company can achieve higher profits. Finally, threats signalize trends or incidents that could have a negative effect on company profitability or market position.

2.2.5 Success factors

Based on the individual analyses of both internal and external environment and the learning from the internationalisation barriers, key success factors in the internationalisation strategy process can be identified. These important characteristics of a company or a product have a substantial importance in achieving success in foreign business activities. The most important determinants are:

- **Experience of firm in business** – Previous experience of management or the company itself eases the process of entering a new market as well as successfully establishing the operations there.
- **Financial assets** – Strong financial background is substantial for overcoming initial periods when business on a new market does not have a rapid start with immediate profits. Also, the process on entering a new market can be financially demanding, too.
- **Innovative technology** – Especially on developed markets the products have to be innovative with high quality, otherwise the new entrant can't succeed with its products. Moreover, modern technology leads to cost savings and better pricing options.
- **R&D quality** – The capability of fast and high-quality reactions on new products from the competition can be a major decisive factor of whether the company will be able to remain on the market in the long term.
- **Broad product line** – Unless selling a niche product with high profit margins, it is important to diversify the risk of economic changes or customer

⁵¹ See Jakubíková, D. (2008), pp. 103

preferences between more products. When entering a new market only with one product, relying on a positive market outlook can have fatal consequences in case of a decrease in demand for this product.

- **Effective distribution channels** – They help the entrant not only to offer the product to as many potential customers as possible, but also have a cost-saving effect that can be crucial in times of a potential price war between competitors.
- **Price advantage** – When operating in the mass market with focus on low price products the capability of selling the product for lower prices than the competitors can lead to a successful internationalisation.
- **Cost position for raw materials** – Strong negotiation power with suppliers of raw materials is an important success factor that gives space for better pricing strategy and potential higher profitability.
- **Cost position for production** – The ability to produce at favourable costs is another cost-saving measure that leads to a higher profitability and increased possibility to succeed in a potential price war.
- **Superior physical facilities or skilled labour** – These are other competitive advantages in the production phase of the value chain that can lead to higher profits or a better pricing of end products.
- **Quality of human resources** – The ability to effectively and efficiently hire new labour at lower costs than competition can have a substantial impact on the entry phases of internationalisation, when the company can't rely on its domestic brand or image that would drive the potential interest of applicants.
- **Effective promotion** – When a company is able to attract customers at lower costs than the competition, it can either dedicate additional resources to a more intensive promotion, or increase the profit margin.

Even though a company can't be a market leader in all of these factors, the management should bear these in mind and it should be their long-term goal to improve the position in most of these. Many of these success factors can be proved to be crucial for being successful on a foreign market and these should be especially paid attention to. The company that possesses the best mix of all success factors can achieve a favourable market share and significant profits in both domestic and foreign markets.

Having analysed the situation of a company trying to internationalize and identifying the key internal and external factors of the company, the next step of internationalisation is the selection of a right strategy that would lead to a successful market entry.

2.3 Strategy selection

A correctly selected strategy can be a crucial determinant of whether the internationalisation process will be successful or not. Based on the previous strategic analysis of the internal and external environment and countries that the company considers entering, it should evaluate the options and select the most promising modes and strategies. Figure 5 illustrates factors a company should consider when being in planning of going international.



Source: Adapted from Jeannet, J.-P., Hennessey, H.D. (1998), pp. 240

Figure 5: Strategy selection factors

The scope of this thesis has already narrowed down the wide variety of strategic factors from Figure 5. The geographic concentration has been predefined as the thesis focuses on potential entry of Chinese carmakers in Europe. Also, the marketing programs, processes and other marketing-related issues are out of scope of this thesis. Therefore, five major factors of strategy selection will be focused on. First, it is the geographic expansion strategies as a factor influencing the internationalisation strategy of a company, primarily forming the relation to the domestic country of a company. This is followed then by the international growth strategies and market entry mode to focus on how the individual countries will be entered in terms of ownership.⁵² Then there are two other factors that were not mentioned by Jeannet but play a significant role in the internationalisation process - the generic strategic first

⁵² Jeannet, J.-P., Hennessey, H.D. (1998), pp. 241

introduced by Porter, forming the USP of the internationalizing company and the strategic timing of market entry.

2.3.1 Geographic expansion strategies

In order to succeed in international competition, companies that intend to go abroad should carefully select the way they are going to operate in the target markets. There are three major distinguishing solutions. In the first one, also called the local responsiveness, the company attempts to customize to each country and bear in mind all regional differences. Whereas when following the global integration solution, companies do business similarly in the entire world regardless of the country or region they are active in. The third option, the so-called glo-cal approach, attempts to take the advantage of both of these basic strategies and coordinate all operations globally with respect to the cultural and other differences in each region or country. The right selection of any of this strategy depends on the degree of globalization in the industry. Four strategic approaches can be identified in this manner: (1) multidomestic, (2) regional, (3) international and (4) transnational.⁵³ Each of them is briefly discussed below, accompanied with a brief insight into the automotive industry as an example and best practice of each strategy.

Multidomestic strategy

This strategy lays an extreme emphasis on differences between each of the country that a company is present in, follows to the greatest extent the theory of local responsiveness resulting in treating each market as a separate one. When following the multidomestic strategy, companies have different products for each market; they are tailor-made for the specifics of that country. The products can differ in ingredients, colours, packaging, sizes, etc. Moreover, also the majority of the value chain is operated within one country. The main advantage of this approach is a strong responsiveness to local needs and this can serve as a differentiation factor; however, the drawbacks are higher costs and limited financial resources, as the company does not share profits among countries.

This approach is not commonly used in the automotive industry for two main reasons. First, the costs of differentiation would be too high to be compensated by increased sales from responsiveness. Second, the markets don't differ so much to make it necessary for carmakers to make the extra effort to introduce special products. However, especially in China and India, many global carmakers produce and sell different models than those that can be bought in the rest of the world. For instance, Skoda introduced in 2011 its small model Rapid that is sold in India only. Although Audi makes global products, in China it offers an extended version of their models to

⁵³ See Ireland, R.D., Hoskisson, R.E., Hitt, M.A. (2008), pp. 154

better suit the needs and wishes of local customers. So does Skoda plan to produce an extended version of its small SUV model Yeti. The special attention that is paid to Chinese needs shows the power of the market that China currently possesses.

Regional strategy

The regional strategy is a less extreme version of the multidomestic one. Companies don't separate each country from each other but try to treat regions as similar markets. Such regions can consist of two (e.g. USA and Canada) or more countries (in the case of the EU). Companies pursuing the regional strategy make use of created networks within the regions to gain economic advantages from it as well as find regional similarities to gain economic advantage from regional adaptation. In this strategy, companies have better financing options as they can leverage the profits from one part of the region for investing in another one. As for the product range, within one region usually the same products are offered, but can significantly differ from products offered in other regions.

In the automotive industry, many good examples can be found to illustrate the significance of regional strategies. As the companies identified commonalities between nearly located countries, they can cluster them into regions and adapt the product according to the regional needs of customers. It is more favourable than the multidomestic approach because the market size of the regions will make the local adaptations pay off. For instance, Ford Motor Company, originally a US company, has a separated subsidiary in Europe for not only selling cars in this regions but they have a dedicated R&D, production and after-sales operations. In the past few years, several models initially developed for European market have been introduced to the US market too, but in the 1990s, before the first truly global model Focus was introduced, no significant similarities between the European and US model range could be identified.

International strategy

This strategy can be perceived as an approach that attempts to maximize the effects from global operations with little flexibility for local adaptations. Not only in terms of the product range, but also in marketing and other operational activities. The majority of strategic decisions come from the global headquarters that is responsible for operating worldwide. The countries and regions then do not possess any significant power to better fit the needs of local customers. The main advantage of this approach is the worldwide built brand recognition for the products, however, succeeding in other regions and continents than the one where the headquarters is based and the original operations started can be proved as difficult.

For the worldwide present carmakers the international strategy would mean a great deal of lost opportunity. Even though the main reason for purchasing a car remains in

the world the same, the needs and demands from customers differ and it might be impossible to introduce a car model that would suit all countries evenly well. There are many models that are sold worldwide, however they are not identical at all. They usually differ in terms of the engine range, equipment, etc. For instance, models of European carmakers offered in Africa have usually traditional, turbo-free engines that are easily repairable in local conditions. So do carmakers offer in many Mediterranean countries the air-conditioning in basic equipment levels and in other countries only as a premium. This emphasis of local adaptations for global products is a main characteristic of the transnational approach.

Transnational strategy

The transnational strategy follows two major goals. First, it attempts to maximize the economic advantages from worldwide operations, and second, simultaneously search for local advantages and adaptations to changing conditions. Transnational companies also seek opportunities in distributing the value chain across the globe according to the maximum value obtainable. As a result, production facilities can be located in countries with favourably low cost of human capital and on the other hand, research labs are located in highly developed countries with a lot of skilled labour. Marketing department can then differ from region to region and pricing strategies even from country to country depending on the purchasing power of each country. In terms of products, transnational companies' goal is to offer global products to the highest degree possible; however, they are willing to make subtle local adaptations when needed. With this approach the worldwide recognized brand of products remains, however, not everywhere the product is completely identical.

The majority of worldwide present carmakers follow the transnational strategy. This approach enables them to maximize the potential of global cars with cost-effective product development; on the other hand small changes of their models can be introduced when the market requires it. Carmakers that are present on those markets for a long time can already learn from the local needs and implement the desired local adaptations even to the first stages of product development. For instance, the this year brand new European version of Skoda Rapid will be later on introduced in China, too. From the construction point of view they will differ significantly, though. Whereas in Europe it will be sold as a five-door liftback, in China the Rapid will be a traditional four-door saloon. The five-door liftback is appreciated by the European customers as an elegant way of connecting the advantages of estate versions with keeping the car elegant. In China, though, most of potential customers seek traditional four-door saloons and a European version might not meet their expectations and requirements so well.

The four basic strategies can be combined, too if the conditions demand it. For instance, many companies use a global approach for the upstream value activities,

such as manufacturing or R&D and design. Marketing, sales and after-sales service downstream value activities are then maintained on a regional or multidomestic basis.

2.3.2 International growth strategies

The international business offers several major strategies how to achieve a long-term growth of the company. They differ not only in the level of scope of engagement of internal forces and business experience but also how the company plans to focus on certain industries and original boundaries. The three basic strategies are: (1) strategy of intensive growth, (2) external growth strategy and (3) strategy of diversification.⁵⁴

Intensive growth strategy

The aim of this strategy is to develop the company from inside out, that means through a gradual expansion and focus on improving the current products in current markets. This can be achieved through various techniques, such as increasing marketing effort, attracting new customers from direct competition or improvements in product or pricing strategies.⁵⁵

The intensive growth strategy is a traditional business strategy in the automotive industry. Through gradual upgrading and extension of the product portfolio as well as launching the products in more and more countries, automotive producers achieve high profits and still are able to keep the global strategy unanimous. However, in the current globalized world with large automotive groups there are not many companies left that have not experienced any mergers or acquisitions with any competitors.

External growth strategy

This strategy is used by companies for two main reasons. Both are oriented on growth through involvement of other, external, forces and companies. First, it allows a horizontal growth through acquisition of direct competitors. This results in strengthening the company's market position, taking the advantage of economies of scale, decreasing competition power, and higher market shares. On the other hands, the vertical strategy allows companies to improve their value chain by gaining control on more activities, minimizing the risk of delayed supplies to the company and the customers, and improving the procurement.⁵⁶

In the automotive industry, strong research and development is crucial for global success. This can be achieved either through continuous improvement through decades, membership in strategic alliances with shared know-how or through

⁵⁴ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 65

⁵⁵ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 65

⁵⁶ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 65-66

acquisitions of competitors with an advanced R&D knowhow. The third strategy is currently being popular especially among car manufacturers from China and India that have a strong financial background, however do not possess enough R&D knowledge to become equally competitive with well-established marques from Western countries. Therefore, Indian Tata Group bought British Land Rover and Jaguar, Chinese SAIC bought MG and Volvo was recently acquired by Zhejiang Geely, also one of the largest Chinese carmakers.⁵⁷ In terms of the vertical integration, due to large corporations active in automotive industry, there are not many vertical acquisitions in the recent history of auto industry. However, it does not mean it does not exist. For instance, Chinese BAIC and Canadian Magna were in talks of acquiring the car design company Pininfarina in 2010, whereas the same year Volkswagen purchased a majority stake in another Italian auto designer Italdesign Giugiaro.⁵⁸

Diversification

Diversification allows companies to spread the business portfolio in many non-related industries or business areas as well as overcome potential seasonal fluctuations.⁵⁹ This can be achieved either by setting up new companies outside of the current scope or acquiring already established market players. However, many risks are connected with this type of strategy, as it requires a large capital intensiveness and managerial skills capable of leading many diverse business areas.

Diversification is a common strategy mainly in countries that have recently joined the developed car industry and the owners are not specifically oriented into car industry. In the case of Indian conglomerate Tata, its business scope reaches not only the automotive industry (Tata Motors, Jaguar Land Rover), but also information technology and communication, raw materials and mining, power generation, food industry and chemicals.⁶⁰

2.3.3 Market entry modes

The permanently changing global environment forces internationalizing companies to wisely select the type of presence they expect to maintain in every market where they compete. The types are called market entry modes and Hollensen (2007) defines them as an institutional arrangement necessary for the entry of a company's products and services into a new foreign market.⁶¹ The entry modes can differ from country to country (alternatively from region to region) depending on many external and internal

⁵⁷ See www.chinadaily.com

⁵⁸ See www.autoblog.com

⁵⁹ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 66

⁶⁰ See www.tata.com

⁶¹ See Hollensen, S. (2007), pp. 295

factors as well as the degree of internationalisation of the company, the desired mode characteristics and transaction-specific behaviour.⁶² According to Root (1994) there are three major rules when evaluating the market entry options:⁶³

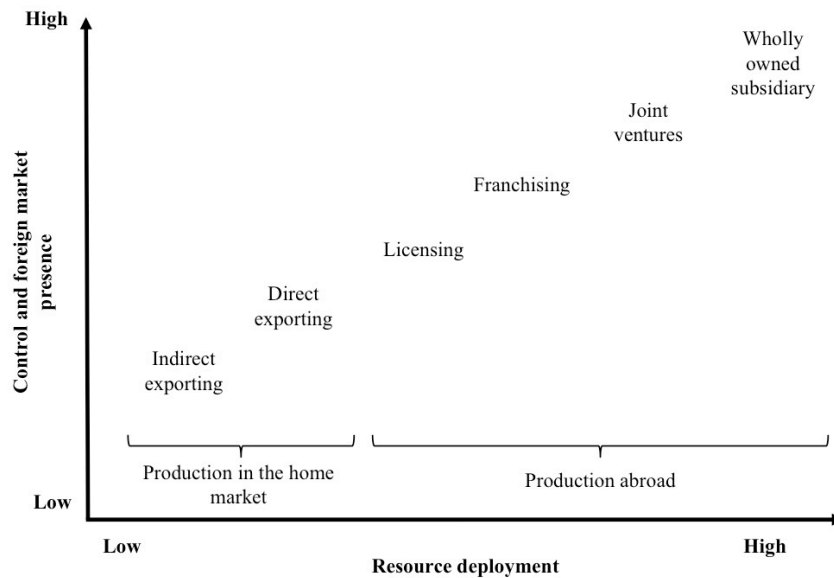
- **Naïve rule** – The company uses the same entry mode for all countries, regardless of country characteristics, level of competition or market outlooks
- **Pragmatic rule** – The company analyses the entering country and selects the safest entry mode available. Usually, it starts with low-risk exporting and only when the particular initial mode is not available or feasible it chooses a different one. Using this rule, not all entry modes are considered and investigated, but the first workable one is selected.
- **Strategy rule** – This approach requires companies to systematically analyse all potential entry modes, compare them with each other and evaluate before a decision is made. Then the most profitable option is selected based on the evaluation of availability of resources, risk connected with the particular entry mode as well as non-profit objectives.

Once a commitment with a specific type of entry mode is made, changes of this mode are costly and difficult. Therefore, they should be made with highest possible care. Not only can the change harm the financial stability of the company, but also the extent to which the company global marketing and other strategies are implemented depends on the selected mode. The market entry modes differ mainly in the amount of resources that are needed to implement that particular entry mode, the control that remains in the hands of the original producer and whether the production is made in the domestic country or abroad. The main entry modes are (1) indirect export, (2) direct export, (3) licensing, (4) franchising, (5) strategic alliances and (6) wholly owned subsidiaries and acquisitions.⁶⁴ The differences between the entry modes are illustrated in Figure 6 and discussed in more detail below. Similarly to the previous part, best practices from the automotive industry are identified.

⁶² See Hollensen, S. (2007), pp. 298

⁶³ See Root, F.R. (1994)

⁶⁴ See Hennessey, H.D., Gillespie, K. (2011), pp. 226



Source: Author

Figure 6: Main modes of entry

Indirect exporting

The least-risky internationalisation mode is usually the indirect exporting. In this stage the company uses several independent entities located in the home country that serve as experienced intermediaries between the producer and the foreign buyers. The responsibility for the goods are thus in the hands of the entities, not the producer. The connection between the producer and the target country is indirect and is beneficial mainly for companies with little or no experience in exporting. On the other hand, the business can be lost when the exporting agent decides to change its supplier.⁶⁵ There are usually two main entities helping companies with the indirect export:

- **Export Management Company (EMC)** – is a company that handles all aspects of export operations under a contractual agreement. They take care of the entire process of selling the products abroad, including marketing research, patent protection, shipping and logistics and all marketing activities. Such a company can either operate as a merchant or an agent that provides services for a fee or commission.
- **Export buying agents** – are individuals that are also active in providing access to foreign markets for inexperienced companies. They are similar to EMCs, however, they usually have limited services and focus only on a few parts of the world.⁶⁶

⁶⁵ See Ball, D.A. (2002), pp. 85

⁶⁶ See Hennessey, H.D., Gillespie, K. (2011), pp. 227

The indirect exporting mode is normally not used by large carmakers because of several reasons. First, indirect exporting is usually preferred by smaller companies that can't afford to spend large amounts of money to enter foreign markets. In case of carmakers, the scope of the business already implies that they will be internationally present and calculate the internationalisation costs. Indirect export also does not allow the companies to fully control the image and all processes. However, especially smaller carmakers might use the indirect export mode to initiate the international expansion in the early internationalisation stage.

Direct exporting

A company uses direct exporting when it serves the customers directly or solely through intermediaries located in foreign markets. No home-based entities are used in this stage. Compared to indirect exporting, this is a more mature method of accessing a new market with more opportunities, but also a higher risk. It already requires more contact with foreign entities, such as sales representatives, distributors or retailers. Generally, there are two main types of direct exporting:⁶⁷

- **Direct export with direct investments** – in this case the company makes use of either foreign-based intermediaries that operate independently and during the value chain process they are owners of the goods for a while, or intermediaries that do not own the goods but only represent the company on the foreign market and sell company products.
- **Direct export with direct investments** – in this stage, companies are already aware of their exporting activities, have their long-term plans with the target country and the foreign-based independent entities are substituted with own ones. Companies can establish for instance representation offices or branches.

Direct exporting is favourable for many carmakers as it provides a fit between the risks and the benefits resulting from direct exporting. This strategy is used especially for smaller markets where it is not advantageous for companies to establish own subsidiaries and production facilities. For instance Skoda Auto is currently present in more than 100 markets worldwide, however, in a majority of them it only cooperates with local organizations and dealers. Usually for each country there is one main importer serving as an intermediate between the carmaker and individual car dealerships.

Licensing

With licensing, the company assigns the right to the licensee, e.g. a right to manufacture a certain product against some agreed royalty.⁶⁸ The licensee pays the

⁶⁷ See Boučková, J. (2003), pp. 268

⁶⁸ See Hollensen, S. (2007), pp. 332

compensation to the licensing company (licensor) in exchange of the technology. Licensing is favourable for the licensee when it gains cheaply access to a patent, know-how or trademark that would not be available any other way. On the other hand, the licensee is heavily dependent on the licensor and in case of a change in the licensor's strategy, it can lose the entire business very fast.

For the licensor, there are numerous identified advantages why to use licensing. First, if a licensor plans to focus on its key competences and outsource all other parts of the value chain, licensing is a useful method for keeping the technology that was originally developed by the company. Second, licensing is favourable when the domestic company either does not have sufficient financial, managerial or marketing expertise to access foreign markets, or the political, economic or other barriers don't allow the company to access the market. A third main reason for licensing comes to play, when the company product is at the end of the life cycle and sales are expected to decrease in the near future, it is a handful way to extend the product life cycle by licensing it to companies in less-developed countries.⁶⁹ The biggest drawback of licensing is the fact that through provision of a license a potential new competitor emerged that possesses the same technologies as the original company. Therefore, contracts often forbid the licensees to operate in the same countries as the licensor.

Carmakers use the licensing entry mode in special cases. In the 20th century as the access to the Eastern Europe was limited for many carmakers from Western Europe, companies such as Fiat decided to sell the license for its model Fiat 125 to the Polish carmaker FSO after Fiat terminated the production in its own facilities. Similarly did Fiat sell the license to produce its model Fiat 128 to the Yugoslavian carmaker Zastava in the 1960s.

Franchising

Franchising is a special type of know-how transfer that is common mainly in services. It is a marketing-oriented method of selling business service, often to small independent investors who have enough capital but little or no prior business experience. In a franchise agreement, in which the franchiser takes care of all marketing activities, such as brand name, logo, products and method of operation and the franchisee is responsible for the operational activities. The franchisee remains an independently owned entity. The franchising agreements are beneficial for both parties. The franchisee gains access to worldwide business network and technologies and for the franchisor it is a favourable mode of entering many countries at the same time with little financial expenditures. However, it only receives royalties from the franchisees and does not have any other sources of income. Moreover, the franchisor should actively and regularly control its franchises because unreliable franchisee could have a fatal consequence on the franchisor's brand image.

⁶⁹ See Hollensen, S. (2007), pp. 333

Because of its special characteristics, franchising as a mode of entry is not used in the automotive industry. As already explained above, it primarily serves service companies to quickly internationalize. However, franchising is used regularly in the sales and after-sales part of the value chain where there are established car dealerships and service centres that offer the option to join their network through franchising.

Strategic alliances and joint ventures

Strategic alliances, or joint ventures are partnerships between at least two independent companies. These companies provide their know-how, resources and experience on a contractual basis.⁷⁰ Based on this contract the parties also share the profit from joint ventures and are managed according to the shares. In case of international joint ventures, both cooperating companies are based in different countries, which leverages the potential gains from cooperation on a foreign market, but, at the same time, makes the cooperation difficult due to different cultures, sizes of the companies as well as other factors. The main difference between strategic alliances and joint ventures is the fact that joint ventures are equity-based cooperation and a new entity is established, whereas in case of a strategic alliance no equity change takes place. The companies can cooperate in both upstream and downstream parts of the value chain.

According to Hollensen (2007), there are four main reasons for establishing joint ventures and strategic alliances. First, the partners can possess different technology and sharing it might be beneficial for both parties and lead to new opportunities in existing sectors. Second, by cooperating with another entity the speed and ease of market entry can be increased. Third, in many countries, government limit the activity of foreign companies on their markets and creating an alliance might be the only possible mode of market entry. Last but not least, through joint coordination and operation of R&D and production activities major costs can be saved and a competitive advantage can be achieved.⁷¹

As mentioned in the previous paragraph, many countries worldwide do not allow companies to establish wholly owned subsidiaries. This is currently the case of China, where Western carmakers are only allowed to manufacture cars when creating a joint venture with one of the local companies. As a result, Volkswagen for instance has joint ventures in China with SAIC and FAW, BMW with Brilliance or General Motors with SAIC.

⁷⁰ See Berndt, R., Altobelli, C.F., Sander, M. (2007), pp. 142

⁷¹ See Hollensen, S. (2007), pp. 339

Wholly owned subsidiary

Wholly owned subsidiaries are operations in a foreign country that are in a full ownership of a domestic producer. It is the highest level of internationalisation activities, with the highest level of opportunities but also the highest risk. In order to establish a subsidiary in a foreign country a great deal of financial resources is required which narrows down the selection of companies that can reach this level. For many SMEs the benefits from such an operation would never compensate the original expenditures needed.

It is beneficial for companies to establish subsidiaries in foreign countries because it gives them the right to fully control the strategy of the subsidiary as well as the right to collect all profits. Also, such a subsidiary can easily be integrated into a global network of the original producer. On the other hand, it might prove difficult to control these subsidiaries and preserve the global values of the company.

Wholly owned subsidiaries are common in the automotive industry in two major cases. First, the carmaker considers the target country important enough to be willing to undergo the additional financial expenditures of establishing a sales subsidiary. As an example, Skoda owns its importer in Germany in order to have a full control over its second-largest market. Second, the company selects the country as a favourable location for its production facilities. Hyundai and Kia, both Korean carmakers established several manufacturing facilities in the Central Europe in the past 10 years and all are fully in ownership of the Korean headquarters.

Table 1 summarizes the key considerations of all abovementioned characteristics of entry modes with special regards to the differences between them and their impact on the potential selection of the particular entry mode. For instance, the speed of market entry might be a crucial factor for an internationalising company. This might eliminate some of the modes as inappropriate. Financial demandingness may also play a role in evaluating potential entry modes. Licensing or indirect export do not require substantial financial resources, whereas establishment of a wholly owned subsidiary might be too costly for many smaller companies. Also, long-term plans with that particular country influence the way the company decides to enter it as with indirect exporting or other low-control modes it can't build a strong and independent entity that would be a part of company global network.

Table 1: Appropriateness of market entry strategies

Strategic consideration	Indirect export	Direct export	Licensing	Franchising	Joint venture	Owned subsidiary
Speed of entry	High	High	High	Moderate	Low	Low
Ease of exit	High	Moderate	Moderate	Moderate	Low	Low
Rapidly changing technologies	Low	High	High	Moderate	Moderate	Moderate
Resource demands	Low	Moderate	Moderate	Moderate	High	High
Profit potential	Low	High	Low	Moderate	Moderate	Moderate
Competitive intensity of market	Low	Moderate	Moderate	Low	Moderate	High
Integration into global network	Low	High	Low	Low	Low	High
Strategically important country	Low	High	Low	Low	Moderate	High
Unimportant market	High	Low	Moderate	Moderate	Low	Low
Cultural distance	High	Low	Moderate	Moderate	Moderate	Low
Fit with host government's goals	Low	Low	Moderate	Moderate	High	Moderate

Source: Based on Hennessey, H.D., Gillespie, K. (2011), pp. 250

2.3.4 Strategic timing of market entry

The strategic-wise correct timing of entry into a market is one of the key aspects that need to be considered. The timing strategy differs based on the fact whether the company wants to time transnational market entries or country specific ones.⁷²

Transnational timing strategies

The transnational timing strategies deal with the sequence with which the company enters individual countries. In this frame, there are two major approaches, the waterfall approach and the sprinkler approach.⁷³ The selection of the entry method not only depends on the financial resources of the company, but also on other factors, such as managerial skills, nature of the product or services or geographical location of the markets.

In case of the waterfall approach, the international markets are entered gradually, when the right time for entering comes. The company first enters a foreign market A, that is the most promising one for the future profits and the market B is entered no

⁷² See Berndt, R., Altobelli, C.F., Sander, M. (2007), pp. 148

⁷³ See Berndt, R., Altobelli, C.F., Sander, M. (2007), pp. 148

sooner than when a significant success is achieved in the market A and sometimes, the entry-related costs have been paid off. Usually, first those countries are entered that have similarities with the original domestic country. Besides, company using the waterfall approach can leverage the obtained knowledge and learn from the previous market entries to either achieve more significant profits from the early stage of market entry, or, alternatively, to enter the market in a more cost-effective way. This approach can also be implemented on a regional scheme, when a company chooses first a region and gradually enters markets within this region and later on enters another region.

The sprinkler approach has a few fundamental differences to the waterfall method. Primarily, the company attempts to enter as many markets as possible with a dedicated budget limitation.⁷⁴ This approach results in much faster market entries, however, it is more financially demanding and it is connected with a higher risk, because many unknown markets are entered at the same time without previous experience.

Country-specific timing strategies

Country-specific timing strategies are related to the comparison with competition. The key question is whether the company should pursue the strategy of a “first-mover” or a “follower”.⁷⁵ Both of these strategies can lead to fundamentally different results, based on the success rate of first movers. Also, it is important to point out that the success of each strategy can differ from country to country and even though in the market A a company successfully entered with the first mover strategy, in the market B it might be beneficial to wait and enter the market later.

The first-mover strategy implies that the company will be the very first one to enter the market, which has significant advantages. First, it enables the company to fully saturate the market with its product as well as create loyalty from many customers. This will worsen the situation for all later entrants, as they will have to compete not only with the products of the main competitor, but also with the perception and knowledge of the market participants. On the other hand, substantial financial costs are associated with the strategy of first-mover, as the company will have to create the whole network and also explain the potential customers the main benefits of the offered solution. Moreover, these will be unique costs that no other competitor will have to pay for accessing the market. In case of a failure, this might negatively affect the position of the first-mover in other markets, too.

⁷⁴ See Berndt, R., Altobelli, C.F., Sander, M. (2007), pp. 148

⁷⁵ See Berndt, R., Altobelli, C.F., Sander, M. (2007), pp. 148

The follower strategy saves a great deal of money, however, when entering the market in a later stage, the market can already be saturated and the company might not be able to sell enough products to compensate the market entry associated costs.

2.3.5 Generic strategies

Porter (1998) defines three major strategies that can help companies outperform their competitors. Each of these strategies represents a fundamentally different conception of how to be present on the market. They are (1) overall cost leadership, (2) product differentiation, and (3) market segmentation.⁷⁶ All the three illustrated strategies aim at gaining additional competitive advantage on the market and according to Porter, the worst strategic error is being stuck in the middle between these.⁷⁷ Each of the major generic strategies is discussed below.

Cost leadership

The aim of this strategy is to achieve an overall cost leadership through offering its products at the most affordable price. This can be achieved by being effective in all stages of the value chain as well as a strict control of all expenses and investments. Besides, usually no or little additional services are provided for free, pushing the price of the basic product as low as possible. This gives the company competitive advantage in above-average profits that can be maintained even in a case of a potential price war with competitors.⁷⁸ It also gives the company a possibility of utilizing economies of scale since it usually achieves high market shares through a penetration strategy.⁷⁹

Cost leadership as a generic strategy is quite common in the car market. Especially, Korean carmakers in Europe successfully established themselves through low pricing strategy that was enabled due to favourable cost production structure and high technology level used. Only a few other European-originated companies are able to compete with Koreans, such as Skoda or Dacia, both taking the advantage of the low manufacturing costs in their domestic countries, where they operate most of their production facilities.

Differentiation

The aim of the differentiation strategy is to offer unique products or services that have an extra value compared to what the competition offers. This can be achieved in many areas, such as design, brand image, technology, features or after-sales service. The

⁷⁶ See www.mindtools.com

⁷⁷ See Porter, M.E. (1998), pp. 40

⁷⁸ See Thenmozhi, M. (2012)

⁷⁹ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 17

differentiation aspects increases the customer loyalty because no company offers such products or services and since the customers find the additional features favourable, they have restricted purchase options. In order to achieve such a strategy, substantial financial resources are required to increase R&D activities, marketing expenses as well as establish high-quality after-sales network. This is however reflected in increased costs and then in high prices of products or services and might be a limiting factor in high-competitive markets that are focused on low prices. Therefore, this strategy is mainly used for sophisticated products and services with high added value.⁸⁰

Differentiation as a key success strategy can be observed in the automotive market only in the higher segments. For instance, German carmaker BMW pursues the aspect of sporty characteristics of its models, which gives it competitive advantages over its main competitors that focus rather on luxury and comfort. Similarly did Peugeot in the late 1990s succeed with its model 206. In that time Peugeot managed to develop a small car priced at the same level as competition, but due to its modern and sporty look that was especially appreciated by female customers, it managed to achieve a significant market share in this otherwise highly competitive market segment.

Market segmentation

In this strategy, the company focuses on a specific buyer group, product line or geographic market.⁸¹ The aim is to build a complete environment or services for a niche target group. As a result, they can offer their customers a complex package of products and services with lost costs, high differentiation, or in the best case, both of these aspects. This strategy is mainly suitable for luxury products and services.⁸²

Luxury cars such as Rolls-Royce or Bentley do not sell only cars. With regards to Porter's market segmentation strategy, they offer their customers a complex range of services connected with the ownership of one of their models. Similarly, Ferrari introduced its special racing model FXX in 2005. This model was designed for circuit racing only, but could be sold to private customers, too. Along with purchase of the car, the customer obtained complex range of services as well as a group of mechanics who looked after the car and were available worldwide to assist the driver.

Based on this theory from Porter, Cliff Bauman and David Faulkner developed a more advanced model called Bowman's Strategy Clock.⁸³ The original three generic strategic were extended to eight, adding not only more success options, but also the likelihood of success for each of the categories. The model is illustrated on Figure 7.

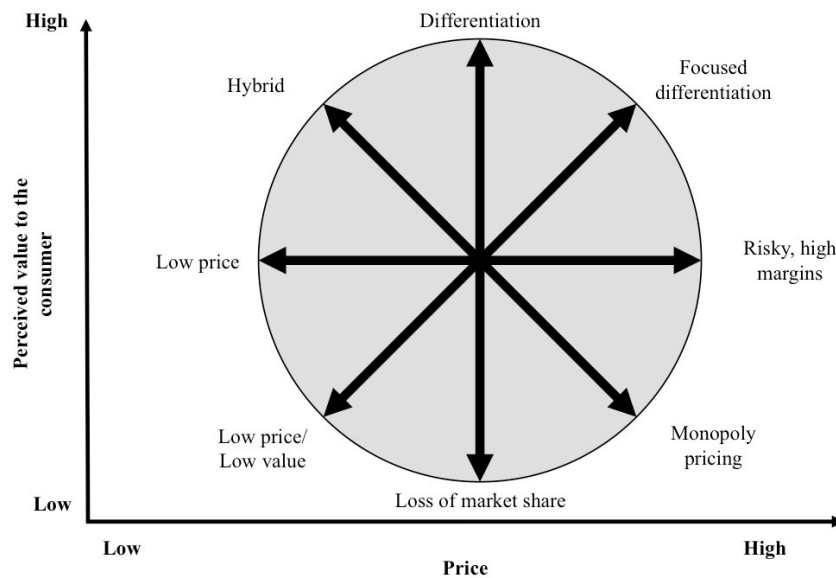
⁸⁰ See Machková, H., Král, P., Lhotáková, M. (2010), pp. 17

⁸¹ See Thenmozhi, M. (2012)

⁸² See Machková, H., Král, P., Lhotáková, M. (2010), pp. 17

⁸³ See www.mindtools.com

Some of the strategies are less likely to succeed in the market; some of them are more favourable. Companies should avoid the categories in the bottom-left quarter as they offer little for low price. The more value companies are able to offer to their customers for reasonable price (moving to the top-right direction), the more likely they are to gain competitive advantage in the market.



Source: Adapted from www.mindtools.com

Figure 7: Bowman's Strategy Clock

3 Chinese automobile market

In 2009, China became the world's biggest automotive market. Within just 10 years since the entry of China to WTO, Chinese achieved to develop themselves from a third-world car market with poor demand and supply to a world's centrepiece, which stays in major focus of all global automakers. The automotive boom was mainly driven by the growth of private automobile purchases that have achieved a stunning annual growth of 35% in the period 2001-2007.⁸⁴ The year after that, when the global recession took place all over the world and highly developed markets suffered from the crisis, China experienced a significant slowdown of sales, either. However, in 2009 the Chinese government stimulus plan triggered the sales fast to a yearly growth of more than 50%.⁸⁵

With total sales of 14.5 million passenger cars in 2011, it clearly topped all the traditional automotive markets, such as the EU, the United States or Japan. Even though the current growth is not as steep as before (CAGR 2010-2011 only 5.4%)⁸⁶, it is expected that the era of automotive China has not come to the end yet. The main reasons for the recent slowdown were primarily the expiration of government stimuli that successfully pushed the sales forward in the times of the economic crisis, the pilot programs for preserving the climate in Chinese cities (such as limitation of registrations allowed in Beijing) and new import tariffs suppressing the competitiveness of foreign carmakers.⁸⁷

Despite the abovementioned barriers and limitations, China still remains a key focus country for many Western automotive players. For instance, Skoda with its recent 2018 Growth Strategy called "Go East" clearly showed its interest to drive their dedication to developing countries, mainly China, India and Russia. Skoda entered the Chinese car market no earlier than 2007. However, due to the global economic crisis that hit the traditional European market hard, China became Skoda's largest market very fast and currently Skoda sells nearly every fourth car there.⁸⁸ Many European and US carmakers also start to reposition its Chinese activities from the pure manufacturing region to a complex set of activities including establishment of regional headquarters in China – General Motors, Jaguar Land Rover or Ford, just to name a few. Or, alternatively, establishing separate R&D centres there to flexibly and fast localise their products.⁸⁹

⁸⁴ See Roland Berger (2010)

⁸⁵ See Roland Berger (2010)

⁸⁶ See Business Monitor International (2012)

⁸⁷ See Business Monitor International (2012)

⁸⁸ See Skoda Auto (2011)

⁸⁹ See APCO (2010)

The future of China seems promising for most major carmakers due to many reasons from both macroeconomic and automotive perspective:

- **GDP growth** – According to the IMF and World Bank, China is keeping a high GDP growth in the past years with no dramatic downturns in the near future. In 2011, the real GDP growth nearly topped the 10% line, basically incomparable to the stagnating European countries (Germany as the best-performing country in Europe only achieved 3.1% in 2011).⁹⁰ The GDP growth until 2016 is expected stable within the 5-10% interval, creating a favourable economic environment with increasing purchasing power of the Chinese.⁹¹
- **Vehicle ownership** – In the last five years, the vehicle ownership rate has increased by 30% every year.⁹² With 61 vehicles per 1000 people in 2011, China still remains definitely in the underdeveloped markets, however with a huge potential for the near future. LMC statistics predict a steep growth for China, reaching the level of Brazil (currently 144 cars per 1000 inhabitants) no later than 2025, by achieving the annual growth of 10.7%.⁹³ The Triad countries remain unreachable for China though. In the US, for instance, each inhabitant “owns” 0.8 vehicles on average, in Europe the motorization rate is slightly above 0.5 vehicles per inhabitant. However, none of these regions is expected to experience any significant growth in the next 15 years, with yearly increase by max. 1%.⁹⁴
- **Infrastructure** – Not only does the Chinese authority look after the car market in general, but also they significantly support the automotive environment by improving the infrastructure. The total length of the highways, for instance, has increased in the period 2000-2012 from 11,605 km to more than 85,000 km, being now the largest highway system in the world.⁹⁵

The current position of the Chinese automotive market is indisputable and the future outlook seems positive. However, there are also many unpredictable factors and unknowns that might change the situation in China dramatically. Therefore, it is vital to analyse the Chinese car market in depth to understand the main characteristics in order to come up with a decent internationalisation plan for Chinese carmakers.

3.1 Economic analysis of China with focus on car industry

The PEST framework is a useful tool for analysing the macroeconomic environment of a target country. In this subchapter, it will be extended by an analysis of the

⁹⁰ See Economist Intelligence Unit (2012)

⁹¹ See International Monetary Fund (2012)

⁹² See Roland Berger (2011)

⁹³ See LMC Automotive (2012)

⁹⁴ See Roland Berger (2012)

⁹⁵ See www.wikipedia.org

automotive sector in China. The aim is to introduce the region, its characteristics and specifics to create a base for a later analysis of the car market itself.

3.1.1 Political, regulatory and legal factors

People's Republic of China, as the full name of China states, is a communist country, led by the Communist party of China, but in terms of the economy, it has been gradually transforming into a democratic country, open to foreign companies and attracting especially the Western investors. Although there is only one central political party, the country is highly fragmented due to a strong power of local authorities in many regions of China. This is significantly perceived in the automotive industry, too, as the goals of the national and local governments differ very often. Whereas the national one's goals focus on increasing the country's competitiveness and catching up with the Western world, local governments pursue many social goals having a great influence of the local welfare, such as maintaining or even expanding current labour force.⁹⁶

However, thanks to the strong political force in the country, the resulting stability is a vital factor for foreign investors. Chinese government also issues regular five-year economic plans (the current one is valid for the period 2011-2016) that outline the major goals for the country in the near future, which again is positively perceived from foreign companies because they can, to a certain extent, plan their Chinese operations. The governments also provide companies with several incentives and subsidies, helping them set up the business operations in the country as well as stimulating the demand in case of need. So did the government for instance in 2009, when it issued the "China's Auto Industry Readjustment and Revitalization Plan", having a large influence on the car demand in 2009.

3.1.2 Economic factors

As already outlined in the overview of the China car market, China has been experiencing a strong GDP growth in the last years and this favourable situation is not expected to finish any time soon. By 2025 China is expected to become the world's second-largest economy in terms of the purchasing power, with only the US being in front. This will be achieved by an annual GDP growth of 8-10% a year, being the fastest growing country in the BRIC and Triad countries.⁹⁷ Although the overall GDP power will be high in China, due to the large amount of population, the GDP per capita will still remain at a low level. The 2010 amount of EUR 2,539 is expected to

⁹⁶ See Harvard Business Review (2003)

⁹⁷ See Roland Berger (2011)

increase to ca. EUR 15,000, whereas the triad level will amount between EUR 42,000 and 60,000.⁹⁸

The positive economic situations as well as the future outlook have numerous positive implications to the Chinese economy. The purchasing power of Chinese people has been rocketing in the past years following the increasing GDP per capita. As the demand for passenger cars is increasing as a result of the stronger purchasing power, the both local and foreign car manufacturers increase their vehicle sales having again a positive impact on the increase of production capacity in China and a better satisfaction of customer needs in the automotive industry.

3.1.3 Social factors

China is the largest country in the world by the size of population. In 2011, there were ca. 1,321 million inhabitants in the mainland of China. However, due to the One Child Policy the working population will be shrinking from 2015 onwards, resulting in a decrease in population by 100 million by 2030.⁹⁹

Even though in the case of China, the market size plays a key role in the business operations and plans, locations of Chinese megacities is a crucial factor that has to be taken into consideration. China's largest cities are located along the coastline leaving the rural areas with a lower purchasing power in the inlands. The increasing urbanization of China will influence not only the habits of Chinese people, but also the environment in the megacities. In 2025, China is expected to have two cities among the world's largest, Shanghai with 20 million and Beijing with 15 million inhabitants.¹⁰⁰

The growing wealth of Chinese population has an especially positive effect on the Chinese middle class that already amounts to 300 million people.¹⁰¹ This group is assumed to be the key potential clients in the automotive industry in the near future. With the motorization rate of only 4%, and with the assumption most of the cars are now driven by the rich people and the middle class, there is a potential market for more than 200 million new cars within the next five years.

As the poor are becoming rich, the rich are becoming even richer. The premiumisation of the Chinese car market is a significant effect. Traditional European luxury brands such as Audi, BMW, Mercedes-Benz or Bentley are increasing their sales in China by double-digit numbers each year. For instance Mercedes-Benz increased their sales in the period Jan-Feb/2010 and Jan-Feb/2011 by more than

⁹⁸ See Economist Intelligence Unit (2012)

⁹⁹ See Economist Intelligence Unit (2012)

¹⁰⁰ See United Nations (2011)

¹⁰¹ See www.money.cnn.com

78%¹⁰². For Bentley, China is already the third largest market and the company is expecting to top the US and UK markets very soon.¹⁰³ However, most of these luxury vehicles are imported due to an unsatisfactory production quality in Chinese production facilities.

3.1.4 Technological factors

China as a nation is well known for its technical advancement and penetration of modern technologies. However, not many research companies, including the ones in the automotive industry, originate from this country. Indigenous Chinese companies lack the advanced R&D knowledge and mostly serve the Western companies as a pure production facility. However, this generalization might result in ignoring some great examples of Chinese companies that are leaders in their segment or one of the key players. For instance, Huawei is a leading company in the telecommunication industry and Lenovo in the both consumer and business PC market. Lenovo, though, as later shown on other examples, also pursued the external growth strategy, when it purchased the PC division of the US company IBM in 2005. BYD Auto, one of the key auto producers in China, is part of a large industry group BYD that is one of the largest battery producers in the world. This predetermines the company to succeed in the future EV segment that is expected to increase substantially in this and the next decade. The acquisitions of Western companies have predominantly one goal – to acquire and increase the R&D knowledge, which is lacking in China.

However, in the chase of greater R&D knowledge, many Chinese companies have been accused of violating the international property rights. There have been many cases made public where Western carmakers accused the Chinese producers of copying their car models. This is to a large extent caused by the fact that most Western carmakers run joint ventures with Chinese companies to operate the businesses in China. As a result, the Chinese parties have then an easy access to the technologies in the joint plants and it is then difficult to trace and protect themselves from any issues. Also, as many producers share their suppliers, it is easy then to transfer any technologies from the Western company to its Chinese competitor.¹⁰⁴

Besides, many cases of copycatting have been identified in the last 10 years. Many car models offered by indigenous Chinese producers have had obvious design and technological similarities with models offered by foreign producers. The most famous case was Chery QQ vs. Chevrolet Spark back in 2003. Not only did the Chinese model resemble the US car, but also due to a speeded-up development phase and CKD-based production of Chevrolet, Chery, a small Chinese carmaker, released the model half a year earlier than Chevrolet. Moreover, the US car was much more

¹⁰² See Volkswagen Group China (2011)

¹⁰³ See Volkswagen Group China (2011)

¹⁰⁴ See UNIDO (2005)

expensive. In the court trial later on, the US producer even proved that both models, Chery QQ and Chevrolet Spark could swap their side doors without any construction adjustments. Nevertheless, NOIPR has not acknowledged any evidence from Chevrolet and the case was closed, unsuccessfully for the US carmaker.

All these factors have to be taken into consideration when dealing with Chinese business partners or operating on the Chinese car market. Due to a different culture, the Chinese perception of business differs from the European or the US one and therefore, all risks and potential harms have to be anticipated and dealt with.

3.2 History of the Chinese auto industry

The development of the Chinese car market was highly influenced by the political regime. In the 1950s in the Mao era, no one really owned a car and there was no proper automotive industry. Most of the automotive production was dedicated to trucks and commercial vehicles and made in cooperation with the USSR that provided the Chinese with technology for large projects. The result of one such project was the establishment of First Automotive Works (FAW). FAW was founded in 1953 and was originally planned to produce only trucks. The first model that was designed in 1956 lasted without any significant changes until the 1980s. Beside FAW, a few more automotive production facilities were opened at that time, such as Second Automotive Works (known as Dongfeng, meaning “East Wind” in Chinese), the Sichuan Auto Works or the Shaanxi Auto Works.¹⁰⁵

After the death of Mao in 1976, things have changed dramatically. The new chairman Deng Xiaoping intended to open the country to the world and one of the cornerstone industries was automotive.¹⁰⁶ During the Deng era, local authorities, whose aim was to increase the mobility of people, gained a significant level of power. The development of the automotive industry was therefore a common goal. In the period 1979-1985 the number of car production facilities increased by more than 100%, from 55 to 114.¹⁰⁷

In the 1986, foreign carmakers were first allowed to enter the Chinese automotive market. However, they only could establish joint ventures with local, state-owned partners and the ownership was limited to max. 50%. The goal of this measurement was to help develop the local car industry quickly, with the utilization of Western technologies.¹⁰⁸ In exchange, the investors obtained the permission to enter a large market, or better speaking, to co-create it as at that time, the passenger car market was

¹⁰⁵ See UNIDO (2005)

¹⁰⁶ See Congressional Research Service (2009)

¹⁰⁷ See Fiala, O., Jara, M., Stradal, S. (2010), pp. 5

¹⁰⁸ See www.factsanddetails.com

basically non-existent. In the first phase, six joint ventures were established – FAW with Audi (production after ten years of operation planned at the level of 50,000 cars), Second Auto Works with Citroen (50,000), SAIC with Volkswagen (75,000), Tianjin Auto with Daihatsu (30,000), Beijing Auto with AMC Jeep (30,000) and Guangzhou Auto with Peugeot (10,000). Later on, the deals were expanded by the cooperation between FAW and Volkswagen, SAIC and General Motors and Changan and Suzuki.¹⁰⁹

In 1994, the Chinese government designed a set of “pillar industries” that were planned to help grow the Chinese economy in the next decade. Automotive industry was selected among these. To support this statement, the government issues the Implementation Policy of the Motor Industry (IPMI) that had four major objectives: (1) establish large-scale manufacturers that would replace the existent small-scale ones, (2) improve the components and parts industries to create a high-quality supplier base, (3) create capabilities to produce own automobiles and (4) support the private car ownership.¹¹⁰

In 2002, China joined the World Trade Organization. This step had a crucial influence on many industries, including automotive. The until-then existent import protections and barriers that aimed to support the competitiveness of the local automotive industry, had to be significantly decreased to comply with the WTO rules. This had a booming effect on the both supply and demand. Most European, US and Japanese carmakers entered the Chinese market in order to profit from the steady passenger market growth. The overall light vehicle production increased in 2002 and 2003 by more than 36% each year, making China the third largest auto market in the world.¹¹¹ In 2005, the passenger car production for the first time topped the production of commercial vehicles with the split ca. 55/45¹¹² and the same year Chinese car export was higher than the car import for the first time.¹¹³ The WTO entry also had a positive effect on the import regulation. The historical import quota was cancelled and the tariff rate for importing complete cars decreased from 200% to 25% as of 2006. See the full list of major WTO measurements in the Appendix 9.

To control and stimulate the automotive industry, the Chinese government regularly issues stimulus packages, such as the New Automotive Industry Policy in 2004 or Auto Industry Readjustment and Revitalization Plan in 2009. Both these plans differ from the one in 1994, though. Although the general goals are alike, the later policies enforce the objectives with strategic directions rather than with regulations. This also signals to the Western world that the transition to a socialist country is successfully

¹⁰⁹ See Just-Auto (2010)

¹¹⁰ See UNIDO (2005)

¹¹¹ See UNIDO (2005)

¹¹² See Congressional Research Service (2009)

¹¹³ See McKinsey & Company (2008)

implemented. However, in special cases the Chinese government still applies the strict regulatory rules, such as the prohibition of establishing car production facilities in other than predominantly allowed provinces in 2009 or implementation of special import tariffs for US cars with high engine displacement in 2011.¹¹⁴

3.3 Current position of Chinese automotive industry

The Readjustment and Revitalization Plan, issued by the government in 2009, had a clear vision of where the automotive industry in China was supposed to develop in the period 2009-2011. Therefore, to estimate to which extent the 12th five-year plan of the Chinese government for the years 2011-2016 is feasible in the current unstable automotive environment, it might be vital to analyse in this chapter the current position of demand and supply not only as standalone statistics, but also in relation with the goals outlined in the 2009 plan.

In 2011, the total production and sales of vehicles in China reached 18.5 million cars.¹¹⁵ That was, compared to previous years a slight disappointment in terms of growth trends, as the year-on-year growth only amounted to 0.8%. That is much lower than the 32% year-on-year growth in the previous year. The decline was mainly caused by sales of commercial vehicles that actually decreased by 6.3%. The sales of passenger vehicles grew by 5.4%, reaching nearly 15 million cars in 2011. Some segments, though, experienced a significant rise in sales, such as SUVs, which grew by 20% year-on-year.¹¹⁶ This might signal a potential premiumisation of the Chinese car market. The hit in production and sales of vehicles in China was also caused by many restrictions from the Chinese government, such as limits of registration in big cities and phasing-out of tax breaks, scrappage schemes and subsidies oriented on encouraging the automotive industry in the times of the global economic crisis. The growth in sales was driven mainly by the first-time buyers in second- and third-tier cities where traffic congestion was not a major issue yet.¹¹⁷

Table 2: Production and sales of vehicles in China, 2009-2011

	2009	2010	2011
Total vehicle production (in m)	13.791	18.265	18.419
Total vehicle sales (in m)	13.645	18.060	18.530
Total passenger car production (in m)	10.384	13.897	14.485
Total passenger car sales (in m)	10.331	13.760	14.500

Source: Adapted from Business Monitor International (2012)

¹¹⁴ See Business Monitor International (2012)

¹¹⁵ See Business Monitor International (2012)

¹¹⁶ See Business Monitor International (2012)

¹¹⁷ See www.factsanddetails.com

The targets of the Chinese government outlined in the 2009 automotive plan expected a 10% annual growth in vehicle production and sales in the period 2009-2011. This on one hand was significantly underestimated as the year-on-year growth reached more than 32%. In the year after that, on the other hand, the growth was much lower, a lot below the targets. This shows two facts mainly. First, the local authorities in big cities such as Beijing, which itself represents 5% of the total car market, might issue measurements in contrast with the national targets. Second, despite the 2009 plan still being in force, the goals of the governments might focus on other objectives already, such as environmental-friendly and sustainable growth, which is in contradiction with the previous double-digit car market growth. The other target, total production of 10 million passenger cars was achieved with ease, as the real numbers outperformed the targets by more than 330,000 vehicles.

In terms of the motorisation segmentation, the 2009 plan outlined the expected market share of passenger vehicles under 1.5 litres for 40% and the cars below 1.0 litres for 15% for 2011.¹¹⁸ This was in line with the subsidy plan supporting the downsizing trends similar to the ones in Europe as well as support plans for sales in rural areas where most people only own old three-wheelers from the 1990s. In 2011, in reality, the targets were met only halfway. Whereas the market share of newly sold passenger cars under 1.5 really increased to nearly 40% in 2011 from slightly above 36% in 2009, the ambitious target regarding vehicles with displacement under 1.0 litres was too high in reality. In 2009, when the plan was released the market share of such small vehicles amounted to 6.7% and two years later it was even lower at the rate 5.9%. The market reacted in reality in opposite to the plans of the government when most of the share lost in ultra-small vehicles shifted to the segment 1.0-1.5 litres. The most probable reason for failure of the plan was the little R&D activity from the producers. Such a low displacement is mostly offered by domestic carmakers and their pace in introducing new and more efficient engines was likely much slower than the two years of the 2009-2011 period. Simply said, the market players were not skilled enough to deliver new, downsized engines to the market in such a short time period.

The 2009 plan also dealt with consolidation of the Chinese car manufacturers. Whereas in 2009 there were more than 100 fragmented car producers, the government released a plan to create within the next three years a group of 2-3 indigenous giants with yearly output of 2 million vehicles and another 4-5 manufacturers with production capacity of 1 million. Even though there were a few M&As in the past three years in the automotive segments, realized mostly by large carmakers such as BAIC or SAIC, none of them achieved the goal of 2 million vehicles and a few more only approached the line of 1 million vehicles.¹¹⁹ Moreover, consolidation as one of

¹¹⁸ See Yu, H., Yang, M. (2010)

¹¹⁹ See LMC Automotive (2012)

the objectives has been present in the automotive plans for the past two decades, however, they proved themselves to be feasible only with difficulties. As a result of all these factors, there are still six major state-owned producers FAW, Dongfeng, SAIC, Changan, BAIC and Guangzhou Auto that do not seem to be merging anytime soon because they are often owned by local governments who want to keep the control over the companies to protect local interests.¹²⁰

The readjustment and revitalization plan also focused on increasing the significance of hybrid and pure electric vehicles. The original target of 0.5 million PHV and PEV sold in China in 2011 or at least 5% of the new sales has failed with only 8,000 electric vehicles sold last year (mostly driven by government fleets)¹²¹ and currently the target seems reachable no earlier than 2015.¹²² Despite the government's significant subsidies for customers opting for electric vehicles (for instance, in Shenzhen customers were offered EUR 15,000 off the original price), they rather chose the petrol-powered alternatives. Not only were the electric cars still very expensive, but also the system was not ready for a boom of electric vehicles. Last year, hardly 16,000 charging stations were installed in the mainland of China, which was less than 10% of the government objectives.¹²³

Based on this analysis, it seems that the government plans are rather a recommendation of the course of the economy than an active steering. Some of the subsidies were very effective (such as encouraging the sales of vehicles with small engine displacement in 2009), others (e.g. support of electric car sales) proved to be ineffective with a longer time needed for the adoption. However, the electric cars remained in the focus of the Chinese government.

3.4 Chinese car manufacturers

This and the next subchapter introduce the major players on the Chinese market. Even though they are traditionally divided in two groups – Chinese and foreign carmakers, in reality, they both are in fact Chinese or the Chinese at least participate in the business with all players. According to the government restrictions, the companies that want to assemble complete cars in China have to do so only in cooperation with a local Chinese company in a joint venture. In this, then, it is restricted to maximum 50% share. Therefore, it is better to consider two other groups of carmakers in the market – the JV-based and indigenous Chinese producers that do not closely cooperate with any foreign producer.

¹²⁰ See www.chinacartimes.com

¹²¹ See www.economist.com

¹²² See www.strategy-business.com

¹²³ See www.economist.com

Despite the fact that the indigenous car brands were first in the market (FAW was established in 1953), nowadays their market share is only less than 35%.¹²⁴ However, their position used to be even worse than it is now. In 2005 their market share hardly reached more than 26%.¹²⁵ As a result of poor engine and car technology of indigenous producers, the JVs had a clear competitiveness advantage and were able to gain a great deal of market share. In the late 2000s though, a new wave of independent producers emerged, such as Chery, Geely or BYD. These manufacturers, already ready for the great transition, not only started from scratch, which gave them the possibility to equip their factories with modern technologies, but they also hired many managers and technicians from Western countries who were supposed to bring the lacking R&D knowledge with them. These companies, while being most similar to the global players from the US and Europe, are also the furthest on the track to expand their business to other countries including Europe.

In 2011, out of the 50 most active indigenous Chinese producers of light vehicles, only three of them made it to the overall Top 10 of passenger cars – Chery on the sixth position with 634,000 cars sold, Geely with 473,000 and BYD selling 448,000 passenger cars in 2011. However, in the light commercial vehicle segment, the Chinese still possess leading roles. All the top nine selling producers have their origin in China, with Wuling being at the top with 1,209,000 commercial vehicles sold, Changan the second with 809,000 vehicles and Dongfeng third with 575,000 vehicles.¹²⁶ Wuling, though, is not a pure indigenous producer as it was established as a JV between SAIC, GM and Wuling.¹²⁷ The following table provides an overview of the major players on the Chinese passenger car market according to the sales in 2011 and their market share.

Table 3: Top 10 passenger car companies in China, 2011

Rank	Brand	Volume	Market share
1	Volkswagen Group	2,327,636	17.80%
2	General Motors	1,293,126	9.89%
3	Hyundai-Kia	1,248,611	9.55%
4	Toyota	926,114	7.08%
5	Renault-Nissan	856,677	6.62%
6	Chery	634,311	4.85%
7	Honda	597,833	4.57%
8	Geely	473,626	3.62%
9	BYD	448,484	3.43%

¹²⁴ See HCA Consulting China (2011)

¹²⁵ See www.factsanddetails.com

¹²⁶ See LMC Automotive (2012)

¹²⁷ See www.chinautoweb.com

10	Peugeot-Citroen	410,179	3.14%
	Total	13,074,269	100%

Source: Based on LMC Automotive (2012)

Creating the statistics, though, is quite complex in China and can lead to various results. Unlike Europe, where the brands and producers are easily distinguishable, in China one Chinese carmaker can have partnerships with several European, Japanese or US producers, as well as one foreign producer can produce its cars in partnership with several Chinese companies.

Out of the aforementioned 50 Chinese carmakers, most only operate on a local level. Only 5-10 companies can be identified as large enough to have an impact on the Chinese car market. Moreover, these companies are the most likely potential entrants onto the European market. Their main characteristics and specifics are described below.

Shanghai Automotive Industry Corporation (SAIC) produces cars not only with its own brands, but also mainly in cooperation with General Motors and Volkswagen Group, producing cars for various brands within these two global groups, such as Volkswagen, Skoda, Chevrolet, Buick and Cadillac. When adding multiple brands that are in possession of SAIC such as Wuling, Baojun or Sunwin, the total output of SAIC tops nearly 4 million cars a year.¹²⁸ This makes SAIC the largest carmaker in China in terms of the total output from its production factories. SAIC has been recently active also in acquisitions of foreign companies with the objective to increase its technological know-how. In 2004 it bought the South-Korean SsangYong and in 2007 as a result of a state-controlled merger with Nanjing Automotive it acquired the intellectual property of MG Rover. Rover cars are currently sold in China under the Roewe brand.¹²⁹

The second largest carmaker in China is **First Auto Works (FAW)**. It is the oldest carmaker in China, established already in 1950s as a joint project between USSR and Chinese government. The total output of FAW was 2.6 million cars in 2011.¹³⁰ It has a close relationship with Chinese officials, which results in many sales to taxi companies and local governments.¹³¹ FAW produces cars for own brands (FAW Besturn, FAW Freewin, FAW Hongqi and FAW Jiefang) and foreign companies (Toyota, Mazda, Volkswagen and Audi).

Dongfeng, originally called Second Auto Works is the third largest carmaker in China. It has alliances with Nissan, Citroen, Peugeot, Kia and Honda. The total output

¹²⁸ See www.chinaautoweb.com

¹²⁹ See www.just-auto.com

¹³⁰ See www.chinaautoweb.com

¹³¹ See www.factsanddetails.com

including Dongfeng own brands outreached the mark of 3 million cars in 2011.¹³² The company is also one of the largest producers of light commercial vehicles in China, which are exported to numerous countries abroad, including the Western as well as Central and Eastern Europe. To support these overseas business operations, Dongfeng is currently in talks with Turkish government to establish a production facility there.¹³³

Chery Automotive belongs to the second-tier group of Chinese producers not dependable on JV with foreign carmakers. It was established in 1997 by the local government to support the employment in the region.¹³⁴ Chery largely benefited from the 2009 revitalization plan that supported small vehicles. In the period 2008-2011 in nearly doubled its production.¹³⁵ It was one of the first Chinese carmakers that decided to rapidly export its vehicles abroad. In 2008, nearly every third Chery vehicle was sold outside China.¹³⁶ A few years ago, Chery even planned to start operating in the most developed markets such as the US, however, nothing came to realisation. Firstly, despite hiring top design houses such as Bertone and Pininfarina to design Chery cars, it was unable to increase the technological quality of its cars to the extent that was acceptable for Western customers. Secondly, after the disastrous entry of Chery's competitors Brilliance and Jiangling in Europe, Chery rather decided to focus on emerging markets for the next few years.¹³⁷ In 2011, it operated production facilities in many countries around the world, such as Russia, Ukraine, Iran, Egypt, Indonesia, Uruguay, Malaysia or Brazil.¹³⁸ In 2012, it targets total export sales of 170-200,000.¹³⁹

Chery became infamous in the early 2000s when it allegedly copied design and technologies of the Chevrolet Spark to create its own model QQ. Despite the fact that the court has not decided in favour of the US producer, the dispute was eventually settled out of court for an undisclosed amount.¹⁴⁰

The independent, privately owned carmaker **Geely** started its business as a producer of kitchen appliances in 1986, but in early 1990s it refocused onto production of motorcycles and scooters. In 2003 then Geely introduced its first own automobiles. The company also started very early with exporting its cars abroad, however, it overestimated its capabilities. Despite its presence at the Frankfurt car exhibition in 2005 and in Detroit three years later, it was unable to successfully establish itself on

¹³² See www.chinautoweb.com

¹³³ See www.carnewschina.com

¹³⁴ See Fiala, O., Jara, M., Stradal, S. (2010), pp. 8-9

¹³⁵ See LMC Automotive (2012)

¹³⁶ See www.just-auto.com

¹³⁷ See www.just-auto.com

¹³⁸ See www.cheryinternational.com

¹³⁹ See www.chinautoweb.com

¹⁴⁰ See www.just-auto.com

the developed markets. However, it has succeeded on the domestic Chinese market. Currently being the 8th largest carmaker in China, it runs a relatively unique production and sales strategy. It rather focuses on third-tier cities and rural areas where it has established hundreds of dealerships with the objective to capture 10% of the Chinese market by 2015.

Geely became famous in the Western countries by acquiring the traditional Swedish car manufacturer Volvo in 2010. By this transaction worth EUR 1.3 billion Geely got access to state-of-the-art technologies that can help Geely enter the developed markets with its own products. Besides, Geely plans to increase the presence of Volvo in the Chinese market, with the goal to build new production facilities near Chengdu and Daqing with the initial capacity of 100,000 Volvo cars. The medium-term sales goal aims to find at least 200,000 new Volvo customers a year by 2015, taking at least 20% of the luxury market in China.¹⁴¹

BYD Auto, another independent Chinese carmaker, possesses a unique strategy compared to its competitors. As a subsidiary of BYD, one of the largest battery producers in the world, it has a crucial competitive advantage in the near future fight for the hybrid and pure electric vehicle market. Currently, it focuses mainly on the domestic market; however, it plans to expand rapidly to developed countries as soon as the conditions are favourable. By 2025, it aims to export half of its production.¹⁴²

Great Wall, selling around 350,000 cars a year in China belongs to rather small producers. However it attempted to enter developed markets already back in 2005 with the introduction of SUV models Hover and Wingle at the Paris motor show. Three years later it exited from the European market, as it was unsuccessful in establishing any long-term sales. In Australia, though, it sold more than 5,000 vehicles in 2011. Great Wall also operates knocked-down-based plants in Russia, Indonesia, Iran, Vietnam, Egypt, Senegal, Venezuela and Malaysia.¹⁴³ Since last year, it produces its cars also in Bulgaria, which was the second time Great Wall entered the EU market.

Brilliance, the last carmaker in this short list, in one of the smallest Chinese producers selling only 152,000 cars last year, however, it has a high-profile export programme since mid 2000s.¹⁴⁴ In 2007, it introduced its BS6 sedan at the Geneva motor show and planned to sell thousands of vehicles every year. The car, however, failed through the safety tests, achieving zero out of five stars possible, being one of the worst results ever. This news circulated around European press and the bad reputation could have been one of the crucial reasons why the Chinese carmakers

¹⁴¹ See www.chinaautoweb.com

¹⁴² See www.just-auto.com

¹⁴³ See www.chinaautoweb.com

¹⁴⁴ See LMC Automotive (2012)

weren't able to establish any long-term successes in the 2000s. Brilliance also runs export operations in Middle East, Eastern Europe, Egypt and Vietnam.¹⁴⁵ In China, beside the production of its own models, it operates a joint venture with BMW.

3.5 Trends, challenges and constraints

The near future of automotive industry in China will be primarily driven by several factors and trends. Some of the factors are under a full control of the Chinese government, such as the 12th five-year industry plan or the environmental regulations. Some of them are rather a result of the market forces that are controllable only with difficulties. To this group we can add for instance the overcapacity of the production market or the second-hand market emerging as a consequence of the fast development of the first-hand market in the last 15 years. Each of these trends will be briefly discussed below in order to identify the key drivers that might have an effect on the internationalisation of the Chinese car manufacturers.

3.5.1 Overcapacity

In the race to achieve the highest sales possible, all producers, indigenous Chinese as well as the foreign ones, invest heavily into expansion of their production facilities. However, as the sales in China now grow less rapidly than before, the overcapacity seems a significant issue for the next few years. Already in 2011, China was expected to have unutilized capacity of 6 million vehicles, which will have risen to more than 9 million by 2016.¹⁴⁶ Car manufacturers already have a capacity of more than 23 million cars in China and by 2019 it is expected to increase by other 17 million.¹⁴⁷ Nearly all major carmakers have recently announced expansion of their current facilities or establishment of brand new ones. With sales only growing by single digits this can have a crucial impact on the industry. Also, this could potentially mean that the overcapacity will be solved by exporting the excess of vehicles abroad.

However, little can be done by the government to prevent this from happening. The producers are often supported by local authorities that mainly focus on increasing the businesses in their region, omitting to accept any broader viewpoint. In August 2009 though, the national government prohibited the carmakers from building factories in other provinces than at these where they already are present.¹⁴⁸ This can, however, have only a slight impact as the companies can always create partnership with in the regions already active partners.

¹⁴⁵ See www.just-auto.com

¹⁴⁶ See KPMG (2012)

¹⁴⁷ See LMC Automotive (2012)

¹⁴⁸ See www.just-auto.com

3.5.2 Consolidation

This issue has already been briefly discussed in the previous sections of this thesis. The national government aims to decrease the number of active carmakers in China, with the objective to pursue the economies of scale, production effectiveness as well as increasing the requirements on technology and quality.¹⁴⁹ China has been dealing with this idea since 15 years ago, however little has taken really place. Probably the most significant merger was in 2007 between the SAIC and Nanjing Automotive. However, this was highly influenced by the awkward situation after the acquisition of MG Rover a few years before as some of the rights were purchased by SAIC and some by Nanjing. With the merger of these two, the acquisition effect could be fully exploited.¹⁵⁰ In 2010, the government issued a statement naming four regional leaders in the auto industry in China that were encouraged to consider regional consolidation – BAIC, Guangzhou Auto, Chery and Sinotruck.¹⁵¹ Later that year, Guangzhou Auto made an agreement to take over the SUV producer Changfeng Motor, through which Guangzhou got access to the partnership with Mitsubishi. In 2011, Chery officially finished the consolidation of assets with Anhui Jianghuai Automobile under the supervision of local governments.¹⁵²

3.5.3 Premiumisation

According to statistics, around 230 million of people can afford a car, which is already ca. every fifth person living in China.¹⁵³ Therefore, purchasing an automobile has increasingly stopped becoming a symbol of financial success. Therefore, the focus of wealthy people has moved to the direction of luxury class cars. Besides, in the near future, Chinese customers will start demanding cutting-edge safety and technological features offered mainly by higher segment cars.¹⁵⁴ The majority of imported cars in China are luxury vehicles of European and US producers. For brands such as Rolls-Royce or Bentley China has become one of the key markets, often outperforming traditional markets such as the USA or the UK. In the pace to support the local production, the government has restricted the conditions for importing the US luxury cars with the engine displacement of 2.5 litres and above in 2011. The objective of this measurement is to encourage the local producers to introduce new higher-segmented cars. The large and large-plus segments are expected to grow by 12.5% each year,¹⁵⁵ reaching nearly 1 million vehicles in 2019.¹⁵⁶ With increasing

¹⁴⁹ See KPMG (2010)

¹⁵⁰ See www.just-auto.com

¹⁵¹ See APCO (2010)

¹⁵² See www.just-auto.com

¹⁵³ See www.strategy-business.com

¹⁵⁴ See Deloitte (2009)

¹⁵⁵ See Arthur D. Little (2011)

¹⁵⁶ See LMC Automotive (2012)

technological knowledge of local manufacturers, the traditional European producers might face a fierce competition very soon. Until then, the premiumisation trend will be a European success story covering a large portion of the luxury market, with only General Motors being a true competitor.

3.5.4 Environmental regulation

Especially the large cities in China, such as Beijing or Shanghai, are increasingly suffering from air pollution and traffic congestion.¹⁵⁷ In order to protect their people, they have recently issued numerous measurements to prevent from worsening the situation. Some of them were controversial, such as limitation of vehicles allowed to be driven in particular days based on the registration plate number or limitation of vehicle registrations in Beijing, others were vital, such as support of environmental-friendly vehicles in the last incentive plans.

In the newest five-year plan that was issued last year, new energy vehicles were identified as one of the seven strategic industries. Besides, the government issued the Energy Saving and New Energy Vehicle Development Plan for the period 2011-2020.¹⁵⁸ New energy cars include electric (hybrid, plug-in and battery), fuel cell and hydrogen-powered vehicles. Through these plans, new energy vehicles are set to receive over EUR 11 billion of investments in order to achieve the target of 1 million new energy cars by 2015. China also plans to build over 2,000 charging stations and 400,000 charging poles in 70 pilot cities. By improving the infrastructure and financially supporting the producers and customers, the government projects to become the number one producer of new energy vehicles in the world by 2020 and annual sales of EV of 4-6 million by 2026.¹⁵⁹

To support the sales of new energy vehicles, the government has also tightened its emission targets. It aims to decrease the average CO₂ emissions of new cars from 187 g/km in 2006 to less than 132 g/km in 2015. The EU, though, goes even further and plans to decrease the target to 96 g/km by 2020.¹⁶⁰ This could be a potential competitive advantage of the European producers, whose models will be ready for these regulations without any significant design and technological changes.

3.5.5 Used car market

Until now, the car industry has preliminarily been driven by first time buyers in first- and second-tier cities along the coastline. However, with increasing sales of new cars,

¹⁵⁷ See Booz&Co (2011)

¹⁵⁸ See APCO (2010)

¹⁵⁹ See KPMG (2012)

¹⁶⁰ See Roland Berger (2012)

so has increased the market with used cars, too. The trade volume of used cars has boomed from marginal 250,000 in 2000 to more than 3.6 million in 2010.¹⁶¹ To keep up with this trend, most major carmakers have introduced used-car service at their certified dealerships. Moreover, the government has issued several policies and incentives to support the used car market.

Whereas currently the used car market is in its embryotic stage, it is expected to experience a rapid boom in the medium term. By 2017, the sales of used cars are expected to surpass the new car sales achieving a yearly amount of nearly 19 million cars.¹⁶²

3.5.6 R&D and talent management shortages

Weak management and lack of R&D are major concerns on the competitiveness of Chinese carmakers.¹⁶³ Even though they have set up joint ventures with many multinational carmakers, they often fail to transfer the know-how as the multinationals have kept the key product development activities.¹⁶⁴ The Chinese companies are therefore able to deliver the basic car products, however they lack any system integration and optimization. This crucial capability has blocked any massive business activities in the developed countries. Therefore, many Chinese companies have hired Western managers to bring their expertise in order to leverage what both parties can do the best.

In terms of technological know-how, Chinese brands have often failed to implement the level of safety and technical features that were common in the developed markets. This was still sufficient enough to succeed on the domestic market as they could lower the prices to such an extent, that the customers found the products attractive. However, in Europe and the USA, the standards were much higher. Because of this fact, Chinese companies, being financially covered by Chinese banks and local government, have in several cases acquired Western carmakers to obtain the know-how. So did Tengzhong acquire the US-based carmaker Hummer, Nanjing Automotive purchased the bankrupted MG Rover and recently Geely acquired Volvo and BAIC some assets of Saab. This trend is expected to continue in spite of being financially demanding, but fast and managerially feasible.

¹⁶¹ See www.chinabusinessreview.com

¹⁶² See Arthur D. Little (2011)

¹⁶³ See Harvard Business Review (2003)

¹⁶⁴ See McKinsey & Company (2008)

3.5.7 Automotive 12th five-year industry plan

As already stated in the previous chapters, Chinese government issues an outline for all industries every five years, informing the businesses and other stakeholders about their intentions and objectives for the next five-year period. So did the government also last year with the 12th five-year plan. In the 10th and 11th plan automotive as a whole industry was one of the key pillars, securing the full support of the carmakers from the side of the national government. With the newest issue, automotive industry is no longer among the prominent ones.¹⁶⁵ This does not mean, though, that the entire automotive industry will be excluded from the incentive plans, but there is a clear transfer to supports of new energy vehicles, which remained within the seven strategic industries.

Specifically, the plan aims to improve domestic carmakers' capability of producing complete vehicles, as well as create a background for production of key components independently of foreign companies. Second, it identifies new energy vehicles as a potential mean that can help China become the global player by developing the cutting-edge technology and leapfrog the carmakers from the developed countries. The production of new energy vehicles will be substantially supported by numerous incentive funds, supportive tax policies and a better credit system. The Chinese government will, as already outlined in the previous sections, improve the infrastructure to accelerate the demand for new energy vehicles.

The five-year plan also projects the increase of production of vehicles to 25 million units by 2015, reduction of emissions by 20% compared with the level of 2008 and a further stage of consolidation of domestic players, now with the objective to create ten large OEMs which will account for over 90% of the total market. From these ten largest OEMs, 2-3 will be in the giant group, producing yearly more than 3 million units and further 4-5 with the yearly production of 1-3 million vehicles. The 12th five-year plan also affects the export targets as it outlines to export 10-20% of total vehicles produced in China by 2016.¹⁶⁶

3.6 Future outlook of Chinese auto industry

Despite its rapid growth in the last ten years and already being the number one market in the world, Chinese car market can still be considered as being in an embryonic stage. Even though the times of double-digit yearly growths are gone, due to the low motorization rate the potential of the Chinese market is enormous. In 2025, China is projected to absorb sales of 37.5 million vehicles, which is twice as much as in 2011. In fact, in China the vehicle sales in 2025 should nearly equal the combined

¹⁶⁵ See Business Monitor International (2012)

¹⁶⁶ See Roland Berger (2012)

sales of the second and third-placed countries India and the USA (23.0 million and 18.5 million vehicles respectively).¹⁶⁷

In the chase to increase the role of China in the global automotive industry, the government will play a crucial role. By setting the framework for the future development of the Chinese car market by issuing the 12th five-year industry plan and the New Energy Vehicle Development Plan, it has clearly stated its intentions to support the environmentally friendly vehicles. The industry, though, will still be mainly driven by traditional internal combustion engines.

3.6.1 Supply and demand projection in China

Until 2020, Chinese vehicle market is expected to grow by 4-7% year-on-year reaching more than 30 million vehicles.¹⁶⁸ This is going to be driven mainly by purchases of sales of passenger cars that are projected to increase every year by 7-8%.¹⁶⁹ The projected sales of passenger cars in China top 26 million cars in 2020, which is nearly 200% of the current sales figures.

In terms of the segments, although the premiumisation of Chinese car market is an attractive trend for many brands, the sales will be driven primarily by small cars. In 2011, 2.9 million small and subcompact cars were sold in China. With a yearly growth of 11%, the market is expected to absorb more than 5.5 million small and subcompact cars in 2020. General Motors, Hyundai and Geely will play leading roles in this class, each selling above 0.5 million small and subcompact cars. For Geely, this would mean nearly 50% of its total passenger car sales. On the other hand, the large and large-plus segment will be dominantly covered by foreign producers. From the nearly 1 million luxury cars sold in China in 2020, only Geely is expected to become an established player with estimated sales of 65,000 luxury cars a year (in 2011, the total sales of Geely in this segment hardly reached 10,000 vehicles).¹⁷⁰

When speaking about the domestic producers, their crucial role in the market will lie in the sales of light commercial vehicles, such as vans or pick-ups. In this class, they are expected to maintain the market share of above 95%. The key players in this segment will still be SAIC with total projected sales of vans and pick-ups of 2.1 million, Changan with 1.4 million and Dongfeng reaching total sales of vans and pick-ups in the amount of 1 million cars. The largest non-domestic player in these segments is Renault-Nissan in the ninth place with 140,000 vehicles.

¹⁶⁷ See Roland Berger (2011)

¹⁶⁸ See www.chinaautoreview.com

¹⁶⁹ See Morgan Stanley (2009)

¹⁷⁰ See LMC Automotive (2012)

The production of the cars is going to develop more or less accordingly with the sales in China, being supported by dramatic increase in production capacity. Nearly every major market player is going to expand its capacities in order to keep up with the increasing demand. Whereas the foreign companies operating through JVs are increasing their capacity to supply the target Chinese market, Chinese domestic manufacturers do not only expand their production to saturate the domestic demand, but certain part of the production is planned to be exported then. Therefore, the following table provides an overview of the capacity increases along the projected sales in China, while it focuses on activities of domestic producers only. In order to determine the excess of the capacity for passenger cars, the production capacity of the Chinese brands had to be amended by subtracting the projected sales of light commercial vehicles. This then could be used to estimate the available capacity for passenger cars.

Table 4: Expected available capacity of major Chinese carmakers in China, 2020

Carmaker	Capacity, 2011	Capacity, 2020	PV Sales, 2020	Capacity utilization, 2020
Geely	890,000	1,200,000	1,300,000	108,3%
BYD	900,000	1,080,000	990,000	91,6%
Chery	1,100,000	1,500,000	930,000	62,0%
Great Wall	530,000	1,150,000	870,000	75,7%
SAIC	600,000	500,000	690,000	138,0%
Changan	750,000	1,400,000	590,000	42,1%
FAW	600,000	700,000	570,000	81,4%
Dongfeng	370,000	10,000	432,000	4300,0%
Jianghuai	300,000	900,000	370,000	41,1%
Brilliance	150,000	110,000	280,000	254,5%

Source: Based on LMC Automotive (2012)

The results from the table clearly show that many of the Chinese manufacturers will struggle meeting the demand in the domestic Chinese market. Companies that could potentially possess sufficient technological know-how to enter the European market, such as Geely with its new range of both small and large cars, or BYD with its PEVs, will be hardly capable of satisfying the domestic market. The only chance for them will be building another production facilities, which will even increase their focus onto the domestic market in the short term. This factor can negatively influence their internationalisation activities and definitely should be taken into consideration when making any conclusions and recommendations.

3.6.2 Foreign activities of Chinese carmakers

According to statistics, Chinese manufacturers are expected to export more than 1,312,000 cars in 2016.¹⁷¹ This is nearly double of the export in 2011. Most of the export activities will be driven mainly by exports of commercial vehicles to emerging countries by producers such as Chery, Changan, Great Wall and BAIC.¹⁷² For most Chinese companies exporting vehicles is not a key activity, but rather a positive spillover resulting from excess of production capacity over the sales in China.

Some of the export figures, however, result from export activities of foreign producers in China. For instance, Honda's production plant in Guangzhou focuses entirely on assembling cars to be exported to other countries. In 2005, this plant itself accounted for nearly 25% of the entire export of Chinese cars. Also General Motors was planning to build a new small car production plant in China dedicated solely for export to the United States, however due to arguments with labour unions in its domestic market it turned down any such activities for the near future.¹⁷³

Several producers actively plan to extend their production capacity to foreign markets to build up entire supply chain abroad. For instance, Geely plans to build a new production facility in Mexico with the original capacity of 50,000 vehicles. Due to the distance between Mexico and China, this plant is expected to focus mainly on supplying vehicles to that Central and South America. Chery, as well as Great Wall, on the other hand, focus their production expansion into the European region, recently setting up production plants in Bulgaria (Great Wall) and Turkey (Chery). Both of these companies originally planned to enter the European market already a few years ago, but due to the economic crisis focused rather on other markets, such as Russia, where the market dynamics were more favourable.¹⁷⁴

Great Wall has already started operating the plant this February, with the initial focus on the domestic Bulgarian market and the surrounding markets such as Macedonia and Serbia.¹⁷⁵ The sales targets are in the range of thousands of vehicles initially, however, the company has already announced plans for expansion to other markets within a few years, targeting to sell 50,000 vehicles by 2015. The other Chinese carmaker, Chery, plans to invest up to EUR 375 million to the production plants in Turkey, taking the advantage of both the proximity to the European market as well as low labour costs in Turkey, Turkish customs union with the EU and a new attractive incentive system introduced by the Turkish government.¹⁷⁶ Besides, Chery also plans

¹⁷¹ See Business Monitor International (2012)

¹⁷² See Fiala, O., Jara, M., Stradal, S. (2010), pp. 10-15

¹⁷³ See Congressional Research Service (2009)

¹⁷⁴ See McKinsey & Company (2008)

¹⁷⁵ See www.zerohedge.com

¹⁷⁶ See KPMG (2012)

to produce cars in the European Union region when it bought an unutilized Fiat plant in Italy last year.¹⁷⁷

The recent mergers and acquisitions between Chinese and foreign manufacturers have also helped Chinese carmakers not only get access to the latest technologies of their developed partners, but they also acquire existing production facilities in the desired region. For instance, Volvo produces its cars in two factories in Europe, Sweden and Belgium, which might be a vital way for Geely, the current owner of Volvo, how to start producing its cars within the European Union without significant financial costs.

In general, with increasing competitiveness of Chinese manufacturers, the foreign activities will rise, too. Within this decade, their technological level will be equal to the one offered by current global leaders from the developed countries. This might result in growing appetite of Chinese brands to enter more markets around the world, including the most traditional markets, such as the United States and the European Union. However, satisfying the demands from their domestic market will remain the number one issue for the Chinese carmakers.

¹⁷⁷ See www.spiegel.de

4 European automobile market

Europe is the most traditional market for automobiles. Many of the crucial inventions in the history of the automotive industry have taken place in Europe and to a large extent Europe is significantly dependent on the automotive industry. It is also a homeland for many large multinational car manufacturers, such as Volkswagen, Renault or PSA Peugeot Citroen. The entire car manufacturing supply chain represents about 33% of all manufacturing jobs in the European Union with yearly investments of EUR 26 billion in R&D and 13 million directly or indirectly involved employees.¹⁷⁸

However, since the global financial crisis that hit Europe in 2008 the automotive industry has been struggling. In 2008 the sales of new vehicles decreased by more than 25% with an annualized loss of over four million units.¹⁷⁹ Many European carmakers planned extensive plant shutdowns and labour layoffs to overcome this crisis. The national governments have identified the automotive industry as one of the key drivers of the European economy and tried encouraging the demand by implementing many incentive programs and cash rebates, e.g. the scrappage scheme. These programs were in the period 2009-2010 in operation in 13 European countries, which accounted for 85% of the entire European car market and only in Germany more than EUR 5 billion was paid out.¹⁸⁰ Despite a short-term increase in sales, driven mainly by Germany, the vehicle sales have not experienced any substantial long-term growth. In fact, the European car sales again fell down by 1.2% in 2011 compared to the year before.¹⁸¹

The main reasons for such stagnation were also related to the abovementioned scrappage scheme. Not only has such a stimulus distorted the market by shifting the car purchases forward (and not increasing the sales in the long term) but also the scheme was implemented too early because it did not force the carmakers to take any steps to reduce the installed capacity. Only two production plants have been closed down since the turmoil in 2008 – General Motors' production site in Belgium and one Fiat's site in Italy.¹⁸² Neither has any carmaker had to exit the industry. The threat of the overcapacity still exists. Besides, the scrappage schemes were oriented on boosting the purchases of fuel-efficient cars that usually are lower priced with slim profit margins for producers and cannibalized the sales of larger, more expensive cars, which had a negative effect on the profitability of the carmakers.¹⁸³

¹⁷⁸ See ACEA (2011)

¹⁷⁹ See European Commission (2010)

¹⁸⁰ See ECIPE (2012)

¹⁸¹ See JATO (2012)

¹⁸² See Deutsche Bank (2011)

¹⁸³ See ECIPE (2012)

4.1 Analysis of the European automotive industry

The automotive industry is a complex system of relationships through the entire value chain. To analyse the European market and all complexities related to it, an adapted industry analysis framework by Thenmozhi, outlined in the theoretical part of this thesis, is used on the example of the European automobile market.

4.1.1 General features and basic conditions of the industry

The European automotive industry is called “the Engine of Europe”.¹⁸⁴ With an annual turnover of EUR 780 billion, the automotive industry plays a pivotal role in the European economy.¹⁸⁵ The annual production amounts to 17 million vehicles (2010), from which nearly 90% are passenger cars.¹⁸⁶ Every fourth produced car in the world has its origin in Europe. The automotive sector is closely linked with other industries, such as electronics, mechanical and electrical engineering, information technology, steel, chemicals, plastics, metals and rubber, involving directly around 50 suppliers into production of a single car. 20% of all EU steel and one third of the aluminium production goes into the production of cars.¹⁸⁷

The European car market can be identified as a homogeneous entity, however it still consists of 27 independent countries with some individual specialities. These countries can be divided into two groups based on its significance to the European car market. The first group consists of five large countries that account for nearly 75% of total passenger car sales – Germany, France, Great Britain, Italy and Spain.¹⁸⁸ The second group then incorporates all other European countries. The large dependency on the five key markets has its drawbacks, though. As car sales in these large countries, with one exception in case of Germany, have been decreasing (2010-2011 y-o-y: Germany +8.8%, France -2.1%, the United Kingdom -4.4%, Italy -11%, Spain -18%), so does the performance of the entire region.¹⁸⁹ With the cascade effect this also negatively influences the suppliers in other countries from the second group.

Several unique aspects characterize the European car market. First, unlike other automotive regions, there is a huge demand of diesel-powered cars, namely 51% of all sold vehicles. In some countries the share of diesel-powered cars is even higher – in Luxembourg, Belgium and Spain it reaches even 70 and more percent. On the other

¹⁸⁴ See ACEA (2011)

¹⁸⁵ See European Commission (2009)

¹⁸⁶ See ACEA (2011)

¹⁸⁷ See European Commission (2009)

¹⁸⁸ See ICCT (2011)

¹⁸⁹ See JATO (2012)

hand in Greece only 4% of all cars have a diesel engine.¹⁹⁰ Secondly, there is a high pressure on decreasing the CO₂ emissions and the fuel consumption, too. The average fuel consumption of newly sold cars in Europe is only 5.8 l/100 km with the accompanied 143 g/km of CO₂. The newly issued legislation by the European Union should push these figures even lower. Third, unlike the US, for instance, the popularity of automatic transmissions is very low, accounting only for roughly 16% of all car sales, mainly driven by luxury vehicles. Last, compared to the US market, there are usually fewer cars owned within one family. Unlike the US, where an average family has 2.5 cars, it is much more common to share one vehicle among all family members.¹⁹¹ This is reflected in the car density of the European car market. Whereas the USA on average has 808 cars per 1000 inhabitants, the European market is at the similar level to Japanese and Koreans, accounting for around 500 cars per 1000 inhabitants.¹⁹²

The significance of the European automotive industry in the worldwide viewpoint has been decreasing, though. With its stagnating sales figures, the orientation of many non-European producers has been turning to emerging markets, such as Russia, China or India. So do in fact refocus the European-based manufacturers. Unlike the recent trend to shift the production of cars from the labour-demanding Western Europe to the CEE region, nowadays they establish new plants outside the European Union, closer to the current automotive growth markets.

4.1.2 Industry environment

Because of its crucial position in the European economy, the both national and European governments have an imminent interest in influencing the car industry. This was observed clearly during the financial crisis as many national governments adopted stimuli programs to support the car demand, but they lacked a broader complexity in terms of coordination with other EU countries. The governments' primary target was to preserve the national employment and national figures, while simultaneously distorting the European car market in the long term.¹⁹³

The European Commission has taken a strong lead in terms of regulation and legislative coordination of the European automotive industry, too. They are predominantly active in the following activities. First, the EC has a clear target on decreasing the environmental load of the automotive industry, regularly tightening the emission legislation by issuing the EURO norms. Secondly, it also tries to regulate the component market by for instance influencing the allowed substances in many car parts (e.g. air conditioner coolants). Third, by supporting the Euro-NCAP initiative, it

¹⁹⁰ See ICCT (2011)

¹⁹¹ See Jürgens, U. (2003), pp. 11

¹⁹² See Roland Berger (2012)

¹⁹³ See ECIPE (2012)

increases requirements on safety features of the cars. Last but not least, European Commission also regulates the end-of-life and recycling requirements.¹⁹⁴

4.1.3 Industry structure and performance

As already stated in the previous part of the analysis, the automotive industry is a crucial driver of the European economy. Not only a large portion of the world's vehicles is produced in the European countries, but also around 24% of all passenger cars are sold in the European Union.¹⁹⁵ In 2011, 13.5 million passenger cars were sold in the EU-27 region, 1.2% less than the year before.¹⁹⁶ However, more importantly, the 2011 figure was 12% below the 2001 level creating a realistic view on the long-term stagnating market in Europe.¹⁹⁷

The majority of sold cars are produced by domestic carmakers, which have historically had a strong position on the European market. In 2010, the domestic carmakers sold 74% of all passenger cars.¹⁹⁸ All top nine carmakers with the highest car sales have its origin in Europe (Due to its little similarities with its parent company Ford of Europe is considered as a Europe-based company). The first non-European carmaker is Toyota in the tenth position with a market share of only 3.9%. The following table provides a detailed overview of the most selling carmakers in Europe.

Table 5: Passenger car sales in Europe by brand, 2011

Brand	Sales 2011 [units]	Market share [%]	% Change 2010-2011
Volkswagen	1,678,279	12.4%	+9.1%
Ford	1,087,912	8.0%	-2.8%
Renault	1,038,313	7.7%	-8.8%
Opel	985,322	7.3%	-1.5%
Peugeot	909,340	6.7%	-9.4%
Citroen	770,175	5.7%	-8.0%
Audi	679,690	5.0%	+9.0%
BMW	640,318	4.7%	+5.2%
Mercedes-Benz	591,348	4.4%	+0.0%
Toyota	532,437	3.9%	-9.4%

¹⁹⁴ See EMCC (2004)

¹⁹⁵ See ACEA (2011)

¹⁹⁶ See JATO (2012)

¹⁹⁷ See ICCT (2011)

¹⁹⁸ See ICCT (2011)

Others	4,630,045	34.2%	-0.1%
Total	13,543,179	100%	-1.2%

Source: Adapted from JATO (2012)

This historically highly competitive market with many carmakers sharing the sales results in difficult position for new entrants. The domestic players are covering all segments of the car market, leaving little space for non-European companies. Despite this fact, both Japanese and especially Korean carmakers are gaining on the market share. In 2011, Hyundai and Kia increased their sales by 12, respectively 11%, and reached a combined sales output of 690,000 vehicles.¹⁹⁹ Their competitive advantage in localized products, appealing design features and aggressive, financially demanding marketing strategies have helped them establish themselves among the top carmakers in Europe with promising future development.

4.1.4 Industry future attractiveness

The short-term outlook for the European car market is not very positive. Deutsche Bank predicts in its reports another year of sales decline for 2012, which is expected to be even more significant than in 2011. Whereas in 2011 the sales of cars in the European Union decreased by slight 1.2%, for the following year the prediction reaches up to -6.4%. Such a rapid decline is comparable to the crisis peak in 2008 and will be caused mainly by dropping sales in Southern European countries but also a 2.2% decline in Germany. The strongest decrease in sales is expected in France (-12.2%) and in the UK (-7.2%). Major markets, such as Germany, the UK or Spain fall to their level reached in 1993, almost 20 years ago. To put this into perspective, in 1993 the total sales of vehicles in China reached 1.3 million, 16 times less than last year.²⁰⁰ These predictions have been confirmed already in the beginning of the year with January sales more than 7% lower compared to a year earlier.²⁰¹ The later market development, though, even worsened the situation on the European car market. Italian and Spanish markets were performing much worse than the original estimations predicted, with year-on-year decline in June by 24% in case of Italy and 12% for Spain. In fact, the Italian sales were the worst June figures since 1979. Other markets are having difficulties, too.²⁰²

In 2013, though, the situation is expected to improve in all major markets. Along with the improving macroeconomic situation and resolving of local economic crises in Greece and Spain the overall demand of passenger cars is expected to increase by

¹⁹⁹ See www.eubusiness.com

²⁰⁰ See Deutsche Bank (2011)

²⁰¹ See JATO (2012)

²⁰² See www.msnbc.msn.com

over 4%.²⁰³ In the medium term, nearly all major producers expect the market to grow significantly, overcoming the recent years of stagnation. Hyundai and Kia, for example, plan to increase their sales from current 0.7 million cars to nearly one million within just three years.²⁰⁴ By 2019, the European market overall is expected to increase by 20.8% to more than 16 million cars a year.²⁰⁵ This rapid increase in sales should create enough market potential for new and recent entrants, such as the Koreans or Chinese.

4.1.5 Industry practices

The competitive environment on the European automotive market has resulted in dropping prices of new cars for many consecutive years. This trend has been speeded up in the recent years by aggressive strategies of Korean carmakers that attempted to gain market share on the European market very fast. Despite the annual inflation rate of around 2% in the European Union,²⁰⁶ the average passenger car prices have not followed the inflation rates. In fact there was a significant price drop after 2009 by merely 2.5%, in spite of the fact that the European carmakers warned that the tighter CO₂ regulation would lead to increase of car prices by more than EUR 2,500.²⁰⁷ Also, there is a recent trend in the European automotive industry to promote worse selling cars by large rebates. In March 2012, the average discounts in Germany and Italy reached an all-time high of 30% off the original price, largely substituting for the already terminated government incentive programs.²⁰⁸

The European automotive market is also characterized by dense distribution network and advanced aftersales support. According to ACEA, there are more than 180,000 dealerships in EU-27, making it to one dealership to 2,800 people.²⁰⁹ These dealerships, mainly selling European-based brands, have created a network of reliable, near-located service centres that are literally in each town. For any new entrants, this would mean increased spending on establishing dense dealership network with complex services.

The high level of competitiveness in the European car industry and the recent recession has also led to strong position of European carmakers in the fields of R&D. Yearly over EUR 26 billion is invested by European carmakers in research, which makes them Europe's largest private investors in R&D.²¹⁰ Over 54% of all automotive

²⁰³ See Deutsche Bank (2011)

²⁰⁴ See Roland Berger (2012)

²⁰⁵ See LMC Automotive (2012)

²⁰⁶ See www.inflation.eu

²⁰⁷ See www.upi.com

²⁰⁸ See www.thefiscaltimes.com

²⁰⁹ See ACEA (2009)

²¹⁰ See ACEA (2011)

patents in 2008 were filed by European carmakers. To put this into a perspective, Japanese carmakers filed only 22%, and Chinese patents accounted for as little as 0.3%.²¹¹

4.1.6 Emerging trends and likely future

Similarly to the Chinese automotive market, also the European one will be influenced by several key drivers and trends. However, unlike China where the major trends include the premiumisation, rapid growth of the used car market or consolidation of fragmented domestic manufacturers, the trends in Europe are clearly focused on improving the efficiency of the vehicles, decreasing their ecological footprint and cutting production costs. I have identified the following five key trends:

Ecological regulations

Originally, the European Union legislative considered regulating the emissions from the perspective of fuel, but in light with the Kyoto Protocol aligned its targets to calculation of greenhouse gases measured by grams per kilometre. Initially the regulations were rather on a voluntary basis, but later the EU came up with directly applied initiatives.²¹² In 2008, the European Parliament and Council approved the new legislation shaping the future of automotive industry in the next decade.

By 2015, the average CO₂ emissions from newly registered cars must not be higher than 130 g/km. This target should be achieved on a staggered basis. By 2012, 65% of new cars should meet the target, 75% in 2013, 80% in 2014 and full production portfolio in 2015. There should also be super-credits for vehicles emitting less than 50 g/km and special conditions for niche manufacturers. Not complying with these legislative will be heavily fined.²¹³ Moreover, the European Union plans to even tighten the limits to 95 g/km by 2020.²¹⁴

Beside the CO₂ regulation, there have been also other initiatives for years. So-called EURO norms limit predominantly other carbons, such as CO, HC or NO_x.²¹⁵ They differ for petrol and diesel engines and are regularly updated with stricter limits. The currently valid norm EURO 5 newly limits NHMC emissions for petrol-powered cars to 0.068 g/km and particulate matters to 0.0050 g/km. Besides, it tightened the limits of NO_x to 0.06 g/km.²¹⁶ The emission limits for diesel engines differs slightly with stricter focus on CO and HC+NO_x. This forces the producers to improve the

²¹¹ See www.acea.be

²¹² See United Nations (2011)

²¹³ See ACEA (2009)

²¹⁴ See Roland Berger (2012)

²¹⁵ See EU-JRC (2008)

²¹⁶ See ICCT (2011)

technology of cars and equip them with upgraded catalytic converters in case of petrol cars and EGR systems and DPF filters for diesel-powered engines.²¹⁷ In 2014, the new version EURO 6 should come to force with even stricter limits on particular matters and NO_x levels. This would force the producers to increase the R&D spending even further and might make the entry of new players harder. The full overview of all EURO norms is in the appendix.

Alternative fuels

With increasing prices of fossil fuels, tighter limits imposed by governments all over the world and increased awareness of the public, car manufacturers are forced into developing sustainable “greener” cars with higher energy efficiency.

There are numerous forms of alternative fuels for passenger vehicles. So far, the major emphasis has been laid on hybrid vehicles as the “easiest” method of creating a more sustainable car with lower fuel consumption and fewer emissions. Despite large investments of carmakers into this technology the market share of hybrid-powered cars remained very low – 0.6% in 2010.²¹⁸ Some countries, for instance Sweden, focus their activities on biofuels made of a mixture of petrol and ethanol (E85, E95).²¹⁹ The share of new vehicles in Sweden powered by E85 was more than 12% in 2010.²²⁰ Many carmakers also focus their R&D activities on developing sustainable cars powered by LPG or CNG, all driven by the ambitious target of the European Union to reach 10% renewable energy use in road transport by 2020.²²¹

However, the highest attention around the world is paid to electric vehicles that offer a perspective of zero-emissions.²²² Due to a globally higher-urbanized population the daily travel distances have decreased to less than 100 kilometres per day.²²³ This opens up the opportunities for electric vehicles whose relatively limited range has for a long time been the top issue. However, some drawbacks remain unsolved. Despite governmental incentives for EV owners and enormous investments of carmakers and governments into the technology (in the EU there has been already invested more than EUR 8.5 billion into EV programmes) no large-scale EV launches have taken place.²²⁴ However, the governments remain optimistic. By 2020, 5.1 million electric vehicles are expected to be on the European roads, which accounts to more than 70% of the total EV market.²²⁵ Also many market researches have shown that consumers in

²¹⁷ See EU-JRC (2008)

²¹⁸ See ICCT (2011)

²¹⁹ See ACEA (2009)

²²⁰ See ICCT (2011)

²²¹ See ACEA (2009)

²²² See European Commission (2008)

²²³ See EUCAR (2009)

²²⁴ See Roland Berger (2009)

²²⁵ See European Commission (2011)

the EU are willing to pay a premium for a greener car – around 40% is willing to pay up to 10% premium for an electric car.²²⁶ However, this is still significantly below the current market prices of EVs.

In order to introduce successfully the EVs into the European market, a complex approach is needed. The joint initiative of stakeholders (e.g. energy suppliers, car manufacturers, infrastructure providers and road authorities, ICT sector as well as customers) will be needed to develop the EV system in the European Union. Any ulterior motives of any of these parties might negatively influence the program, harming the EV future.

Downsizing

Although a large focus from both the public and the experts is laid on enhancing the usage of new fuel technologies, such as hybrid engines, and FEV, some producers try improving the fuel efficiency and reaching the emission limits by improving the currently used ICEs. With the increasing efficiency of turbo-chargers and compressors, many carmakers downsize the engines and achieve the same horsepower with less engine displacement. This is a vital method for many carmakers how to lower the emissions without heavily investing into alternative fuel systems. The average engine displacement in the EU decreased by nearly 100 ccm in the period 2004-2010 and is expected to decline even further in the near future.²²⁷

For instance Volkswagen Group and BMW have been constantly improving their ICEs by the method of downsizing. BMW, for decades known for its state-of-the-art six-cylinder engines, is increasingly making use of its new four-cylinder engines with lower displacement. Its brand new 1 Series only offers four cylinder petrol and diesel turbocharged engines and even its brand new 3 Series has all but one four-cylinder engines. Whereas the previous generation of the 3 Series was produced with only one four-cylinder engine accompanied by other six-cylinder ones (not counting the eight-cylinder M3). The horsepower though remained at the same level, just with fewer cylinders and less displacement and potentially a turbocharger. Even the top sportive M5, in the previous generation powered by a 5.0 V10 engine, has changed dramatically.²²⁸ The current generation is powered by a 4.4 biturbo V8 engine, while producing even more horsepower.²²⁹

Skoda, the Czech carmaker, also heavily relies on downsizing. Some of its newest products, including Roomster, Fabia or Rapid are powered exclusively with turbocharged, low-displacement engines. The only exception is the basic three-

²²⁶ See EurotaxGlass (2011)

²²⁷ See ICCT (2011)

²²⁸ See www.auto.cz

²²⁹ See www.bmw.de

cylinder 1.2 HTP engine. The other, though, are either 1.2 and 1.4 TSI petrol engines, or 1.6 TDI diesel engines.²³⁰

Such approach to lowering the emissions is very appealing to many carmakers and it is expected to become a widespread trend for most European carmakers in the near future.

Shift towards Central and Eastern Europe

Central and Eastern European region offers an attractive environment for car manufacturers and has been attracting numerous investments from both Western European and overseas carmakers. The cheaper labour, close proximity to the core Western European markets and increasing sales in the CEE region itself provide main reasons for carmakers to invest there. For WE carmakers, CEE means a favourable alternative to offshoring the production outside Europe and for overseas carmakers, especially the Koreans, it provides an attractive way how to enter the European car market with their own production. Carmakers from the developing countries, such as China or India, are attracted by the lower quality requirements and lower purchasing power of the customers.

Table 6: Overview of major past and future automotive investments in CEE

Investor	Target country	Year of investment	Value [EUR m]
Volkswagen	Slovakia	2011-2016	1,500
Ford	Romania	2008-2012	1,200
Hyundai	Czech Republic	2006-2012	990
Volkswagen	Hungary	2010-2013	900
Daimler	Hungary	2009-2012	800
Renault	Romania	2008-2011	650
General Motors	Hungary	2010-2012	500

Source: Adapted from Roland Berger (2012)

Table 6 provides a detailed overview of major automotive investments in the CEE region. They are driven by both European and Asian OEMs. Several large production sites have or will be installed by the first-tier suppliers as well, but this is out of scope of this thesis. So far, the main investments have been attracted by the Czech Republic, Slovakia, Poland and Hungary. Slovak and Czech economy is heavily dependent on the car production as it accounts for nearly 7.5% of GDP.²³¹ Over 100 vehicles per 1000 inhabitants are manufactured in Slovakia and the Czech Republic, significantly

²³⁰ See www.skoda-auto.cz

²³¹ See U.S. Federal Government (2010)

above the EU average of 36 vehicles.²³² However, the second-tier countries, such as Bulgaria, Romania and Serbia are in the pace to catch up with the first group. In fact, Serbian government has announced they want to copy Slovakia by attracting European investments in the car industry.²³³

On the other hand, the CEE region, currently serving the investors from developed countries as an attractive manufacturing region of lower-segmented vehicles, might be missed out on the future trend of hybrid and electric vehicles as there is little governmental push, little R&D from producing OEMs and few signs of any EV producers, which is in contrast to the current innovation activities in Western Europe.²³⁴

Car import duties

Although around 85% of all vehicles sold in the EU are manufactured in the region, import tariffs and other restrictions can have an enormous influence on potential entrants. The current EU tariffs on cars and light commercial vehicles are 10% (for some developing countries 6.5%) and even though it is quite modest it is a sufficient level to restrict imports.²³⁵ Because of the competitive environment in the European car market, a 10% price increase can largely affect the potential business success. On the other hand, any decrease of the import duty can help the importers achieve a significantly higher profitability.

The 10% import duty is, though, very low compared to other countries and regions. This protective measure by governments serves to helping the domestic producers be more competitive and is applied merely by developing countries. For instance, there are large import duties on passenger cars in India (101%), Thailand (80%) and Indonesia (65%).²³⁶ China and Russia both apply a 25% import duty, but in both cases this is significantly lower than before the accession to WTO. In fact, both countries are expected to further decrease the import duties in the medium term.²³⁷ Korea currently applies an 8% import duty,²³⁸ whereas for instance Japan is a duty-free country in terms of car imports.²³⁹ Some countries have a more favourable approach towards non-complete car imports, such as SKD and CKD units. On one hand it lowers the import costs of cars to their countries, on the other hand it forces the carmakers to establish assembly sites in the target countries to finish the car for sale.

²³² See ACEA (2011)

²³³ See U.S. Federal Government (2010)

²³⁴ See Ernst&Young (2010)

²³⁵ See ECIPE (2012)

²³⁶ See ACEA (2009)

²³⁷ See www.en.rian.ru

²³⁸ See ACEA (2009)

²³⁹ See ECIPE (2012)

In July 2011, with the introduction of a free trade agreement between the EU and South Korea, there was a drop in car import duties from the aforementioned 10% to 6.5% for cars with engine displacement above 1,500 ccm and 8.3% for smaller cars. This change, despite being very modest, along with the market development and new model launches of Korean carmakers led to a nearly 70% increase in car imports from Korea in the first nine months after the FTA came into effect.²⁴⁰ The effect on trade was reciprocal, though. In the same period the cars export to Korean also rose by 70%, signalling a large effect of the immediate decrease of the import duty from eight to just 4%. According to the FTA, within the next five years both regions are supposed to fully eliminate all import tariffs on passenger cars.²⁴¹

However, in the near future, due to problematic relations between China and the European Union, no such FTA is expected to come into force. The Chinese car exporters will still have to count with the 10% import duty. This might influence their internationalisation strategies and increase their focus on an entire production of cars within the EU.

4.2 Cases to learn from

The European automobile history already records two successful stories of new entrants into the highly competitive European car market. Japanese and Korean carmakers entered the European market slowly with a few mistakes in the beginning, but they were able to learn from their mistakes, improve their strategy and currently are thriving in the market. For instance Hyundai experienced one of its best years in 2011, with yearly sales up by 10% and market share of nearly 3% in EU-27.²⁴² Kia Motors, a sister company of Hyundai recorded a 22% sales increase in the same period.²⁴³ Moreover, Kia continued with the growth even this year, achieving year-over-year growth of nearly 25% in January-June period of 2012.²⁴⁴

If the Chinese enter the European market in a larger scale, they could potentially learn from the Korean and Japanese best practices. Therefore, in order to form a potential strategy for Chinese manufacturers, it is vital to analyse how these two nations entered the European car market, with what expectations, and what they had to do to establish successfully on the European automobile market.

4.2.1 Japanese case

²⁴⁰ See www.theasianlawblog.com

²⁴¹ See Congressional Research Service (2011)

²⁴² See Roland Berger (2012)

²⁴³ See www.kia-press.com

²⁴⁴ See ACEA (2012)

The Japanese export boom in the 1980s is attributed to two major factors. First, the oil crisis in 1970s hit the US market very hard. The US producers were not ready to respond quickly to the customers' demand of cheaper, fuel-efficient cars. The Japanese, though, had such cars in their portfolio. The second reason for an active internationalisation of the Japanese carmakers was the large saturation of the Japanese car market, allowing only a minor growth potential for the OEMs.

At that time, the Japanese set up a few joint ventures with local US partners to start selling cars. Their first start was unsuccessful. They little responded to customer preferences in other than fuel consumption aspect. In fact, the sales were so low that Toyota withdrew from the US market after one year, returning two years later.²⁴⁵ However, the Japanese learned very fast and they made use of their advanced lean production that they introduced at their US production sites and an extremely efficient dealer network.²⁴⁶ In the first phase, the Japanese coexisted along the large US producers, such as Ford, General Motors or Chrysler, because they only offered small, cheap cars. But at a later stage, as the consumer preferences developed, they started achieving higher market shares by offering consumer-friendly, reliable and high quality cars for an affordable price.²⁴⁷ By 1989 the Japanese already had a more than 25% share on car production in the USA.²⁴⁸

The Japanese launch in the European market was very similar to the one applied in the United States. Their focus was on cheaper, lower-segmented cars and efficient production processes. However, their market entry was aggravated by non-tariff barriers and trade agreements limiting imports to Europe. For instance, the imports to Italy and France were legislatively limited to 3% of the market and 2,500 vehicles a year. However, as the sales gradually developed, the Japanese carmakers achieved a market share in the European countries cumulatively of nearly 12% in 1992.²⁴⁹

The Japanese OEMs also actively invested in many FDIs, creating in Europe an entire automotive value chain based on their best practices of lean production, streamlined organizational structure and R&D with constant innovation. In 2009, the Japanese operated thirteen manufacturing sites in ten countries of the European Union, with total production of 1.13 million cars a year. That is nearly double of the figures ten years before. Besides, their heavy investment into local R&D centres further increased their competitiveness. In 2006, the Japanese OEMs had twelve R&D and design centres in the EU, developing custom-made solutions for European customers.²⁵⁰ Surprisingly, even the Japanese Formula One teams Honda and Toyota

²⁴⁵ See Kristiansen, D., Garaas, H., Halvorsen, V., Utengen, A. (2006), pp. 82

²⁴⁶ See Graves, A. (1993), pp. 3-5

²⁴⁷ See Kristiansen, D., Garaas, H., Halvorsen, V., Utengen, A. (2006), pp. 82

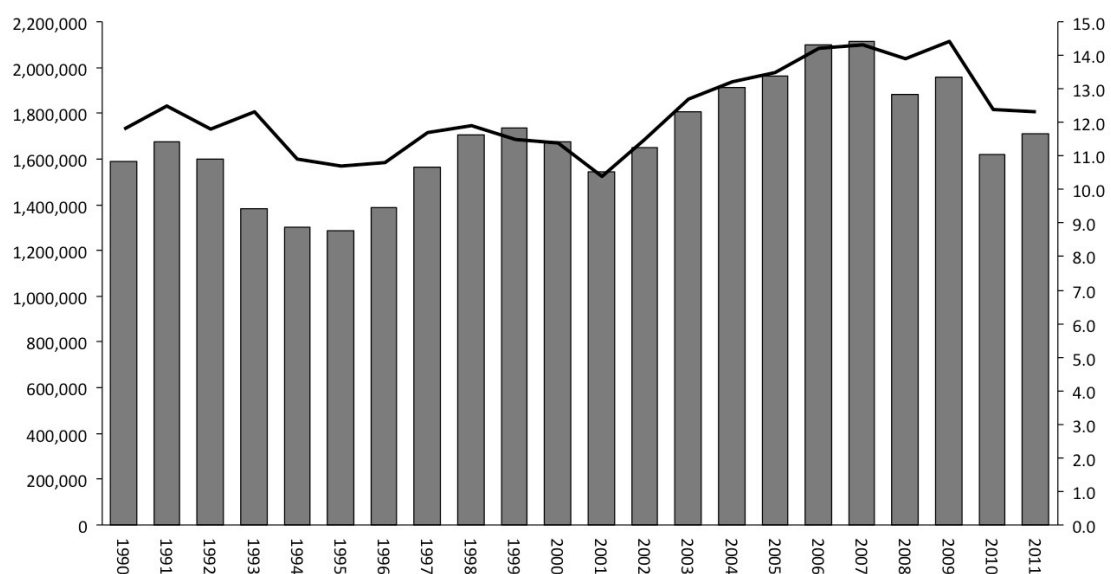
²⁴⁸ See Graves, A. (1993), pp. 4

²⁴⁹ See Graves, A. (1993), pp. 4

²⁵⁰ See JAMA (2010)

were headquartered in the UK, respectively Germany. This signals their large commitment to the European car market.

The economic crisis in 2008 hit the Japanese OEMs similarly to the European players. However, an even more influential effect on the Japanese car sales had the recent boom of Korean carmakers that possess similar USPs to the Japanese when they entered Europe in 1990s and often are even more price attractive. The price advantage of Japanese car has been lost and currently they do not possess any significant competitive advantage. Figure 8 summarizes Japanese last twenty years of presence on the European car market in terms of total sales of Japanese OEMs and their cumulative market share.



Source: Based on ACEA (2012)

Figure 8: Development of sales and market share of Japanese OEMs in Europe, 1990-2011

4.2.2 Korean case

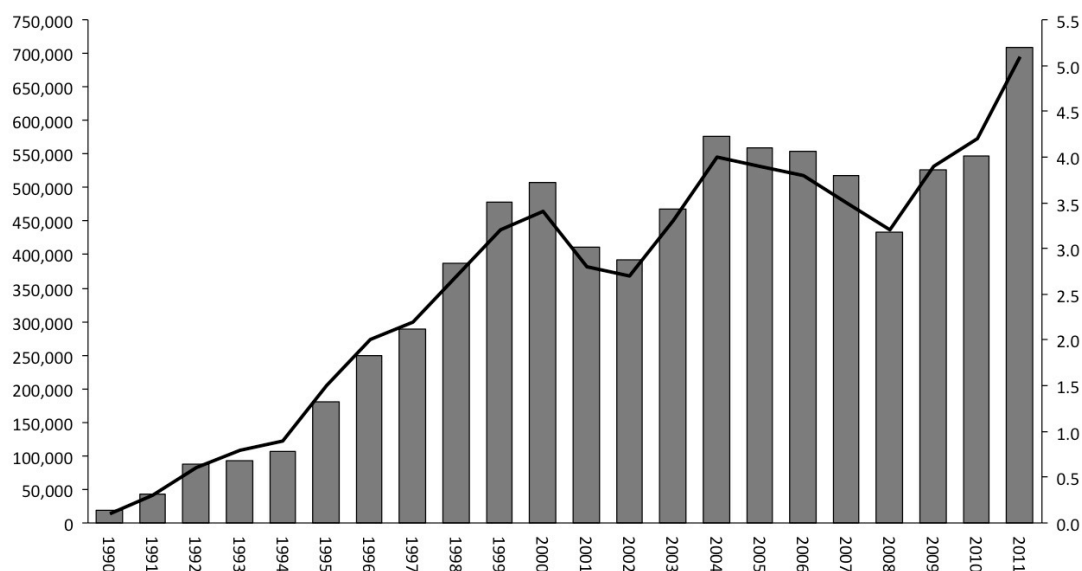
The initial internationalisation drivers for the Korean manufacturers were very similar to the previous case of Japan, also mainly driven by the domestic market saturation. First entering the US market in mid 1980s the Western European market followed in the next stage in early 1990s. Whereas in 1990 the total sales of all Korean manufacturers to Western Europe accounted for mere 20,000 units, two years later the sales exceeded 100,000 cars. In 1996, they reached 300,000 cars. Such a rapid boom of sales in Europe was caused by Korean high level of production quality, focus on after-sales network, wide product portfolio and aggressive marketing strategies.²⁵¹ Besides, as their sales in the USA became more competitive, they changed their

²⁵¹ See Lee, M. (1997), pp. 12

strategy to a more diversified one, covering all major car markets. This included their focus on Europe as well.²⁵²

However, their aggressive strategies with high quality and long warranty period had not paid off for a long time. Their initial international strategy was repositioned to a multidomestic strategy by taking heavily the regional differences and specifics of the European car market into account. They also found out that a large portion of the success on the European market is influenced by the both interior and exterior design of the cars. The Asian design promoted in early 1990s by the Japanese and at the end of the 1990s still by Koreans was not largely appealing to the European customers, who put high attention to small details and quality of used materials.

As a result, both Hyundai and Kia established dedicated design centres in Europe. Hyundai's European design centre was established in 2003 in Rüsselsheim, Germany²⁵³ and Kia followed soon, by opening its centre in Frankfurt am Main, Germany in 2007.²⁵⁴ Besides, in 2006, Kia Motors hired a brand new Chief Design Offices Peter Schreyer, a former Audi designer, responsible for many successful Audi models from early 2000s. This dedicated multidomestic approach and aggressive pricing strategies started paying off very soon, with rapid sales boom even in the times of the economic crisis a few years ago. Currently, Kia and Hyundai belong to few carmakers in Europe, whose sales are constantly increasing while simultaneously building up the market share.²⁵⁵ The rapid increase in sales and market share in the European car market in the last 20 years is summarized in Figure 9.



Source: Based on ACEA (2012)

²⁵² See Chung, M. (1997), pp. 6

²⁵³ See www.hyundai.com

²⁵⁴ See www.kia-press.com

²⁵⁵ See ACEA (2012)

Figure 9: Development of sales and market share of Korean OEMs in Europe, 1990-2011

Appendix 4 then outlines the major design changes that have been implemented by Korean brands in the last 15 years. The formerly “Asian look” has turned to an entirely European-based design, responding to consumer preferences, while still retaining the favourable car and after-sales prices because of their highly efficient manufacturing processes.

Major carmakers from Europe and the US have already discovered the potential of the Korean car manufacturers and have initiated many alliances in the last 15 years. As a result of the local economic crisis in the late 1990s, Renault favourably started cooperating with the Korean conglomerate Samsung and Daewoo was acquired by General Motors.²⁵⁶ SsangYong was first acquired by Daewoo but later sold to Chinese SAIC. Hyundai merged with Kia in 1997, and in 2000 DaimlerChrysler purchased a minority stake in this company.²⁵⁷ Later on, though, it sold the stake again, leaving Hyundai/Kia independent.

²⁵⁶ See EMCC (2004)

²⁵⁷ See www.just-auto.com

5 Preparedness of Chinese carmakers for the European car market

The previous analysis of the entry of Japanese and Korean carmakers to Europe has shown that even though the competitiveness on the European car market is enormous, with well-thought strategy and unique capabilities it is possible to enter the market successfully and achieve long-term growth and increasing sales. Therefore, with wisely selected strategy the Chinese might succeed as well. Whether or not the Chinese carmakers will be capable of repeating the success of the Japanese and Koreans depends on many factors, though.

The external market conditions are favourable. The European car market has been struggling for the past few years, but the future sales outlook remains optimistic. In the next 10 years the market is expected to grow, reaching sales of above 16 million cars a year in 2019.²⁵⁸ Besides, the clear trend of shifting the market towards cheaper, smaller and more efficient cars is matching the position of Chinese car manufacturers. With the recent success of Korean carmakers and Romanian Dacia the market's perception of cars from car-wise less-developed countries has changed and could help the Chinese enter the market more quickly and with higher sales.

This chapter's objective is to analyse the current strengths and weaknesses of Chinese in the European car market and outline their potential advantages and threats that they might leverage or respectively should be aware of. These aspects will serve to the aim to identify a plausible internationalisation strategy of Chinese carmakers in the next chapter.

5.1 Recent activities of Chinese carmakers

Although this thesis' goal is to identify the future means of entry of the Chinese carmakers to Europe and potential implications for currently established players, it does not mean the Chinese have not entered the market yet. In fact, their first attempt occurred in mid 2000s with a too-early and very unsuccessful launch of several models on the market. The initial plans of Chinese were very optimistic, but in the end no significant sales were achieved. The second wave of entry of Chinese happened a few years ago, with a rather different strategy focusing merely on Eastern European markets with lower purchasing power and lower market requirements. The true entry of Chinese similar to the previously mentioned cases of Koreans and Japanese has not taken place, though.

²⁵⁸ See LMC Automotive (2012)

As outlined in the previous paragraph, the Chinese are currently trying to enter less-developed Eastern European car markets. Great Wall, for instance, has recently started manufacturing cars in Bulgaria, with the objective to sell dozens of thousands of cars in the medium term.²⁵⁹ In fact, this might be the very first Bulgarian attempt to become a significant player on the European car production field, trying to join the Romanians, who have successfully established themselves with the production of Dacia cars and currently are attracting more and more investors from the automotive industry. The Chinese actually also tried to enter the Romanian market with an acquisition bid for a former Daewoo car production site at Romanian Craiova, but eventually Ford acquired the plant and is currently producing its light commercial vehicles and has just started production of its mass model B-Max.²⁶⁰ The mid-term production plans reach up to 180,000 cars by 2015.²⁶¹

In Slovakia, the Chinese carmaker Jianghuai Automotive has been in discussion with the local government about possible construction of a production site since 2010, but no deal has been finished yet. The plans for an expansion into the European continent are serious, though, as the company has established an R&D centre in Italy in 2005 and has been continuously exploring the options to enter the European market.²⁶²

Also Turkey remains very attractive in the eyes of the Chinese investors, as both Chery and Dongfeng have announced their intention to invest into new car manufacturing sites in the near future.²⁶³

Such recent activities could signal that the Chinese carmakers have already made a decision to aggressively enter the European car market. In order to identify the best practices as well as mistakes to learn from, I have analysed three cases of Chinese activity on the European car market that could potentially be vital for the subsequent analysis of Chinese capabilities: the very first attempt of Chinese carmaker Brilliance and Jiangling in mid 2000s, the recent purchase of Volvo Cars by Geely Automotive and the aforementioned production launch of Great Wall in Bulgaria. Each case symbolises a different internationalisation approach towards Europe.

5.1.1 Brilliance and Jiangling early entry

In 2006, the Chinese carmakers Brilliance and Jiangling tried entering the European car market for the very first time. They had ambitious goals to achieve tens of thousands sold cars within a few years, however, none of them succeeded. There were

²⁵⁹ See Ernst&Young (2010)

²⁶⁰ See www.media.ford.com

²⁶¹ See LMC Automotive (2012)

²⁶² See www.europe.autonews.com

²⁶³ See Ernst&Young (2010)

several reasons why none of them was capable of establishing itself on the European, highly competitive, market.

First, they underestimated the safety regulations in the EU. Since introduction of Renault Laguna in 2000 as the first car to achieve full five stars in the Euro-NCAP safety tests, the both European carmakers and customers started to become “obsessed” with having as safe cars as possible. In 2006, six years after the Renault Laguna, most of the offered cars achieved four or five stars in the test. Jiangling, entering the market with its SUV Landwind, shocked the European public with a disastrous result of the crash test, obtaining zero stars and achieving the worst crash test result ever.²⁶⁴ This news circulated around the European press and the model has closed itself the market door even before the market launch. In fact, ADAC insisted on banning the product from European roads.²⁶⁵ Also Brilliance, entering with its luxury model BS6 had difficulties passing the crash test.

Secondly, the Chinese have misjudged the characteristics of the European market then. Neither of the brands, Jiangling or Brilliance offered a diesel engine to their cars, despite the fact that the sales of diesel engines amount up to 50% of the European market. So did Brilliance not take into account that it should offer a combi version of its BS6 model, even though majority of European customers’ purchases in this segment are combis. The third, and maybe the most important factor for Brilliance was that they entered the European market with its large model but in that time this segment was dropping by 6% every year.²⁶⁶ All these factors have resulted in that Brilliance and Jiangling have jointly sold only 150 vehicles in 2007, hugely below their expectations.

5.1.2 Geely-Volvo acquisition

The global economic crisis hit primarily the US producers very hard. General Motors, Ford and Chrysler struggled with their operations and had to be supported financially by the US government. In line with the restructuring activities started already before the crisis peak in 2009, Ford sold some of its subsidiaries in Europe. Jaguar and Land Rover, both being part of the Ford Motor Company for many years, were sold to the Indian Tata Motors in 2008. Ford’s large portion of stake in the Japanese Mazda was also sold, decreasing the ownership from 33.4% to just over 13%, gaining Ford around EUR 400 million.²⁶⁷ However, even this operation did not help Ford raise enough capital to survive the crisis and yet another long-time acquisition had to be reconsidered, namely the ownership of the Swedish car manufacturer Volvo.

²⁶⁴ See www.euroncap.com

²⁶⁵ See Congressional Research Service (2009)

²⁶⁶ See McKinsey & Company (2008)

²⁶⁷ See www.ford.com

Despite the fact, that Volvo was a strategic acquisition of Ford and Ford had no intentions to get rid of the company there was one crucial change in the European legislative that hit Ford hard. Namely, the EU tightened the CO₂ emission legislation that significantly handicapped manufacturers offering large vehicles with high engine displacement, which has been a focus for Volvo for very long time.²⁶⁸ Besides, Volvo had not been making profit for many years. All these forced Ford Motor to search for a new owner of Volvo.

The negotiation phase with potential investors took more than one year. The most interested parties came all from China. Volvo offered them a unique chance to get access to the latest technologies developed by Volvo and high skilled labour, which would both ease the Chinese speeding up their R&D activities. All Chery, Dongfeng and Changan were highly interesting in bidding for Volvo. In the end, Ford decided to sell the stake to another Chinese carmaker – Geely Automotive.

Geely has large plans with Volvo for the next years. By 2015, it wants to produce a large portion of the vehicles in China and for that Geely builds new production capacities in Chengdu and Daqing, raising the sales targets to 200,000 Volvo vehicles sold in China by 2015, taking 20% of the luxury market.²⁶⁹ This is five times more than in 2011.²⁷⁰ Besides, it also wants to strengthen the production in Europe and therefore bought an existing production facility from the GM in Belgium in 2010.²⁷¹

The potential constraints for Geely in restructuring Volvo might be the high cost structure of the operations (labour and production costs in Sweden are incomparable to those in China or CEE) and fluctuating sales and profits. However, the latest news note that the Geely activities have so far been very promising as Volvo after years of loss making reported profits in two consequent years – 2010 and 2011.²⁷²

5.1.3 Great Wall production launch in Bulgaria

This year in February, Great Wall became the first Chinese carmaker that opened a production facility for its own passenger and light commercial vehicles within the European Union. Great Wall plans to produce a whole range of cars for Europe in this plant in the near future, topping the yearly sales of 50,000 cars by 2015.²⁷³ The target countries are initially to be Bulgaria, Macedonia and Serbia, later though Great Wall plans to launch its products all over Europe. In the initial stage, the cars will be

²⁶⁸ See Fiala, O., Jara, M., Stradal, S. (2010), pp. 13

²⁶⁹ See www.chinaautoweb.com

²⁷⁰ See LMC Automotive (2012)

²⁷¹ See Fiala, O., Jara, M., Stradal, S. (2010), pp. 17

²⁷² See www.goteborgdaily.se

²⁷³ See www.spiegel.de

assembled from imported SKD kits, but if proved successful, Great Wall plans to expand the plant to include an entire production process.²⁷⁴

The reasons for Great Wall to establish an entire production facility in Europe were primarily the increasing labour costs in its domestic country, China. For many producers it is more advantageous to produce the cars dedicated for export in countries far away in the target regions. So Great Wall for instance produces cars in Russia, Indonesia, Egypt and Ukraine.²⁷⁵ These countries were wisely chosen not only because of their proximity to target countries of sales – North Africa and Eastern Europe, but they also have favourable labour costs and appealing government programmes for attracting foreign investments.

As a business model of operating the production plant, Great Wall chose a joint venture with a local manufacturer Litex Motors. In this JV, Great Wall owns 10% of the shares, with the rest financed by Litex.²⁷⁶ This should help Great Wall learn from its Bulgarian partner and increase their quality processes with the aim to transfer this know-how later on to other production plants.

However, many experts are sceptical that Great Wall could largely succeed in this project. LMC Automotive projects the total sales of Great Wall in Western and Eastern Europe to 27,000 vehicles in 2020, significantly lower than what Great Wall predicts.²⁷⁷ There are also doubts that the operations of the plant could be profitable in the near future. According to some calculations, the plant would have to sell 15,000 cars a year to be viable. The entire cumulative new-car Bulgarian, Serbian and Macedonian market amounted only to 22,000 cars last year, which would mean for Great Wall to gain more than 68% of the market if we assumed that Great Wall would sell the cars only in these three countries. In this region, the used-car market is especially strong with sales of 200,000 vehicles last year as only a few percent of the population can afford to buy a brand new car.²⁷⁸ On the other hand, the region is expected to grow in terms of sold new cars in the next decade, which is in favour of Great Wall's activities. In order to succeed in this project, though, Great Wall would have to not only to increase the product portfolio in this plant, but also to launch its models fast in other markets across Europe with focus on countries similar to the Bulgarian one where it could offer a favourable mix of price and value, such as Romania or Turkey where the demand of new cars is much stronger than in the abovementioned three countries.

²⁷⁴ See www.nytimes.com

²⁷⁵ See www.spiegel.de

²⁷⁶ See www.novinite.com

²⁷⁷ See LMC Automotive (2012)

²⁷⁸ See www.nytimes.com

5.2 Internal factor analysis

The potential success of the Chinese carmakers on the European market depends not only on the external factors, such as the market size or competitors' activities, but largely on the internal ones that actually decide on whether or not the company has sufficient capabilities to internationalize. Although not all Chinese car manufacturers are alike, they share most characteristics. In case there is a factor with differing results, it will be taken into consideration.

The theoretical part of this thesis outlined four key internal factors that influence the internationalisation strategies of companies. First, there are management objectives, influencing the dedication of companies to go international in the medium and long term. Second, the management experience and resources analyse the capabilities of in-house experts to manage the internationalisation process successfully. Third, the potential internationalisation is heavily influenced by the production capacity available for additional demand. Last but not least, it is important to determine whether the Chinese companies can finance their internationalisation process.

5.2.1 Management objectives

The recent actions of Chinese carmakers in Europe have proven that many of them are planning to expand to Europe. Carmakers, such as Geely, Chery, Dongfeng or Great Wall have already invested large amounts of money into their European activities. For some of them entering a European market can be a signal of their maturity, for some cooperating with European companies can be a vital strategy how to improve their capabilities in the fields of organizational processes or R&D and gain access to the latest technologies. BYD, largely specializing on EVs, for example, is especially attracted by the improving business environment for electric vehicles that, in the eyes of many government representatives, will be the key mobility concept in the future.

Therefore, it can be concluded that the Chinese carmakers are definitely dedicated to their expansion to Europe and are willing to invest heavily into their operations on the European continent.

5.2.2 Management experience and resources

International experience of Chinese companies and their capability to assess the target market and respond quickly to arisen changes is probably one of the most significant drawbacks of the Chinese carmakers. Similarly to the Japanese and Koreans, whom it took years to understand the European market and amend their behaviour to the needs of the locals, it might hinder the Chinese rapid expansion as well. Secondly, whereas

the Japanese and Koreans expanded to Europe because of the saturated domestic market and had high-skilled management and production staff, the Chinese are still at a developing stage on their home market and have not gained enough experience how to compete on a highly competitive market.

Nevertheless, the quality of the Chinese staff has been improving in the recent years. With the increasing wealth of Chinese many talented students study abroad in order to adapt themselves to the US- and European style and understand the main characteristics, but also many carmakers also run own universities, technical schools and graduate school and one of their focus is onto the development of their own talents.²⁷⁹ This is especially the case of private-owned Chinese carmakers such as Geely Automotive. Besides, in order to speed up the process, the Chinese often hire experts from developed countries either in form of headhunting or by acquiring entire Western companies. By the acquisition of Volvo Cars, Geely not only fully entered the European car market, but predominantly got access to hundreds of top-skilled technicians and business experts and who can be used to improving the processes and know-how of Chinese colleagues.

However, if the Chinese enter the European market, they need to build up entirely new sales and service network. The question is whether they will follow the strategy of the Koreans who send lots of expatriates to Europe to overview their business operations and local people are primarily used to lower-positioned jobs and management of individual dealerships, or whether they will try incorporate the Europeans also into the top management of the European headquarters. This could largely influence their success rate. Although sending expatriates to the target country can be an easy strategy to fully control the European operations, there could be potential cultural and organizational mismatches between the two groups, hindering the expansion onto the European car market.

To support this statement with factual data, it might be beneficial to analyse the development of top management of Volvo Cars after Geely Automotive acquired it. Two years after the acquisition, there are four Chinese representatives in the Volvo's Board of Directors out of fourteen members – the Chairman of the Board Li Shufu, and three regular Board members Winnie K.W. Fok, Peter Zhang and Daniel Li. In terms of the Executive Management Team, responsible for the daily operations, out of 13 members, there is only one Chinese representative, namely Freeman H Shen, responsible for China Operations.²⁸⁰ All other members are from the Western countries. This provides a clear signal that the Chinese have learned from the mistakes of their Korean and Japanese predecessors and even though they have a control of the company they try to leverage the local know-how.

²⁷⁹ See Shaker, N. (2010), pp. 21-23

²⁸⁰ See www.volvocars.com

To summarize, the current level of management knowledge of Chinese carmakers is definitely insufficient to achieve larger success on the global market. However, due to their rapid learning curve and attracting high-skilled labour from developed countries, the gap between the Chinese and Europeans should be diminishing and in the medium term, the globalizing Chinese carmakers should be at the level of their Western-based competitors, ready to compete on the most-competitive and developed markets.

5.2.3 Production capacity

Chapter 3 dealing with the analysis of the Chinese car market has identified several constraints in terms of the available production capacity. The market in China is expected to grow by around 5-10% every year for the next decade and therefore the Chinese car manufacturers have to amend their production capacity accordingly. As a result, by 2020 many Chinese carmakers might lack enough capacity to serve even their own domestic market. This situation largely differs from the internationalisation process of Korean and Japanese carmakers that were primarily driven by stagnation on their domestic market and a need to grow.

On the other hand, they might solve this constraint by establishing new production sites in the European continent, similarly to what many of them have been doing in the last few years (see Chapter 5.1). Also, due to restructuring activities of current market players there might be available production sites for purchase. In the first 6 months of 2012, there were several announcements by the global players to close their factories in Europe. First, General Motors' subsidiary Opel plans to close its production site in Bochum, Germany by 2016 to solve its overcapacity issues.²⁸¹ So do Fiat and PSA Peugeot Citroen cut many jobs and each carmaker group plans to close one factory in their domestic market.²⁸² These closures could potentially create attractive opportunities for expanding Chinese carmakers. Moreover, also local governments might welcome the Chinese for preserving the employment in the region and support the investors financially. The drawbacks are, though, that these production sites are located in Western counties that have high operating costs.

To conclude, currently the Chinese do not have enough capacities to serve the European market through export and they would have to open new factories for their European activities. By taking the advantage of available sites across Europe in the next few years the Chinese could quickly obtain high-skilled labour and existing supplier network. The strategy, though, has crucial disadvantages in the production cost structure related to operating production sites in Western Europe.

²⁸¹ See www.foxbusiness.com

²⁸² See www.businessweek.com

5.2.4 Financial capacity

The financial situation and funding possibilities largely depend on who owns the carmaker. In China generally, there are three types of ownerships. First, the carmaker can be owned by the state, falling within the authority of the highest government. This is the case of most large Chinese carmakers, such as SAIC, FAW, Dongfeng or Brilliance. The finances are nearly unlimited, but they are largely influenced by the targets of their owners, the state. Second, such as Chery, the company can be owned by a local government, being established originally to support the employment in the region. The financial possibilities are also very large, but similarly to the state-owned carmakers, the local government decides on most investment activities. Third, the carmakers can operate independently under the ownership of private persons, such as most global car companies. Geely, BYD and Great Wall belong to this group. In this case the financial base reflects the business success of the company and there are no external subsidy opportunities, with the exception of special loan programmes from the Chinese government. However, these privately owned companies are usually part of a large corporation creating for the car subsidiary a strong background in terms of funding of its expansion.

On the other hand, profits of private carmakers do not reach figures promising rapid expansion possibilities without help of their parent companies or the Chinese government. Speaking in figures, Geely Automobile Holding for instance achieved a yearly profit of EUR 199.8 million in 2011, an increase of only 13% year-on-year.²⁸³ BYD's profit even decreased by 44% last year due to fierce competition in the domestic market, reaching EUR 181.7 million in 2011.²⁸⁴ Great Wall, though, was able to expand its operations recently, achieving a 27% net profit growth in 2011 to EUR 445.1 million.²⁸⁵ This allows Great Wall not only to expand its operations in domestic China, but also to support its new production site in other countries outside China, such as the aforementioned joint venture in Bulgaria.

The major reasons for low profitability of many Chinese carmakers are not only a rapid expansion in production capacities, building up the capacity for future market growth, but predominantly a high cost structure with ineffective production expenditures, large investments into R&D and a too wide product line, creating barriers for any economies of scale. Nevertheless, with increasing know-how of the OEMs and improving the production process the profitability is expected to grow in the next years.

As outlined, the financial possibilities for most Chinese major players are relatively large, comparable to the global players such as GM, Ford, Toyota or Volkswagen.

²⁸³ See www.bloomberg.com

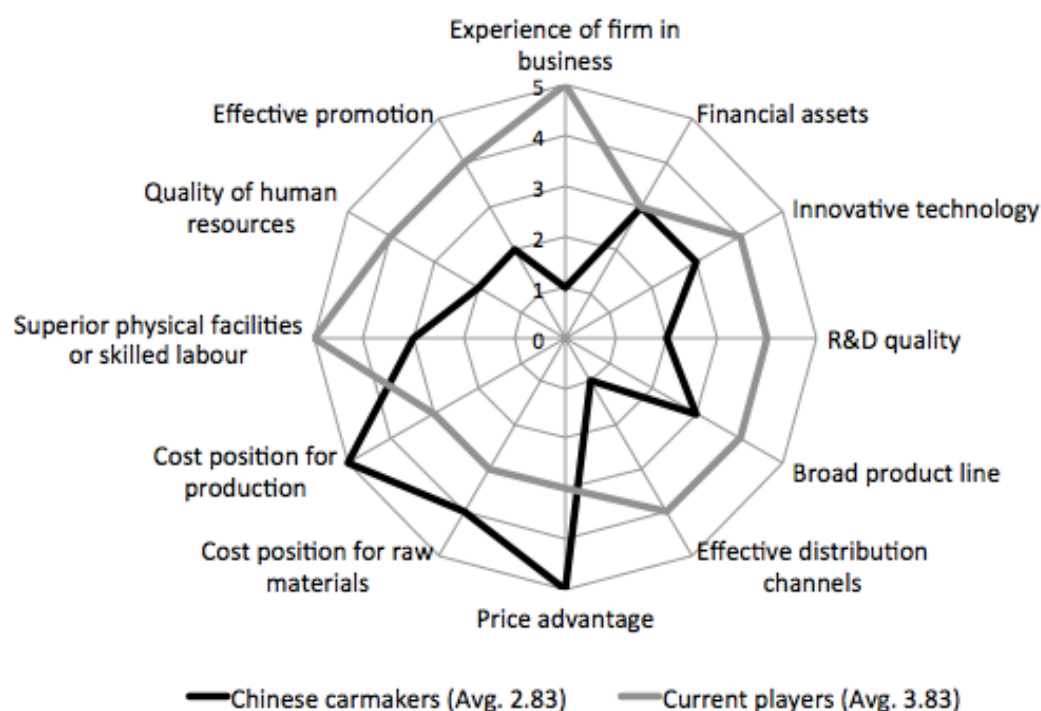
²⁸⁴ See www.chinaautonews.com

²⁸⁵ See www.autonews.gasgoo.com

Therefore, the finances should not be a major issue when analysing the potential expansion of Chinese carmakers to Europe. Nevertheless, the current profits the Chinese brands currently are achieving do not allow them for a precipitous expansion to Europe.

5.3 Success factors

The success factors identified in the chapter 2.2.5 are a powerful tool for describing the major aspects influencing the success of an internationalisation strategy of a company. The following figure is based on the up-to-now analysis of the Chinese carmakers and identifies the key advantages and disadvantages of Chinese carmakers in comparison with their European, Japanese and Korean counterparts, already present on the market. Not only strong capabilities are needed to succeed on a market, but also a clear competitive advantage in several factors is crucial for distinguishing themselves from the established players.



Source: Author

Figure 10: Analysis of success factors' possession of Chinese and European carmakers (5 – best, 1 – worst)

The figure states that there are several major differences between the established market players and the potential new entrants from China. Whereas in the fields of financial assets and position in purchasing of raw materials both parties are similarly equal, in most factors the Chinese carmakers stay behind their European counterparts

creating possible barriers for success. To determine to which extent these deficiencies are substantial for the market entry, a short comparison analysis will be provided for each of these factors in the following section of the thesis.

5.3.1 Experience of firm in business

This is one of the most significant factors where the currently present carmakers have clear and undisputable advantages. Whereas the Europeans built the market and the Japanese, US-Americans and Koreans entered the market decades ago, the Chinese, due to their recent history, have little experience with presence on a highly competitive European car market. They already tried entering the market in the mid-2000s, but without a significant success, selling in the second phase only a few hundred vehicles a year.²⁸⁶

To succeed on the market, they would need to cooperate with strong and experienced business partners. This can be achieved either through strategic alliances or, in special cases, through acquisitions of active market players such as when Geely acquired Volvo Cars in 2010. This obtained know-how can be leveraged for a future entry of own Geely cars onto the market. Also the joint venture between Great Wall and Litex Motors in Bulgaria signals that the Chinese are aware of their insufficient knowledge about the market and they seek strong partners that they can use in their third phase of conquering the European car market. Also, hiring managers from Europe or the USA can be a way to increase their competitiveness in the area of expertise.

5.3.2 Financial assets

As already analysed in the previous section of this chapter, the Chinese have in most cases a strong financial background, despite stagnating profits in the last year. Some of the Chinese producers experience rapid increase in sales and profit (such as SAIC or Great Wall), some struggle striving to restructure their cost structure. The restructuring activities might hinder any short-term expansion into Europe, but if successful, their medium- and long-term increase in competitiveness might become a major issue for current players and create enough capital for a successful establishment of European operations.

The market players in Europe, who will compete with the Chinese, do not have a identical profit profile. Whereas the Koreans, Volkswagen and premium-class producers, such as Daimler or BMW are able to achieve profit growth every year, other carmakers Opel, Renault, Fiat or PSA struggle and their sales and profits

²⁸⁶ See ACEA (2012)

decrease. For instance, due to Opel, General Motors lost EUR 609 million in its European operations last year and PSA lost EUR 358 million in the same period.²⁸⁷

5.3.3 Innovative technology and R&D quality

Because of global sourcing of major multinational carmakers, many Chinese firms have easy access to the latest technologies, which are supplied by global first-tier suppliers all over the world. Therefore, for Chinese carmakers there are no significant barriers for implementing full range of airbags, the latest version of ESP, rear-seat DVD system or the Stop&Go system. What they do lack, in contrast, are new fresh ideas and brand new innovations in the field of fuel efficiency, decrease of CO₂ emissions and safety features and primarily the capability to develop such technologies from scratch. In case of product launch in Europe, they will not compete with the current players with any especially innovative solutions, but merely provide average, proven, technologies with a lower price tag.

There is one area, though, where the Chinese might become key players in a future technology – the EVs. Because of strong support from the national government and low cost of supplied parts, several Chinese carmakers focus on developing a full portfolio of electric vehicles with the objective to sell them across the globe. Besides, for companies such as BYD, the battery technology has been a key business area for a long time and BYD itself plans to launch many EVs in Europe in the medium term. With lower manufacturing costs of key parts of the EVs, they will be able to achieve final vehicle prices unreachable for most European players.

5.3.4 Broad product line

There is a two-fold definition of product line. First, there is the distinction of how many models the carmaker offers. Second, within the one model the carmakers differ based on how many engines, equipment levels or construction versions they offer.

In terms of the first division, a broad product portfolio is currently not a big issue for large Chinese carmakers. In fact, some Chinese OEMs are even striving to reduce the number of models offered to consolidate the portfolio. The second viewpoint creates a large gap between the Chinese and European carmakers. Whereas the commonality on the European car market is that each OEM offers a wide range of models, each with several petrol and diesel-powered engines and levels of equipment, in China on one hand, a carmaker offers up to seven or eight models, on the other hand, each only with one, maximum two types of engines and restricted levels of equipment.

²⁸⁷ See www.nytimes.com

For the Chinese market, this strategy is sufficient, maximizing the economies of scale, but on the other hand, such a strategy does not work in Europe, with European purchasing habits. Even the Japanese and Korean carmakers, originally offering a very restricted level of personalization, now, with increasing production in Europe they have managed to extend their portfolio with a higher level of customization to keep up with the European trends.

Great Wall's new wave of products offered through its production site in Bulgaria, however, has not considered this trend of customization and for its new Voleex C10 hatchback only offers one engine, one level of equipment and very limited extras. The other models – Steed 5 and Hover H5 at least offer a choice of 4x2 or 4x4 versions and in case of Steed 5 two engines to choose from.²⁸⁸ These limitations are largely caused by the CKD production model, but if Great Wall plans to expand to the Western Europe as well, it will definitely have to reconsider its product strategy.

5.3.5 Effective distribution channels

The Great Wall's strategy of shipping the CKD models to Bulgaria for a final assembly could be effective for the initial phase of the Europe entry, but in the medium term a whole production chain will be crucial for the success. This is based on the case of Koreans, who initially shipped the complete cars from Korean plants. Not only was it financially demanding due to several import taxes, but also primarily the production proved to be inflexible, forcing to produce models not directly responding to the needs of European customers. For instance, Hyundai i30, the company's key model in Europe, was initially shipped from Korea in its first generation, but in 2008 Hyundai moved the entire production to its new plant in the Czech Republic. However, unlike its related product Kia Cee'd that was manufactured in Europe from day one, it possessed some characteristics, blocking an even greater success of the model, such as low-quality interior with hard plastics. The new generations of both models were not only designed in European design centres of both companies, but are also manufactured there, being close to the customers and pushing the costs as low as possible. As a result, basically all key models of European and Japanese players are manufactured in the region.

Moreover, in terms of sales and service network the Chinese currently lack effective and widespread sales network that is needed to serve their customers. In order to succeed on the competitive European market, the Chinese are currently selling their cars through very limited amount of dealers who are not skilled enough to outperform the Western brands by the level of customer service. If the Chinese want to establish themselves successfully on the European car market, this is definitely one of the key factors that have to be improved and focused on.

²⁸⁸ See www.greatwall.bg

5.3.6 Price advantage

Even in their domestic market, the Chinese brands rather focus on lower-income groups and government fleets, leaving the top, high-profit segment to foreign carmakers. In Europe, the situation is expected to be very similar, with Chinese competing at lower market segments, primarily focusing on price-value ratio. The competition in this segment is fierce, though. Not only are there the Koreans with their very innovative, well equipped and price attractive models, but also Renault's subsidiary Dacia, manufactured in Romania, is a potentially direct competitor of Chinese brands. The success of Dacia with its models Sandero, Duster and especially Logan has signalled the Chinese carmakers, that after the crisis in 2008 the European customers are willing to purchase cheap and lower-quality cars. With the technical quality of Renault, low manufacturing costs of Romania and currently few direct competitors, Dacia has achieved an enormous sales success in the recent years.

5.3.7 Cost position for raw materials

In the globalized supplier market, no crucial advantages are possessed by the Chinese carmakers in terms of traditional materials, such as steel or plastics that constitute a great portion of a manufactured car. In December 2011, for instance, the price of benchmark hot-rolled coil steel in Germany cost EUR 478, whereas in Asia EUR 483.²⁸⁹

There is, though, one special group of materials, where the situation largely differs based on the country of origin of the carmakers, namely the rare earths. Rare earths are a group of 17 metals that are crucial for many high tech products, such as automobiles or PCs. There is a significant imbalance in global supplier network of rare earths. More than 80% of the market is dominated by China.²⁹⁰ This was achieved by an aggressive pricing strategy of the Chinese, when they first pushed the prices of rare earths very low to make other mines struggle business-wise and many mines had to close down the business and then the Chinese increased the prices significantly. In fact, the prices of rare earths have skyrocketed in the past years, achieving in some cases a change in price of 5,800% in the period 2005-2011.²⁹¹ Nevertheless, in 2012 the prices of several key rare earths have been decreasing again.²⁹²

Such domination by China on the field of rare earths might have a substantial effect on the competitiveness of global carmakers. Whereas the Chinese carmakers could close favourable deals with the rare earths suppliers, the non-China based carmakers

²⁸⁹ See www.ft.com

²⁹⁰ See Roland Berger (2011)

²⁹¹ See Roland Berger (2011)

²⁹² See www.asianmetal.com

can face further increase in prices, resulting in increasing production costs and restricted orders.

5.3.8 Cost position for production

Compared to the current market players the Chinese have a clear competitive advantage in their option to wisely choose the regions for their manufacturing sites. Whereas most European carmakers produce their cars in the lands of origin that face the high operating costs, low flexibility but high productivity, the Koreans (unlike the Japanese) have chosen to manufacture their key models in the CEE region that benefit from its proximity to the key Western European market, high production quality and low cost labour.

The Chinese have several strategies to choose from. First, they could export the cars manufactured in China or in other country outside the European Union. This, on one hand, would mean very low production costs, on the other hand also an appalling manufacturing quality. Second, they could produce the cars in the target region, either directly in Western Europe, or in the CEE region, following the strategy of Korean carmakers.

The Chinese have, up to now, have not decided which strategy would be most profitable. On one hand, they have plans to build new production sites in CEE, such as Great Wall in Bulgaria or Chery in Turkey, but they have also acquired unused plants of Opel in Belgium and Fiat in Italy. The final choice depends merely on the positioning strategy of the Chinese producers. If the Chinese carmakers plan to focus on cheap cars and compete with Dacia, CEE region would be the best choice. If they, on the other hand, plan to enter higher segments to challenge Western European players, producing the cars directly in WE could attract totally other customer groups. Anyway, this option to select their production destination from day one gives them a massive competitive advantage compared to the current market players.

5.3.9 Superior physical facilities or skilled labour

The current market players in Europe clearly dominate in this factor. First, due to fierce competitiveness of the industry in Europe and constant innovation of the product and process, they have achieved high automation of the manufacturing process based on usage of robots. The remaining personnel are very productive and top-skilled, especially in the WE-located production sites. This created a strong pressure on any new entrants, such as the Japanese and the Koreans. They, though, possessed top productivity and innovative production processes, diminishing the potential advantage of the Europe-originated producers and in several aspects even improving the manufacturing process.

The Chinese, however, do not have any such superiority in manufacturing in terms of technology or productivity. Their global competitiveness has been based on low production costs due to low wages and from that resulting low automation. Without significantly improving their position in manufacturing they might not reach quality needed for succeeding in the European car market. Acquisition of unused plants and headhunting European experts might be a solution to this constraint, but without internal constant improvements, the other players might increase the technological gap again.

5.3.10 Quality of human resources

HR management is another of the main deficiencies of Chinese carmakers when benchmarked with the currently well-established European players. Their deficiency in managerial skills to develop an internally strong and competitive organizational culture is hindering the Chinese from active competition with the foreign-based players even in their domestic Chinese market. However, some Chinese OEMs are aware of this deficiency and are working hard on changing the situation dramatically. Geely, for instance, has an active approach towards internal development of technical talents by operating its own technical schools, universities and supporting exchange programmes for many identified talented students and employees. Such an approach is very rare in the Chinese automotive industry and it is expected to take a long time to catch up with the European, Japanese, Korean or US competitors.

In terms of the European market entry, many European employees would have to be hired in many managerial stages to create not only a strong regional headquarters, but also an effective and flexible dealership network. The capability to attract high-skilled Europeans to run their daily business might become an issue due to the image of Chinese car manufacturers.

5.3.11 Effective promotion

Due to the sellers' market in many of the target regions of Chinese carmakers including the domestic one, Chinese have not been forced to focus on effectiveness of their promotional efforts. Unlike the Korean carmakers Hyundai and Kia, who have continuously worked on improving their image and perceived quality on the developed markets. For instance by entering into global marketing sponsorships to become official sponsors of football FIFA World Cup and UEFA EURO.²⁹³ Similarly, Volkswagen became the official partner of the Beijing Olympic Games in 2008,²⁹⁴

²⁹³ See www.newsauto.pl

²⁹⁴ See www.beijing2008.cn

BMW has become the official partner of this year's London Olympic Games²⁹⁵ and Nissan will be the official partner of the Olympic Games in Rio in 2016.²⁹⁶ For instance Skoda, in contrast, focuses on smaller events, less financially demanding, but with similar audience reach, such as Tour de France or Ice Hockey World Championships.²⁹⁷ No such global activity has been identified in the case of Chinese carmakers.

If the Chinese want to conquer the developed markets, they would have to amend their promotion accordingly, too. Not only POS campaigns and country-wide marketing activities, but continuous improvement of the brand image would be needed, including entering motorsport activities in the target regions to demonstrate their high technical capabilities. So far, only Chery has been active in this field as it participated in the 2010 and 2011 Dakar Rally with its Rely X5 SUV. Similarly, Great Wall participated in the recent 2012 edition.²⁹⁸

5.4 Conclusion

Based on the analysis of the Chinese car market, its main domestic players, the target European car market as well as the internal characteristics and specifics of the Chinese carmakers in relation to the European car market in the previous chapters, one should be able to state whether the Chinese will enter Europe in an ever more massive way.

It is important to point out that there is no way the Europeans can protect significantly its domestic market against new entrants in a coordinated way. They can increase the import taxes or introduce import quotas, but this would still not affect any FDI from the side of Chinese carmakers. However, the main question is whether the Chinese will want to split their focus on two regions – remain active on the domestic market to catch up with the increasing demand of passenger cars as well as invest heavily into expansion to far located European market.

The conclusion is ambiguous and depends on the type of the Chinese carmaker. The OEMs owned by the government or state or the ones closely cooperating with Western car manufacturers through various joint ventures will see the expansion as a way to scale up their market and to increase the footprint of the Chinese industry. In case they closely transfer the technologies with their Western partners via domestic JVs, there will be no need to acquire other players such as when Geely bought Volvo. Their potential interest in entering the highly competitive European car market rather

²⁹⁵ See www.bmw.co.uk

²⁹⁶ See www.rio2016.com

²⁹⁷ See www.skoda-auto.com

²⁹⁸ See www.dakar.com

depends on the development of the car market in China and any strategic decisions made by influential parties, such as the Chinese government, respectively.

On the other hand, Chinese private manufacturers, such as Geely, BYD or Great Wall do not have any JVs in China. They develop their products individually and they face severe R&D shortages and are negatively affected by the increasing level of innovation of their competitors. They will actively seek business partners that might help increase their global competitiveness. For them, entering Europe might not only be a vital chance to achieve higher sales, but primarily to form strategic alliances with local companies to help them with their R&D. The likelihood of a more significant presence of Chinese carmakers from this group is very high.

To conclude, from what has been stated above, it is very likely that in the near future several Chinese carmakers will increase their presence in the European market and challenge the currently established players. To estimate the potential implications for the current market players, it is important to find out what strategy the Chinese car manufacturers will use for their European activities, which is the key focus of the next chapter.

6 European third wave strategy of Chinese carmakers and its implication on current market players

The analysis in the chapter five has come to the conclusion that it is likely that certain Chinese carmakers will enter the European car market in a greater extent than so far. Primarily those carmakers that lack any domestic cooperation with global carmakers or those that already have some activities in Europe. There are two major questions resulting from this statement.

First, the question is what will be the most likely way of increasing their European footprint in the short and medium term in terms of strategic entry choices. According to previous sections, in the first wave they entered Europe through export strategy with little business separation from their domestic country. The second wave represented primarily by Geely's acquisition of Volvo clearly showed the changing Chinese strategy with more emphasis laid on understanding the target European market and leveraging the local knowhow. The first part of this chapter will therefore focus on defining the most probable expansion strategy of Chinese carmakers into Europe.

The second part, then, is closely linked to the first part and covers the possible implications for current market players that would result from the expanding Chinese carmakers. Similarly to the Americans several decades ago, the Japanese in the 1990s and Koreans in the 2000s and early 2010s, whose entry into the market has had fundamental impact on the performance and structure of the European car market, the expected increased footprint of Chinese will do so similarly. Therefore, based on the recognised data in the previous chapters and sections, potential consequences and from that pinpointed recommendations will follow in this final part of the thesis.

6.1 Entry strategy for Chinese carmakers

Chapter 2.3 has identified five theoretical frameworks that form the strategic internationalisation approach of a company. First, it is important to define the relationship between the Chinese headquarters and the European division through the geographic expansion strategies. The following international growth strategies then mark out the intensity of the Chinese operations with respect to ownership. This strategic core then influences the potential market entry mode. Consequently, an important factor is the time schedule and time frame used to enter the new markets, respectively the region, followed by the suitable strategy to emphasize and build upon the company USPs.

This section will step by step apply all these theoretical concepts on the Chinese carmakers that are likely to enter Europe and will result in a clear strategic overview of the Chinese carmakers in Europe in 2010s and beyond.

6.1.1 Geographic expansion strategies

This theory reacts to the concept of global integrations versus local responsiveness, ultimately resulting in a financially demanding, but very successful glo-cal approach. Within this frame, four key strategies are known – multidomestic, regional, international and transnational. Each of them varies based on the relation towards local changes and global similarity.

Most global car manufacturers apply the transnational strategy. This is due to the large product-wise similarity of the global car market and necessity to coordinate the business around the world. The transnational strategy allows them to create one global concept of a model and adapt it to individual markets or regions to either comply with different legislation or to fulfil the specific customer requirements. So, for instance, the cars sold in Europe have to comply with the strict EURO 5 emission rules, whereas in Africa or Asia the limits are significantly looser. As of the customer requirements, customers in developed car markets such as the USA or Europe have exacting requirements on safety and comfort features as well as quality of the materials used. However, Japanese, US-American and European carmakers can profit from the transnational strategy due to their high-level quality of the original product targeted to their domestic regions.

The Chinese carmakers, however, have a clear disadvantage in the low quality of the cars they currently have in production. Therefore, to cope with the European car market they can't use this product portfolio to the new market. As a result, the international and transnational strategies can't be used at the moment before they develop their domestic products and services to the competitive level with the multinationals. Both regional and multidomestic strategies provide with enough local responsiveness to respond to the specific requirements of the European market. The multidomestic strategy, though, reflects the needs of each country specifically, with no clustering of the markets. In case of Europe, and especially the Western European markets, due to the business interconnection caused by the European Union there are no dramatic differences. The Western European markets can be considered as one region with very similar customer needs and similar purchasing power (not taking into consideration local specifics such as right-hand driving in the UK). Therefore, the regional expansion strategy proves to be the optimal for Chinese carmakers in Europe and might learn from the Japanese and Korean approach.

The divergent product portfolio is not the only part of the business. In the best case, the regional expansion strategy includes all factors of the business such as

establishing regional headquarters, establishing regional R&D centres that will focus on the European market products creating tailored solutions for the local customers as well as a network of interconnected European operations that will leverage the obtained know-how from one market to improve the business and offered services in other markets of the region. Only such a complex approach towards the European market similar to the one applied by other non-European carmakers can help Chinese achieve a significant success similar to the recent Korean success story.

The complex approach towards the new region with little economies of scale with the domestic market creates increased financial and other burdens on the new entrants. Taking into consideration the financial situation of the potential Chinese entrants and the development and expected CAPEX needed on the Chinese market to cope with the local competitors, most of the companies will not be able to fully dedicate internal teams to the full expansion into other regions. Therefore, the creation of the regional strategy with “around-the-clock” approach with dedicated R&D and production performed locally will be mostly a matter of the next five to fifteen years, but definitely not by 2015. Until then the Chinese carmakers are expected to manage the activities in Europe from their Chinese headquarters with several small business teams in Europe to gather the know-how first, explore the market and then, when the company is internally ready, enter the market with full speed.

6.1.2 International growth strategy

Before identifying the most suitable market entry mode for the Chinese carmakers, it should be clear what growth strategy they would most likely use. There are three basic strategies. First, the Chinese carmakers can extend their business through internal growth by entering more markets, such as Europe or the USA with their products or by increasing their product base and entering into more segments. Opposite to that, the companies can grow externally by acquiring other market players in the automotive industry. Third, and in our case the least relevant option is the diversified approach with automotive players growing by acquisition of non-automotive companies. On the other hand, this strategy could also be applicable the other way around when the European car market could be entered through acquisition by a Chinese company that has not been active in the automotive industry before. Identification of such a company is out of the scope of this thesis, though.

Based on the preceding analysis of the characteristics of the major Chinese car manufacturers and the international activities of several of them so far, it can be stated that it is mostly probable that the Chinese carmakers will pursue both types of expansion, intensive as well as external. Through the internal growth they will secure the long-term existence of their brand, whereas the external acquisition of other players (along the entire value chain) will help them increase their global

competitiveness and catch up with global carmakers in terms of level and speed of innovation and quality of R&D, which is in line with the 12th five-year industry plan.

Due to the stagnating performance of many established players on the European car market, such as PSA or Opel, there could be attractive acquisition potential for Chinese in the near future. General Motors has been considering selling its Opel subsidiary for years due to Opel's low profitability (after GM closed their Saab subsidiary Opel has remained GM's only European-originated footprint in Europe, not taking into account the imported Chevrolet brand). The Chinese carmakers might become an attractive investor either to purchase a minority stake in Opel to help finance Opel's current business and help increase Opel's presence in China, and in reverse obtain access to top-level R&D and know-how in marketing and human resources management (the major identified areas where the Chinese substantially stay behind the European players). Or, alternatively, GM could decide to sell its all stake in Opel and through such a move the Chinese could not only get access to one of the top European carmakers, but also gain fast and easily more than 7% of the whole European car market. Such an acquisition could have a totally different consequence than the Geely's 2010 acquisition of Volvo, whose market share is around 2% in Europe.²⁹⁹

Besides, a close cooperation with a European player could help the Chinese enter the market more aggressively. The Chinese could not only use the internal know-how in their lacking fields, but through its partner enter the European market using the partner's distribution channels, supplier network as well as existing production capacities, which were the key external areas for improvement. This would rapidly speed up the internationalisation process into Europe.

Such an acquisition of a carmaker is not a time-wise straightforward process. It took Geely nearly two years to close the deal to purchase Volvo from Ford Motor Company. Under the assumption that there are no talks between a potential acquirer and GM as the owner of Opel at the moment, it would mean that on the ownership level, at least until 2014, the Chinese would only be present in Europe via Geely's Volvo. In 2014, the European car market is expected to be growing already, increasing on one hand the attractiveness of Opel for the Chinese, on the other hand, diminishing the will of GM to sell its stake in Opel. The right momentum for Chinese to acquire Opel was in late 2000s in the times of a deep economic crisis when GM needed financial support either through government subsidies or loans, or, alternatively, through sales of its subsidiaries. Therefore, the likelihood of change of ownership of Opel is lower than two or three years ago. As a result, there might not be an existing acquisition target in Europe for Chinese at all and they would have to grow intensively with own brands.

²⁹⁹ See ACEA (2012)

6.1.3 Market entry mode

In the previous parts it was concluded that the most likely approach towards entry into Europe would be a regional strategy with intensive growth model. This section is then to identify the most suitable entry mode for the Chinese carmakers. As outlined in Chapter 2.3.3 there are numerous entry modes, each having certain advantages as well as drawbacks. The appropriateness of each of these modes was discussed in the Table 1 and with direct respect to the Chinese carmakers in Europe then in the Appendix 6. From this analysis the following conclusions can be stated.

On the high level, the regional strategy created through intensive growth can only be achieved with higher resource deployment and tighter control of the activities. Therefore, the basic direct and indirect exporting would not be suitable for entry into the European car market. The major reasons are the imposed 10% import tax, insufficient production capacity in the domestic Chinese market due to a still developing market and poor quality and innovative solutions applied into the product portfolio sold in China. Besides, the large distance between the Chinese and European market has increasing demands on the logistics capabilities as well as costs, which are not outweighed by the labour costs in China that have also been growing in the past years.

Licensing is a useful method for companies that want to share a high-end product or service with less-capable manufacturers or entrepreneurs. From this factor, it is very unlikely that in the highly innovative and competitive market such as the European car market some carmakers would be interested in licensing Chinese cars. Licensing in general is not a very common entry mode in the automotive industry and if it is applied than in the direction from the developed country to a less developed one, but definitely not the other way around.

Therefore, there are two remaining modes – strategic alliances and joint ventures, and the wholly owned subsidiaries. Joint ventures have been applying for years in the Chinese car market, and it is still the only way for the non-Chinese carmakers how to enter that market from the legal point of view. Besides, the Chinese carmakers can contribute with their local knowledge and pool of Chinese labour. In Europe, though, there are not many reasons why the current players would establish JVs because of Chinese lack of know-how in most parts of the automotive value chain. On the other hand, it is more likely that in order to enter Europe the Chinese carmakers themselves would create JVs for their joint operations in Europe. Not only would that significantly decrease the costs needed to establish new operations, but also the potential share of know-how would be beneficial for them. This will also be in line with the proposed consolidation plans of the Chinese government.

In terms of the strategic alliances, this might be appealing for the Europeans and Chinese in a higher extent especially in the fields of development of EVs and

alternative fuels. As already stated in the previous parts, BYD possesses significant know-how in the areas of development of batteries and is already running several production plants across Europe. Such an R&D oriented strategic alliance might be beneficial for the current players in order to achieve competitive advantage against other European players in the chase to win the future EV market. In return, BYD might obtain access to other know-how of European players and use it not only to increase their competitiveness in their domestic Chinese market, but also to start their business operations with own brands in Europe.

Wholly owned subsidiaries with own production plants either with a full value chain or CKD or SKD-based, therefore, remain the only suitable mode of entry for Chinese carmakers if the intensive approach is taken into consideration. This mode requires substantial financial resources as in addition, is very time intensive. As a result, no short-term entry of Chinese carmakers can be expected. In the first stage, similarly to what Great Wall is currently doing, they will most probably start their operations in less-demanding markets, such as CEE and SEE that have an enormous potential for price-attractive, lower quality cars. Gradually, with increasing know-how and capabilities, proceed then to further markets towards the Western Europe. Therefore, the first production plants can also be expected primarily in countries such as Romania, Bulgaria, Serbia or Turkey, where then governments attract foreign investors and are open to cooperate with Chinese carmakers in order to increase their footprint in the European automotive industry. The plants located in WE and currently owned by Chinese carmakers will in the short and medium term rather remain a source of technical knowledge.

6.1.4 Strategic timing of market entry

The concept of the strategic timing has already been opened in the previous section when discussed the optimal location of the production facilities. In terms of the transnational timing strategies, it has been concluded that the most likely strategy will be based on the waterfall approach, gradually increasing the market footprint in time due to the following reasons.

First, the Uppsala internationalisation strategy states that the market footprint increases with development of internal capabilities. The waterfall approach is a result of such a strategy. Chinese carmakers currently have little experience with running automotive business in Europe. Entering many markets at once (sprinkler-based approach) would result not only in increased probability of repeating the same mistakes, but especially depressed share of knowledge from individual market entries. On the other hand, with the sprinkler approach the economies of scale could be achieved as well as higher sales from day one in hands with higher production utilization and from that resulting shorter payback period. The risk of failing is

however too high and the third wave of Chinese entry might be as unsuccessful as the previous two.

Therefore, in the first stage, the Chinese are expected to focus on SEE markets where the demand for low-priced cars is high and the market resembles their domestic one. Great Wall has already started manufacturing cars in Bulgaria with the target to reach sales of 50,000 cars by 2015 mostly due to coverage of SEE markets. Other Chinese carmakers, such as Chery or Geely, will also start their operations in SEE first. During this first stage lasting 3-5 years they will study the European market specifics, build their supply chain as well as gradually increase the product quality. The estimation of the learning period is based on the study of Great Wall's plans as well the success story of Dacia as a SEE-originated carmaker. Because of the low European presence of Chinese carmakers at the moment, this stage can be expected to fully start no earlier than 2013-15.

Therefore, the Chinese carmakers will most likely start expanding their business to Western and Central Europe in the period after 2020. Not only will they manage to adapt their product and business strategy to the local European conditions, but also the car market in WE will have gained a momentum by then, opening the doors for more producers. Moreover, in 2020 the Korean carmakers, currently being in the rapid growth stage, might reach their peak and face similar challenges that the Japanese have faced in the last years. The full incorporation of the Chinese carmakers into the European automotive industry can therefore become reality in 10-15 years from now, in the first half of the next decade.

6.1.5 Generic strategies

The key aspect in this section is the differentiation factor for the Chinese carmakers in Europe with the objective to achieve a competitive advantage. Porter has defined three key conceptions in this area – cost leadership, differentiation and market segmentation. Bowman has enhanced this concept by creating a clock-wise diagram with two axes setting the price and perceived value of the company. This diagram results in eight various strategies, each having a different impact on the business development and perceived competitive advantage.

Chinese carmakers, due to their recent history, low R&D quality and general environment on their domestic market, are predefined to take a position of price-oriented manufacturers rather on the left-hand spectrum of the clock diagram. In this segment there are five general market positions that the Chinese can possess. The bottom left corner of the diagram results in poor sales due to low perceived value, even though the price has remained low as well. The goal of the Chinese carmakers should be to distinguish themselves from the competition and achieve a higher perceived value than most price-oriented manufacturers.

This, however, might become a problem for them. The competition in the low-priced market segments is significant. Not only has Dacia as a typical low-price representative to be taken into consideration, but also the Korean carmakers Kia and Hyundai have achieved to gain the hybrid market position delivering the customers high perceived value for a more favourable price than the traditional market players. Within this playfield it will be difficult for the Chinese not to end up in the “low-price/low-value” segment of the Strategy Clock, which leads to zero lifetime customer value and no customer loyalty. Such market players only succeed by continual attracting of new customers who for some reason have opted for such a product.

It would be incorrect though to conclude that once the Chinese carmakers are pushed into this segment they will lose the business in Europe and will exit. For a certain period of time, especially in the opening phase of their European entry, they can remain in this segment but constantly improving its products and services in order to shift at least to the “low-price” segment. Similarly the Korean carmakers have achieved to shift from the original “low-price” strategy to the “hybrid” one, creating a base for their consequent sales boom as the customers have discover the strengths of Korean cars.

The Chinese, therefore, should learn from what the Koreans have achieved in the past decade and determine drivers that led to such shift to the hybrid segment. The major success factors of them were the cost leadership resulting in favourable product prices, direct orientation on specifics of the European car market such as design or range of the equipment levels and aggressive marketing strategies.

Alternatively, not competing on the cost level with Dacia and Koreans, the Chinese could try finding a specific market segment that they will be able to completely take over. For instance the Chinese have long-standing tradition in producing light commercial vehicles. Most current players have underestimated this market and the Chinese could find themselves in this straight away, having Dacia as the only direct competitor in Europe. The Koreans and Japanese carmakers, for instance, completely leave out this market segment despite the predicted nearly 7% annual growth rate for the next eight years.³⁰⁰

As a conclusion the Chinese might have troubles differentiating themselves from the current players, primarily Dacia, Kia and Hyundai who offer standard to high value for favourable prices. In order to succeed on the European market either the Chinese will have to find a special market segment, such as the LCVs, or in the passenger car market and focus on achieving a perceivable competitive advantage similarly to what the Koreans have done in the last 5-10 years.

³⁰⁰ See LMC Automotive (2012)

6.2 Implication for current market players in Europe

The potential successful “invasion” of Chinese automobiles into Europe should follow the path Hyundai and Kia have stepped into a decade ago with aggressive marketing strategies and dedicated product portfolio. Their presence has significantly influenced the European car business and has been one of the key reasons why several European carmakers are currently struggling with staying profitable. Due to responding to customer preferences, establishing production and R&D facilities in the region, taking the advantage of highly efficient production processes and from that resulting favourable product prices and shorter product life-cycles the Koreans were able to increase their sales even in the times of a deep economic crisis and numerous incentives for locally originated carmakers. They were one of the first to introduce state-of-the-art design features into the mass segment, such as LED daylights, which was highly appreciated by the European customers. They have achieved to become a classic for other carmakers and showed a path of success that is worth following.

If the Chinese carmakers are able to learn from the Korean success, leverage it to a further extent, learn from their own mistakes and shortcomings and take the advantage of what they are good at, such as fast implementation of technologies, they might influence the European car market in a similar way their Asian predecessors did. Similarly to Koreans who have successfully replaced the Japanese when they were at the end of their era, the Chinese cars will probably be the successors of the currently booming Korean carmakers. Therefore, it is beneficial to analyse the main impact of the Chinese market entry on the current players, including the non-European carmakers from the USA, Japan and South Korea.

This analysis will consist of four major parts. First, it will be analysed to which extent the current players will be affected by the Chinese in terms of sales and market share in two major European regions – Western Europe and CEE. Second, their presence will have an impact on the pricing strategies of many European carmakers as they will become one of the most affordable brands and attract the price-sensitive customers. Third, due to their cheap domestic access to attractive technologies, such as LED or TV panel production, they might easily approach customers who seek design-wise attractive vehicles with newest features that are cheap to manufacture, but are perceived as a luxury in Europe. Last but not least, due to substantial and still increasing know-how of the Chinese carmakers in alternative fuel systems, they might become serious players in this emerging and governmentally favourably supported market segment.

6.2.1 Sales and market share of current players

The Chinese impact on the car sales in Europe can be divided into two main phases, already outlined in the previous sections of the thesis. In the first one, dated into the

2010s, the Chinese will primarily focus on creating their operational base in Europe and developing their skills, while predominantly targeting the developing markets in Central and Eastern Europe. With increasing European footprint and several joint ventures with local businesses, their product portfolio will become more competitive. In terms of sales, by 2019 the Chinese are expected to achieve cumulative single-digit markets shares in the Eastern European region, which at first sight does not seem much, however, it is for instance equal to the current cumulative market shares of Honda and Mazda. In this perspective, their presence on the Eastern European car market will be quite perceivable.

Their sales will be originated from two main sources. First, due to the growing market in Eastern Europe, the potential for new players will be positive. Second, the Chinese will be able to attack several current players and approach mainly price-sensitive customers who seek cheap vehicles with little requirements in terms of luxury or cutting-edge technological features, e.g. Dacia or Russian-originated carmakers. The market for such vehicles is expected to rise substantially. Besides, producers who do not have any clear competitive advantage, such as Mitsubishi or Suzuki might be hit by the increasing presence of Chinese carmakers.

In the second stage, after 2020, the Chinese will likely reposition their business footprint and try to expand to the highly competitive Western European markets, too. Until 2020, the Chinese cars will see demand primarily from currently economically suffering countries, such as Spain, Italy or Greece, whose customers will be willing to sacrifice a certain level of product and service quality in favour of price. The amount of such customers is not large, though, and sales of Chinese carmakers will remain below 1%.

The key success for Chinese lies in becoming competitive in the mass segment, currently dominated by the Korean carmakers and several European brands, such as PSA or Opel. Also Chevrolet, owned by GM and positioned at the same level as the Koreans, is increasing its sales. However, this is easier said than done. The requirements of the mass customers will even after 2020 remain complicated for the Chinese. Only a fully dedicated approach towards the Western European market will help them establish there and become a serious competitor for other players.

An analogy of such a success can be seen in the case of Koreans, who have successfully taken over the role of Japanese carmakers. After the crisis in 2008 and 2009 that hit both Koreans and Japanese carmakers, the Koreans were able to position themselves better in the price-sensitive market and grow massively. If such a crisis comes in ten or fifteen years, the Chinese can be ready for attracting a large part of the market like the Koreans have been doing now. Without such an impulse from the market, if it continues to grow even after 2020, a considerable success of Chinese in Western Europe will be rather unlikely.

As for the current European players, in Western Europe the Chinese should not affect them so much. From the customer point of view, they will be rather perceived as a substitute for other non-European players. The premium segment should not be influenced at all; the mass one will remain a dream target for the Chinese, but as already mentioned above, other external factors will be needed to clear the way for the Chinese producers.

6.2.2 Profitability and cost structure

Although the impact on sales of current European players will not have been so significant until 2025, the Chinese might influence the market more through indirect factors, such as the price/value factor and generally perceived vehicle price justification. The current European car market is heavily competitive with minimal profit margins for most carmakers. In fact, many European carmakers, such as Opel, PSA, Fiat or Ford, have been loss making in the last few years with negative outlook in the near future.³⁰¹ This is caused not only by decreasing sales in Europe, but also by high production costs and inflexible operations. For instance PSA, who has been financially suffering since the crisis in 2008, plans to shut down a few production plants to save money and reduce their utilization gap that is currently at mere 65%.³⁰²

The Korean carmakers, Hyundai and Kia have recently pushed the prices even lower. This has helped them increase their market share heavily since 2008, however, made most competitors in the mass segment struggle. Such a competitive environment offers a success potential only for companies that can efficiently manage their costs while maintaining a competitive level of production quality.

The Chinese carmakers, such as Geely, Chery or BYD, will be willing to sacrifice a part of their short-term profits in favour of a market establishment and a consequent long-term growth. They will not have such a favourable position as the Japanese and Koreans, who were able to finance their European market entry from their domestic operations, but still many Chinese carmakers will be financially strong enough to open up a yet another price war. They will take the advantage of their production presence in CEE countries that offer a more favourable cost position than what most European carmakers are possessing.

In order to compete with the cheap Chinese products the Korean carmakers can be expected to adapt their pricing strategies to match those of the Chinese and retain a favourable price/value position. However, in ten years the Koreans will be from the customer perspective mostly comparable to the Europe-originated carmakers and such a drop in their prices will affect their competitive position not only in the downward

³⁰¹ See Deutsche Bank (2011)

³⁰² See www.nytimes.com

direction against the Chinese brands, but also in the upward one against the struggling mass producers. This might have fatal consequences for the mass carmakers.

Therefore, in expectation of such a shift in the European car market, the domestic players should increase their presence in the developing markets, such as China, India or Brazil, where the major market growth is expected for the next 15 years. This might become a serious issue mainly for PSA Peugeot Citroen, whose core markets remain the ones on the European continent and any further decrease in sales or decrease in market prices may intensify their financial problems.

6.2.3 Design and technological features

The success of the Korean carmakers can be attributed also to their appealing design features. In fact, they have brought numerous vehicle parts to the mass segment that were only available in the premium market before. For instance the front and rear LED lights, before only found at Audi or BMW cars, have recently made their entry into mini and compact segment, largely due to the rapid implementation of Korean carmakers. In reaction to that also other carmakers, such as Volkswagen, started implementing such features to their compact products. Seat, striving for success of its brand new Leon, has introduced the very first LED-only front lights in the compact segment in cooperation with Audi. This is a clear sign to the Koreans that the Europeans can match this trend.

Whereas in Europe, the LED lights have for long been a typical sign for high-end vehicles, in China they have already been used throughout the entire product portfolio for many years. In fact, for instance Skoda uses LED rear lights in its Octavia and Superb models, although in the European region they use standard lamps. This is due to two main factors. First, the Chinese customers are more attracted to such luxury features (therefore many brands use additional chromed plates and parts in their Chinese models), but also the production costs of such parts is very cheap compared to what it costs to produce them in Europe. Similarly, TV screens for the rear seat passengers are usually only available as very expensive optional extras in higher segments, whereas in China they are a typical standard feature for many medium class vehicles. In general, in China there is a much higher focus on rear seat passengers as it is expected that premium cars will not be driven by the owners themselves.

Such an approach and favourable production costs of many premium features could cause a slight shift in the vehicle equipment structure. The Chinese carmakers can use this knowledge to differentiate themselves from the competition by introducing such luxury features to lower segments. This will have a substantial impact on how the current players position their products and individual equipment levels within a product group.

Hypothetically, if the Chinese introduce brand new products for the European market that will be in standard equipped by touch screens for all passengers, LED front and rear lights and other formerly premium optional extras, the customers might turn a blind eye to other not-so-good product characteristics, such as below-average handling or only four stars from the Euro-NCAP test. In order to keep up with such an offer, the current players will be forced to introduce these features too, or at least justify in the eyes of the customers why they are charging hundreds to thousands of EUR for these optional extras. This will mean additional expenditures will no direct increase in product price, resulting in an even more unenviable financial situation of the European carmakers.

6.2.4 Alternative fuels

In several parts of this thesis it has been stated that the Chinese government has large plans with decreasing their ecological footprint and focusing on environmentally friendly powertrain systems, such as hybrids or EVs. In fact the government has included this area into seven strategic areas that will be heavily supported within the 12th five-year industry plan. Therefore the Chinese are expected to rapidly increase their capabilities and R&D expenditures in this area to catch up with the Europeans and US-Americans.

In Europe, the EU has similar plans with alternative fuels, setting an ambitious target to decrease the average CO₂ emissions to just 95 g/km by 2020. Because the average figure was as high as 136 g/km in 2011, this target can be achieved only by creating a favourable and subsidized business environment for low- or zero-emission vehicles, giving the customers a reason to buy these vehicles. Such environment can include many types of support, from decreased taxes, over creating the entire infrastructure, to direct subsidies for buyers of low-emission vehicles.

For Chinese carmakers, this could mean a great opportunity for their growth. BYD, for instance, has some unique know-how in developing and producing electric vehicles and is planning to introduce them in Europe, too. In order to justify the enormous investments in the EV area the governments and institutions are expected to drive the demand of EV vehicles. Despite the fact that the governments will be likely to support their local producers during renewing their fleet, the Chinese might count as a favourable price/value option in cases when the budget of individual institutions is very limited.

In 2025, around 48% of the newly sold vehicles are expected to be represented by environmentally friendly models (EVs, hybrids/PHEVs, mild hybrids) in Europe.³⁰³ This amounts to nearly eight million vehicles and for the Chinese the period of

³⁰³ See Roland Berger (2011)

introduction of EVs to Europe in 2015-2025 might be one of the best and one-time only opportunities how to enter the European market. Therefore, it is likely that they will do their best to be present during this growth stage and take as a large piece of the pie as possible. For the current players, this means another segment that the Chinese are likely to attack. If the European players are not ready to offer price attractive and at the same time environmentally friendly vehicles to the European customers, the Chinese might take over.

6.3 Conclusion

It is highly probable that the Chinese will sooner or later try to enter the European car market in their so-called third wave. Similarly to the Koreans, their strategy will focus on creating the entire value chain network in Europe, with little direct export of complete vehicles from China. Their regional approach will be financially very demanding, but due to the large differences between the European and Chinese market such a dedicated approach is inevitable. However, creating the network and learning how to succeed on the highly competitive European market will take a few years and failing for the third time might be fatal. Therefore, it is likely the Chinese will enter the Eastern European markets first, where the similarity of customer needs to China is much higher than in WE. In the second stage then, when their biggest potential in Eastern Europe will have been depleted and their targets met, they will refocus on the Western-European countries. This does not mean that they will have omitted this market before, but their activities and investments will primarily target the CEE region until then.

Even though through their intensive internal growth they will unlikely achieve any large sales in the ICE segment in Western Europe by 2025, they might influence the other market players, their pricing strategies as well as their implementation strategies of several technological features. Such an indirect impact on the vehicle market might have an even more dramatic impact than their sales of thousands of vehicles. On the other hand, in the area of EVs and hybrids, the Chinese might become a serious competitor for the current players and largely influence the market structure and prices in this developing segment.

Besides, it is important to keep in mind that the enormously competitive business environment might result in a search for strategic partners for several current players, e.g. PSA or Opel. For Chinese, this might become an attractive solution to their market entry problems and through external growth by acquiring an established market player they might not only get access to the latest technologies, but primarily to a large customer base amounting to several hundreds of thousands customers and a developed distribution network.

7 Conclusions and Recommendations

This final chapter of the thesis will cover a conclusion taking into account all previous chapters' research and analyses. Besides, several recommendations for further research will be provided. These further studies can not only increase the depth of the research of this thesis in several key areas, but also observe the future activities of Chinese carmakers and compare their actual behaviour with the strategic conclusions that were outlined in this thesis.

7.1 Conclusion

The internationalisation of Chinese carmakers is a long-term process initiated already a decade ago, originally rather focusing on the light and heavy commercial vehicles that had been the core of the first phase of the automotive industry in China. Later on, with increasing presence of global automotive companies in China and with that related growing know-how of Chinese carmakers due to the government policy of automotive joint ventures the Chinese started exporting the passenger vehicles, too.

In terms of their presence in Europe, their internationalisation process can be divided into three main phases. In the first one, dated to mid 2000s, several Chinese carmakers entered the then growing market with large hopes for establishing fast and gaining rapid sales increases. However, the reality could not have been more different. Because of their weak sales network and horrifying results in Euro-NCAP safety tests, they failed in selling more than hundreds of cars a year. As a result, some carmakers persisted in selling their cars in Europe, some have exited the market completely.

The second phase followed after the credit crunch in 2008 when the worldwide automotive industry was severely hit by the crisis. The American giants had to be bailed out by the government, leaving little cash to them for supporting their decreasing sales in the saturated and highly competitive European market. The American affiliates in Europe experienced various consequences. Opel, originally owned by GM, is still in possession of this US company, however their future strategies are with a question mark. Its sister company Saab's production was completely shut down after unsuccessful negotiations with several potential automotive partners, including Chinese companies. Lately, it was purchased by a Swedish-Japanese-Chinese consortium that plans to produce electric cars in Saab's production plant. Volvo, for years owned by Ford Motor, was sold to Chinese Geely in 2010. Through this acquisition Geely got access to the newest technologies and the entire European market, too.

The third stage started in 2011 with the Great Wall establishing own production facility in Bulgaria, which was the very first Chinese automotive plant inside the European Union. The aim of this thesis was to analyse this third stage dated into the period 2012-2025 and whether the current situation and the likely future in their domestic Chinese market will allow them to set aside enough resources for the European market entry. Besides, an analysis of the Chinese carmakers' internal capabilities was conducted to find out whether they will be internally capable of running successful business in Europe. Also, a part of the analysis was related to the situation on the European market and whether the future outlook of the European car market will offer a space for new market players from China.

The research showed that the most probable Chinese market entry into Europe in this third stage would be divided into two main phases. In the first one, the Chinese carmakers will rather focus their activities onto the CEE region and to support this business they will establish new production plants in this region, specifically with focus on Bulgaria, Romania and Turkey. Through this phase they will saturate the less-competitive markets that do not require such high-technology vehicles and emphasize more the pricing factor.

With growing knowledge base and Europe-dedicated products a later expansion into Western Europe is inevitable. However, this will probably not happen before 2020 and depends largely on the macroeconomic situation in Europe. Similarly to the market shift after 2008, when the Koreans started conquering the European market and were actually one of the few carmakers that were increasing not only the actual sales but also their market share, which grew from three to nearly 6% in the last three years, the Chinese carmakers could take the advantage of another such market slump and replace the Koreans in the pole of price-value attractive market players. Alternative fuel segment of the market can be another push for the Chinese that possess unique expertise in several electric vehicles components.

7.2 Recommendation for further research

The main limitation of this thesis is the outside-in factor that did not allow obtaining the specific strategies from the Chinese carmakers and was therefore based on many assumptions and estimations resulting from the research findings. An inside-out analysis might be vital to complete the picture of the Chinese internationalisation strategies with focus on the European car market.

Also, based on the outlined unique know-how of Chinese in the area of alternative fuels leveraged by the Chinese government's new policies towards greener technologies, a thorough analysis of the Chinese future global footprint in electric vehicles might be an attractive field of study. Similarly to the Chinese government,

numerous countries issue new initiatives and support programmes for mass launching efficient vehicles and the Chinese might play a crucial role in this segment.

This thesis, written in mid-2012, could also offer only a short-term insight into the Great Wall's Bulgarian internationalisation plans as well as only a few future plans of Geely with Volvo have been announced so far. A comparative analysis of the strategic conclusions outlined in this thesis with the real activities of the Chinese carmakers in the period 2012-2015 could offer an interesting field for further investigations.

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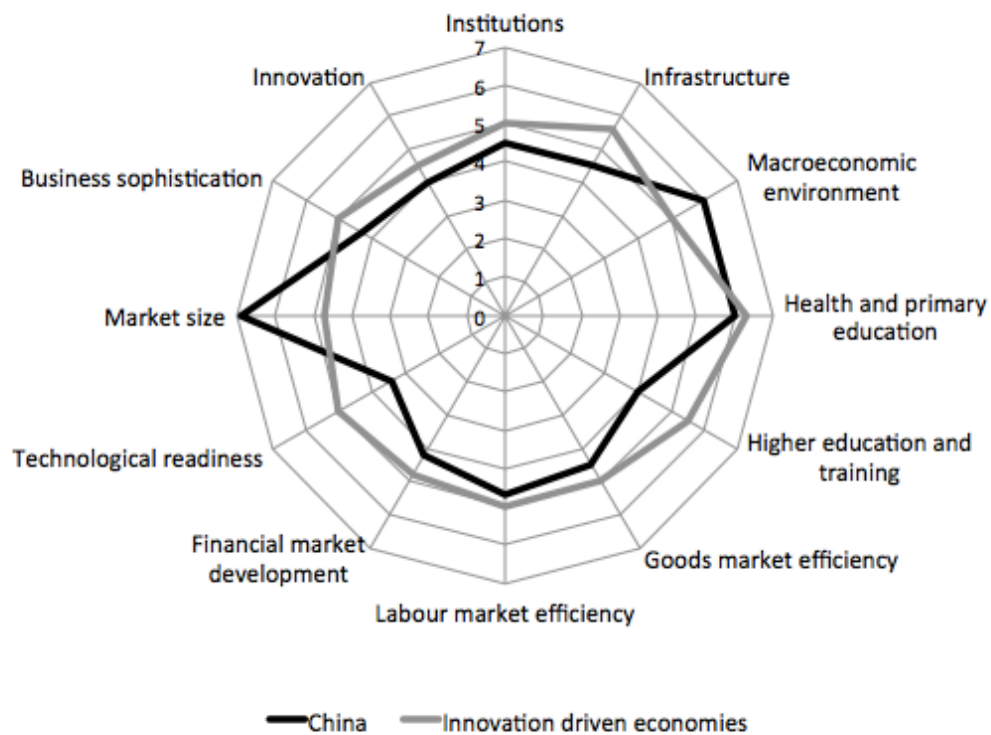
Appendix 2 - Passenger car sales according to world's regions, 2011

Region	2011 Sales	% change 2010-2011
Western Europe	9,868,299	-2.7%
Eastern Europe	761,369	-5.0%
Japan	3,524,789	-16.3%
United States	6,240,483	8.9%
Canada	693,735	-1.6%
Brazil	2,748,848	4.6%
India*	2,570,829	2.0%
China	14,500,000	5.2%
Turkey	593,165	16.4%
Russia**	2,560,786	41.5%

*refers to period April 2011-April 2012 **refers to light vehicles, comprising of passenger cars and light commercial vehicles.

Source: Based on Business Monitor International (2012)

**Appendix 2 – Stage of development global competitiveness index:
China vs. innovation driven economies (5 – best, 1 – worst)**



Source: Based on World Economic Forum (2011)

Appendix 3 – Overview of EURO 1-6 emission limits

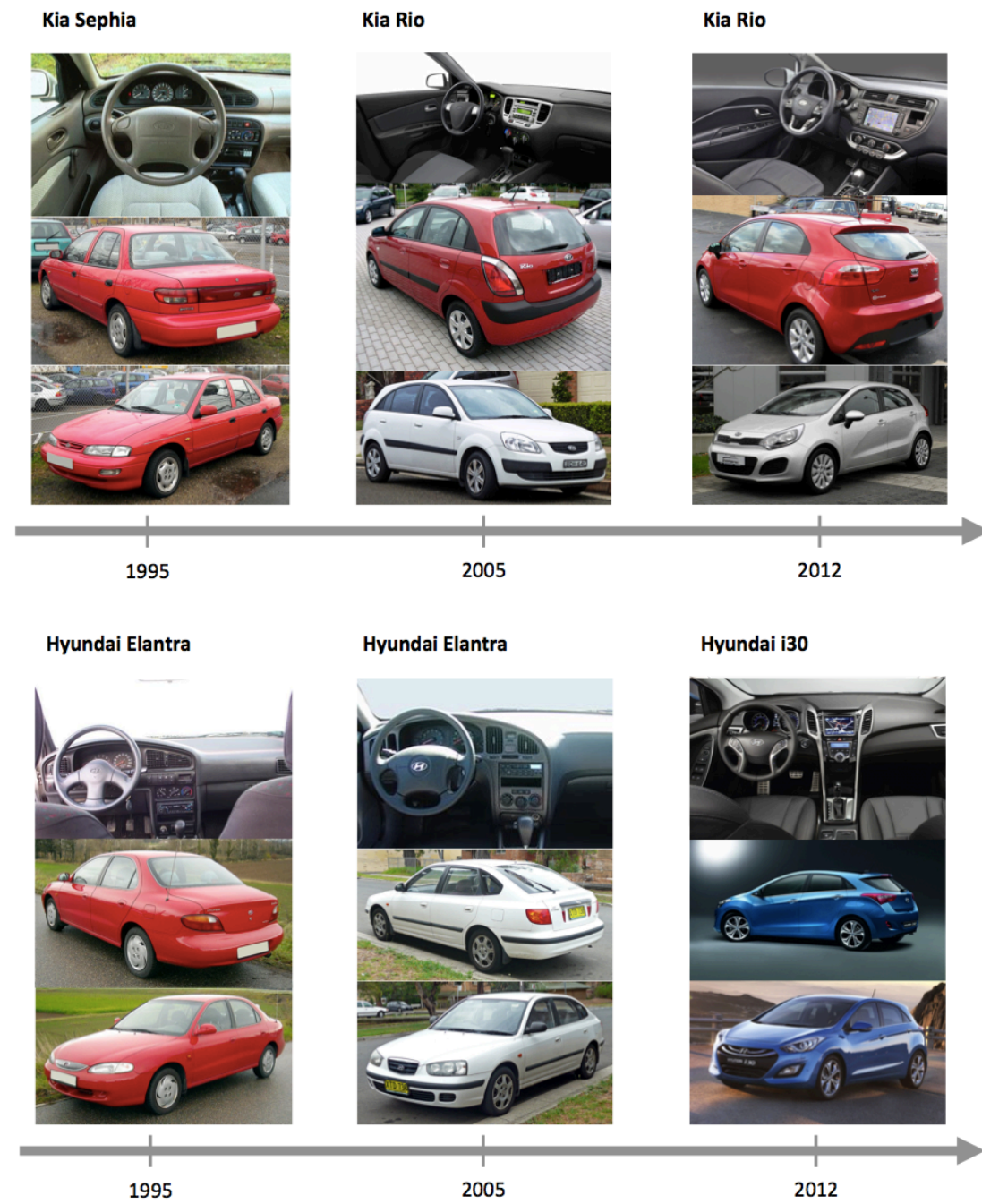
g/km						
Petrol	EURO 1	EURO 2	EURO 3	EURO 4	EURO 5	EURO 6
Period	1992-95	1996-99	2000-04	2005-09	Sept 2009	Sept 2014
CO	3.160	2.200	2.300	1.000	1.000	1.000
HC**			0.200	0.100	0.068	0.068
Nox			0.150	0.080	0.060	0.060
HC+Nox	1.130	0.500				
PM					0.005*	0.005
Diesel	EURO 1	EURO 2	EURO 3	EURO 4	EURO 5	EURO 6
Period	1992-95	1996-99	2000-04	2005-09	Sept 2009	Sept 2014
CO	3.160	1.000	0.640	0.500	0.500	
HC						
Nox			0.500	0.250	0.180	0.080
HC+Nox	1.130	0.700	0.560	0.300	0.230	
PM	0.180	0.100	0.050	0.025	0.005	0.005

* - only for direct engines that operate partially or wholly in lean burn mode

** - for EURO 1 to EURO 4, HC refers to total hydrocarbons, for EURO 5 and EURO 6, HC refers to non-methan hydrocarbons

Source: Adapted from EU-JRC (2008), pp. 118

Appendix 4 – Exterior and interior design changes by Kia and Hyundai, 1995-2012



Source: Author

Appendix 5 – SWOT analysis of Chinese carmakers in Europe

<i>Strengths</i>	<i>Weaknesses</i>
<ul style="list-style-type: none"> • Fast implementation of technologies • Rare earth supplier position • Production sites selection possibility • R&D expertise in alternative fuel powertrains 	<ul style="list-style-type: none"> • No experience in European business environment • High entry costs • Lower quality compared to current market players • Product image and quality • Import duties
<i>Opportunities</i>	<i>Threats</i>
<ul style="list-style-type: none"> • Subsidy programmes by CEE country governments • Electric vehicle programmes • Improving attitude of customers towards cheaper cars 	<ul style="list-style-type: none"> • Korean carmakers extending their business • Falling sales of passenger cars in WE • Negative attitude towards non-European brands • Increasing emission and safety standards

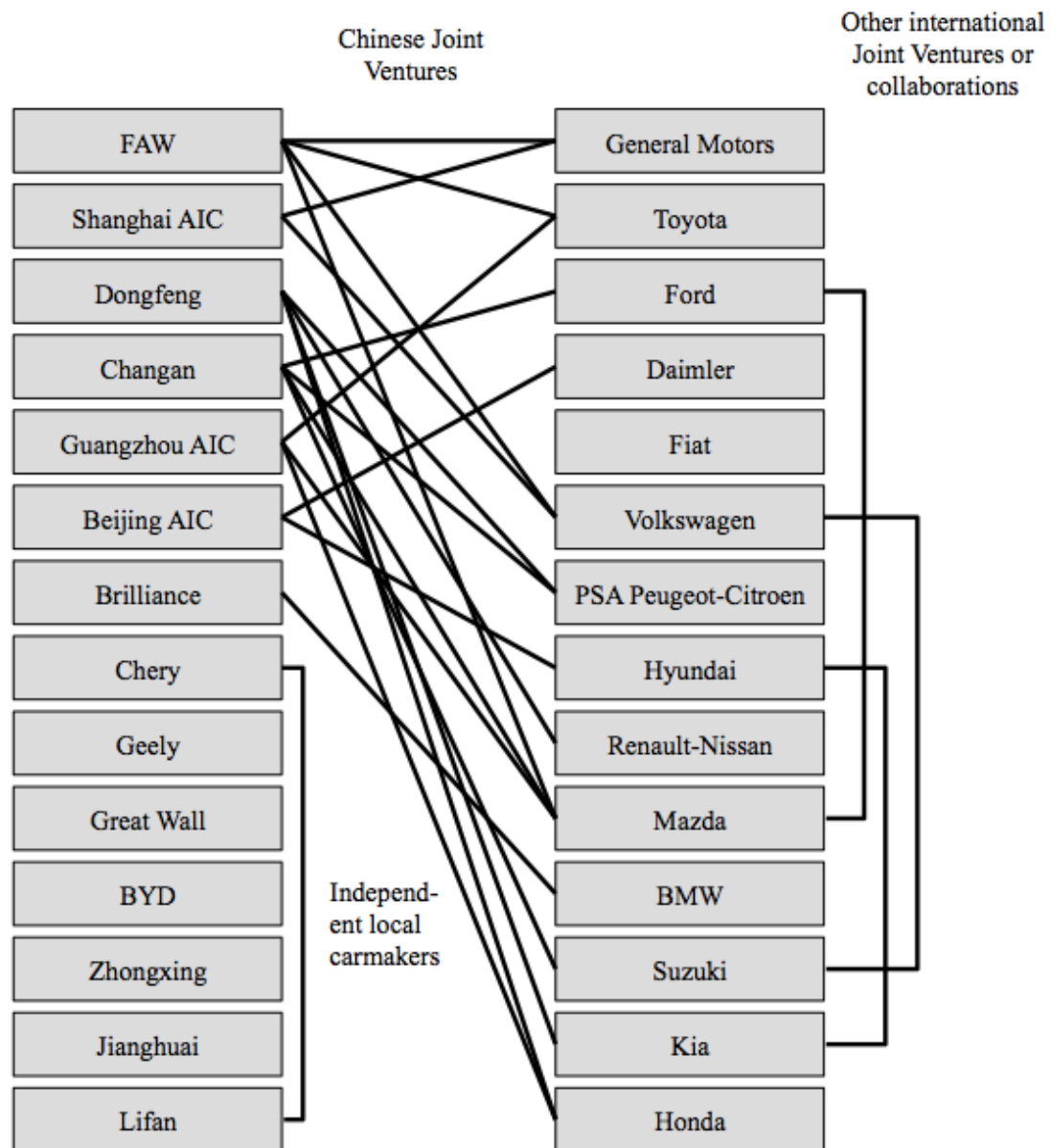
Source: Author

Appendix 6 – Evaluation of market entry modes for Chinese carmakers to Europe

Mode of entry	Advantages	Disadvantages
Indirect exporting	<ul style="list-style-type: none"> • Low entry costs • Ease of market exit • Institutional assistance 	<ul style="list-style-type: none"> • Little direct contact with the target market • Fees paid to the assisting company • Little possibility to influence the business
Direct exporting	<ul style="list-style-type: none"> • Direct contact with the target market • Relatively easy market entry and exit 	<ul style="list-style-type: none"> • Import duties • Little capacity in domestic production plants • Low domestic product quality
Licensing	<ul style="list-style-type: none"> • No suitable product for licensing 	<ul style="list-style-type: none"> • No suitable product for licensing
Franchising	<ul style="list-style-type: none"> • No suitable product for franchising 	<ul style="list-style-type: none"> • No suitable product for franchising
Joint venture	<ul style="list-style-type: none"> • Potential joint cooperation of more Chinese carmakers • Sharing of entry costs • Expertise sharing 	<ul style="list-style-type: none"> • Difficulty finding the right partner • Difficult to exit the market
Owned subsidiary/FDI	<ul style="list-style-type: none"> • High growth potential • Additional production capacity • Direct influence on the business 	<ul style="list-style-type: none"> • High costs • Difficult to exit the market • Lengthy process

Source: Author

Appendix 7 – Overview of major automotive joint ventures in China



Source: Based on www.chinaautoweb.com

Appendix 8 – Product portfolio of Great Wall in Bulgaria

Voleex C10



Steed 5



Hover H5



Source: www.greatwall.bg

Appendix 9 – Overview of major Chinese WTO commitments

	Pre-WTO	Post-WTO
Import tariffs on vehicles	70-200%	25% as of July 1, 2006
Import tariffs on components	15-50%	10% by 2006 (average)
Import quotas	Annual quota	None by 2006
Local content requirements	40% in first year, 60% in second year, 80% in third year	None
Distribution	Foreign investment not allowed	No restrictions after 2006
Financing	Foreign non-bank financial institutions prohibited from providing financing	Non-bank financing allowed in selected cities

Source: Based on European Commission (2004)