

Heritage with a High Price Tag:
The Rise of China's Luxury Automotive Industry

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AUTHOR'S NOTE

Ever since I was a little girl, I had a passion for the automotive industry and each November, my father and I would attend the Los Angeles Auto Show. At these shows, I was always drawn towards two types of cars: concept cars and luxury cars. The first, concept cars, are prototypes that showcase futuristic styling and new features. Concept cars allow manufacturers to push the limit beyond their traditional vehicle lineup and promote excitement for the changes that lie ahead for the brand. The second, luxury cars, are the expensive, prestigious vehicles. They elicit a desire that feeds upon one's aspiration to eventually accumulate enough wealth to own and drive one. This perceived idea assumes that owning a luxury vehicle is a result of one's economic and social status. Although one is a prototype and the other is readily available, both share an element of manufacturing in common: the manufactured sense of desire.

This manufactured sense of desire is what has fueled my passion for cars – to further learn, understand and see how manufacturers evolve. From an academic standpoint, I began learning German three years ago with the sole purpose of working at a German automotive manufacturer. I chose to learn German because brands such as Audi, Mercedes-Benz, Porsche, and BMW tend to dominate the luxury market, and their strong reputations are known across the world. The notion of luxury further stimulated my interest when I realized that all German brands focus on the luxury market, even Volkswagen which owns Audi, Porsche, Bentley, Bugatti, and Lamborghini. From a personal standpoint, I try to incorporate learning about cars into many facets of my life. For example, when I travel, I include a visit to the local automobile museum in my itinerary whenever possible. I have visited the Petersen Automotive Museum in Los Angeles, the Henry Ford Museum of American Innovation in Dearborn, Michigan and

BMW World in Munich, Germany, all in addition to the numerous Auto Shows I have attended in both Los Angeles and Charlotte.

My passion for the automotive industry led me to intern last summer with Toyota Motors North America at the Lexus Southern Area Office in Alpharetta, Georgia. During the internship, I rotated through four different departments: merchandising, vehicle supply, sales operations and service operations. These departments provided me with the experience to understand the United States' luxury automotive industry and their emphasis on the concepts of luxury, branding, and desire. These three concepts synergistically influence the three traditional components of the automotive industry: the manufacturer, the dealer, and the consumer. I worked on various projects and travelled throughout Lexus' Southern region on behalf of the manufacturer to explore these three components. At the end of my internship, I learned through dealership visits and customer consultations that luxury, branding, and desire are not just perceptions, but culturally ingrained values of society.

This thesis focuses on the luxury automotive industry, in part due to my passion for this segment of the market and to my previous work experience with a luxury manufacturer. I chose China as my country of focus not only because I am an Asian and Middle Eastern Studies major with a concentration in Chinese, but also because China represents the largest car market in the world. China provides a unique perspective of the luxury automotive industry especially as the industry did not begin there until post 1978. I seek to discover how China has surpassed every country, even countries such as the United States with 125 years of automotive industry development, in both the number of automobiles manufactured and sold in just 40 years. There was an old expression often used in economic circles that, "As goes General Motors, so goes the

nation . . .,” a phrase Charles Wilson (the president of GM) said during a Congressional hearing in 1953:

Wilson was asked whether there was any conflict between his job and becoming Secretary of Defense. He responded, “I cannot conceive of one because for years I thought what was good for our country was good for General Motors, and vice versa. The difference did not exist. Our company is too big.”¹

Now, 65 years later, that same sentiment may be said about the Chinese automotive industry, “As goes Chinese auto sales, so goes the global economy.”²

¹ Hartung, Adam. "As Goes Apple, So Goes The Nation: Jobs In The Digital Service Economy." *Forbes*. November 06, 2015. Accessed March 26, 2018. <https://www.forbes.com/sites/adamhartung/2015/11/06/as-goes-apple-so-goes-the-nation-jobs-in-the-digital-service-economy/#2aba61ae6443>.

² Jones, Jeremy. "As Goes General Motors, so Goes the Nation." *Young Research & Publishing Inc*. September 11, 2015. Accessed March 26, 2018. <https://www.youngresearch.com/researchandanalysis/economy-researchandanalysis/as-goes-general-motors-so-goes-the-nation/>.

INTRODUCTION

For Automobiles, Failure Builds Resiliency



Figure 1

Between 1958 and 1960, the American manufacturer Ford Motor Company invested \$200 million to \$250 million (\$1.55 billion in 2015 dollars adjusted for inflation) on the Edsel venture [Figure 1],¹ yet lost \$350 million on the Edsel.² Ford sought to create a higher end vehicle division, positioning the Edsel to appeal to middle-class Americans. It was priced between \$2,500 and \$4,000,³ significantly higher than the average Ford. Poor styling, reliability and quality issues limited the Edsel's total sales to 84,000 - about half of its projected rate.⁴

¹ Perkins, Chris. "The Edsel Proved Why You Should Never Design a Car by Committee." *Road & Track*. October 09, 2017. Accessed March 28, 2018. <https://www.roadandtrack.com/car-culture/classic-cars/a32380/ford-edsel-history/>.

² Feloni, Richard. "4 Lessons from the Failure of the Ford Edsel, One of Bill Gates Favorite Case Studies." *Business Insider*. September 05, 2015. Accessed March 28, 2018. <http://www.businessinsider.com/lessons-from-the-failure-of-the-ford-edsel-2015-9>.

³ *Ibid.*

⁴ *Ibid.*



Figure 2

Between 1975 and 1982, DeLorean Motor Company invested more than \$200 million in the DMC-12⁵ [Figure 2].⁶ The car, known as the “Back to the Future” time machine, experienced many delays in its production originally scheduled for 1979 which it did not begin until 1981.⁷ As a result, fewer than 9,000 vehicles were built. This delay in conjunction with the costly production in Northern Ireland, unfavorable exchange rates and a lack of consumer interest led to the company’s bankruptcy in 1982.⁸

⁵ "6 Failed Car Companies." DeLorean Motor Company (1975 - 1982) (5) - FORTUNE. Accessed March 28, 2018. http://archive.fortune.com/galleries/2010/autos/1002/gallery.failed_car_companies.fortune/5.html.

⁶ Padeanu, Adrian. "1983 DeLorean DMC-12 Is a Mint Condition €56,900 Time Capsule." Motor1.com. March 17, 2015. Accessed March 28, 2018. <https://www.motor1.com/news/53992/1983-delorean-dmc-12-is-a-mint-condition-eur56900-time-capsule/>.

⁷ "Expensive Failures: DeLorean DMC-12." CarBuzz. April 19, 2013. Accessed March 28, 2018. <https://carbuzz.com/news/expensive-failures-delorean-dmc-12>.

⁸ "6 Failed Car Companies."



Figure 3

Between 2011 and 2015, the Chinese government invested \$1.6 billion in the local Chinese car brand, Hongqi (known in English as Red Flag), a unit of the state-owned FAW Group [Figure 3].⁹ In 2013, Hongqi launched its flagship model, the H7. In 2013, the H7 sold around 3,000 units.¹⁰ In 2014, the H7 sold 2,708 units.¹¹ In 2015, the H7 sold 5,021 units.¹² “The spike in 2015 was a result of China banning its army from using foreign cars in a bid to promote local brands.”¹³ As a comparison, “BMW sold 5,000 cars every three days in China, and Audi every two days.”¹⁴ China’s massive \$1.6 billion investment in research and design for this luxury vehicle has yet to pay off.

⁹ Products. Accessed March 28, 2018.

http://www.faw.com/product/product.jsp?FileName=RedH7_tedian&left=jc&co=c5&about=Passenger.

¹⁰ “China’s Luxury Car Brand Continues to Fight for Market Share.” South China Morning Post. September 11, 2017. Accessed March 28, 2018. <http://www.scmp.com/news/china/society/article/2110694/chinas-luxury-car-brand-continues-fight-market-share>.

¹¹ Ibid.

¹² Ibid.

¹³ Ibid.

¹⁴ Ibid.



Figure 4

On July 18, 2017, Audi China, a joint venture between FAW Group and the luxury German manufacturer Audi, debuted a car commercial in China that sparked domestic and international outrage [Figure 4].¹⁵ The reporting of the controversy emerged from global new sources such as CNN, US Today, The Washington Post, Shanghai List, and The Telegraph. The mainstream story coverage connoted a negative advertisement reception, which was pulled within hours of its release. The commercial – both visually and linguistically – crafted a narrative that objectified women through the direct comparison between wives and used cars. The advertisement went as follows:

¹⁵ Finnerty, Joe, and Digital Motors. "Sexism Outrage as Audi Advert in China Compares Women to Second Hand Cars." The Sun. July 19, 2017. Accessed March 28, 2018. <https://www.thesun.co.uk/motors/4052995/sexism-outrage-as-audi-advert-in-china-compares-women-to-second-hand-cars/>.

The commercial begins in a pastoral setting with a wedding between a Chinese bride and groom. Before the two recite their vows, the groom's mother rushes to the altar to inspect the bride. The mother pulls back her ears, pinches her nose, and looks inside her mouth. When the groom questions his mother's action, the mother gives the couple the "A-Okay" hand sign. However, the mother then focuses her attention to the bride's chest, and the bride responds by quickly covering her chest with her hands. The scene immediately transitions to footage of a red Audi sedan navigating a curvy road, and a deep male voice states, "An important decision must be made carefully. Only with an official certification can you rest easy."¹⁶

As a result of the backlash, Audi China distanced itself from the commercial, and claimed that "the ad's perception that has been created for many people does not correspond to the values of our company in any way," and "the responsible department of the joint venture has arranged a thorough investigation of the internal control and coordination processes so that an incident like this can be excluded in the future."¹⁷ The public outcry against the commercial elicited many emotions that can be organized into several categories including anti-foreign sentiment, sexism, and the flaws in cultural assumptions.

¹⁶ Pham, Sherisse, and Serena Dong. "Audi Ad Likening Women to Used Cars in China Backfires." *CNNMoney*. Cable News Network, 19 July 2017. Web.

¹⁷ *Ibid.*

These four chronological examples represent failures in the automotive industry. The first two examples are instances of failure in the United States. The United States' automotive industry has 125 years of development, and has had many failures. The Edsel and the DeLorean DMC-12 are only two examples that show despite failure, the US automotive industry continues to grow and evolve; evidenced by its position as the second largest automotive market in the world.¹⁸ The second two examples are instances of failure in China. The Chinese automotive industry has only 40 years of development and yet has surpassed every country to become the largest automotive market in the world.¹⁹ Once again, despite these recent failures, the Chinese automotive industry is thriving.

Why are these two markets still thriving despite experiencing manufacturer setbacks? Resiliency! Resiliency in the automotive industry is fundamental to the success of any manufacturer. Regardless of a brand's extensive history in the automotive industry, failures will occur and will occur often. As a whole, the automotive industry vacillates, and those companies that can weather the storm will remain successful. A brief look at Ford Motor Company shows that despite the speedbump with the Edsel in 1958, in 2016, Ford held an approximate 15 percent market share in the United States.²⁰ The extensive history of the United States' automotive industry mirrors the current development of the Chinese automotive industry to a certain extent. Nevertheless, there are still no definitive answers to which attributes in China's market conditions during the past 40 years have led to the creation of the largest automotive industry in the world.

¹⁸ "Largest Automobile Markets Worldwide - New Car Registrations 2017 | Statistic." Statista. 2017. Accessed March 28, 2018. <https://www.statista.com/statistics/269872/largest-automobile-markets-worldwide-based-on-new-car-registrations/>.

¹⁹ Ibid.

²⁰ "Ford - Vehicle Sales Market Share in the U.S. 2016 | Statistic." Statista. 2016. Accessed March 28, 2018. <https://www.statista.com/statistics/239614/vehicle-sales-market-share-of-ford-in-the-united-states/>.

This thesis seeks to answer that question through historical analysis, examination of the present environment as well as a consideration of political, economic, and social factors that have influenced the automotive industry. To begin, we must define the terms “automotive,” “automobile,” and “automotive industry.” These terms are critical to understanding this thesis’ intention – to culturally bridge the gap in China’s automotive industry’s past, present and future. Automotive, an adjective, describes many aspects related to automobile engineering such as design, manufacturing, and operation. For example: brakes, chains, and engines are automotive parts used to create an automobile.²¹ Automobile, a noun, refers to a four-wheel passenger vehicle. The terms automotive and automobile are synonymous, but not the same. “Automotive is related to automobiles; automobile is the end product of the automotive industry.”²² Thus, the automotive industry encompasses a broad range of organizations and companies that include all passenger vehicles and ancillary industries. This thesis will employ the above definitions, and will focus on the Chinese automotive industry as a whole – incorporating the role of both automobiles and their supporting industries.

This thesis also incorporates cultural factors that have shaped the past history and will shape the automotive industry’s future, and so each chapter begins with the use of iconography. The image of China’s first premier Zhou Enlai’s (周恩来) Buick at his house in Shanghai is repeatedly used as a cultural component that ties together the heritage of the past, the present,

²¹ "Difference Between Automobile and Automotive." Difference Between. July 01, 2011. Accessed March 28, 2018. <http://www.differencebetween.com/difference-between-automobile-and-vs-automotive/>.

²² "Difference Between Automobile and Automotive." Pediaa.Com. December 29, 2015. Accessed March 28, 2018. <http://pediaa.com/difference-between-automobile-and-automotive/>.

and the future. The image evokes thought provoking questions about the implications of luxury which advise each chapter's composition. The first chapter provides a historical background and establishes the current context of the automotive industry in China through two well-known strategy perspectives. Michael Porter's "Five-Forces-Model" and "Clusters and the New Economics of Competition" provide a framework to evaluate the Chinese automotive industry's development and global competitiveness. The second chapter argues how the industry's highly competitive nature has transformed the role of luxury among Chinese automotive consumers. The chapter tackles three specific issues that focus on the relationship between luxury, culture and Chinese automotive consumers. The three issues are: what is luxury, who buys luxury and evolving trends in luxury. In conclusion, this thesis seeks to identify the future of luxury in the Chinese automotive industry as "Cars with Chinese characteristics." One way to understand "Cars with Chinese Characteristics" is through the lens of the Chinese philosophy, yin-yang, where yin and yang are complementary forces that interact to form a dynamic system in which the whole is greater than the assembled parts. There is a recurring paradoxical theme of yin-yang values within Chinese culture. Through the creation of paradoxes, we learn that heritage is the bridge between the past and the future. The future of luxury in the Chinese automotive industry lies within the resilient and innovative brands that are able to manifest this heritage with a high price tag.

CHAPTER ONE

Strategy Perspectives on the Chinese Automotive Industry



Figure 1: China's first premier Zhou Enlai's (周恩来) Buick at his house in Shanghai.

The introduction and proliferation of the automobile in China has a distinct history based primarily upon political, economic, and cultural factors that governed the development of the industry. The production of automobiles in China began in the late 1920s and 1930s with early manufacturing focused on military use. During this time, foreign vehicles were also imported into China solely for use by top-ranking government leaders such as China's first premier, Zhou Enlai (周恩来) and China's nationalist leader, Sun Yat-sen (孙逸仙)[Figure 1].¹ In the 1950s, the function of the economic state and the development of the automotive industry stopped because of the reform policies of Mao Zedong(毛泽东), the Communist Party leader. In the 1960s, Mao Zedong (毛泽东) launched the Cultural Revolution (文化大革命), a sociopolitical

¹ Most Americans Associate Buick with a Gone Era. "Buick Is a Lot More than a Dad Wagon in China." CNNMoney. February 23, 2017. Accessed March 28, 2018. <http://money.cnn.com/2017/02/22/news/companies/buick-china-history-brand/index.html>.

movement that sought to end the four olds: old ideas, old customs, old culture, and old habits. He sought to transform China through attacks on both the intellectual elite and on traditional values. He delayed the development of China not only by halting industrialization, but also through stalling China's modernization. Chairman Mao's policies negatively impacted the Chinese economy as evidenced by China's 12 percent decrease in industrial production from 1966 to 1968.² Following the death of Mao Zedong (毛泽东) in 1976, his successor, Deng Xiaoping (邓小平), implemented a series of market economy reforms that promoted private property, open markets, and international commerce. These economic reforms, also known as the "reform and opening up" policy, led to the influx of foreign companies and organizations. They created an environment that stimulated economic growth and provoked fierce competition, largely through the direct promotion of the rapid development and investment in the automotive industry.

The political climate of the 1980s proved to be crucial to the emergence of the automotive industry because it gave China the economic capability to heavily invest in and develop its industries and sectors. In the 1980s and 1990s, budget constraints created a lack of public transport and the reform policies sought to rapidly modernize the transport system in China, targeting mainly urban areas.³ Although China was traditionally known as "...the 'kingdom of bicycles' with 500 million bicycles or one bicycle for every two people of its population in 1987,"⁴ this distinction gradually shifted throughout the 1980s to the 2000s, reflecting the profound growth in the consumption of automobiles. In part, the growth was due to the strong emphasis that Chinese government officials placed on investing in the country's

² History.com Staff. "Cultural Revolution." *History.com*, A&E Television Networks, 2009, www.history.com/topics/cultural-revolution.

³ Calkins, Martin. "King Car and the Ethics of Automobile Proponents' Strategies in China." *Journal of Business Ethics*, vol. 85, 2009, pp. 157-172. *JSTOR*, JSTOR, www.jstor.org/stable/40294829.

⁴ Calkins 161.

automotive industry by forging agreements and joint ventures with foreign automobile manufacturers to build and supply vehicles for domestic consumption. In 1983, the first Chinese government agreement took place through a joint venture with American Motors Corporation to manufacture Jeeps in China. Next, the government-backed Shanghai Automotive Industry Corporation forged joint ventures with Volkswagen and General Motors in 1984⁵ and 1997,⁶ respectively. The joint ventures not only cemented early-mover advantages for these companies, but also yielded foreign expertise to rapidly transform the industry from being underdeveloped to highly competitive.

The sheer number and projected growth of cars in China are staggering. In 2016, carmakers sold 28.03 million vehicles,⁷ a 13.7 percent increase from the previous year. Early entry companies such as General Motors sold 3.87 million cars with sales up 7.1 percent from the previous year,⁸ while Volkswagen sold 3.98 million vehicles, an increase in sales by 12 percent.⁹ Although China surpassed every individual country in vehicle sales in 2010,¹⁰ it still holds a lower vehicle ownership rate compared to the United States. China has 58 vehicles per 1,000 persons, while the United States has 804 vehicles per 1,000 persons. In 2017, there were

⁵ China, Volkswagen Group. "SAIC VOLKSWAGEN." *Volkswagen Group China SAIC VOLKSWAGEN*, www.volkswagengroupchina.com.cn/content/vgc/content/en/partnership/shanghai_volkswagen.html.

⁶ GM. "GM and SAIC Celebrate 20th Anniversary of First Joint Ventures." *Media.gm.com*, 12 June 2017, media.gm.com/media/cn/en/gm/news.detail.html/content/Pages/news/cn/en/2017/June/0612_GM-and-SAIC-Celebrate-20th-Anniversary.html.

⁷ Kwong, Phoenix. "China Car Market Has Bumper Year but 2017 Outlook Weaker." *South China Morning Post*, 12 Jan. 2017, www.scmp.com/business/china-business/article/2061642/china-2016-car-sales-surge-fastest-rate-three-years.

⁸ Kwong, "China Car Market Has Bumper Year but 2017 Outlook Weaker."

⁹ Boston, William. "VW Sold 10.3 Million Vehicles in 2016." *MarketWatch*, 10 Jan. 2017, www.marketwatch.com/story/vw-sold-103-million-vehicles-in-2016-2017-01-10.

¹⁰ "Will China's Vehicle Population Grow Even Faster than Forecasted?" *ACCESS Magazine*, 26 May 2017, www.accessmagazine.org/fall-2012/will-chinas-vehicle-population-grow-even-faster-forecasted/.

only 194 million¹¹ Chinese car owners, roughly 14 percent of its 1.382 billion population.¹² By 2025, China expects 35 million in vehicle sales.¹³

This chapter examines the competitiveness of the Chinese automotive industry using two strategy perspectives: Michael Porter's "Five-Forces-Model" and "Clusters and the New Economics of Competition." These two complementary strategy perspectives will provide a solid foundation to understand the current state of the automotive industry in China as well as show how the automotive industry has been cultivated through the influence of political, economic, cultural, and social factors both domestically and internationally. This thesis begins with an overview analysis of each perspective and then applies the theories specifically to China. Through the lens of the "Five-Forces-Model," the Chinese automotive industry is highly competitive. The "Five Forces" are extended to include the role of the government as a so-called "Sixth-Force." In addition, the formation of clusters allows automobile manufacturers, and the surrounding interconnected industries, to work more productively. High productivity and innovation creates competitive advantages for China's automotive industry in the global economy.

Michael Porter's Five Forces Model + One

Michael Porter's "Five-Forces-Model" gives a conceptual framework to understand the competitive forces within an industry, and how these forces drive economic value among industry actors. Porter first described his *Five Forces Model*, which has shaped the strategy field

¹¹ "China: Number of Vehicles 2016 | Statistic." *Statista*, www.statista.com/statistics/285306/number-of-car-owners-in-china/.

¹² "China - Population 2016." *Countryeconomy.com*, 18 Apr. 2017, countryeconomy.com/demography/population/china.

¹³ Jourdan, Adam. "China Targets 35 Million Vehicle Sales by 2025, NEVs to Make up One-Fifth." *Reuters*, Thomson Reuters, 25 Apr. 2017, www.reuters.com/article/us-china-autos-electric/china-targets-35-million-vehicle-sales-by-2025-nevs-to-make-up-one-fifth-idUSKBN17R086.

and revolutionized the analysis of industry attractiveness, competition intensity, and profitability, in a 1979 Harvard Business Review article. Porter argues that “every industry is different, but the underlying drivers of profitability are the same in every industry.”¹⁴ The Five Forces are: the bargaining power of buyers, the bargaining power of suppliers, the threat of new entrants, the threat of substitute products or services, and the rivalry among existing competitors [Figure 2].¹⁵ These forces

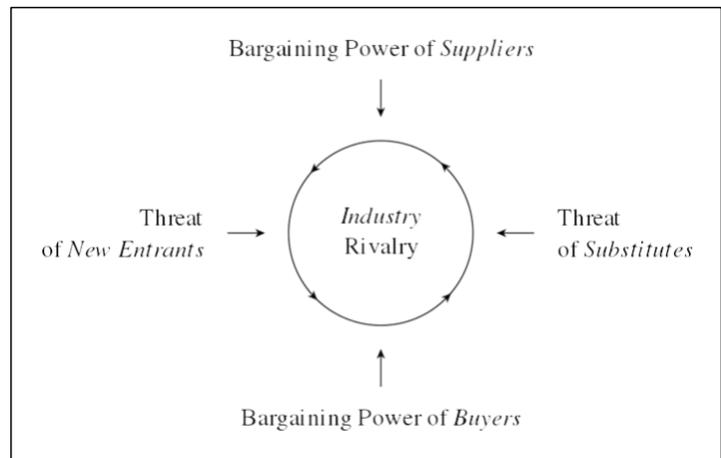


Figure 2

play a critical role not only in explaining why industries sustain different levels of profitability, but also in determining an industry’s competitive structure. This thesis also adds the Chinese government as a “Sixth-Force” in the Chinese automotive industry due to its control over regulations, taxation, and trade policies.

Force One: The Bargaining Power of Buyers

The bargaining power of buyers plays a crucial role in any given industry. Consumers have either high or low levels of power in an industry, which allows their power to influence either the increase or decrease in prices and the products/services offered. According to Porter, “buyer power is highest when buyers are large relative to the competitors serving them, products are undifferentiated and represent a significant cost for the buyer and there are few switching

¹⁴ “Institute for Strategy & Competitiveness.” *The Five Forces - Institute for Strategy and Competitiveness - Harvard Business School*, 13 Dec. 2017, www.isc.hbs.edu/strategy/business-strategy/Pages/the-five-forces.aspx.

¹⁵ “Porter’s Five Forces Analysis.” Wikipedia. March 26, 2018. Accessed March 28, 2018. https://en.wikipedia.org/wiki/Porter's_five_forces_analysis#/media/File:Elements_of_Industry_Structure.svg.

costs to shifting business from one competitor to another.”¹⁶ In other words, the greater number of buyers compared to the number of competitors in the industry plays a crucial role in the buyer’s bargaining power. Further, within any given industry, multiple buyer segments differentiated by “price,” “premium,” or “quality” may exist.

Chinese automobile buyers have a high level of bargaining power. China’s sheer population size as well as the high number of vehicles readily available, at various price points, allow for Chinese buyers to dominate this force. Their high bargaining power creates vehicle segmentation options that extend beyond vehicle size and includes multiple levels of luxury. In addition to these types of vehicle segmentation options, the Chinese automotive industry’s structure has bred competition among its brands. As a result, apart from the standard offerings found in most countries; in China, there are sub-brands, a joint venture between a local brand and a foreign brand. In 2016, there were 130 passenger car brands available with automotive production accounting for more than 75 OEM (original equipment manufacturer) groups and 184 vehicle assemblers.¹⁷ Thus, the bargaining power of Chinese buyers remains high due to the numerous options offered by Chinese and foreign manufacturers, resulting in nearly non-existent switching costs between competitors resulting in the difficulty for manufacturers to retain customer loyalty.

Force Two: The Bargaining Power of Suppliers

The bargaining power of suppliers is determined by their number within a specific industry and the demand conditions among industry competitors. Suppliers determine the price of goods and services and so “powerful suppliers can use their negotiating leverage to charge

¹⁶ “Institute for Strategy & Competitiveness.”

¹⁷ Tauber, Martin, and Zisheng Zhen. “The Chinese Automotive Market – Much More than Just Large.” *MMTA*, 22 June 2017, mmta.co.uk/2017/06/22/chinese-automotive-market-much-just-large/.

higher prices or demand more favorable terms from industry competitors, which lowers industry profitability.”¹⁸ The bargaining power of suppliers is affected by the number of industry players, the distinctiveness of the goods and services, and the cost to switch from one supplier to another. With fewer suppliers, companies rely on only certain suppliers, and as a result, these suppliers hold more power. In contrast, more suppliers lead to lower levels of power and leverage in an industry.

There are a large number of Chinese automotive suppliers which include both automotive parts suppliers and fuel suppliers. The supplier groups are highly concentrated due to the formation of automotive clusters in China. In 2016, the specialty auto parts suppliers were valued at 150 billion RMB with 30 percent growth every year.¹⁹ For example, in Changchun there are 26 vehicle manufacturers and 416 producers of auto parts. Out of these part makers, one fifth had an annual output value greater than 100 million RMB.²⁰ In the Guangzhou Development Zone, there are about 70 foreign parts suppliers. Japanese companies account for 30 percent of that market.²¹ China’s intense automotive demands, and large number of suppliers to meet these demands indicates a low level of bargaining power for the supplier. However, this low level of bargaining power is somewhat offset by the Chinese automotive industry’s demand to manufacture a high volume of vehicles.

Force Three: The Threat of New Entrants

The threat of new entrants poses a force against current competitors, determinant upon an industry’s strong or weak barriers to entry. The threats include a series of barriers such as

¹⁸ “Institute for Strategy & Competitiveness.”

¹⁹ “China - Automotive IndustryChina - Automotive Industry.” *China - Automotive Industry*, 14 July 2017, www.export.gov/article?id=China-Automotive-Components-Market.

²⁰ Cfernandes. “China’s Automotive Clusters.” *Conquer China*, 25 May 2014, www.conquer-china.com/chinas-automotive-clusters/.

²¹ Ibid.

“economies of scale, cost of building brand awareness, accessing distribution channels, and government restrictions.”²² With the threat of new entrants, the “entry brings new capacity and pressure on prices and costs”²³ and “puts a cap on the profit potential of an industry.”²⁴ Weak barriers to entry oftentimes force current players to maintain lower prices and focus on customer retention. Strong barriers to entry allow for higher profitability of the involved competitors,²⁵ however, the threat of entry increases when those competitors expand operations to other geographic locations.

There are four aspects that account for the threat of new entrants into the Chinese automotive industry. These aspects are:

- The threat of new entrants by local brands
- The threat of new entrants by foreign brands
- The threat of new entrants by sub-brands
- The threat of new entrants by local or sub-brands geographical expansion.

The threat of new entrants in the Chinese automotive industry are currently high as a result of environmental concerns which has shifted fuel consumption from petroleum or diesel-based vehicles to hybrid, plug-in hybrid, or electric vehicles. By 2025, China aims to manufacture 35 million vehicles with one fifth of those vehicles being new energy vehicles.²⁶ The role of autonomous vehicles further poses a threat to traditional automobiles due to the many and high cost resources needed to develop such technologically-advanced and capable vehicles.

²² “Institute for Strategy & Competitiveness.”

²³ Ibid.

²⁴ Ibid.

²⁵ “Porter's Five Forces of Competitive Position Analysis.” *CGMA*, 11 June 2013, www.cgma.org/resources/tools/essential-tools/porters-five-forces.html.

²⁶ Jourdan “China Targets 35 Million Vehicle Sales by 2025, NEVs to Make up One-Fifth.”

From a historical perspective, the number of automotive manufacturers is extraordinary. Today, China is in its early phase of its automotive life-cycle, similar to Germany in the 1950s.²⁷ In this phase, there is a strong demand for new vehicles which fuels a highly competitive environment. However, international manufacturers have an edge over many Chinese competitors. The protection of intellectual property laws by foreign brands has negatively impacted the vehicle production of domestic Chinese brands, both technologically and qualitatively. The ability to protect this technology from local Chinese competitors is essential in a foreign brand's battle for market share.²⁸

It is important to note that foreign brands not in forged joint ventures with Chinese manufacturers pose a low threat to the Chinese automotive industry. Domestic production in China accounts for more than 95 percent of the total motor vehicle market share.²⁹ While in the United States, imported vehicles account for 25 percent; in China, less than 5 percent of vehicles in the country are imported due to high taxation rates. For example, a Jeep Wrangler manufactured in Ohio has a suggested retail price of \$40,530 in the United States, but in China, the imported Jeep Wrangler will sell for \$71,000, a staggering \$30,000 increase.³⁰ While the steep import taxation serves as a powerful force to motivate mass-market brands to localize their products, the taxation also creates a uniquely competitive market for the growth of China's joint ventures and local brands.

²⁷ Volti, Rudi. "A Car for the Great Asian Multitude." *Technology and Culture*, vol. 49, no.4, 2008, pp.995-1001. JSTOR, JSTOR, www.jstor.org/stable/40061622.

²⁸ Jurgenson, Helika. "Protection of IPR in the Automotive Industry in China." *Your IP Insider*, 25 July 2016, www.youripinsider.eu/protection-ipr-automotive-industry-china/.

²⁹ "Read 'Personal Cars and China' at NAP.edu." *National Academies Press: OpenBook*, www.nap.edu/read/10491/chapter/5#39.

³⁰ Bradsher, Keith. "China's Taxes on Imported Cars Feed Trade Tensions with U.S." *The New York Times*, The New York Times, 20 Mar. 2017, www.nytimes.com/2017/03/20/business/economy/china-us-trade-tariffs.html.

Force Four: The Threat of Substitute Products or Services

The threat of substitute products or services directly affects the livelihood of the existing products or services and the profitability of the industry. With a high threat, substitute products or services reduce both the supplier's power and the market attractiveness. "The threat of a substitute is high if it offers an attractive price-performance trade-off relative to the industry's product or if the buyer's cost of switching to the substitute is low."³¹ Thus, in the analysis of growth and development in an industry, one must account for substitute products or services to ensure the sustainability of that industry.

The threat of substitute products or services is neither high nor low for the Chinese automotive industry. Mass transit and bicycles are alternate forms of transportation, and a shared economy offers an alternative to private vehicle ownership. In China, scooters account for a majority of the personal transportation system. Electric bikes are the most accessible form of motorized transport because they are reasonably priced, do not require registration, and can be conveniently charged by a power outlet. Electric bikes are the most common form of short distance transportation—they are so common that they are used by the police and are the basis for taxi services in some cities.³² Forecasts predict the annual sales of e-motorcycles and e-scooters will reach 40 million by 2023.³³

China controls 30 percent of the global market, ranking first in the world in terms of vehicles manufactured and sold.³⁴ However, in a report by the global consulting firm McKinsey & Company, "Finding the Fast Lane: Emerging Trends in China's Auto Market," it found from

³¹ "Institute for Strategy & Competitiveness."

³² Hanlon, Mike. "Tongji Automotive Design Research Institute Begins to Make Its Mark." *New Atlas*, New Atlas, 28 Apr. 2013, newatlas.com/tongji-automotive-volare-personal-intelligent-electric-vehicle/27227/.

³³ "E-Bikes - Worldwide Sales 2023 | Forecast." *Statista*, www.statista.com/statistics/255653/worldwide-sales-of-electric-bicycles/.

³⁴ Tauber, Zheng "The Chinese Automotive Market – Much More than Just Large."

the responses of 3,500 Chinese consumers that only one-third stated they needed to own cars, and only 50% of recent car buyers said cars were a necessity.³⁵ Despite the future prediction that the Chinese automotive industry will grow to an estimated 35 million cars manufactured in 2025,³⁶ the rise of a shared economy – e-hailing, ride-sharing or other mobility services – may threaten the automotive industry. This threat could potentially reduce private vehicle sales by as much as 4 million vehicles by 2030, out of an estimated 40 million in annual vehicle sales. Alternatively, due to the heavier use and need to replace these shared vehicles faster, the figures could be offset by the sales of up to 2 million shared vehicles for mobility services.³⁷ Although there is a potential threat from the increased use of a shared economy, the threat is mitigated because a shared economy still requires the production of vehicles.

Force Five: The Rivalry Among Existing Competitors

The rivalry among existing competitors measures the competitive environment, each player's level of power, and their ability to threaten companies in that industry. "If rivalry is intense it drives down prices or dissipates profits by raising the cost of competing."³⁸ The larger the number of competitors, along with the number of equivalent products and services offered, the lesser the power of a company. The role of suppliers and buyers directly affects the rivalry; if there are low switching costs, suppliers and buyers can seek out a company's competition. The following are just a few of the many factors that influence the level of intensity in competition:

- Competitors that are numerous (or equal in size and market position)
- High exit barriers

³⁵ Gao, Paul, et al. "Finding the Fast Lane: Emerging Trends in China's Auto Market." *McKinsey & Company*, Apr. 2016, www.mckinsey.com/industries/automotive-and-assembly/our-insights/finding-the-fast-lane-emerging-trends-in-chinas-auto-market.

³⁶ Kwong, "China Car Market Has Bumper Year but 2017 Outlook Weaker."

³⁷ Gao "Finding the Fast Lane: Emerging Trends in China's Auto Market."

³⁸ "Institute for Strategy & Competitiveness."

- High fixed costs
- High commitment to the business
- Diverse approaches and goals.³⁹

The competition between automotive manufacturers is intense. There is a continuous need to match improvements in technology, performance, and customer service as well as a constant pressure for price competition. The rivalry among existing competitors is fierce due to high fixed costs and low differentiation. This not only affects profitability, but also lessens the power each company holds. McKinsey & Company's report showed that Chinese car buyers are becoming more practical and less status-conscious. Over the past decade, car prices have fallen four percent each year as a result of the intense competition among automakers. This is in part due to the increased use of digital channels to compare offers and press dealers for lower prices. While more than half of the consumers aspire to upgrade to a better brand when they buy their next car, 37 percent of the consumers were willing to buy used vehicles in order to buy cars with better features for their money.⁴⁰

The rivalry among existing competitors will continue to grow in the coming years. In September 2017, the Chinese government announced that it aspires to ban gas and diesel cars in the future. The sales of electric and plug-in hybrid vehicles rose 53 percent from 2015 to 2016,⁴¹ and China accounted for more than 40 percent of all electric vehicles sold worldwide.⁴² By 2020, the Chinese government projects to have five million electric cars on the road.⁴³ These ambitious aspirations have further stimulated the competition among manufacturers, as evidenced by

³⁹ "Institute for Strategy & Competitiveness."

⁴⁰ Gao "Finding the Fast Lane: Emerging Trends in China's Auto Market."

⁴¹ Kwong, "China Car Market Has Bumper Year but 2017 Outlook Weaker."

⁴² Pham, Sherisse. "China Wants to Ban Gas and Diesel Cars." *CNNMoney*, Cable News Network, money.cnn.com/2017/09/11/news/china-gas-electric-car-ban/index.html.

⁴³ Ibid.

General Motors and Volkswagen both moving their research, development, and production of electric cars to China. China's future demand for electric vehicles has resulted in General Motors and Ford adding a combined 33 electric models to their lineups, and Volvo announcing that every car from 2019 onward will have an electric motor.⁴⁴

Force Six: The Role of the Government

The role of the government can become an additional competitive force of an industry; regulations, taxation, and trade policies directly affect the flow of business within that industry. While regulations can either stimulate or inhibit development, taxation policies similarly can either encourage or prevent the growth within an industry. Regarding trade policies, the receptiveness of the economic state to foreign direct investment may allow for investors to avoid tariffs and further develop the internal economy.

As previously mentioned, the Chinese government plays an extensive role in the regulation and control of the automotive industry; it is considered one of the main pillars of the Chinese economy.⁴⁵ The Chinese government heavily encourages and enacts policies for the development of domestic automobile consumption. However, in the upcoming years, more foreign and Chinese automotive manufacturers will build cars for export. For example, General Motors' Buick Envision, a compact luxury crossover manufactured in China and originally only intended for the Chinese consumer, was exported to the United States market for the 2017 model year. The purchase of Volvo by Geely, a leading Chinese manufacturer, has led to the Volvo S60, a luxury sedan, and is the first Volvo model to be built in a factory in Chengdu. It also became the first Chinese-built car from a major manufacturer sold to American buyers in late

⁴⁴ Ibid.

⁴⁵ Tauber, Zheng "The Chinese Automotive Market – Much More than Just Large."

2015. As for upcoming plans, due to higher costs, Ford plans to build the 2019 Focus, one of its most affordable models, at a production facility in Hangzhou.⁴⁶

In Martin Calkins' *King Car and the Ethics of Automobile Proponents' Strategies in China*, he states that, "officials in the central government regulate approvals as part of the economic planning process for the country while local officials strike particular deals to benefit their specific regions."⁴⁷ The role of the central government can be seen through its taxation policies to boost the automotive industry as the economy slowed. In 2015, the Chinese government implemented a tax cut policy on cars with engines of 1.6 liters or below and a reduction in sales tax from 10 percent to 5 percent.⁴⁸ The government took the necessary measures to ensure an increase in the number of automobile sales. The role of the central government is further represented through their involvement in almost every level of setting contracts.⁴⁹ For example, Beijing Automotive Industry Corporation is a state-owned enterprise and holding company of several automobile manufacturers and has joint ventures with DaimlerChrysler AG and Hyundai Motor Company.⁵⁰ Similarly, Shanghai Automotive Industry is a state-owned automotive design and manufacturing company that forged joint ventures with General Motors and Volkswagen.

The role of local governments can be seen through the example of Chery Automobile. Chery, founded in Wuhu in the Anhui province, began as a wholly government-owned car manufacturing company in 1997.⁵¹ In 2015, it sold approximately 505,000 vehicles.⁵² The

⁴⁶ Threewitt, Cherise. "Which Cars Are Made in China and Sold in the U.S.?" *U.S. New & World Report*, 26 July 2017, cars.usnews.com/cars-trucks/cars-made-in-china.

⁴⁷ Calkins 162.

⁴⁸ Tauber, Zheng "The Chinese Automotive Market – Much More than Just Large."

⁴⁹ Calkins 162.

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² Chery International. "Chery Group Sells 550,100 Units in 2015, Increasing by 8.3% Year on Year." *News | News | Chery International*, 29 Jan. 2016, www.cheryinternational.com/news/20160129146.html.

government's role further expands across industries and sectors as "Chinese automobile companies sometimes forge agreements across ancillary industries owned or controlled by the government, as in the case of Chery Automobile's agreement with China Petroleum and Chemical Corporation (Sinopec) and SMC Corporation to develop technologies related to alternative fuels."⁵³ The involvement and the role of the Chinese government in the automotive industry is highly unique in that it is critical not only to structure joint ventures and develop domestic consumption of automobiles, but also for the role that it plays with its foreign partners.

Michael Porter's Clusters and the New Economics of Competition

Michael Porter's *Clusters and the New Economics of Competition* analyzes the importance of location with the advancement of open global markets, along with faster lines of transportation and communication. Porter argues that despite these advances in global sourcing, the "economic map of the world is dominated by what I [Porter] call *clusters*: critical masses – in one place – of unusual competitive success in a particular field."⁵⁴ Porter defines clusters as "a geographic concentration of interconnected companies and institutions in a particular field...[that] encompass an array of linked industries and other entities important to competition."⁵⁵ Porter argues that clusters are an alternate structure of organization, and the proximity of location in clusters fosters better coordination, flexibility, and trust. Clusters not only increase productivity, but also increase the pace of innovation and stimulate the formation of new businesses. Porter incorporates the role of the government in this model and argues that in the future, the public and private sector must maintain a cohesive relationship in order to maximize productivity and economic development.

⁵³ Calkins 162.

⁵⁴ Porter, Michael. "Clusters and the New Economics on Competition." *Harvard Business Review*, 1998, pp. 77–90.

⁵⁵ *Ibid.*

Porter constructs his argument into six sections to assert the strength of the local business environment as a competitive advantage in the global economy. After Porter explains the definition of clusters, he continues his argument to describe why clusters are critical for competition. Since modern competition depends on productivity, the local business environment influences the quality of surrounding businesses. Clusters and productivity are synonymous because the local business environment gives better access to employees and suppliers, specialized information, institutions and public goods, innovation as well as better motivation and measurement.⁵⁶ Developed clusters also have lower barriers to entry which promote the formation of new businesses within existing clusters.

Porter incorporates the government to state his stance against industrial policy. Government interventions through subsidies and restrictions on investments by foreign companies tend to target limited industries. Industrial policies do not create environments that support productivity, but rather focus on industries that the government deems desirable to its economy. In conclusion, Porter insists for newly defined goals of the public and private sector relations to incorporate mutual dependence and collective responsibility.

The automotive clusters within China encourage high levels of productivity and incorporate a fundamental competitive advantage that fosters community within the clusters. The intra-industry as well as inter-industry benefits such as the sharing of knowledge, institutions, highly specialized skills, and access to technology help drive the future of the automotive industry. Porter argues that location is critical to the structure of the new economics of competition, and the coastal locations of the automotive clusters in China highlight how Deng Xiaoping's (邓小平) economic reforms shaped the formation of industries. In addition to the

⁵⁶ Ibid.

open-door policy, the creation of special economic zones (经济特区) attracted foreign investments to particular locations along the coast. In fact, 90 percent of foreign direct investment is concentrated in the coastal region.⁵⁷

There are six automotive clusters within China's regions: the Yangtze River Delta, Pearl River Delta, Beijing-Tianjin, Northeast China, Central China, and Southwest China. This section will focus solely on the Yangtze River Delta to allow for an in-depth analysis of the cluster. The region has an extensive industrial history and is comprised of the following cities: Shanghai, Nanjing, Hangzhou, and Ningbo. This section will then argue that when combined with the role of the government, China's automotive clusters truly promote a mutually dependent and highly productive environment. China's industry conditions foster the growth of intra-industry and inter-industry development and provide the industry with competitive advantages in the global economy.

Yangtze River Delta – Shanghai, Nanjing, Hangzhou, Ningbo

The Yangtze River Delta is one of China's oldest and most consolidated automotive clusters. The cluster has an advanced economy and high-quality manufacturing. It encompasses the Shanghai International Auto City which was built in 2001. The city, located in Anting, includes the Auto Parts Industrial Park of Shanghai International Auto City, the Jiading Huangdu Industrial Zone, and the Jiading Nanxiang High-Tech Park.⁵⁸ The park has formed industries in auto parts, auto logistics, and electronic components as well as in household appliance and machine manufacturing. The park has also attracted auto electronic projects and R&D institutions. The Shanghai Auto Electronic Industrial Base includes the National Auto Test

⁵⁷ Batisse, and Cécile. "The Location of Manufacturing Industry and Spacial Imbalance." *China Perspectives*. November 29, 2006. Accessed March 28, 2018. <http://journals.openedition.org/chinaperspectives/502>.

⁵⁸陈之琳. "Shanghai International Auto City." *Shanghai International Auto City*, 5 July 2013, www.chinadaily.com.cn/m/shanghai/jiading/2013-07/05/content_16736375.htm.

Center, Shanghai Automotive Engineering Institute, and Tongji University Engineering Test Center. Shanghai Volkswagen, Optima-Roush, and the Toyota Research and Development Center are located in close proximity, portraying the strong industrial concentration and supportive services within the cluster.⁵⁹ The intra-industry and inter-industry benefits are represented through “integrated functions of manufacturing facilities, a research and development center, a trading area, an exports park, tourism facilities, a golf link, an auto museum, exhibition centers, catering and entertainment facilities, [and] a metropolitan service center.”⁶⁰ Shanghai is at the core of the automotive industry cluster with its leading position as one of China’s automobile bases since 1949. While Shanghai and the Jiangsu Province (Nanjing) developed state-owned enterprises and joint ventures with foreign manufacturers, Zhejiang Province (Ningbo and Hangzhou) developed from private automobile manufacturers. The role of five different factors – manufacturers, suppliers, finance, institutions, and related industries – are critical to the highly competitive nature of the industry, and they function collectively to stimulate the surrounding economy.

Manufacturers

Shanghai Automotive Industry Corporation (SAIC), is one of the largest automobile groups in China, and continued its lead in 2016 with 6.49 million vehicles sold, up 9.95 percent from the previous year.⁶¹ Shanghai has more than 50 world-class automobile joint ventures, and the SAIC-GM (Shanghai Automotive Industry Corporation- General Motors) joint venture in 1998 brought huge investments to the local industry. Along with its forged venture with General

⁵⁹ Ibid.

⁶⁰ “Shanghai International Autocity Development Co., Ltd.” *Shanghai International Autocity Development Co., Ltd.: Private Company Information - Bloomberg*, www.investing.businessweek.wallst.com/research/stocks/private/snapshot.asp?privcapid=224405645.

⁶¹ “SAIC Sells 6.49 Million Vehicles in 2016.” *SAIC USA*, 4 Apr. 2017, www.saicusa.com/saic-sells-6-49-million-vehicles-in-2016/.

Motors, SAIC additionally produces products with joint venture companies that are sold under the brands Baojun, Buick, Chevrolet, Iveco, Škoda, Volkswagen and Wuling. There are also brands that are exclusive to SAIC such as Maxus, MG, Roewe, and Yuejin. Volkswagen and General Motors chose to partner with SAIC because of its strategic geographical position along the coast and close accessibility to China's ports. Chinese independent automakers Geely and Chery have additionally set up plants in the surrounding area.

Suppliers

Along with the establishment of SAIC and its joint ventures, China's largest automotive parts and components industrial base was formed with a full product range and huge scale. One of the suppliers in the region, Schaeffler, has a research and development center in Anting (the Shanghai International Auto City), as well as a plant in Nanjing and a sales office in Shanghai.⁶² Other suppliers include TRW, Continental, and Valeo (a joint venture between Valeo International Holding Company and Huayu Automotive Systems), as well as Johnson Controls, which recently unveiled its Asia-Pacific headquarters this year in Shanghai.⁶³ The Shanghai International Auto City is a major industrial town, and the Auto Parts Industrial Park is an integral component. Since 2013, the park has introduced over 280 projects, 80 percent of which are engaged in auto parts production.⁶⁴

⁶² "Schaeffler Greater China." *Schaeffler Greater China Company*, 15 Nov. 2017, www.schaeffler.cn/content.schaeffler.cn/en/company/company.jsp.

⁶³ Johnson Controls. "Johnson Controls Unveils 'Smart' Asia-Pacific Headquarters in Shanghai." *Johnson Controls* www.johnsoncontrols.com/insights/2017/enterprise/features/johnson-controls-unveils-smart-asia-pacific-headquarters-in-shanghai.

⁶⁴ Shanghai International Auto City. Accessed March 28, 2018. http://english.jiading.gov.cn/2013-07/05/content_16736375.htm.

Finance

The financial sector plays a crucial role in providing financial services to the increasing number of automotive retail customers. One example is the joint venture between GMAC-SAIC, which allows customers to contribute to the development of the automotive market by supporting China's growing network of dealership entities with tailored financing solutions. Another example is China Pacific Insurance Group, headquartered in Shanghai, which is the second largest property insurance company in mainland China and provides integrated insurance services through its subsidiaries.

Institutions – Government & Universities

Institutions are key players in the development and competitive advantage of clusters. The collaborative role between the universities, the government, and the manufacturers have played a key role in the development of the automotive industry in the Yangtze River Delta region. Shanghai Tongji University's automotive engineering department is one of the best domestically, and coordinates with SAIC-VW to cultivate automotive experts. In 2017, the President and CEO of Volkswagen Group China announced the following:

“... a new initiative to explore multi-party cooperation for a smart city together with Tongji University Shanghai, and with fast-developing cities in east China and the Yangtze Delta area. The new partnership aims to pilot innovative smart mobility solutions, contribute to urban planning, optimize public commuting services and improve efficiency in urban transportation.”⁶⁵

⁶⁵ “Volkswagen Group China Forges Partnerships with Local Leaders to Make Daily Life Easier as Cars Evolve.” *SHINE - BEYOND A SINGLE STORY*, 18 Apr. 2017, www.shine.cn/archive/business/autotalk-special/Volkswagen-Group-China-forges-partnerships-with-local-leaders-to-make-daily-life-easier-as-cars-evolve/shdaily.shtml.

Volkswagen Group China further announced a 50-50 joint venture with Mobvoi Inc., a Chinese developer of artificial intelligence and voice recognition technology, showing its commitment to working with local partners “to lead the new era of digitalization and sustainable mobility solutions.”⁶⁶ In 2009, the Tongji Automotive Design Research Institute (TADRI) was established as part of the Chinese and Shanghai Government’s plan to create a center of automotive expertise and give the Chinese automotive industry a competitive edge. TADRI collaborates closely with other institutions including the Clean Energy Vehicle Engineering Center, Shanghai Automotive Wind Tunnel Center, Shanghai Fuel Cell Vehicle Powertrain Company, and the Shanghai Academy of Spaceflight Technology (SAST).⁶⁷

Related Industries

The role of the media feeds off the automotive cluster in China, as one of the largest newsletters, Automotive News China, is delivered to more than 20,000 Chinese automotive industry executives and global automotive executives weekly. Automotive News China is located in Shanghai and covers,

“... domestic Chinese automakers (SAIC, First Automotive Works, Chery, Geely, etc.) who export vehicles worldwide as well as the purchasing operations of global automakers (General Motors, Volkswagen, Toyota, etc.) that do business in China. It also covers global suppliers (Aisin Seiki, Faurecia, Lear, Visteon, etc.) who make auto parts in China for export to North America, Europe and Japan, as well as domestic Chinese suppliers (Wanxiang Group, Chongqing Tsingshan, Tianjin Automotive, Guizhou Honghu, etc.) who sell to automakers in China and worldwide.”⁶⁸

⁶⁶ Ibid.

⁶⁷ Ibid.

⁶⁸ “Automotive News China About Us.” *Automotive News China*, www.autonewschina.com/en/aboutus.asp.

Automotive News China plays a significant role in the delivery of updates about the automotive industry and receives help from the surrounding automotive cluster. Additionally, the Shanghai International Automobile Industry Exhibition, which was first held in 1985, stands as the nation's oldest auto exhibition. While it rotates every other year with the Beijing Auto Show, the presence of the exhibition in Shanghai indicates the prominence of the automotive industry in this region.

Predictions

Several key threats to the automotive industry will have various impacts on the region's competitive advantage in the future. These threats include rising labor prices, the saturation of the market, the fierceness of competition, environmental threats and regulations, increased oil prices, and the costs associated with car maintenance. A shared economy threatens private vehicle ownership yet has the power to transform the current Chinese automotive industry through advancements and innovation in technology. The government's control over foreign manufacturers through joint ventures seeks to boost local Chinese manufacturers. However, local Chinese brands do not control a significant portion of the market, and so consolidation will need to occur before any significant change happens.

A healthy pace of innovation is critical to the future of success of the Chinese automotive industry. The introduction of more electric vehicles and new autonomous vehicles bodes well for this continuous improvement. Porter's "Five-Forces-Model" and "Clusters and the New Economics of Competition" frameworks give two different approaches to analyze the competitive intensity and market attractiveness of the Chinese automotive industry. While the "Five-Forces-Model" [plus the role of the government] shows how the Chinese automotive

industry reacts to potential threats and existing competition, the “Clusters” model allows for the contextualization of all of the working parts within the automotive and related industries.

Together, these two models demonstrate how all the components in the Chinese automotive industry work together synergistically to create a multiplier-effect within the economy. However, in the case of China’s automotive industry, the government truly drives not only the influx of foreign brands, the manufacturing of vehicles, and the organization of clusters, but also consumer purchases which are critical for the survival, expansion, and high-competitiveness of the automotive industry.

CHAPTER TWO

Luxury Among the Nouveau Riche: The Chinese Tuhao (土豪)



Figure 1: China's first premier Zhou Enlai's(周恩来) Buick at his house in Shanghai.

The previous chapter examined the historical context of the Chinese automotive industry and analyzed its competitive landscape utilizing Porter's "Five-Forces-Model" and "Clusters and the New Economics of Competition" frameworks. This chapter will thematically explore the transformation of luxury brands in the Chinese automotive industry. China's automotive industry is unique not only in relation to its rapid industry development, but also in its increased consumption of luxury vehicles.

One of the first influences of a global luxury vehicle in China began with the emergence of General Motor's brand, Buick [Figure 1].¹ In 1911, General Motors debuted its first export vehicles to China, Australia, and New Zealand. In 1912, Buick arrived in China and became the chosen vehicle for high-ranking political leaders such as Sun Yat-sen (孙逸仙) and Zhou Enlai

¹ Most Americans Associate Buick with a Gone Era. "Buick Is a Lot More than a Dad Wagon in China."

(周恩来), as mentioned in the previous chapter. In the 1930s, “Buicks were a symbol of luxury in China,” and “accounted for a sixth of the cars on Chinese roads”² In 1949, Buick sales were halted after the Communist Party won the country’s civil war. After a long absence, General Motors, through its joint venture with SAIC, opened a Buick factory in Shanghai in 1998 and sales resumed.

This close association between China’s political leaders and Buick established a public connection early on that cemented Buick as a glorified luxury brand. The image on the previous page invites us to consider the significance of the relationship between Buick’s perceived luxury and the Chinese elite, originally only for government officials. With the explosive growth of the Chinese middle and upper classes, has the cultural perception of luxury automobiles changed?

The chapter has three sections: “What is Luxury?,” “Who Buys Luxury?,” and “Evolving Trends in Luxury.” First, the “What is Luxury?” section will question the term luxury and will define a luxurious automobile in China. The section will then include a cultural comparison between two luxury brands in China and the United States. Next, the question “Who Buys Luxury?” is explored. After Deng Xiaoping’s (邓小平) reforms and opening-up policy in the 1980s, the Chinese economy experienced tremendous growth. The economic growth created different economic classes, and the Chinese middle and upper classes emerged. The correlation between the two classes rise in wealth and the exponential growth of luxury vehicles indicate the reliance on important trends that influence the cultural aspects of luxury. Lastly, “Evolving Trends in Luxury,” will analyze the behaviors of Chinese luxury car consumers. Tying back to the image of Zhou Enlai’s (周恩来) Buick, this section will explore the cultural perceptions of

² Bradsher, Keith. "G.M. Sees China, and the Chinese, in a Chevrolet." The New York Times. January 11, 2007. Accessed March 28, 2018. <https://www.nytimes.com/2007/01/11/business/worldbusiness/11sinochevy.html>.

luxury cars from their arrival in 1912 to present day. While the previous chapter focused on the Chinese automotive industry's landscape, this chapter will assert that its highly competitive nature has transformed the role of luxury in the fairly "new" automotive industry. This is important because this stage of growth for China creates high risks and high rewards for innovation that adds value.

What is Luxury?

The implications of the word "luxury" are complex to untangle, not only because interpretations vary from culture to culture, but also from person to person. Luxury embodies an aura of prestige; a high-quality product that holds a feeling of exclusivity. Luxury is differentiated; it is superior in quality; it is a demonstration of status; it is a display of wealth; and it is an icon of power. While luxury can be found in an abundance of concepts, it is not common, inexpensive, or low quality. Nevertheless, something can be expensive, but still not luxurious. When speaking about luxury vehicles, the notion of luxury varies even more because vehicles incorporate technology features as well as advanced design packages. Some luxury consumers value the concept of conspicuous consumption, while other luxury consumers value the extraordinary experience and feel of luxury. A brand's cultural perception in society further denotes whether a certain vehicle is luxurious or not. For the purpose of this thesis, the term luxury automobile encompasses the above definition of luxury in combination with a manufactured automotive experience. Automotive manufacturers not only physically produce luxury cars, they also manufacture desire.

In general, all cars will function in very similar ways. The physical difference is in each car's performance. Luxury cars will pamper drivers and passengers with features such as

massage chairs and upgraded suspensions. These features provide a temporary escape for drivers and passengers, isolating them from road imperfections and outside noise. The massage chairs further provide a therapy that combats the negative effects of inactivity. Thus, luxury car ownership provides the customer with a superior experience that extends far beyond the vehicle's physical value.

A further look into the perceptions of luxury automotive brands gives insight to how luxury brands create cultural value in the automotive industry. The luxury automotive industry's segments are as follows: premium compact cars,³ entry-level luxury/compact executive cars,⁴ mid-size luxury/executive cars,⁵ high-end luxury/full size cars,⁶ ultra-luxury cars,⁷ and luxury SUV/crossover cars⁸ [Figures 2-7].



Figure 2: 2018 Audi A5 Sportback, Premium Compact Car



Figure 3: 2018 Lexus IS, Entry-Level Luxury/Compact Executive Car



Figure 4: 2018 BMW 5 Series, Mid-size Luxury/Executive Car

³ "Audi A5 Sportback 2.0 TDI Ultra S Line | Car Leasing." Nationwide Vehicle Contracts. Accessed March 28, 2018. https://www.nationwidevehiclecontracts.co.uk/Audi_a5-sportback-new-model-2-0-tdi-ultra-s-line-78523.htm.

⁴ Lexus USA. "2018 Lexus IS - Luxury Sedan." Lexus USA. Accessed March 28, 2018. <http://www.lexus.com/models/IS>.

⁵ BMW 5 Series. Accessed March 28, 2018. https://www.vehie.com/m/bmw-5-series-2018-sedan--m550i_xdrive.

⁶ "2018 Tesla Model S Reviews and Rating." Motor Trend. Accessed March 28, 2018. <http://www.motortrend.com/cars/tesla/model-s/2018/>.

⁷ "2018 Porsche Panamera Turbo S E-Hybrid Pumps out 680 Horsepower." Engadget. February 25, 2017. Accessed March 28, 2018. <https://www.engadget.com/2017/02/25/2018-porsche-panamera-turbo-s-e-hybrid-pumps-out-680-horsepower/>.

⁸ "2018 Bentley Bentayga Onyx Edition AWD Overview." Roadshow. Accessed March 28, 2018. <https://www.cnet.com/roadshow/auto/2018-bentley-bentayga/>.



Figure 5: 2018 Tesla Model S, High-end Luxury/Full Size Car



Figure 6: 2018 Porsche Panamera, Ultra-Luxury Car



Figure 7: 2018 Bentley Bentayga, Luxury SUV/Crossover Car

The above images portray various levels of luxury that are differentiated by their brand, quality, performance, design, features and status. While the perception of luxury varies amongst cultures, these examples provide a general foundation to understanding the types of cars associated with each segment in the luxury automotive industry. The cultural value of luxury shifts in every country's market because historical, political, and social factors shape the perception. A further comparison between two luxury global automotive brands – Buick and BMW – will show how cultural values influence society's perception and that the meaning of luxury is purely subjective.

Buick

In 2005, General Motors' Vice Chairman, Bob Lutz called Buick a “damaged brand.”⁹ From 2002 to 2015, Buick sales in the United States declined by 48 percent.¹⁰ In 2015, Buick sold 1.2 million vehicles worldwide, with 80 percent sold in China and only 18 percent sold in the United States.¹¹ In 2016 between the months of January to May, Buick ranked as the most

⁹ Frankel, Todd C. "That's a Buick?" In China, unlike the U.S., There's No Doubt." The Washington Post. January 20, 2016. Accessed March 28, 2018. https://www.washingtonpost.com/news/business/wp/2016/01/20/thats-a-buick-in-china-unlike-the-u-s-theres-no-doubt/?utm_term=.d54995fa2472.

¹⁰ Cain, Timothy, and Jack Matthews. "Buick's U.S. Sales Rollercoaster Ride -." GCBC. July 18, 2017. Accessed March 28, 2018. <http://www.goodcarbadcar.net/2014/05/buick-brand-sales-figures-breakdown-by-model-2002-2013/>.

¹¹ "Buick China Auto Sales Figures." Carsalesbase.com. Accessed March 28, 2018. <http://carsalesbase.com/china-car-sales-data/buick/>.

prestigious brand to lift one's social status in China, with 470,000 cars sold and a 29 percent growth rate from the previous year.¹²

From the above examples, one can recognize the volatility of Buick's global activity. Although sales do not directly correlate to cultural perceptions, perceptions influence the desire to purchase vehicles. In the United States, Buicks represent the image of a solid family car, "your grandfather's Buick," one associated with the United States' car culture past. Over the past several years, Buick has tempered its perception in the mainstream to appeal to younger car buyers. Buick created the campaign, "That's not a Buick" to humorously confront its perception as a car for older consumers. Buick's Vice President of Marketing, Tony DiSalle commented, "The campaign has worked well and has shown us that there now is a higher opinion of the Buick brand than there had been, a higher buying consideration of the brand than there had been, and a greater acceptance of the brand than there had been—all this as we prepare to launch new products."¹³ While the rebranding of Buick's image was necessary for vehicle sales in the United States, the perception of Buick in China is the polar opposite.

Since its arrival in 1912, Buick has influenced the landscape of luxury automobiles in China. Buick symbolizes the modernity of the 1920s, a luxury brand once reserved for nationalist government officials like Zhou Enlai (周恩来). In 1998, General Motors became a manufacturer in Shanghai and in 1999, its joint venture launched production. General Motors chose Buick as its first brand to manufacture because of the brand's cultural heritage and its legacy tie to high-ranking government officials. Since then, Buick has utilized its upscale reputation to target

¹²Dunne, Michael J. "Bad News For U.S. Automakers In China: The Chinese Are Closing The Quality Gap." *Forbes*. July 25, 2016. Accessed March 28, 2018. <https://www.forbes.com/sites/michaeldunne/2016/07/25/why-chinese-love-buicks-and-jeps-but-are-dissing-chevrolets-and-chryslers/#116f0f7241ed>.

¹³"Buicks Ad Campaigns Reversing, Improving Public Perception." *The News Wheel*. March 18, 2016. Accessed March 28, 2018. <http://thenewswheel.com/buicks-ad-campaigns-reversing-improving-public-perception/>.



Figure 8

China's growing middle class. Buick's success is due to two factors: heritage and right products.¹⁴ In China, foreign SUVs are the luxury vehicles of choice¹⁵ and Buick manufactures a popular one in China – the Envision [Figure 8].¹⁶ The model sold more than 20,000 units in January 2018,¹⁷ and has been so successful that it is exported to overseas markets like the United States.

BMW

In the United States, BMW is a powerful and masculine luxury brand that epitomizes all the images that come to mind when one hears the phrase “a pretentious yet aggressive high-performance vehicle.” The reception of BMW has been culturally influenced by the nature of its owners. For example, in 2013 a study by the Institute of Personality and Social Research at the University of California, Berkeley, stated that “BMW drivers were the worst when it came to following traffic regulations.”¹⁸ Similarly, Car Throttle, a popular online community for car enthusiasts, “carried out a poll with around 7,500 respondents, [and] 41 percent tagged BMW drivers at the most disliked ones.”¹⁹ In China, BMW is seen as a symbol of corruption. The following incident, which occurred in April 2015, is an example of why BMW has this reputation:

A BMW racing through a fruit market in Foshan in China's Guangdong province knocked down a 2-year-old girl and rolled over her head. As the girl's grandmother

¹⁴ Most Americans Associate Buick with a Gone Era. "Buick Is a Lot More than a Dad Wagon in China."

¹⁵ Davies, Alex. "Why Chinese Buyers Are Obsessed With Buick." Business Insider. April 23, 2013. Accessed March 28, 2018. <http://www.businessinsider.com/why-chinese-buyers-love-buick-2013-4>.

¹⁶ "2016 Buick Envision." Media.gm.com. Accessed March 28, 2018. <http://media.buick.com/media/us/en/buick/vehicles/envision/2016.html>.

¹⁷ "Buick Envision China Auto Sales Figures."

¹⁸ "Why Are BMW Drivers Hated So Much." BMW BLOG. October 20, 2015. Accessed March 28, 2018. <http://www.bmwblog.com/2015/10/20/why-are-bmw-drivers-hated-so-much/>.

¹⁹ Ibid.

shouted, “Stop! You’ve hit a child!” the BMW’s driver paused, then switched into reverse and backed up over the girl. The woman at the wheel drove forward once more, crushing the girl for a third time. When she finally got out from the BMW, the unlicensed driver immediately offered the horrified family a deal: “Don’t say that I was driving the car,” she said. “Say it was my husband. We can give you money.”²⁰

Luxury brands cultural perceptions in China and the United States invite the question, “What is luxury?” These cultural perceptions play into the value that brands create in the automotive industry. This section has shown that a luxury automobile extends beyond its functionality to create a manufactured experience. Yet, who exactly in China purchases these manufactured luxury experiences?

Who Buys Luxury?

The Middle Class

The middle class is one segment in China that buys luxury vehicles. This class has the economic means to spend its disposable income on luxury items. According to a McKinsey report titled *Mapping China’s Middle Class*, “The explosive growth of China’s emerging middle class has brought sweeping economic change and social transformation. By 2022, more than 75 percent of China’s urban consumers will earn 60,000 to 229,000 RMB (\$9,000 to \$34,000) a year.”²¹ The stark increase in the number of middle class consumers, particularly upper middle class in China indicates a rise in the consumption of luxury goods. “The evolution of the middle

²⁰ Sant, Geoffrey. "Why Drivers in China Intentionally Kill the Pedestrians They Hit." Slate Magazine. September 04, 2015. Accessed March 28, 2018. http://www.slate.com/articles/news_and_politics/foreigners/2015/09/why_drivers_in_china_intentionally_kill_the_pedestrians_they_hit_china_s.html.

²¹ Barton, Dominic, Yougang Chen, and Amy Jin. "Mapping China's Middle Class." McKinsey & Company. Accessed March 28, 2018. <https://www.mckinsey.com/industries/retail/our-insights/mapping-chinas-middle-class>.

class means that sophisticated and seasoned shoppers – those able and willing to pay a premium for quality and to consider discretionary goods and not just basic necessities – will soon emerge as the dominant force.” The upper middle class are projected to experience a 22.4 percent growth in private consumption from 2012 to 2022, indicating the upper middle class’

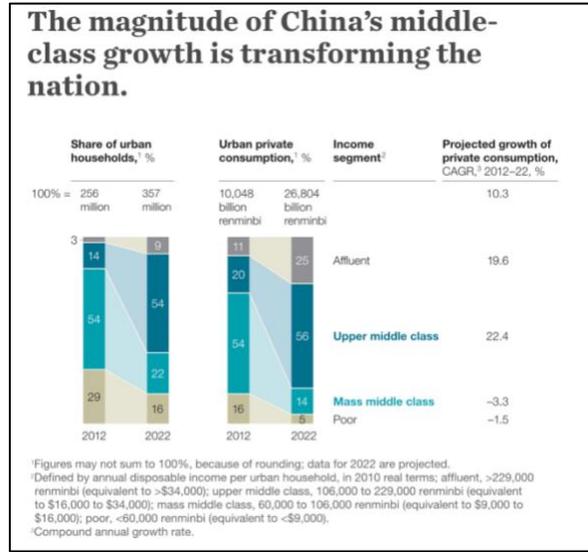


Figure 9

significance in consumer spending.²² McKinsey estimates that by 2022, “the upper middle class will account for 54 percent of urban households and 56 percent of urban private consumption”²³ [Figure 9].²⁴ With over half of China’s urban population classified as the upper middle class, we must also take into consideration the role of demographics, specifically who is spending and where they are spending.

Demographics are sets of statistical data that study population segments by certain characteristics. McKinsey reports that, “In 2002, 40 percent of China’s relatively small urban middle class lived in the four Tier-one cities: Beijing, Shanghai, Guangzhou and Shenzhen. By 2022, the share of the megacities will probably fall to about 16 percent [Figure 10].²⁵ They won’t be shrinking, of course; rather, middle-class growth rates will be far greater in the smaller cities of the north and

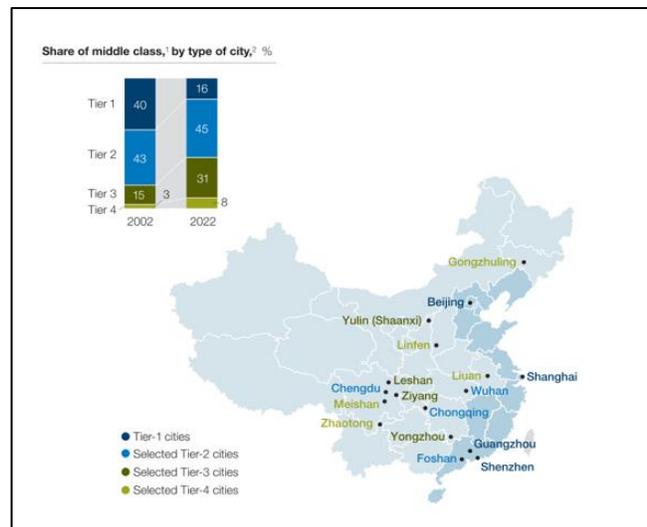


Figure 10

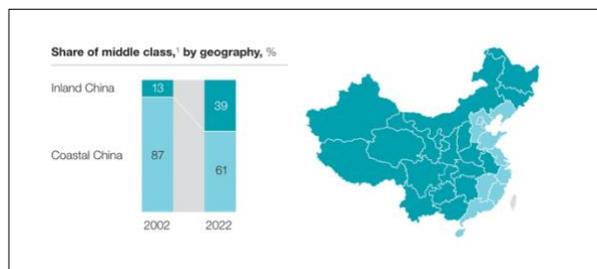
²² Ibid.

²³ Ibid.

²⁴ Ibid.

²⁵ Ibid.

Figure 11



west.”²⁶ The shift in demographics highlights how the wealthy Chinese are rapidly changing. In the 1980s, the economic reforms were first started along the coast, which concentrated the

urban wealth to those coastal cities. Investments in factories and access to trade propelled the rise of incomes in the coastal cities. However, the concentration of wealth now spreads over vast geographic locations. While luxury purchases previously only occurred in tier-one cities, there is a shift to more equal distribution between China’s inland and coastal regions [Figure 11].²⁷ The changing concentration of Chinese luxury consumers signifies that the advent of the middle class has transformed the nation’s economy. Next, it is important to examine the rise of the nouveau riche.

The Tuhao

In 2011, 130 Ferraris paraded through the streets of Guangzhou in a celebration of the brand’s 20 years in the country.²⁸ In 2012, Rolls Royce launched a \$1.2 million “Year of the Dragon” edition of its Phantom and all eight sold in two months.²⁹ The vehicle of choice for ladies who lunch is the Maserati Quattroporte, upwards of 2.2 million RMB.³⁰ In China, the emergence of the nouveau riche, the new wealthy elites, are known as the tuhao (土豪).

The term “tuhao” dates back more than 100 year ago. Tuhao referred to “wealthy landholders who would bully peasants or underlings.”³¹ In the 1930s, Communists used the

²⁶ Ibid.

²⁷ Ibid.

²⁸ Branigan, Tania. "China and Cars: A Love Story." The Guardian. December 14, 2012. Accessed March 28, 2018. <https://www.theguardian.com/world/2012/dec/14/china-worlds-biggest-new-car-market>.

²⁹ Ibid.

³⁰ Ibid.

³¹ Frank, Robert. "China Has a Word for Its Crass New Rich." CNBC. November 15, 2013. Accessed March 28, 2018. <https://www.cnbc.com/2013/11/15/china-has-a-word-for-its-crass-new-rich.html>

slogan “da tuhao, fen tian di (打土豪，分田地) which translates as “overthrow the local tyrants and divide the land.”³² The older translation of the term meant “local tyrant,” while the translation now means “crass rich.” The tu (土) translates as earth and the hao (豪) translates as wealth. For the term’s current use, “the *tu* draws on its colloquial use as a synonym for unrefined or vulgar, and *hao* picks up a new

tone from the Chinese phrase *fu hao* (富豪), which means rich and powerful.”³³ The word came to fruition on online platforms such as WeChat and went viral to describe the conspicuous consumption of the new wealthy elite. The term has gained such global prominence that



Figure 12

the Oxford English Dictionary considered adding the term tuhao to its 2014 edition. A popular example to demonstrate the use of the term is “the new gold iPhone 5S is known in China as the tuhao gold iPhone”³⁴ [Figure 12].³⁵ Tuhao refers to objects or people that are flashy, expensive, and lack class. The term is slightly offensive and derogatory in nature, as “the term provokes a mix of scorn and envy... [among the] superrich [who] are widely criticized as being corrupt and

³² Qin, Amy. "Yet Another Way to Mock Chinas New Rich." The New York Times. October 15, 2013. Accessed March 28, 2018. <https://sinosphere.blogs.nytimes.com/2013/10/15/yet-another-way-to-mock-chinas-new-rich/>.

³³ Ibid.

³⁴ Frank, Robert. "China Has a Word for Its Crass New Rich."

³⁵ Au, Truman. "Why the Gold iPhone Is Mocked As 'Nouveau Riche' In China." Cult of Mac. July 26, 2015. Accessed March 28, 2018. <https://www.cultofmac.com/262860/gold-iphone-tuhao-china/>.

materialistic.”³⁶ In the Chinese blogosphere, tuhao has become the center of one of the most popular jokes. The joke goes as follows:

A young man asks a Zen master, “I’m wealthy, but unhappy. What should I do?” The Zen master says, “Define ‘wealthy.’” The young man answers, “I have millions in the bank and three apartments in central Beijing. Is that wealthy?” The Zen master silently holds out a hand. The young man says: “Master, are you telling me that I should be thankful and give back?” The Zen master says, “No... Tuhao, can I become your friend?”³⁷

“Tuhao, can I become your friend” has become a popular catchphrase that conveys resentment as well as desire. As inferred, the tuhao’s abundant wealth allows the new social class to splurge on luxury vehicles. In 2015, one Chinese car owner in Beijing wrapped his Range Rover in shiny gold [Figure 13].³⁸ This Range Rover priced between 1.4 million RMB and 3.3. million RMB (US \$223,000 to \$525,000) epitomizes the term tuhao.



Figure 13

Wealth Among the Chinese Elite

In 2016, China ranked third in the world in household wealth, trailing the United States and Japan. China had 1.6 millionaires which accounts for five percent of all millionaires worldwide and nine percent of the top wealth holders. China ranks second in the world with the

³⁶ Ibid.

³⁷ "The Beverly Hillbillies of China : 土豪 Tuhao." 我的网站 - Home. Accessed March 28, 2018. <https://online1on1mandarinlessons.weebly.com/blog/the-beverly-hillbillies-of-china-tuhao>.

³⁸ "Range Rover Gold." Car News China. Accessed March 28, 2018. <https://www.carnewschina.com/wp-content/uploads/2015/12/range-rover-gold-2.jpg>.

number of ultra-high net worth individuals, whose net worth is above \$50 million. The wealth per Chinese adult has risen from \$5,670 in 2000 to \$22,854 in 2016.³⁹ We now know who purchases luxury vehicles, but how did the tuhao accumulate wealth?

There are three ways that the wealthy elites have earned their money in China: the product of China's market-oriented reforms, the beneficiary of China's booming housing and stock markets, and the powerful government elite. As mentioned in chapter one, Deng Xiaoping (邓小平) implemented a series of market economy reforms in 1978 that favored private property, relatively open markets, and international commerce. The "reform and opening up" policy led to the influx of foreign companies and organizations which created environments that stimulated economic growth and bred competition. The product of China's market-oriented reforms allowed for private business owners, lawyers, consultants, other senior professionals, and celebrities to amass material wealth. In a historical fashion, the powerful elite such as officials in administrative units of the party and the government as well as high-level managers of state-owned-enterprises have been supplemented by various forms of grey income. As a result, the product of China's market-oriented reforms and the powerful government elite fueled the rise of the beneficiaries of China's booming housing and stock markets. In 1978, less than 20 percent of the Chinese population lived in big cities. Now more than half of all Chinese live in cities.⁴⁰ Real estate developers, stock brokers, capital market players, real estate speculators and investors profited off the rise of the new wealthy in the transition from rural to urban living.

³⁹ "China Ranks Third in the World in Household Wealth." China Ranks Third in the World in Household Wealth - Business - Chinadaily.com.cn. Accessed March 28, 2018. http://www.chinadaily.com.cn/business/2016-11/23/content_27468348.htm.

⁴⁰ Waldmeir, Patti. "Chinese Billionaires' Guide to Getting Very, Very Rich." Financial Review. October 07, 2015. Accessed March 28, 2018. <http://www.afr.com/lifestyle/chinese-billionaires-guide-to-getting-very-very-rich-20151005-gk1a6j>.

Evolving Trends in Luxury

Global demands for luxury goods are becoming increasingly more common in society. In 2017, the annual sales for luxury goods exceeded \$200 billion.⁴¹ According to the fourth annual *Global Powers of Luxury Goods* report issued by Deloitte Global,

Emerging consumer markets continue to drive luxury market growth. In China, Russia and the United Arab Emirates, markets that we have categorized as emerging luxury markets, the percentage of consumers claiming to have increased their spending stood at 70 percent, compared to 53 percent in the more mature markets (EU, US, Japan).⁴²

The report examines and lists the 100 largest luxury goods companies globally, gives a global economic outlook, and discusses the key trends shaping the luxury market. The study concluded that quality is the key driver of luxury purchases, with wealthy Chinese as the top spenders when it comes to quality. In fact, 93 percent of Chinese consumers buy luxury products because of their premium quality.⁴³ Vicky Eng, Retail Sector Leader, Deloitte Global comments, “The essence of luxury is changing from an emphasis on the physical to a focus on the experiential and how luxury makes you feel. However, among high-net-worth individuals, premium quality is still a ‘necessity’ and these consumers keep a keen eye for artisanship and hand-made products.”⁴⁴

In China, the representation of power is luxury; the archetypes of power are the political leaders. They have the type of characteristics similar to those of athletes and entertainers in the United States. In general, if a powerful leader is driven in a Buick, the Buick is seen as a vehicle

⁴¹ Arienti, Patrizia, Patrizia, and EMEA. "Global Powers of Luxury Goods | Deloitte | Global Economy, Luxury Consumer." Deloitte. May 12, 2017. Accessed March 28, 2018. <https://www2.deloitte.com/global/en/pages/consumer-business/articles/gx-cb-global-powers-of-luxury-goods.html>.

⁴² Ibid.

⁴³ Ibid.

⁴⁴ Ibid.

of power. In the United States, if an athlete or an entertainer is driven in a Mercedes-Benz, or a window-tinted high-end SUV, then that is the type of vehicle one aspires to have to represent the power and the influence of the owner.

A recent study conducted by McKinsey & Company in September of 2017 details China's evolving car buyers. The study analyzed consumers from 44 tier-one to tier-four cities and seven counties, located in 19 key clusters across China. These clusters contributed to 90 percent of China's urban GDP and contain half of its population. The study identified two trends among Chinese consumers – the relationship between Chinese consumers and local brands as well as their relationship with premium (or luxury) brands.⁴⁵

The relationship between Chinese consumers and domestic brands remains weak in terms of domestic brands providing upscale vehicles. The data collected from the study showed that only eight percent of consumers say local players have aspirational brands that they want to buy next. In part, this is due to the international competition in premium segments, as well as the difficulty in establishing and producing upscale vehicles. However, “Chinese brands were the biggest winners in the entry-level SUV segment where they faced limited competition from international players, capturing an 89 percent share of this lower-price-tier market.”⁴⁶ While the average cost for entry-level vehicles is priced between 50,000 and 100,000 RMB (\$7,650 and \$15,300), the average cost for premium expensive vehicles is over 400,000 RMB (\$63,000).⁴⁷ In contrast, the relationship between Chinese consumers and premium brands is strong in regard to international brands. Within the Chinese car market, there is an ongoing trend in consumer purchases to move upscale to premium products, as “55 percent of respondents who replaced or

⁴⁵ Baan, Wouter, Paul Gao, Arthur Wang, and Daniel Zipser. "Savvy and Sophisticated: Meet China's Evolving Car Buyers." McKinsey & Company. Accessed March 28, 2018. <https://www.mckinsey.com/industries/automotive-and-assembly/our-insights/savvy-and-sophisticated-meet-chinas-evolving-car-buyers>.

⁴⁶ Ibid.

⁴⁷ Ibid.

complemented their existing cars in 2016 chose more expensive ones.”⁴⁸ While the study predicts that the Chinese premium segment will continue to outpace the rest of the market in terms of growth measured by sales, brand loyalty influences the momentum held by any particular international brand. Although “loyalty among international car owners is higher than that for local ones as consumers have the highest loyalty to premium brands,”⁴⁹ nearly half of the consumers surveyed traded up to a more premium brand, indicating both the volatility and the significance of customer retention in a highly competitive market.

Synopsis

“With the explosive growth of the Chinese middle and upper classes, has the cultural perception of luxury automobiles changed?” The answer to this question is yes. The rise of the middle and upper classes has sparked a change in the perceptions of luxury automobiles. Their wealth has catalyzed a chain reaction in the automotive industry - from parts suppliers to dealerships – to continuously create superior manufactured automotive experiences. These experiences extend beyond owning a vehicle, and play into the cultural perceptions of luxury. The examples of Buick and BMW demonstrate that perceptions are entirely subjective, based upon the individual human experience and interpretation. The middle and upper classes buy into these experiences, and will continue to buy into these experiences as their numbers grow.

From Zhou Enlai’s (周恩来) Buick to the gold Range Rover, there has been a shift in cultural tastes and desires. However, two reasons to purchase luxury vehicles remain the same: the value for the feel and experience of luxury and the value of conspicuous consumption. These two values shape the evolution of luxury Chinese car consumers. Middle class luxury consumers

⁴⁸ Ibid.

⁴⁹ Ibid.

will try to get the most bang for their buck. Upper class luxury consumers will continue to demand cutting edge vehicles for a manufactured sense of luxury. Together, both classes value vehicle quality. The demand for high-quality has transformed the luxury automotive industry, from one with few to one with many manufacturers. The proliferation of the luxury Chinese automotive industry has driven global economic change.

CONCLUSION

Cars with Chinese Characteristics

The past two chapters have provided the framework to understand the development of the Chinese automotive industry and the rapid rise of luxury consumption with the explosive growth of the Chinese middle and upper classes. Why does this matter? It matters because the Chinese automotive industry's history and changing cultural perceptions within the luxury segment are guides to its future. The future of the automotive industry in China not only involves the consumption of vehicles, but also the continued manufacturing of vehicles with relatively low labor costs. These two components are critical to continue the tremendous growth that China has experienced since the 1980s. In the past 40 years, the Chinese automotive industry has re-entered and now dominates the global market. With over three times the number of years of experience and despite continuing its industry development, the United States still ends up in second place.

The true power fueling China's automotive industry is its population. Today, only 14 percent of the Chinese own vehicles. Where does the future lie for the untapped potential of the largest car market in the world? While many political, economic, and social factors attribute to automotive industry's growth, its future lies in the idea that Chinese heritage will serve as a bridge between the past and the future. Deng Xiaoping's (邓小平) "socialism with Chinese characteristics" (中国特色社会主义) bridged traditional Chinese heritage, Mao Zedong's (毛泽东) Marxist agenda and the new global economic demands for a market economy to launch China into unprecedented, explosive growth. "Cars with Chinese characteristics" will serve as the next catalyst for China's global economy bridging together traditional Chinese heritage with the advancements in the technology and transportation for the future.

A way to understand “cars with Chinese characteristics” is through the classical Yin Yang explanation. Yin Yang, a concept within Taoism, “views all universal phenomena as being created by dual cosmic energies.”¹ When these two opposite energies are together, they are complete. The image of Yin Yang [Figure 1]² shows that while Yin (black) and Yang (white) are two connected yet contrary halves, a piece of Yin exists in Yang and a piece of Yang exists in Yin. “Yin Yang offers a holistic and paradoxical worldview and methodology.”³ The paradoxical methodology is rooted in the foundation of values in Chinese society, ranging from the philosophical concept of Yin Yang to the structure of paradoxical sub-concepts in the Chinese language. For example, “the word ‘things’ is called dongxi; dong means east and xi means west. From a Chinese perspective, everything embraces opposite properties such as east and west. Another classical example is weiji – the Chinese word for ‘crisis’: wei means danger and ji means opportunity.”⁴ These two linguistic examples highlight the intricate, paradoxical nature of Chinese language, an intrinsic expression of culture. The concept of the paradoxical Chinese culture is increasingly apparent in the rise of modernization and globalization, with a connection to the very nature of Deng Xiao Ping’s (邓小平) socialism and Chinese characteristics (中国特色社会主义). His paradoxical ideas of “socialist market economy,”⁵ “one country; two



Figure 1

¹ "Changing Chinese Values: Keeping up with Paradoxes." *International Business Review*. April 08, 2008. Accessed March 28, 2018. <https://www.sciencedirect.com/science/article/abs/pii/S0969593108000292>.

² "Yin and Yang." *Wikipedia*. March 19, 2018. Accessed March 28, 2018. https://en.wikipedia.org/wiki/Yin_and_yang#/media/File:Yin_yang.svg.

³ "Changing Chinese Values: Keeping up with Paradoxes."

⁴ *Ibid.*

⁵ *Ibid.*

systems”⁶ and “stability and development”⁷ suggest that despite the traditional philosophy of Yin Yang, modern paradoxical versions exist and root the values of Chinese society.

The phrase “cars with Chinese characteristics” combines two paradoxes – modern vehicles with advanced technology, performance, and design with the traditional, historical aspects of Chinese culture. Although these two do not seem synonymous, China is not China without its history. “China is one of the world’s four ancient civilizations, and the written history of China dates back to the Shang Dynasty (c. 1600-1046 BC) over 3,000 years ago.”⁸ Chinese history continues to influence the values of its society today, and has been present in the consumption of luxury which traces back to China’s silk roads. These ancient networks of trade routes were central for cultural interaction between regions of the east and the west from 130 BCE to 1453 CE.⁹ One link between China’s historic cultural influence and a global luxury brand exists today in the motif of the luxury fashion brand, Louis Vuitton [Figures 2-3]¹⁰:

In 1854, Louis Vuitton designed waterproof trunk cases for travel utilizing lightweight coated canvas. To prevent his waterproof design from becoming copied, he printed a motif composed of flowers and quatrefoils and put a trademark on it. The quatrefoil design is an iconic derivative from Ancient Chinese history. From 114BC to the 18th century, during the time of the establishment of the Silk Road, the quatrefoil gained popularity and spread throughout India and to Europe, and to France, where in the 19th century, Louis Vuitton derived inspiration for his flower + quatrefoil motif that would become symbolic of the Louis Vuitton luxury brand...the design itself is a derivative

⁶ Ibid.

⁷ Ibid.

⁸ "The History of China - Over 3,000 Years of Civilization." ChinaHighlights. January 04, 2018. Accessed March 28, 2018. <https://www.chinahighlights.com/travelguide/culture/china-history.htm>.

⁹ "Silk Road." Ancient History Encyclopedia. Accessed March 28, 2018. https://www.ancient.eu/Silk_Road/.

¹⁰ "From the Silk Road to Alibaba: The Modern Iconography of Luxury Brands." Global Founders. Accessed March 28, 2018. <https://www.globalfounders.london/blog/from-the-silk-road-to-alibaba-the-modern-iconography-of-luxury>.

from the Han dynasty in China, when the quatrefoil was present in many bronze emblems and ceramics.¹¹

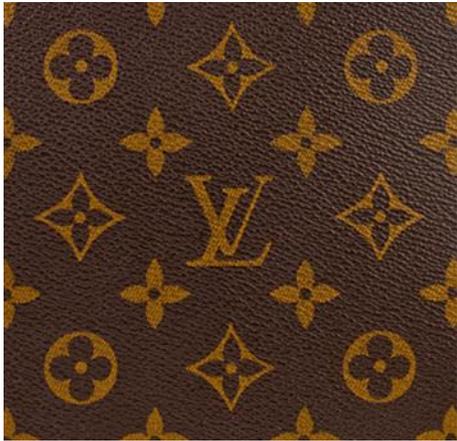


Figure 2



Figure 3

Louis Vuitton incorporates cultural aspects of China’s past into its contemporary design to create both an elevated luxury design and an elevated luxury product – heritage with a high price tag. The Yin Yang approach explains how the paradoxical nature works in a luxury setting through the example of Louis Vuitton, as it uses the thousands of years old motif in combination with its latest designs. The heritage of the old influences the design of the new to create one of the largest luxury fashion brands in the world.

Following suit, “cars with Chinese characteristics” represent another paradox. While luxury cars become increasingly common in China, “cars with Chinese characteristics” elevate that luxury experience. The elevated luxury is the manifestation of China’s cultural and traditional history and values in the form of a superior, luxury vehicle. The paradox lies in the fact that China’s automotive history is 40 years old and China’s cultural history is over 3,000 years old. The combination between these two players cultivates a car that transcends the notion of luxury and represents one of heritage. Although, this “new” heritage comes at a high price. Through the Yin Yang approach, the following examples will examine three luxury vehicles

¹¹ Ibid.

manufactured by the British carmaker, Rolls Royce, and one by the Chinese brand Hongqi, a subsidiary of FAW Group.

In 2012, Rolls Royce launched a “Year of the Dragon” edition of its Phantom. At a price of \$1.2 million, the special edition phantom incorporated a hand-painted dragon on its wheelbase as well as hand-stitched dragons on its cushions. Although there were only eight created in total, the expensive vehicle sold out within in two months [Figures 4-5].¹²



Figure 4



Figure 5

In 2013, Rolls Royce launched a “Year of the Horse” edition of its Phantom, again in preparation for Chinese New Year. “The horse imagery on the interior and exterior of the model is inspired by depictions of the horse in traditional Chinese ink painting”¹³ [Figures 6-7].¹⁴



Figure 6



Figure 7

¹² Joseph, Noah. "Rolls-Royce Sells out of Million-dollar Year of the Dragon Edition Phantoms in Two Months." *Autoblog*. January 27, 2012. Accessed March 28, 2018. <https://www.autoblog.com/2012/01/27/rolls-royce-sells-out-of-million-dollar-year-of-the-dragon-edition/#slide-endcap>.

¹³ "Rolls-Royce Gears Up for Year of The Horse with Zodiac-Inspired Ghost." *Jing Daily*. December 28, 2013. Accessed March 28, 2018. <https://jingdaily.com/rolls-royce-gears-up-for-year-of-the-horse-with-zodiac-inspired-ghost/>.

¹⁴ *Ibid.*

While Rolls Royce's history dates to 1904, the origins of Chinese New Year dates to thousands of years ago, with religious ceremony observed during the Shang Dynasty (1766 BC – 1122 BC).¹⁵ The Chinese New Year legend states that:

the beginning of Chinese New Year started with the fight against a mythical beast called the 'Year.' The 'Year' looked like an ox with the head of a lion and was believed to inhabit the sea. On the night of New Year's Eve, the 'Year' would come out to harm animals, people, and their properties. Eventually, people discovered that the 'Year' feared the color red, fire, and loud sounds. Therefore, for self-protection, people formed the habits of posting red Dui Lian in front of their houses, launching fireworks, and hanging lanterns at year end.¹⁶

The use of the Chinese New Year animal in the vehicle is essential to the explanation of the current portrayal of the Yin Yang approach, as well as to the notion of luxury in China. Rolls Royce manufactures desire by capitalizing on the commercialization of Chinese culture, and through the exclusivity of their vehicles. The incorporation of red in the vehicles plays into the history of Chinese New Year, tying together the past and the present in luxury form.

Rolls Royce extends the incorporation of Chinese cultural traditions such as Chinese New Year into significant historic symbols in Chinese culture. In 2013, Rolls Royce unveiled a one-of-a-kind bespoke Ghost inspired by Chengdu's famous Golden Sun Bird relic [Figures 8-9].¹⁷

¹⁵ "Chinese New Year History." Chinese New Year. Accessed March 28, 2018. <http://www.chinesenewyears.info/chinese-new-year-history.php>.

¹⁶ Ibid.

¹⁷ "Rolls-Royce Creates the 'Chengdu Sun Bird' Ghost." Pursuitist. October 30, 2013. Accessed March 28, 2018. <https://pursuitist.com/rolls-royce-creates-chengdu-sun-bird-ghost/>.



Figure 8



Figure 9

The relic, a ring-shaped piece of foil made of nearly pure gold, contains a pattern that consists of four birds flying in the same direction [Figure 10].¹⁸ “The piece is believed to be an illustration of an ancient Chinese myth recorded in the classic *The Legends of Mountain and Seas*, written about 2,500 years ago. According to the book, the ancients believed the sun was carried up to the sky every morning and then pulled

down at dusk by four birds.”¹⁹ In the \$272,000 vehicle, it not only features the motif taken from a Shang dynasty relic found at Chengdu’s Jinsha ruins in 2001, but also incorporates gold throughout the vehicle by featuring it on the hood, roof, trunk lid,

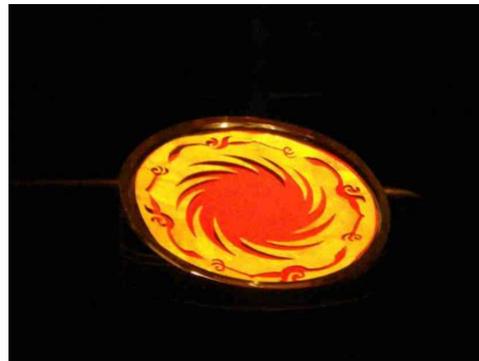


Figure 10

tread plates, wheel hub and logo.²⁰ “In 2005, the State Administration of Cultural Heritage adopted the Golden Sun Bird as the symbol of China’s cultural history,”²¹ Similar to the history of Louis Vuitton in relation to its motif, the true value of luxury lies within symbol’s historical tie to Chinese culture.

¹⁸ "Jinsha Site Museum." CNTO China Like Never Before. Accessed March 29, 2018. <http://www.cnto.org/iconic/jinsha-site-museum/>.

¹⁹ "Chengdu's Golden Treasures Are Tops with Tourists." Chengdu's Golden Treasures Are Tops with Tourists - China - Chinadaily.com.cn. Accessed March 28, 2018. http://www.chinadaily.com.cn/regional/2015-01/20/content_19359099.htm.

²⁰ "Rolls-Royce Crafts One-Of-A-Kind Chengdu Sun Bird Ghost Model." Jing Daily. October 10, 2013. Accessed March 28, 2018. <https://jingdaily.com/rolls-royce-crafts-one-of-a-kind-chengdu-sun-bird-ghost-model/37600/>.

²¹ "Chengdu's Golden Treasures Are Tops with Tourists." Chengdu's Golden Treasures Are Tops with Tourists - China - Chinadaily.com.cn. Accessed March 28, 2018. http://www.chinadaily.com.cn/regional/2015-01/20/content_19359099.htm.

In 2013, Hongqi launched the L5, the most expensive Chinese car [Figure 11].²² Hongqi created three variants: one for the government, one as a parade car and one for civilians. The Hongqi L5, priced at 5 million RMB (\$760,000), is inspired by the Hongqi CA770 state limousine [Figure 12],²³ a



Figure 11



Figure 12

vehicle manufactured only for the Chinese government from 1966 to 1981. During that time,

fewer than 3,000 vehicles were produced in total by all Chinese manufacturers, and only 847 Hongqi CA770 state limousines were built.

The Hongqi L5 pays respect to its Chinese heritage through its retro design as well as in the low number manufactured. On the exterior,

the Hongqi L5 incorporates a “red flag badge on the front fender,”²⁴ which pays tribute to the Chinese flag and “the design of the taillights is taken from the shape of traditional Chinese lanterns.”²⁵

The brand’s characters above the license plate that write hongqi are “supposedly

written in Mao’s handwriting.” On the interior, “...the inner rim of the steering wheel is for the

horn. You have to pull the rim towards you, instead of pushing it away. The system is a nod to

the past again; it was just like that on the CA770.”²⁶

²² Feijter, Tycho De. "Meet the Hongqi L5, China's Most Expensive Car." *Forbes*. June 08, 2016. Accessed March 28, 2018. <https://www.forbes.com/sites/tychodefeijter/2016/05/26/meet-the-hongqi-l5-chinas-most-expensive-car/#1917683758c7>.

²³ *Ibid.*

²⁴ *Ibid.*

²⁵ *Ibid.*

²⁶ *Ibid.*

The three Rolls Royce's and the Hongqi highlight how luxury automobile manufacturers incorporate odes to heritage as a means to elevate the notion of luxury in the Chinese automotive industry. In China's highly-competitive and developed automotive industry, the price of vehicles is no longer a concern. While all luxury vehicles manufacture a sense of desire, the desire has been obtained and is readily available to luxury consumers. How do manufacturers respond to the need to create new positioning in the market? As with the cases of Zhou Enlai's (周恩来) Buick, Louis Vuitton, Rolls Royce, and the Hongqi - the answer is in the Yin Yang approach.

Throughout this entire thesis, Zhou Enlai's (周恩来) Buick has been referenced as a touchpoint of the past that has created the Chinese cultural perception of luxury for the present and will continue in the future. Zhou Enlai's (周恩来) Buick embodies a sense of nationalism, a connection to Chinese heritage, and the powerful force that vehicles hold to advance a nation's economic growth. Despite a few failures such as the Hongqi H7 and the Audi China commercial along the way, the Chinese automotive industry has remained resilient. The Chinese automotive industry's resiliency, in combination with its ability to connect with its past, has fueled sustainable success. Finally, the combination of innovative technologies (new energy vehicles and the development of connected cars) with the fickle demands of the luxury segment, are creating enormous pressure on the Chinese automotive industry. Like a diamond, created from the pressure of many years, this industry is in the midst of a major transformation. Einstein once said, "We cannot solve problems with the same level of thinking that created them." The power of the new paradigm of the Chinese automotive industry's luxury segment can catapult the thinking to a new level, reaping huge rewards for many years and decades to come. Innovation will occur in response to the preference towards foreign markets, which manufacture the desire to lead, while striving to serve. This servant leadership is quintessential luxury and the very

essence of the paradox of the Chinese culture. There is simplicity on the near side of complexity, and simplicity on the far side of complexity. The luxury segment of the Chinese automotive industry will continue to lead, having made the journey of discovery onto the far side of complexity. The impact of this transformation will be a green automotive industry that is sustainable and profitable, putting pressure on the rest of the world to work responsibly. In the words of Lao Tzu, the Chinese automotive industry must “Stand before it and there is no beginning. Follow it and there is no end. Stay with the ancient Tao, Move with the present.”²⁷

— Lao Tzu, Tao Te Ching

²⁷ "The Universal God." Google Books. Accessed March 29, 2018.
[https://books.google.com/books?id=x9KSAAtZwnL8C&pg=PA91&lpg=PA91&dq="Stand before it and there is no beginning. Follow it and there is no end. Stay with the ancient Tao, Move with the present." — Lao Tzu, Tao Te Ching&source=bl&ots=U1wtSxnPrw&sig=BLW1V7FahSmVH9-NZJpwi25Zg6A&hl=en&sa=X&ved=0ahUKEwjWrfDMt5DaAhUwhuAKHfolAPMQ6AEILDAB#v=onepage&q="Stand before it and there is no beginning. Follow it and there is no end. Stay with the ancient Tao, Move with the present." — Lao Tzu, Tao Te Ching&f=false](https://books.google.com/books?id=x9KSAAtZwnL8C&pg=PA91&lpg=PA91&dq=%22Stand+before+it+and+there+is+no+beginning.+Follow+it+and+there+is+no+end.+Stay+with+the+ancient+Tao,+Move+with+the+present.%22+---+Lao+Tzu,+Tao+Te+Ching&source=bl&ots=U1wtSxnPrw&sig=BLW1V7FahSmVH9-NZJpwi25Zg6A&hl=en&sa=X&ved=0ahUKEwjWrfDMt5DaAhUwhuAKHfolAPMQ6AEILDAB#v=onepage&q=%22Stand+before+it+and+there+is+no+beginning.+Follow+it+and+there+is+no+end.+Stay+with+the+ancient+Tao,+Move+with+the+present.%22+---+Lao+Tzu,+Tao+Te+Ching&f=false)

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