

Managing the Dragon Blog Post

Connectivity: A 'Game Changer' For Chinese Auto Companies

By: Jack Perkowski | October 10, 2013

For an industry that traces its origins to the late 1800s, the global automobile industry is facing fundamental, far-sweeping changes the likes of which it has never seen before. Ever since 1908, when **Henry Ford** decided to power his new Model T with a gasoline internal combustion engine, the basic technological architecture of the passenger car has been set. While the internal combustion engine has certainly undergone substantive changes over the years, the changes have been evolutionary, not revolutionary. As a result, an internal combustion engine and a transmission remain the key components in a passenger car over a 100 years later.

Rather than technology, automakers have tended to use appearance and product design as their principal competitive weapons. This practice of attracting customers by offering new models with added features, many of which are cosmetic in nature, has led many industry analysts to characterize passenger cars as nothing more than "differentiated commodities." The traditional emphasis on marketing, coupled with the large scale of the global auto industry, has lulled the traditional automakers into a sense of complacency. According to **Adam Jonas**, the head of Morgan Stanley's Global Auto research team, too many automakers are more [focused](#) on next year's models than attempting to adapt to technological change.

Meanwhile, the passenger car is being re-defined by the internet and the insatiable demand on the part of consumers for convenience, around the clock connectivity, and the instant availability of ever more content. At the same time, cameras, sensors, software, and artificial intelligence can now be used to integrate the electronic and mechanical features of an auto in a way that replaces the human element and makes new capabilities like autonomous driving possible.

As is often the case, industry outsiders have been the first to recognize the potential of these new disruptive technologies, even on well-established products like the automobile. In the United States, Google [plans](#) to build driverless cars and Apple wants to get into the act and [build](#) electric cars as early as 2020. In China, at least 20 new car companies have been formed over the past 18 months. Some are pure startups; many involve combinations of Chinese automakers with China's leading internet companies such as Alibaba, Baidu, Tencent, and LeEco; and virtually all are having little problem attracting large amounts of private capital.

One reason the world's technology giants are attracted to the auto industry is because it is big. With revenues of \$234 billion and \$75 billion, respectively, Apple and Google need large new markets to achieve meaningful future growth, and the auto industry is one of the largest in the world. Every year, consumers spend approximately \$1.5 trillion on cars — about the same amount that consumers spend on smartphones, handsets, HDTVs, watches, DVD players, video games, consumer PCs, and tablets.

Perhaps more importantly, though, the world's leading technology leaders view the passenger car in a fundamentally different way than traditional automakers. Rather than

seeing the car as a product to be sold, they view the car as just another platform for sending messages and selling services and content, not unlike a personal computer, a smartphone or a tablet. In this context, the distance driven and the amount of time a consumer spends in an automobile are the key metrics, not the number of cars sold. Hence, the success of ride-sharing models like Uber that are shaking up the industry the world over.

Who are the winners and losers in this new world of the connected car? Morgan Stanley's Jonas thinks the traditional automakers may be a dying breed. According to him, the auto industry is likely to experience dramatic consolidation in the next 15 to 20 years due to the lack of technological foresight on the part of traditional automakers. By not looking forward, many won't survive, Jonas contends, and the number of major automakers could go from around thirty today to as few as six.

Due to the sheer size of China's auto industry and the number of Chinese already using the internet, it should come as no surprise that Chinese companies have a natural advantage in this new environment. At 25 million units sold per year, China is already the world's largest new vehicle market by far, and with 721 million internet users, China has more than twice as many consumers on-line as in the United States. Moreover, the China market is still growing. A forty million unit new car market is not that many years away, and internet penetration among China's population is still only 52 percent, compared to 89 percent in the U.S. Any company that succeeds in gaining a meaningful market share of the car market in China will automatically be a large player globally — with good growth prospects to boot. In addition to the inherent market advantages they enjoy, Chinese companies that combine the ability to manufacture an affordable product with the software and content necessary to create a consumer-friendly connected car will benefit from government regulations that non-Chinese companies find difficult to navigate. One only has to look at Google, which has had well-publicized problems in China, as well as the other large international internet companies, none of which have had much success gaining share in China against their Chinese counterparts.

The changes now sweeping the global auto industry are playing into the hands of Chinese companies that are well positioned to take advantage of these changes, which is why so many of China's largest internet companies are flocking to autos. When it comes to China, a company like LeEco, for example, with 500 million subscribers; vast content that spans smartphones, TVs, sports, film and entertainment; and experience doing business in the country, has a decided home field advantage, and a built-in user base.

A "game changer" is an idea or event that changes the way something is done, thought about, or made. Combining passenger cars with the internet and connectivity may just fit the strictest definition of the term, not just for China, but for the global auto industry as well.

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