

## **Automotive Economies of Scale**

Chinese car manufacturers will sell around 1.5 million cars this year. The emergence of local car manufacturers in China has been strong and they now control around 28 per cent of the market and are second only to the Japanese.

Unfortunately, the Chinese companies are too numerous. There are 30 different Chinese manufacturers with cars on the market and 24 of those have a market share of less than one per cent. Few of the Chinese brands are anywhere near achieving the economies of scale needed to guarantee long-term survival.

Many companies are off-shoots of related engineering firms. Lifan began making motor cycles. Margins fell, so they decided to diversify the business and open a car plant. With sales of 16,000 per year, the company is struggling.

The Chinese consumer is also undiscerning when it comes to car purchases. Because many are buying a car for the first time, they are unaware of the reliability. Companies have attracted buyers using low prices, which is achieved through low R&D, low testing programmes and poor quality components.

Such cost characteristics make it easy for firms to enter the market. The car industry is also very capital intensive requiring significant amounts of investment. With a booming Shanghai stock market, floatations and equity raising have grown apace and enabled more competition in the automotive sector.

In the long term, the Chinese industry will need to see a considerable wave of consolidation if there are to be many survivors. SAIC has announced that it is in talks to merge with Nanjing Automobile, a state-owned group which has a joint venture with Fiat. The two Chinese companies picked up parts of the UK's Rover group two years ago when it went into bankruptcy and since then they have launched almost identical versions of a former Rover Sedan. Some observers believe the talks could be a forerunner of other mergers - especially between state-owned companies. China's carmakers have made an impressive start but many face a long road before they become viable competitors with sustainable businesses.

## Questions

1. What are economies of scale?
2. European car manufacturers tend to have one or two car plants which service the entire EU, why?
3. How might mergers between rival Chinese car manufacturers realize better economies of scale?