

Position Paper on Developing Hong Kong's Automobile Parts and Components (APC) Industry

The automobile parts and components (APC) industry has significant potential, even though it is at a relatively early stage of development in Hong Kong. The rapid growth of the automobile industry in China is increasing demand for APC there and presenting huge opportunities for Hong Kong enterprises. As government support usually plays a crucial role in the development of an emerging industry, particularly during its early stages of development, the Government should consider formulating strategic policies to help the APC industry grow in Hong Kong.

Industry Features

Although Hong Kong does not have an automobile industry, many Hong Kong manufacturers do export a wide variety of external and internal APC. These items include signal lights, antennae, side mirrors, exhaust systems, window glass, cables, heat-proof & shock-proof parts, car audio products and car security systems.

In Hong Kong, there are about 230 manufacturing setups and 1,270 companies dealing with import-export of APC, employing about 6,800 workers¹. Many local manufacturers are small electrical or metal work factories. Most of them carry out production in the Mainland or have set up joint-ventures with Chinese or overseas companies there to take advantage of lower production costs and proximity to the Mainland market. Many manufacturers are producing APC on OEM basis, but some large manufacturers are producing their own branded items and are actively engaged in the development of high value-added products.

Hong Kong's exports of APC have grown steadily in recent years. Following a 4% increase year-on-year in 2002, exports of APC surged by 7% to HK\$10.3 billion in 2003 and by 16% to HK\$9 billion in the first nine months of 2004². One salient feature of Hong Kong's exports of APC is the dominance of re-exports, which account for about 99% of total exports³. This may suggest the importance of Hong Kong as a trading centre and entrepot for APC, in particular, for the Mainland market.

Major markets for these products include the Mainland, the US, Japan, Germany and the Netherlands. The Mainland and the US are the two largest export markets, accounting for 24% and 19% of the total in 2003⁴. Product-wise, car radio (HS852721 and 852729) and direct parts and accessories for motor vehicles and motorcycles (HS8708 and 8714) are the two largest items, accounting for 35.7% and 21.6% of the total in 2003⁵.

¹ "Entering Mainland's Automobile Supply chain – Opportunities for Auto Part and Related Industries", Hong Kong Trade Development Council.

² "Entering Mainland's Automobile Supply chain – Opportunities for Auto Part and Related Industries", Hong Kong Trade Development Council.

³ Business-Stat ONLINE, Hong Kong Trade Development Council.

⁴ "Entering Mainland's Automobile Supply chain – Opportunities for Auto Part and Related Industries", Hong Kong Trade Development Council.

⁵ "Entering Mainland's Automobile Supply chain – Opportunities for Auto Part and Related Industries", Hong

The local aftermarket for Hong Kong-made APC remains small. Japanese cars dominate the market and usually use tailor-made spare parts. Nevertheless, Hong Kong is quite competitive in general items such as number plates, wipers and signal lights.

Future Development

The automobile industry has been identified as one of the Mainland's pillar industries. In 2003, the Mainland was ranked as the fourth-largest automobile producer and the third-largest market⁶. The APC industry will play an increasingly important role in the supply chain of automobile industry. This vibrant Mainland market offers vast opportunities for Hong Kong enterprises.

The opening up of the Mainland has brought economic prosperity, boosting demand for automobiles. The increase in demand is also partly explained by continued growth in highway infrastructure. The Mainland's production of automobiles grew at an annual rate of 22.2% from 1.63 million in 1998 to 4.44 million in 2003⁷. During this period, the growth in automobile sales was satisfactory, expanding in terms of volume at an annual rate of 22.7%⁸. The Mainland's vehicle ownership, driven mainly by sedan and passenger car segments, has exceeded 23 million units, nearly doubling the 1998 level⁹.

With continued strong economic growth, people's livelihood will improve further, thus boosting demand for automobiles. According to the World Bank's statistics, the Mainland's 149-person per automobile ratio indicates the huge potential of growth when compared with advanced economies' 2.1-person per automobile and the low to middle income economies' 23.3-person per automobile¹⁰. The State Information Centre estimated that the demand for automobiles would increase from 6.3-7.7 million units in 2005 to 13.2-19.1 million units in 2010¹¹.

The increased demand for automobiles has elicited robust input demand for APC. As an automobile is composed of thousands of items, which are produced by over 50 industries with different expertise, the spill-over effects of automobile production should benefit the suppliers of APC. Along with healthy value sales in recent years, the annual sales of APC grew by 34% to RMB 292 billion in 2003¹². According to a report issued by the Hong Kong Trade Development Council in 2003, annual sales of APC are expected to grow by 10% per annum before 2010¹³.

Kong Trade Development Council.

⁶ China Automotive Industry Yearbook.

⁷ China Automotive Industry Yearbook.

⁸ China Automotive Industry Yearbook.

⁹ "Entering Mainland's Automobile Supply chain – Opportunities for Auto Part and Related Industries", Hong Kong Trade Development Council.

¹⁰ The World Bank Economic Review.

¹¹ State Information Centre – China Economic Information Centre.

¹² "Entering Mainland's Automobile Supply chain – Opportunities for Auto Part and Related Industries", Hong Kong Trade Development Council.

¹³ 《中國汽車零配件市場狀況》，Hong Kong Trade Development Council.

The growth in vehicle ownership has boosted demand from the aftermarket for spare APC. According to a survey done by the China Association of Automobile Manufacturers, around 11% of the industry sales of APC were sold in the aftermarket in 2003. The major selling items included parts for chassis and parts for engines, accounting for about 37% and 20% of the total respectively¹⁴. Retail sales of APC have also grown steadily. Car radios, CD players and speakers grew by more than double from RMB 1.47 billion in 1998 to RMB 3.04 billion in 2003¹⁵. Other popular accessories include decorative items, storage accessories and cleaning apparatus.

In the Mainland, APC manufacturers numbers about 4,400¹⁶; many of these enterprises have acquired specialised know-how and technical expertise. However, high-technology products are uncommon and many key items are just imitation of those produced in advanced countries. Mainland manufacturers lag far behind the international level in terms of production, product and technology development. There are few adaptive designs, and creative designs are even scarcer.

Since local products produced in the Mainland fail to meet the needs of the market, major APC have been imported. In addition, most multinational automobile producers import those key items for their own use. APC imports have increased tremendously in recent years. In 2003, auto APC imports surged by 74% to US\$6.73 billion, and by another 30% to US\$4.95 billion in the first seven months of 2004¹⁷.

The further opening of the Mainland market will offer business opportunities for Hong Kong enterprises. The automobile supply chain is highly structured with players operating like a cartel, making it difficult for newcomers to penetrate into the market. Under China's WTO commitment, import quotas imposed on automobiles and APC will be removed completely by 1 January 2005. The Mainland is also set to lower import tariffs on automobiles to a maximum of 25%, and to reduce tariffs on APC to an average of 10% by 1 July 2006.

The substantial lowering of import tariffs on automobiles has already intensified competition in the market. Both domestic and joint venture assemblers are feeling the pressure to review their supply chains in order to improve product quality, while minimising costs by sourcing from quality but competitive suppliers. Such pressure is likewise been transported up the supply chain from assemblers to first, second and third-tier suppliers. As a result, the supply chain is undergoing reshuffling, in turn creating leeway for new but competent, competitive suppliers like Hong Kong enterprises. Those manufacturers who undertake production in Hong Kong by successfully keeping cost under control and soliciting the required technicians and technology will be able to capitalise on the zero-tariff benefit when exporting products to the Mainland under CEPA.

¹⁴ China Association of Automobile Manufacturers.

¹⁵ Euromonitor.

¹⁶ China Automotive Industry Yearbook.

¹⁷ China Association of Automobile Manufacturers.

Concerning the target market, Guangdong should be the top priority for Hong Kong enterprises, despite the fact that the largest production bases are located in Shanghai, Jilin and Hubei. With huge potential for development, Guangdong will soon become a major automobile production base in the Mainland. Being close to the market, Hong Kong manufacturers will be able to effectively employ zero inventory and just-in-time production techniques in their logistics management. Since Guangdong's APC output still accounts for a small share in the market, it relies very much on "foreign" auto part suppliers, thus providing Hong Kong companies with huge room for expansion.

Following the establishment of a sedan manufacturer in Guangdong in 1985, the Province has been identified as one of the major production bases. Since 1997, many foreign automobile companies, including the three largest Japanese auto companies, namely, Toyota, Honda and Nissan, have set up operations in Guangzhou. Large manufacturers prefer to station in Guangzhou because it is an important market in China. The fight for market share in the Pearl River Delta will be intense because the region has long accounted for 25% of the total sedans sales in China¹⁸.

As APC producers set up by business operations alongside multinational automobile companies, large clusters have been formed. APC producers in Guangzhou are set to provide training to local management staff and workers, familiarising them with advanced production techniques. These talents will soon become another asset to Guangzhou.

The past years have witnessed robust growth in the automobile sector in Guangzhou. In 2003, the automobile production reached 189,000 units, up 400% from 2000. The output value of automobile production grew by 68.3% year-on-year to RMB 46.2 billion, while the output value of APC amounted to RMB 10.3 billion, up 46.9%¹⁹. The Guangzhou Municipal Board for International Investment estimated that in 2010, automobile production would reach 1 million units, whilst output value of automobiles and APC would amount to RMB 120 billion and RMB 204 billion respectively²⁰.

Guangzhou is expected to become a major APC production centre as well as a preferred business and investment location for Hong Kong companies. The Huadu Auto City-Guangzhou (花都汽車城) is an important production base in the north of Guangzhou. Apart from local APC producers, a joint-venture with investment by Unipres Corporation, one of the largest automobile parts companies in Japan, has also made its presence in the Huadu Auto City-Guangzhou. As of August 2004, there were 70 APC companies operating in the Huadu Auto City-Guangzhou, with a cumulative investment of RMB 2 billion²¹.

The Huadu District Government has identified the automobile industry as its key industry and formulated strategies and plans for its development. In the Huadu Auto

¹⁸ 《本田、豐田先後布棋，中國汽車業第四極隱現廣州》，People's Daily Online.

¹⁹ 《廣州發展汽車工業現狀及對策研究》，Industry, Economy Research Institute -State Council Development Research Centre.

²⁰ Guangzhou Municipal Board for International Investment.

²¹ 《廣州花都崛起世界級產業集群》，People's Daily Online.

City-Guangzhou, activities found there include production of automobiles, APC, trade, logistics, exhibition, education and information sharing. Preferential policies are provided to attract investment and talents as well as to create a favourable trading environment. Apart from infrastructural facilities, the District Government also plans to establish a motor school to train more technicians.

Baiyun (白雲區), another district in northern Guangzhou, which is the largest trading market in the city will become another hotspot for APC producers. Eastern districts like Guangzhou Development Zone (開發區), Zengcheng (增城), Huangpu (黃埔) and southern districts like Nansha (南沙) will also attract some APC manufacturers.

Supplies are polarised in the aftermarket. While original branded spare parts are relatively expensive, alternative spare items made by local enterprises are sold at very low price levels, but are of poor quality. Medium-priced quality spare parts account for only a small portion of the sales in the aftermarket. Many Mainland car owners are increasingly buying better quality items. As some Hong Kong companies already competently supply high quality spare APC at competitive prices, the rising demand for medium-priced items in the aftermarket implies considerable opportunities. At present, auto part distribution centres are growing rapidly as one distribution channel for spare APC. Three auto part distribution centres have already developed successfully in Guangzhou (廣州市陳田湛隆汽配市場、廣州市集祥汽配城及廣州倚雲汽車用品廣場).

Problems Encountered by Hong Kong's APC Industry

The Hong Kong APC industry in general encounters problems in four major areas. First, the small local consumer market fails to support an automobile industry, impeding the development of the APC. Production of at least 250,000 units or more would be required for economies of scale to materialise.

Second, more efforts on R&D are warranted as reliability and security requirements of the automobile industry are very stringent. Many assemblers tend to work in collaboration with APC suppliers to develop new products. Assemblers will not source from suppliers who cannot meet internationally recognised technological levels. Few Hong Kong manufacturers carry out R&D activities and their investment in automobile-related technologies is insufficient.

Third, Hong Kong manufacturers lack a track record of supplying high-quality products to the automobile supply chain, and few comply with the recognised quality system requirements and standards. As a result, most Hong Kong suppliers have to go through the time-consuming and stringent vendor selection process of company audits.

Last, Hong Kong companies' distribution networks in the Mainland and their marketing expertise in the auto parts sector are inadequate. Furthermore, the geographic proximity advantage only applies to the Pearl River Delta market, something that does not help when exploring other markets in the Mainland.

Recommended Strategic Actions

The opening up of the fast-growing automobile market in the Mainland will provide vast opportunities for Hong Kong APC manufacturers. In view of the problems currently faced by the industry, the Federation urges the Government to consider adopting the following strategic actions:

1. Setting up an APC R&D centre

The APC industry has to possess strong R&D capability to develop innovative and reliable products. Stepping up R&D activities will enhance competitiveness because of the heavier financial burden on the companies concerned. With limited manpower and financial resources, it is difficult for Hong Kong SMEs to actively engage in R&D activities.

To improve the R&D capability of the industry, the Government should set up an APC R&D Centre. Such a centre will identify technology gaps and define the R&D problems facing the industry and bring together researchers in the field to conduct R&D and offer technology solutions to the industry. It will also develop core competencies in the specific focus area and help train researchers for on-going support for the development of the industry. Better communication with the local producers is required to ensure that the R&D activities are relevant to industry and market needs. Furthermore, the Government should provide necessary financial assistance to support the industry's R&D activities.

With appropriate Government support, it is anticipated that the Hong Kong APC industry will eventually improve its R&D capability. As resources commanded by SMEs are limited and the requirements of the APC industry are stringent, Government support will be pivotal to building up the industry's R&D strength.

2. Trade Development Council stepping up promotion effort

The Hong Kong Trade Development Council should actively promote the industry by organising more auto parts exhibitions in the Mainland and establish a permanent exhibition centre. A car solely assembled by parts and components all produced by Hong Kong manufacturers should be displayed to demonstrate the diverse production capabilities of the local industry. By participating in these exhibitions, Hong Kong manufacturers will not only establish business contacts but can also learn more about the latest technology and product trends.

In addition, Hong Kong manufacturers will be able to meet potential business partners, both local Mainland and foreign-invested enterprises. Local Mainland enterprises should be able to understand the Mainland market better and form good relationships with assemblers and APC suppliers, thus, they can provide useful assistance to Hong Kong manufacturers in tapping the market.

By capitalising on their resources and investment experience in the Mainland, Hong Kong companies could work with foreign-invested enterprises, which often

encounter difficulties in dealing with Chinese corporate culture. The technical know-how, production expertise and business networks of these foreign-invested enterprises will be of great use to Hong Kong companies.

Linking up partnerships with Japanese companies should be a key strategy of Hong Kong enterprises. The presence of Toyota, Honda and Nissan in Guangzhou offer huge business opportunities to Hong Kong companies. Most Japanese automobile assemblers have a well-established supplier network in place already and many Hong Kong manufacturers have found it difficult to enter these markets. Nevertheless, some Japanese APC suppliers are small to medium companies with limited resources and inadequate understanding of the Chinese society, corporate culture or local laws and regulations. This should provide a niche for cooperation between Hong Kong and Japanese companies.

Apart from organising exhibitions, the Hong Kong Trade Development Council should also step up efforts to provide information on local Chinese and foreign-invested enterprises, thus facilitating Hong Kong companies to identify and locate business partners.

3. Setting up testing facilities to support the development of the APC industry

It should be noted that quality and reliability are essential benchmark to success in the automobile industry, as a single small defect may cause a costly production problem in the supply chain. Multinational automobile producers and international automobile institutions have established certain quality system requirements and standards, especially for APC suppliers. Automobile producers tend to source from suppliers who are able to comply with these requirements; in general they are all first and second tier suppliers. To improve their competitiveness, Hong Kong manufacturers should strive to obtain certification on these standards. To cope with the needs and enhance the technology level of the industry, the HKSAR Government should provide support to companies in the private sector to set up testing and certification facilities in Hong Kong.

4. Providing product liability insurance guarantee

Large automobile producers are very demanding with regard to APC procurement. They require suppliers to compensate them for any losses due to commodity recalls and returns. However, losses arising from recalled and returned commodities, faults and negligence on the part of APC suppliers, as well as certain punitive claims, are not normally covered by product liability insurance commonly available in the market. To obtain orders from these large automobile producers, Hong Kong companies need to insure themselves against possible substantial claims. In this regard, the HKSAR Government should liaise with private insurance companies with a view to extending the coverage of product liability insurance they offer to include product recalls. If necessary, the Government may consider providing guarantees. If no companies offer such insurance coverage, the Government should consider establishing an APC Product Liability Insurance Bureau.

5. Providing comprehensive training on automobile technology

The provision of high quality products as well as the enhancement of technology levels hinge primarily on abundant supply of automobile technicians. At present, the Hong Kong Productivity Council provides APC training in design, manufacturing, engineering analysis and management systems. The Vocational Training Council offers courses like motor vehicle maintenance and repair as well as oil pump, hydraulic motor, cylinder: their structure and maintenance. Apparently, a comprehensive training programme relating to automobile technology is missing in Hong Kong. To train up more automobile specialists, the Government should encourage local higher education institutions to organise comprehensive programmes on automobile technology and quality management.

Conclusion

Although Hong Kong is not a renowned APC supplier, a number of Hong Kong companies have already successfully tapped the APC market. The provision of Ceta and the benefits it offers serve to further facilitate the sale of Hong Kong-made APC in the Mainland. Hong Kong, in fact, possesses the strengths to capitalise on booming demand from the Mainland's automobile market.

Most automobile assemblers already have a well-established supplier network in place and new auto parts and accessories suppliers will find it difficult to enter the market. In face of the challenges arising from market opening under China's WTO commitment, assemblers have to review their supply chains in order to minimise costs, thus bringing new business opportunities to new suppliers, including those from Hong Kong. Newcomers have to take immediate action to penetrate into the market, as APC suppliers and sub-contractors will soon link tightly up with different supply chains after the reshuffling.

Hong Kong companies should try to improve their competitiveness in order to tap the Mainland market. The Government's active support is necessary to Hong Kong enterprises, especially SMEs. As the industry is now at a critical juncture, the Government should give serious consideration to the recommendations above and take promote actions to promote Hong Kong's APC industry.

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