

Swot analysis of volkswagen for china



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SWOT analysis provides the strengths and weaknesses as an internal factor of the company and Opportunities and Threats for the external environment of the company. Any company has to change its strategic planning according to the SWOT analysis. SWOT analysis will also help the company to analyze the prospects after the acquisition of a Chinese car company.

Strengths

Volkswagen has strong position in the Chinese market as it has a long experience in this market. Volkswagen has a strong brand portfolio; a good mix of luxury models are included in its portfolio and German engineering with competitive pricing will make a big difference. Volkswagen has a strong research and development department which continuously works for the improvement in the quality, functionality and environmental compatibility. Volkswagen design team can come up with the customize design which will suit the customers of China.

Weakness

Poor performance in Africa and North America can be issue for concern for Volkswagen. Operational inefficiency and weaker productivity are other reasons for concern for Volkswagen as it has relatively low employee productivity compared to its competitors.

Opportunities

There is encouraging rate of growth in the Chinese car market. Chinese car market has reached \$98 billion in 2008. Market consumption has reached to 7.4 million units in 2008 which is an increase of 17.8% compared to

previous year. The volume of market is expected to reach 13 million by year 2013 (Datamonitor, 2010).

Threats

Increase in the production cost due to the increase in the raw material prices. Increase in the government rules regarding the labor may also increase the prices. Increase in the competition may cause price wars due to which there will be fall in prices.

Automotive Industry in China

In recent years, passenger car sales has increased spectacularly as the demand is increased due to the increase in the income of the people and decrease in tariffs, followed by the access to the World Trade Organization (WTO) by China in 2001 (Dauterive, J. and Fok, W., 2004), and also due to the emergence of low cost manufacturers of cars. Due to this growth China has the world's second largest automobile market after U. S. therefore China has become an attraction for the investors from all over the world.

There is enormous growth potential in the automotive industry in China and in the coming few years, various factors will derive the demand.

In 2008 only 22 people out of 1000 were car owners which are very low as compared to global average of 120 per 1000 people, and in U. S. 600 out of 1000 people are car owners in the same year. There was a very low economic growth in 2009 but still disposable income is increasing rapidly, and owning the car has become affordable for a major proportion of people. Government has also recognized automotive sector as a growing industry

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therefore it is decreasing the restriction on owning a car and it is investing a huge amount on rebuilding the roads. Stimulus packages were introduced by the government at the end of 2008 and incentives were given to the consumers on buying cars. Car sales in 2008 increased just only 7.3% which is the lowest growth rate in past 10 years but in May 2009 sales increased exceptionally by 42% (Automotive Industry Report, 2009).

There are enormous growth prospects in China's car market, the rate of car ownership is low and financial industry for automobiles is immature. As China is a developing country, its economy is expected to increase rapidly, it is least expected that the car industry will grow in a steady or balanced way. The car registration rate rose in 2002 and 2003 was 63% and 70% which were not sustained and the growth rate was moderate in 2004 with 16% and further modest in 2005. This slowdown of growth coincided with the huge investment in the productive field which led to the decline in the prices. However automotive sector recovered very strongly with the growth rate of 30% in 2006 and 24% growth rate in 2007 respectively (Automotive Industry Report, 2009).

PESTLE Analysis

To get the overview of the external macro environment in China, PESTLE analysis is done. PESTLE analysis is done in order to find out the factors which will affect the operation and market of the organization.

Political:

After joining WTO, China opened its market in 2001. China is a single party and social republic state which is under the control of communist party. Import duty is 28% on cars. All legislative assembly is elected in every 5 years. Income tax rate for international firms and domestic firms is 25% since 2008.

Economic:

Per capita income of China for 2007 is US\$5400 which is a 12% as compared to 2006. Consumer expenditure increased 7.8% in 2007. In China official unemployment rate in urban area is 4% and it has a total workforce of 800 million people but many of them lack skills and education. Inflation rate in October 2008 was 4% while in April 2008 it was 8.5%. There are 27.7 million cars in use and it is the second largest opportunity for Volkswagen and the growth rate was 18.3% from 2002 to 2007. Other factors for concern are increase in the prices of oil and raw materials.

Social

There is lot of potential in Volkswagen as there is a clustered area for it. In next 10 years the earning of urban household is expected to increase by 24%. Societies are increasing as the birth rate twice that of death rate but by 2015, people aged over 65 would be 146 million. In China number of inhabitants is 1330 millions.

Technology

After an effort of ten years, information network is build which connects more than 2000 cities of China and it is linked to all major international

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networks (Peng, G. and Nunes, M, 2007). Road network and the roads systems in the city are improving, government is focusing on improving this. There are 94% people in China who use the radio and TV, and there are 214 million people in China who make use of the internet connections.

Environment

The prime minister of China, Wen Jiabao is decreasing the China's dependency on the companies which are risky for the environment of China; one of the reasons for this may be that the air pollution in China is 20 times higher than the pollution in the OECD following countries. One third of the water resources are polluted and the emission of CO₂ is higher than that of U. S. concern related to this is that there is very few segment mainly educated who are concerned about the environment in China. China adopted the automobile emission control system from Europe but the results shows, China lags approximately 10 years from Europe in using that system (Mittwoch, 2008).

Legal

New regulations were introduced in 2008 which were in favor of the workers; also labor cost has risen 40% in 2008 as compared to 2000, so labor is not cheap as it was 10 years back. According to Chow, 1997, cited in Dauterive, J. and Fok, W., (2004), there may be a problem for the investors from western nation as they does know only about the modern legal system.

Porter's Five Forces

In order to analyze the automobile industry in China, Porter's five forces is applied. This evaluation is useful as the environment involved in it impacts the strategy of the Volkswagen.

Bargaining Power of Suppliers

There are lot of international as well as domestic suppliers who supplies the automobile parts, and generally they work only with one or two companies. Switching cost from one supplier to another is very low the therefore the risk is low.

Threat of Substitute product

There are very few alternatives like the electric or hybrid cars which are environmental friendly. Therefore the risk of substitute product is low.

Bargaining Power of Buyers

Due to the economic situation there is medium demand and high supply; conditions are also changing due to the involvement of government in the credit system and the environment safety rules. Therefore the risk from bargaining power of suppliers is high.

Entry Barriers

There are government regulations on Joint Ventures, there is high competition and threshold is medium still there is huge potential left as only 3. 3% people in China have car. Therefore the risk is medium in terms of entry barriers.

Competitive Rivalry

Competition risk is very high as there are lots of competitors like Honda, Citroen, Toyota, General Motors, Suzuki and others, in the Chinese market.

Conclusion from the Analysis

Based on the Porter's five analysis China is a attractive market for the investment as there is a long in the market therefore Volkswagen has strong competitive position. Due to the medium entry standards many other competitors will also try to enter the market but they can be manageable. It is also beneficial that manufacturers of cars have the power over the suppliers. There are very few alternative to the cars therefore people will not consider much before buying the car.

Prospective Acquisition

Chery Automobile Co. Ltd is taken as the company which should be overtaken, because already this manufacturer has strong market in the China, and acquisition of Chery will add value to the Volkswagen.

Overview of Chery Automobile Co. Ltd.

It was founded in 1997 so it is just 12 year old company and this company was founded by five state owned investment companies, initially they invested RMB 3. 2 billion. First fleet came on the road on 18 March 1999. And till 2007 Chery has produced one million cars which is a very huge number, this means that Chery has come out as a successful independent Chinese car company. And now through innovation and its reputation Chery is on the way to become world famous. Sales volume was 305, 200 in 2006 which was 61.

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5% increase than the sales volume in 2005, while the sales volume in 2007 was 381, 000 units which was again an increase of 24. 8% compared to sales volume in 2006. In 2007 119, 800 units were exported which was an increase of 132% compared to the compared to the previous year. So Chery was rank 1 in exporting the cars to overseas for 5 consecutive years (Chery Automobiles, 2010).

Challenges or the requirements for a joint venture in China

Problem faced by Venture capitalist is the money paid to the company founder cannot be cashed out. In China in order to form a joint venture both foreign as well as the international firm should put in the capital. According to the company law 1994, for a limited liability company, the domestic company should register a capital of RMB 500, 000, with the local or state “Administration of Industry and Commerce” (Dauterive, J. and Fok, W., 2004). This capital requirement is relatively high as compared to the low average personal income of the people of China but this is not a problem for Chery and Volkswagen. There is a restriction for the foreign investors for the investment in the sectors like value added telecom, basic telecom services and the media.

Another difficulty in China is the undeveloped communication infrastructure because of which it is very difficult for a foreign company to monitor and oversee the entrepreneurial firms. For the people with limited capability of language it is very difficult for them to travel. Other difficulties arise from the lack of infrastructure for the support of business in such a huge country and there is substantial cost to gather the micro and macro level information on economy, this adds to the difficulty in monitoring the activities of business

once the investment has been done, because of this a monopoly of company management develops in the sources of information as there is asymmetry of information between the investor and the Chinese management of the company.

Corporate governance in China

Corporate governance in China is very common; it was a long time back when the manufacturing companies were known as factories which were owned and managed by states or the officials appointed by governments. The emerging corporate governance in China is facing a lot of critics from the reform oriented people both in the business as well as the academic world and particularly since China has entered into the WTO. Most prevalent problem in China is lack of corporate culture. This may be because of lack of the specific kind of law requirement related to fiduciary duty, which would restrain the official from the company if there is any conflict of interest between him or her and the company or the duty of care toward the good performance for the company. Although PRC Company Law exists according to which if any harm caused to the company due to any improper behavior of director then he has to compensate for it, but according to the Chinese Law the shareholders of the company cannot take any legal action against the director (Kan, L and Zhu, L., 2003).

But the situation now is changing due to the large number of foreign investments in China, and particularly foreign direct investments, western companies which are coming are putting more emphasis on the accountability to shareholders and the transparency in the system. In the late 2002 the foreign investment in China surpassed to the investment in <https://assignbuster.com/swot-analysis-of-volkswagen-for-china/>

American which was surprise but this was due to the off again and on again approach of the PRC firms in China, though the percentage of investment in the form of M&A was very less. Another difficulty comes in term if pricing, evaluating the price of the company which has to be overtaken. Generally the evaluation done by the foreign investment companies following the internationally accepted evaluating methods is less compared to the prices calibrated by the Chinese sellers (Kan, L and Zhu, L., 2003).

Another challenge faced by the foreign companies is about the employment. Foreign investors generally emphasize on the bottom line which often results in the lay-off, and compensation is asked from the foreign companies by the workers who are laid off. Foreign investors also have to deal with the “ employees without the post” and the “ internally retired employees”, there are many legal challenged in retaining the existing employees like is FIE decides to transfer its business to SOE the legal concern is how FIE will manage in transferring its employees. There are other issues like uncertainty in the anti-trust provision of latest rules about mergers and acquisitions as well as the practical problems in the some foreign exchange rules like the equity interest which is paid till now can only be controlled not the whole planned investment capital (Kan, L and Zhu, L., 2003).

Rules and Regulation in China

China has gradually set up the whole legal system in order to encourage the investors from all over the world and to create a friendly environment for foreign investors. “ The Law of the people’s republic of China” was created in 1979 by the “ National People’s Congress” for the “ Chinese- Foreign Equity Joint ventures”. And in the following 30 years China has issued a long series

of laws for the operation, establishment, liquidation and termination of the foreign invested firms. The main three regulation and laws in China are, “ The Law of the People’s Republic of China on Chinese-Foreign Contractual Joint Ventures”, “ The Law of the People’s Republic of China on Chinese-Foreign Equity Joint Ventures” and “ The Law of the People’s Republic of China on Wholly Foreign-Owned Enterprises”. These laws provide the bases for the rights of the foreign funded firms and also protect the interest and legitimate rights of the overseas as well as domestic investors. China has changed its rules and regulation in accordance with the WTO, certain obsolete rules and regulation has been abolished and gradually issuing rules and regulation which are compatible with the WTO. For example some rules regarding the balance the balance of foreign invested money and local money were discarded, also the laws like “ The Law of the People’s Republic of China on Chinese-Foreign Equity Joint Ventures” were revised in 2001 while “ The Law of the People’s Republic of China on Wholly Foreign-Owned Enterprises” was revised in 2000 (China. com, 2005). On April 13, 2010 China has changed some of its rules and regulation about the foreign investment, and according to these rules, the companies which are not environmental friendly and cause pollution, projects with over capacity in existing industries and energy gorging investments are not invited while the service sectors, high tech, environmental protection and energy saving companies are duly invited good business condition is promised for these companies (Xinhua, 2010).