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A COMPARATIVE ANALYSIS OF THE U.S. AND CHINESE AUTOMOTIVE
FINANCIAL SERVICE INDUSTRY

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Abstract

The purpose of this study is to compare the automotive financial services sector in the United States and China to determine whether opportunity for investment purposes exists in the Chinese automotive financial service industry.

A general industry overview is developed surrounding both internal and external factor analysis in each country. The comparison highlights the relative efficiency of the United States system, relevant to potential application within the Chinese system. Various political and economic constraints and opportunities are evaluated.
INTRODUCTION

The Chinese economy has kept a high growth rate compared to the rest of the world, and related to this growth the automotive industry has played a very important role. The Chinese government has confirmed that the automotive industry will be one of the leading industries for future development, and will place more weight on this industry in future. The growth of the economy and development of the automotive industry stimulated vehicle consumption. Now in the Chinese market there is a great demand for vehicles and related services, which suggests that investment opportunities exist.

The Chinese automotive industry remains in it early stages, and has not yet created a complete system to support the entire industry for a continuous growth. For example, an incomplete financial services system creates a significant drag on growth, especially in relation to the support financial services has provided to the industry outside of China.

Therefore, it will be an opportunity for both Chinese market and investors: Chinese market need to learn how to complete the automotive financial service system and investor can invest in Chinese market to enjoy the rapid economy growth and obtain the automotive financial service market share.

In this study, the financial services sector of the United States automotive industry is selected to be compared to that of China. The results of this comparative analysis will suggest that a feasible investment opportunity currently exists to invest in the Chinese automotive financial service industry.

LITERATURE REVIEW

I. Introduction of the Automotive Financial Service Industry

The definition of the automotive financial service industry is continuously changing along with the extension of the automotive financial service business scope. Based on the current status, the automotive financial services industry includes commercial banks, subsidiary automotive financial companies of automotive manufacturers, credit unions and their related service organizations. All of these organizations supply financial services for automotive consumers, manufacturers, and dealers.
In early periods, automotive financial service supplied only loan service to support inventories for manufacturers and their underlying dealers, as well as permitting dealers to supply various loans or leasing services for their customers. Later, corresponding to the extension of business scope, it started to supply consumers, automotive manufacturers and dealers with a complete array of financial services.

An integrated automotive financial service system should include three functions: 1). maintaining sales systems, integrating sales channels, and supplying market information for automotive manufacturers; 2). supplying wholesale inventory financing, operational financing, and equipment financing for automotive dealers; and 3). supplying consumer loans, lease financing, maintenance financing, insurance, etc., for automotive consumers.

The market for automotive financial service has already matured, and now includes lease financing, vehicle purchase saving, insurance, credit cards, etc. Financial services have filtered into every step of the automotive industry and other related industries such as manufacturing, sales, purchase, and the scrapping of automotives. Automotive financial services may also include conditional financing, savings, credit cards, loans, insurance and guarantees, thus forming a comparatively integrated automotive financial service industry chain.

It is predicted that automotive financial services will not only be one of the main sources of the automotive industry’s profit, but will also be one of the directions for development of the finance industry that is likely to focus on popular, complicated, and expensive add-ons.

II. A Historical Perspective of the Automotive Financial Service Industry

The automotive financial services sector is a large contributor to the growth of the automotive industry in developed countries, which can be seen in the example of the United States.

In the 1930s, rapid growth in the United States’ automotive financial service industry contributed to a significant increase in automotive sales. Production and sales were one million vehicles in 1932, increasing to four million in 1937, and eight million in 1950. Annual averages for production and sales were nine million during the 1960s. By category, the quantity of vehicles in the market from 1940 to 1970 increased from five million to nineteen million for public buses and trucks, while cars increased from twenty-eight million to ninety million. This represents an average of one vehicle for every two people. The growth of sales resulted in
increased production, facilitated the development of the parts and tire industry, road construction, gas stations, maintenance service, the touring industry, the restaurant and hotel industry. The automotive industry is essential to the United States’ economy, and the automotive financial service industry is essential to the automotive industry.

III. The Current Picture of Chinese Automotive Financial Service Industry

The Chinese economy is currently based on manufacturing. The service industry has a weak background, as the Chinese economy was closed for almost thirty years after the Second World War.

The country’s economy was concentrated in agriculture and manufacturing. In 2006, the whole service industry which includes the automotive financial services industry, contributed only forty percent (39.5%) to China’s GDP (Gross Domestic Product), and in the automotive industry, financial services contributed only twenty percent\(^1\) to vehicle sales. The potential for expansion can be recognized by comparing China’s service industry to that of the United States, which contributes seventy percent to GDP and of which financial services is an important component. In the United States, eighty percent of automotive purchases are supported by financing. A great business opportunity awaits investors who can apply the appropriate elements of the United States automotive financial service industry to China.

The experience and study\(^2\) from the history of most developed countries is that when a country’s per capita GDP reaches seven hundred US dollar, automotive consumption will significantly increase and the automotive industry will be a strong growth point in the economy. The Chinese economy now produces US $2,460\(^3\) per capita GDP. Despite current slowing, the Chinese economy is expected to remain one of the fastest growing markets for the foreseeable future at approximately eight percent (8.5%)\(^4\) annually.

The standard of living has improved, as indicated by consumer surveys conducted by the National Bureau of Statistics in China which reported that, in 2006, more than half (52.6%) of residents were interested in purchasing a vehicle, and one out of ten (11.3%) intended to do so within a short period of time. The survey also indicated that, in addition to family income and

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\(^1\) National Development and Reform Commission of People’s Republic of China


\(^3\) National Bureau of Statistics of China

\(^4\) The World Bank: East Asia Update, April 1. 2008.
automotive prices, the availability of financing and other automotive services, such as insurance, plays an important role in determining automotive purchases. The Chinese have a conservative attitude toward spending money; they tend to spend money after saving. However, as the economy developed, people, especially the younger generation, learned that financing is an efficient way to purchase products ahead of time. They do not need to wait until they save the full price, such as buying a car, which will take a long time to save; financing, it seems, may be the best way.

Overall, the Chinese market now has a strong and increasing ability to increase automotive consumption; accordingly, professional financial services and other related services are in great demand.

Some automotive companies, such as GM and Volkswagen, have had more than twenty years to establish their financing branches as well as their cooperative manufacturers. They have lived with growth problems throughout their history, and know the Chinese automotive market well. For example, Shanghai General Motors has their own service company, GMAC SAIC (General Motors Acceptance Corp., SAIC Shanghai Automotive Industry Corporation Group), which supplies mortgage and insurance services, etc.

The fact that manufacturers play an important role in the automotive service area does not mean there is no chance for a specialized automotive service company. On the contrary, this situation only means that in the Chinese market, there is not an independent, professional automotive financial service system as of yet.

U.S. AUTOMOTIVE FINANCIAL SERVICE INDUSTRY ANALYSIS

I. The General Picture
   i. The History

   Automotive financial service companies have almost one century of history in developed countries. The world’s first automotive financial service company was GMAC, established in 1919. The creation of automotive financial service separated the capital of automotive manufacturing from sales, supported the needs of volume production as well as the needs for capital intensity, and accelerated the great development of the entire automotive industry.
Commercial banks later intervened into this market and competed with automotive financial service companies for loan volume.

ii. The Current Status

Currently, after ninety years of development, the automotive financial service industry has developed and matured in developed countries. Consumer loans and lease financing have been the main methods of automotive sales. The turnover volume of consumer loans from all automotive financial service companies, which are subsidiaries of automotive manufacturers, has exceeded the turnover volume of manufacturing, and thus has become the primary source of industry profits.5

Major participants in the automotive financial service industry in developed countries are automotive financial service companies, banks, credit unions, and trust companies. The major services are installment sales contracts,6 lease financing, investment financing and the transfer or refinancing of installment sales contract.7

The United States has encouraged consumer financing development since the 1920s, and from this point, automotive financial service stimulated individual consumption, and accelerated the United States automotive industry’s long-term stable development. At present, almost every automotive manufacturer group has or had its own automotive financial service company and supplies automotive financial service throughout the world. For example, GMAC8 serves forty countries or regions globally, has eighty years of experience, and has supplied one hundred fifty million vehicles with a total of one trillion US dollars in loans.9

Currently in developed countries, seventy percent of individual purchases are handled by financing. The United States has the highest average financing ratio, at ninety-two percent, followed by the UK at eighty percent, Germany at fifty percent, and Japan at forty-four percent. As the profit from vehicle sales has continued to decrease, automotive financial service has

5 Analysis of Chinese Automotive Service Models, Yan Tong, Liaoning Economy, Vol. 02, 2004
6 Installment sales contract: commonly used for vehicle purchase. After applying for loan from automotive dealer or a bank, consumers obtain use of the vehicle while making periodic payments – typically monthly – which include a portion of principal plus interest expense. When all payments have been made, title to the vehicle is passed to the consumer.
7 Transfer or refinancing installment sales contract: when automotive dealer or commercial bank signs the sales contract, provides loan to consumer, and where the principal is amortized through several sequential payments, typically monthly. The dealer or bank then sells the contract to another commercial bank or financial service organization and transfers the loan. The seller can earn the interest differential between the two contracts.
8 April 3, 2006, GM sells fifty-one percent of stock in GMAC to Cerberus Capital Management, a private capital investment group at a price of fourteen billion US dollars. In 2005, GM had a deficit of US ten billion US dollars (10.5), thus needed the cash flow from this sale to reduce the deficit pressure.
9 GMAC SAIC: http://www.gmacsaic.com.cn
become the main source of industry profit: one-third of automotive group profits come from financial service. In addition to generating profits, the availability of automotive financial service cultivates a group of brand loyalists through the provision of zero-down payment or zero interest rate financing.

In the United States, as well as other developed countries, the existence of these conditions has created an environment in which consumers have many options and relative convenience in providing their vehicle purchase needs: 1). an open competitive market economy; 2). an open free financial service system that allows various service formats to exist; 3). rapid economic development such as that experienced during the 1940s to 1960s; and 4). and a comprehensive legal system, political system, and credit system.

iii. The Trend

In today’s economic environment of slowing growth and rising unemployment, profits are decreasing, while at the same time, costs are increasing in United States automotive financial service companies. As a result, all of the financial service firms are under severe threat of downward credit ratings. This is especially true for independent automotive financial service companies, which are more fragile than the automotive financial service companies that are subsidiaries of automotive manufacturers. This fragility is most evident in companies that target low-credit customers. In 2008 and beyond, these automotive financial service companies will face great pressure to control costs and retain liquidity. Some analysts predict that sales of automotives in 2008 may decrease to fifteen million (15.5) units. This may reduce the interest and capability of automotive financial service companies to compete and attract new customers, thereby influencing their profitability.

II. Participants

i. Automotive Financial Service Companies

There are two types of automotive financial service companies. The first and primary type is a subsidiary of automotive groups, which supplies loan services to mainly their own automotive group dealers and retailers, and allows their dealers to supply various loan or lease financial services. Almost every major automotive group has its own subsidiary automotive financial service company, such as Toyota, Ford, etc.
For this kind of company, their competitive advantage is financial services, which is their core business. Being related to automotive manufacturers and dealers means that they can easily locate customers, and network points. They have a complementary relationship with automotive dealers due to their positive impact on sales volume.

The other type is independent automotive financial service companies that are independent from automotive manufacturers. They build their relationship independently with automotive dealers, and have their own networks of operation. Because they do not have a relationship with manufacturers, they may specialize in different areas of financial service. For this kind of company the American Automotive Association (AAA), a federation of sixty-nine individual motor clubs with over one-thousand locations across the United States serves as an example.

ii. Credit Unions

A credit union is a cooperative financial institution that is owned and controlled by its members, and operated for the purpose of promoting thrift, providing credit at reasonable rates, and providing other financial services to its members. Capital comes not only from members’ saving and funds, but also from financing from other banks and credit unions. Credit unions supply many types of loans, but consumer automotive loans are a very important business component.¹⁰

iii. Trust Companies

A trust company is a corporation, especially a commercial bank, organized to perform the fiduciary functions of trusts and agencies. It is normally owned by one of three types of structures: an independent partnership, a bank, or a law firm, each of which specializes in being a trustee of various kinds of trusts and in managing estates.

Traditionally, trust companies operate financial business for customers as a constituent. For example, they may operate customers’ estates or other personal properties, arrange and operate retirement pensions, annuities, operate sinking funds for companies, etc.

There are two main functions of a trust company: the first is a property trust, which means operating property and arranging investments as a consignee. The second function is absorbing

¹⁰ *Analysis of Chinese Automotive Service Models*, Yan Tong, Liaoning Economy, Vol. 02, 2004
savings and supplying loans as a realty financial service agent. The capital of a trust company mainly goes to financial bond and stock investment, and some long-term mortgages. In recent years, the difference between trust companies and commercial banks has grown considerably smaller. From the 1970s, trust companies vigorously developed new business areas, and took aggressive measures to improve their competitive power such as developing professional automotive financial service departments. Automotive financial service is an important business component for trust companies.

III. Service Options

i. Basic Service

Companies which specialize in vehicle loan services offer wholesale and retail automotive loans. Wholesale loans provide inventory financing for automotive dealers, based in part on the dealer’s credit rating and sales potential. With these loans, after the funds are distributed, a financing guarantee is registered by the lender with state government agencies before automotive manufacturers sell vehicles to dealers. After the automotive financial service company has satisfied the manufacturer’s invoice, the dealer obtains insurance on unsold vehicles. Not only do automotive financial service companies provide dealer financing, but also wholesale leasing and consumer training and consultation services.

In contrast to wholesale financing, customers purchase vehicles directly from dealers with retail automotive loans. Dealers then typically sell the financing contract to an automotive financial service company, at a discounted price, and the service company subsequently collects the payments. Approximately seventy-five percent of the automotive loan market is made up by retail automotive loans, and the relative profit potential is much higher than from wholesale loans.

ii. Value-added Services

Special situations and services exist in the automotive financial service industry, and these situations add value to customers and service organizations alike. For example, special loan treatment can be given to those customers who apply vehicle discounts to their cash down payments. Lessees can select open- or closed-end leases in decisions that will impact the maintenance fees paid to the lessor. Consumers can gain points which translate into purchase
dollars through affinity credit cards issued by automotive manufacturers or financial service companies. Additionally, financial service companies can supply extended vehicle maintenance plans which cover both materials and labor for most maintenance needs.

These and other services permit differentiation of financial service companies, and at the same time provide additional profit above that earned on straight financing. The automotive financial service industry operates with large-scale participants and in various services such as floating price service, investment financing service, old-new exchange service, and public affairs automotive financial service. Due to varying consumer preferences, different needs are being presented to automotive financial service companies, and these companies are attempting to satisfy as many of these needs as possible.

There are two primary value-added services: lease financing and investment financing.

1. Automotive Lease Financing Service

Automotive leasing includes lease financing and operation leasing in two services. The chart below illustrates the procedure for this service:

Figure 1. Lease Financing Operation Procedure

Lease financing is an important service in the automotive financial service industry. Lease financing is a bridge between the automotive manufacturer and consumer. The consumer obtains the right to use the vehicle in return for monthly lease payments. When the contract is due, the consumer generally buys the vehicle, thus obtaining full ownership. The terms that are typically utilized in this combination of lease and sale are as follows:
A. The consumer pays monthly usage fees to the dealer.

B. If the total usage fees paid by the consumer equal to the value of the vehicle or exceed the present value after depreciation, the consumer can obtain ownership of the vehicle according to the terms of the lease contract.

C. If the consumer has not paid an amount equal to the total value of the vehicle by the end of the lease contract, the consumer has the choice of: 1) paying the balance of the amount written in the lease contract and obtaining ownership of the vehicle, 2) if the value of the vehicle is higher than the contracted balance, the consumer can sell the vehicle, pay the balance to the leasor, benefit from the price difference; or 3), simply return the vehicle to the leasor.

Lease financing has advantages over loans. For the leaseholder, “lease then purchase” is more flexible. After the lease is due, the leaseholder has the right to buy the vehicle or not. If the consumer does not want to buy the vehicle, he can return the vehicle to the leasor. For the leaseholder, if they use the lease contract, they do not need to worry about whether the vehicle will be resold, because the ownership is not important to them. However, for the traditional consumer who uses installment sales contracts, if they cannot pay the balance and the dealer resells the vehicle, it will result in potential financial shortfalls for the customer.

2. Automotive Investment Financing Service

Automotive investment financing service is the professional investment financing service aimed at automotive consumption. For example, automotive financial service companies absorb some capital from private funds; they manage these funds to earn profit. The profit is mainly used to pay the related prices and fees of the vehicles bought from automotive dealers, and the remainder can be the company’s return on investment. This service gained popularity in the 1960s and 1970s, influenced by the inflation of the era. Automotive financial service companies then became involved in capital markets, created innovative new investment products, and gained competitive advantage against other financial service entities in the process.
The chart below illustrates the procedure for this service:

**Figure 2. Investment Financing Operation Procedure**

Either directly or indirectly, automotive financial service companies often establish professional fund companies or private funds in the name of a branded automotive club. These clubs solicit membership by enticing the prospect with attractive automotive financing. Club profits are used to repay the principal and interest when the automotive financial service company purchases the vehicle. In this manner, customers not only participate directly in managing the automotive financial service company’s investment activities, but also benefit from the profits brought in by professional financing. Although a certain level of risk exists for the customers, the risk seems to be both low and manageable.

Investment financing service combines vehicle purchase and investment together. In this service, the capital is separated into two parts: the vehicle purchase capital, to pay the down payment and fees of purchase, including the deposit, and the financing capital, managed by investment experts or a credit automotive financial service company. Profit from financing capital will flow back to the automotive financial service company, to repay the principal and interest.

The advantages of investment financing service are:

A. It increases the automotive consumer’s consumption ability: Through this service, consumers can spend the future value of this investment to purchase a vehicle ahead of schedule. Through the diversified investment portfolio operated by professional financing manager, the profit of investment will be increased, which increases consumers’ repayment ability, thus, increasing automotive consumption.
B. It eliminates the credit risk, ensures the automotive financial service company’s benefit, and increases the competitive power of automotive financial service companies. Because the consumer consigns part of the capital to the automotive financial service company to invest, the consumer effectively gives credit insurance to the automotive financial service company, thus decreasing default risk and interest rate risk. Through investment financing, automotive financial service companies enhance their relationship with the consumer, which in turn cultivates company loyalty. Through investment financing, automotive financial service companies receive long-term capital which permits them to accelerate capital turnover and asset liquidity.

C. It stimulates automotive sales; when investment financing satisfies the consumer’s vehicle purchase needs, it can also bring the customer investment profit, thus increasing the consumer’s purchase power, and increasing the sales income of the automotive financial service company itself.

CHINESE AUTOMOTIVE FINANCIAL SERVICE INDUSTRY ANALYSIS

I. The General Picture
   i. The History

The development of automotive financial service in China remains in the very early stages. Since 1995, the SAIC group (Shanghai Automotive Industry Corporation Group) has joined forces with a national financial service organization to supply automotive loan services to Chinese consumers. As a result of their entry into this field, the development of automotive financial service industry in China can be summarized into four stages.

The first stage is that of “no outcome,” the end of which occurs in 2000. In this period, financial service organizations basically didn’t supply automotive financial service, because automotive consumers were mainly governmental or corporate, and seldom private families, so the only method of obtaining automotive was that of full payment in advance.

The second stage is the “blowout” stage, occurring from 2001 to 2003. Purchases by individuals were increasing during this period, and all commercial banks started to develop vigorously their consumer automotive loan business. These two factors resonated together, bringing the “blowout” of automotive consumption. At the same time, the consumer automotive
insurance business segment of insurance companies developed rapidly. By 2003, Chinese private consumer automotive loans totaled more than two hundred billion RMB (approximately twenty eight billion US dollar), and approximately one-third of newly added private vehicles were financed.

The third stage is the “deepfreeze stage” from the second half of 2003 to August of 2004. Because the price of vehicles continued to decline in China, automotive usage blossomed before the system of properly evaluating creditworthiness was developed. This resulted in a great deal of bad debts. Starting in February 2004, the consumer automotive financing service of all commercial banks contracted sharply. Thus, commercial banks, insurance agents, automotive dealers and manufacturers saw their levels of activity which were related to automotive sales go into deep hibernation.

The fourth stage started from August 18, 2004, at which point the first automotive financial service company - GMAT-SAIC Automotive financial service company, Ltd. (GMAC-SAIC) opened business in Shanghai. This is a date with milestone significance, representing the beginning of the conversion of the Chinese automotive financial services industry to that of domination by automotive financial service companies. This type of business continued to contract at commercial banks until many banks actually left the market temporarily. Within one year of the banks’ departure, Ford, Toyota, and Volkswagen had opened their own automotive financial service companies.

ii. The Current Status

Currently there are nine automotive financial service companies in the Chinese market, almost covering all of the large automotive groups: SAIC-GMAC, VW, Ford, Toyota, Hyundai, Volvo, Dongfeng Peugeot Citroen Finance, Nissan and Fiat. Among them, Nissan and Fiat are newly established in 2008, and additional entrants await government authorization. All of these automotive financial service companies are preparing to compete in the emerging Chinese market, based on their parent-automotive group’s capital power and their international automotive financial service experiences, to capture as much market share as possible.
iii. The Trend

In 2007, Chinese automotive sales totaled almost nine million (8.79)\textsuperscript{11} units. If it is assumed that the average price was thirty thousand US dollars\textsuperscript{12}, the total sales volume would be two hundred and fifty billion US dollars. Based on this number, if the financing rate in China increased from twenty to thirty percent, it would mean an incremental sales potential of twenty-five billion US dollars.

From these statistics, the development of the automotive financial service industry can be predicted over future years: the period 2007 to 2015 will represent the stage of developing competition. In this stage the financial service system will continue to deepen its access into all Chinese markets, and will mature as the automotive industry itself matures in China. By the end of this period the automotive financial service company will control the automotive loan market, serving not only the ultimate consumer but also the entire automotive industry. Simultaneously, the financial service component of the automotive industry will become the primary source of profit within the entire industry, similar to the industry’s evolution in other countries, Of course, industry evolution in China may not replicate that of the United States or other parts of the world, but logic suggests that the Chinese manufacturers are mostly global groups, and they are likely to introduce what has been proven or successful elsewhere.

In all, the Chinese automotive market will form a system that contains manufacturers, automotive financial service companies, commercial banks, joint venture automotive financial service organizations, and credit unions, with all these leading participants competing in a complementary manner. Surely, the Chinese market has its own characteristics, such as the social consumption culture,\textsuperscript{13} or their own brand of government system that will affect future development. However, the future development of diversification, convenience and safety will definitely be stimulated by the financial service demand in this market.

II. Participants

i. Commercial Banks

Commercial banks are the main supplier in the Chinese automotive financial service industry market. They have abundant capital power, broad customer recourse, a completed

\textsuperscript{11} National Bureau of Statistics of China
\textsuperscript{12} Prices in the Chinese market are generally higher than the world’s average
\textsuperscript{13} See the detailed explanation at the Culture risk in the section of Chinese Market Environment analysis.
branch network, and a settlement network. While supplying customers with automotive financing, they can also supply full-scale financial services.\textsuperscript{14} The prior contraction of commercial banks in this industry gave them the opportunity to develop more stringent credit standards, to reduce the risk from defaulted loans.

However, industry reliance upon commercial banks has its downfalls; their aim is to profit through interest income rather than to guarantee the stability and continuity of a specific industry. When the automotive industry is depressed, banks reduce related financial services. This characteristic conflicts with that of automotive industry goals, which are tied to increasing volume production levels and continuous sales. Because they lack a direct relationship; commercial banks will not develop specialized services such as risk management or marketing.

\textbf{ii. Automotive Groups’ Subsidiary Automotive Financial Service Companies}

There are nine automotive financial service companies established by the main automotive groups in the Chinese market, who are currently supplying automotive financial services: SAIC-GMAC, Volkswagen Finance China, Ford Finance China, Toyota Financial service China, Hyundai Finance China, Nissan Finance China, Volvo Finance, Dongfeng Peugeot Citroen Finance and Fiat Finance.

In the automotive industry, scale efficiency is especially obvious, as would be expected in the automotive financial service industry. However, the business scale is limited for financial service companies currently operating in China. At present, Chinese automotive sales are only forty percent of the level of General Motors in the US. As a result, the subsidiary financial service companies cannot translate their specialization into a scale that would permit operating efficiencies.

Because these companies are mainly serving their automotive group’s needs rather than the needs of final consumers, the specific services being offered are severely limited. The main purpose of these companies is to supply long-term financing to fund such areas as the group’s technology improvement, new product R\&D\textsuperscript{15}, and sales marketing. Facilitating customer sales

\textsuperscript{14} Above paragraph mentioned that business volume of commercial banks has declined, but they remain the primary supplier of financial service.

\textsuperscript{15} Research and Development.
is only one sector of their business, which further limits the advantages of these financial services companies.\(^{16}\)

III. Service Options

In China, the primary business of automotive financial service is consumer loan service, which involves banks, automotive dealers, automotive manufacturers, financial service companies, and some other non-bank financial service organizations. Based on differences in responsibility and relationship depth with consumers, consumer automotive financial service can be separated into three profit objectives or services: 1) the direct service that has the bank as the main participant, 2) the indirect service that has the automotive dealer as the main participant, and 3) the direct service that has the non-bank financial service organization as the main participant. Their main business operation procedure is:

**Figure 3. Chinese Automotive Financial Service Operation Procedure**

i. Direct Service through Banks

For this service, the bank is the center of every business process and supplies services directly to the consumer. For example, bank attorneys investigate consumer credit, estimate loan levels, and sign loan contracts directly with the consumer. The consumer purchases the vehicle

\(^{16}\) Analysis on Current Situation and Existing Problems of Chinese Automotive Consumption Loan, Cong Liu, Qiu Yao, Yan Liu; Source: Heilongjiang Foreign Economic Relations & Trade, Vol 7, 2005
from the appointed dealer, purchases insurance from an appointed insurance agent, and the bank and insurance agent take on the related risks.

This service has the specific advantages of having sufficient capital, a broad network, and a relatively low cost of bank funds. However, the disadvantage is the severe workload from serving consumers in a face-to-face style. Moreover, several needs will develop other than providing capital. For example, in a timely and comprehensive manner, the bank needs to understand pricing, dealer relationships, and the full range of other automotive services and products. These requirements increase the necessary investment of capital and manpower. Because automotive markets are continually changing, the competitive marketing strategy of automotive manufacturers and dealers is continually changing. Commercial banks tend to have a delayed response time, however, and the quality of their financial products and services are affected because of this. At present, the size of the consumer automotive loan market is not yet large. This service can adapt, but along with the increase of the automotive loan business, this intensity and speed of entry may be challenging.

ii. Direct Service through Non-bank Financial Service Organizations

This service is nearly identical to the direct service of a commercial bank as the main participant, but the capital to finance loans is derived from the subsidiary automotive financial service company under automotive manufacturer groups. The direct service company holds the capital and the scope of the business are aimed at group-owned automotive products. In this service, the risks are held by the automotive financial service company and the insurance agents.

This service of the consumer automotive loan market is China’s most popular service. It joins the automotive financial service company with manufacturers and commercial banks, working together effectively with automotive financial service as the primary objective.

iii. Indirect Service through Automotive Dealers

For this service, the automotive dealer is the center of every business process, signing loan contracts directly with consumers and charging a two percent to four percent commission fee, based on the value of the vehicle. Dealers complete the consumer credit investigation and evaluation, handle the insurance and check-in procedure, assure consumers the use of their new asset, handle the loan procedure, and collect payments for the bank.
The biggest advantage of this service is convenience: it supplies consumers with a one-stop service. Accordingly, the risks of the loan are shared by dealers and insurance agents. Because dealers are most familiar with the market, the reaction of automotive products and service can be the fastest under this service. For example, financial service can be modified according to market changes. Because of the difference in credit standards (compared to the direct service with commercial banks), this service enlarges the scope of consumers, which cultivates the market, stabilizes the sales network, and fixes the target consumer segment. The problem with this service is that capital resources are limited and capital cost is high. Also, the business of evaluating credit is not the primary business of dealers, and their lack of experience can translate into bad extensions of credit. A final problem is that this service is available only in a certain customer segments that have a comparatively high credit quality.

**COMPARISON OF THE U.S. AND CHINESE AUTOMOTIVE FINANCIAL SERVICE INDUSTRIES**

<table>
<thead>
<tr>
<th>General picture</th>
<th>U.S. Automotive Financial Service Industry</th>
<th>China Automotive Financial Service Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>History</td>
<td>90 years</td>
<td>Commenced in 1995.</td>
</tr>
<tr>
<td>Current Status</td>
<td>Market is mature but saturated.</td>
<td>Remains in the very early stages.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Automotive service companies are the main participants in this market.</td>
</tr>
<tr>
<td>Trend</td>
<td>Decreasing profit margin, due in large part to legacy costs.</td>
<td>Significant great market potential with total sales volume two hundred and fifty billion US dollars.</td>
</tr>
<tr>
<td></td>
<td>Reduced credit ratings.</td>
<td>Increasing profit margins.</td>
</tr>
<tr>
<td></td>
<td>Decreasing consumption demand</td>
<td>No credit ratings.</td>
</tr>
<tr>
<td></td>
<td>because of economic conditions.</td>
<td>Increasing consumption demand.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Automotive financial service companies will be the leading role of the market.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Service options will be enlarged and diversified.</td>
</tr>
</tbody>
</table>
### Table 1 cont.

| Participants | Many professional players:  
1. Automotive financial service companies with professional financial service  
2. Credit Unions which can specialize in automotive financial service  
3. Trust Companies with significant capital which can be specialized in automotive financial service | Few professional players:  
1. Commercial Banks with capital but not focused on automotive financial service.  
2. Automotive Groups’ Subsidiary Financial Service Companies offer professional financial service but tied only to their parent companies. |
| Service Options | Various services options for different level consumers.  
1. Basic Service: wholesale and retail automotive loans: to customers who can afford the normal down payment and interest rate.  
2. Value-added Services: for customers who cannot afford the down payment and interest rate.  
1). Automotive lease financing service: for customers who do not have sufficient capital to purchase but cannot postpone consumption.  
2). Automotive investment financing service: for customers who have sufficient capital to purchase outright or make monthly payments. | Primary business of automotive financial service is consumer loan service.  
1. Direct service through Bank: bank deals with all investigations and loans at a specified interest rate; has weak connection with the vehicle purchase itself.  
2. Direct Service through non-bank financial service organization: same as bank.  
3. Indirect Service though automotive dealer: Dealer is always tied to parent manufacturer company. Dealers familiar with the sales but not experienced with the entire process of offering financial services, such as investigating consumer credit. |
From the comparison table above, the following observations can be noted:

1. From the comparison of the general status of the United States and the Chinese automotive financial service industries, it can be seen that a mature market exists in the United States while the Chinese market is still in its growth phase. Although the United States market is relatively stagnant, the Chinese market has significant development potential of two hundred and fifty billion US dollars per year.

2. From the comparison of the participants in the United States and Chinese automotive financial service market, it can be seen that the participants in the United States are diversified, and are not limited to automotive financial service companies. In the Chinese market, there are only commercial banks and automotive groups’ subsidiary financial service companies. Moreover, these organizations all have disadvantages in supplying sufficient services, because their service objectives are not to meet the customers’ need; thus they cannot develop services based exactly on these demand.

The gap between the United States and Chinese consists primarily between the numbers of potential financial sources for automotive purchasers in the United States versus the few choices available to the Chinese consumer.

3. The United States has a systematic range of financial services offered at different levels, from which consumers can select based on their financial purchasing power. In the Chinese market, services are not yet transparent; consumers can select the supplier but must accept from a limited menu of services. In addition although China offers simple loans it fails to compete in the additional support services provided by United States’ financial services providers.

To summarize the above comparison, the opportunity for new professional automotive financial services ability to attract an extensive range of consumers is lagging in the Chinese market as compared to the United States market. It can be concluded that the Chinese automotive financial service industry is waiting for professional financial service providers to formalize the service system and stimulate the enormous consumption potential. There is a service void and an opportunity for investors to exploit.

China has been viewed as a strong market for many types of investment for many years. The economic environment is generally favorable and profitable for most investors, especially for the long term. However, for any investment, the Chinese economy presents risks that will influence investment success. When considering the potential Chinese market, it is helpful to
look into the economic, political, legal and cultural environment of the United States to provide comparisons.

U.S. MARKET ENVIRONMENT

I. U.S. Investment Environment
   i. Economic Environment

   The economy of the United States is the largest national economy in the world. It is a mixed economy in that private firms make the majority of the microeconomic decisions while being regulated by the government. The United States economy ranks number one in GDP compared to the rest of the world and maintains a high level of output per person (GDP per capita, forty-four thousand US dollars in 2007, ranked number ten in the world). The United States has maintained a stable overall growth rate at approximately three percent. Moreover, the United States economy has maintained a low unemployment rate, and high levels of research and capital investment funded by both national and foreign investors, because of decreasing saving rates.

   Figure 4a\textsuperscript{17}: U.S. GDP from 2001 to 2007

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{U.S.GDP.png}
\caption{U.S. GDP from 2001 to 2007}
\end{figure}

\textsuperscript{17} See Exhibit 6: http://www.wikipedia.org
Led by the 1990s information and biotechnology industries, the United States economy has until recently been in a rapid growth stage for ten or more years. The automotive industry, construction industry, and financial industries are the most essential industries to this economy. During this stage, the American economy was more closely intertwined with the global economy than it ever had been. No matter whether in international trade or investments, the United States played a very important role in the global economy.

However, the United States economy is entering an adjustment stage, especially after August 2007, when the sub-prime crisis arose. As a result of the crisis, real estate prices were decreasing nationally (in some markets by as much as twenty-five percent by 2007), gas prices were soaring, consumption demand was decreasing; thus, slowing down the entire economy. Although the Federal Reserve has decreased the federal funds rate to stimulate the economy, it has not stopped the present economic downturn.

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18 See Exhibit 7: http://www.wikipedia.org
Figure 5a: U.S. Finance Industry Gross Income from 2001 to 2007

Figure 5b: U.S. Automotive Production and Sales from 2001 to 2007

From observing the two charts above, it can be seen clearly that the finance industry and automotive industry both have a low growth rate, and are in a decided period of downturn. Moreover, as the sub-prime crisis continues, it is difficult to predict how deep and wide this crisis will influence the economy as a whole. The International Monetary Fund (IMF) has predicted that the United States economy may experience less than a two percent (1.9%) growth rate beginning in 2008.

ii. Political Environment

The political environment of the United States takes place in the framework of a presidential, federal republic, where the President of the United States, United States Congress, and judiciary share federal powers, and where the federal government shares power with the state governments.

Federal and state elections operate as a two-party electoral system. This system has been proven and has kept the country stable on political mattes and economic direction.

The United States’ economic success seems to validate the view that the economy operates best as government leaves businesses and individuals to succeed on their own merits in open, competitive markets. Generally, the government is supporting and favorable to the economy.

iii. Legal Environment

While the federal government shares power with the state governments, the legal system of United States is shared by federal laws and states’ laws. Companies have to follow both the federal law and the state law where the company is located.

The legal system of United States is comparatively complete. A central characteristic of the United States economy is a reliance on private decision-making ("economic freedom") in economic matters, and this is enhanced by relatively low levels of regulation, taxation, and government involvement, as well as a court system that generally protects property rights and enforces contracts.

II. Risks in the U.S. Market

i. Economic Risk

The United States’ economy appears by recent economic indicators to be moving into a recessionary period, with GDP already significantly less than three percent annually. This economic downturn is rooted in the various financial instruments which were designed to support economic growth but have instead contributed to the current financial crisis. The financial downturn appears to have started from the real estate sub-prime crisis, extended to relative financial sectors, and has ultimately influenced the entire economy. The direct influence has already occurred: consumption demand is decreasing which is exacerbating the economic

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downturn. Furthermore, as the stock market declines, investors are leaving the market and looking for safer places to invest, to avoid additional loses, which merely expands market volatility. The automotive financial services industry is related to both the financial and automotive industries, and at this time the financial market and credit system are not stable, as a result automotive sales are falling, for example sales at Ford are down twelve percent in 2007, and gas prices continue to increase. Profit in the automotive financial services sector is not realistic now, and probably not in the foreseeable future.

ii. Political Risk

The year 2008 is a presidential election year, which means there will be a new president with new policies and economic direction. Based on historical precedent in the political system of the United States, this change will not be dramatic. The government will attempt to promote economic recovery and stability. However, the economic bailout plan is massive and unprecedented; it is difficult to predict precisely the risks that will be faced by investors in this environment.

iii. Legal Risk

Because the United States legal system contains both federal and state laws; investors must consider how these jurisdictions will be impacted in the current environment, and adjust investment and risk levels accordingly. One particular modification that may occur is passage of the Standards of Vehicle Exhaust Emission. This legislation could directly influence the structure of the automotive industry and thus influence the structure of the automotive financial services industry as well.

iv. Cultural Risk

People in the United States have a high awareness of finance. Financial services are everywhere in their daily life, and the various financial vehicles are an indispensable part of their life, so the development of automotive financial services was natural in United States market.

The only cultural risk will be the decreasing consumption demand caused by the financial crisis, as well as any long-term effects from sustained increases in the price of petroleum products. These effects could dampen vehicle consumption patterns indefinitely.
III. Competition in the U.S. Market

The automotive financial service industry has a long history as a comprehensive system in the United States. Within this system, all types of financial service organizations, mainly automotive financial service companies, credit unions and trust companies, are offering differed levels of professional and convenient financial services to consumers and dealers, covering almost all level of consumer segments. Accordingly, although the market in the United States is mature, the competition is fierce. Until recently, lenders were attempting to attract more customers by reducing the percentage of down payment as well as the interest rate. As a result, profit margins have dipped to unattractive levels and, to illustrate the impact, Daimler Finance announced in July, 2008 the cessation of their lease financing business; other financial service companies are expected to follow.

It can be concluded that the United States automotive financial services market is mature and saturated. It is difficult to find a unique opportunity among the market players to compete with the existing experienced financial service companies.

CHINESE MARKET ENVIRONMENT

I. Chinese Investment Environment

The Chinese market has always had a favorable policy to encourage foreign investment, especially in areas where such investment is needed for economic development and reformation of the economic structure. Foreign investment in the service industry is always being encouraged, as foreign investment has always played an important role in the automotive industry, this area can be considered safe for direct foreign investment.

Following is the economic, political, legal and cultural environment of Chinese market, which covers nearly all factors that might influence the feasibility of an investment opportunity.

i. Economic Environment

Although the Chinese economy is somewhat of a hybrid - a “planned economy” moving

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22 Around 1985, China started to introduce foreign investment into Chinese market, to encourage foreign investors. China had several favorable policies, for example: lower income tax rates, up to a maximum of only fifteen percent compared to the rate of twenty-five percent in 2008 and thirty-three percent thereafter for local companies, support from local government for registration, special protection for property rights, etc.

toward a “market economy” - it has remained one of the world’s strongest regions of growth for many years. The development of the Chinese market was even more rapid subsequent to China’s joining the World Trade Organization (WTO).

As the charts below indicate, the Chinese economy has kept a growth rate around nine percent annually for the period 2001 to 2007, which is much higher than the United States or European rate of one to three percent for the same period. This observation alone presents strong motivation to invest or expand investment in the Chinese economy. (See Figure 6a and Figure 6b)

Figure 6a\(^2\): Chinese GDP from 2001 to 2007

\(^2\) See Exhibit 2
Specifically considering the Chinese industries of automotive and finance, the annual growth rates are even higher than that of the overall economy (See Figure 7a). This is a remarkable statement, considering that both of these industries are starting from a weak Chinese industrial base. Development during these years built the foundation of industry, accumulated the experience, and trained an educated and experienced workforce. In the automotive industry the growth rates of production and sales are significant. (See Figure 7b) So, in all, it can be concluded that the two basic industries of automotive and financial services are both developing rapidly.

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25 See Exhibit 3
The United States has a long history of investment in China. Up to July, 2007, United States investment has included fifty-three thousand (53,754) individual and corporate projects totaling fifty-five billion US dollars (55.42), and has provided approximately ten billion US dollars in profit. Statistically, seventy-three percent of these investments are profitable, and almost forty percent (37%) of these investments have higher profit margins than their organization’s global

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26 See Exhibit 4  
27 See Exhibit 5  
28 Ministry of Commerce of People’s Republic of China
profit margin. Moreover, more than half of United States companies (51%) which invest abroad rank China as their top future market for foreign investment. In all, the Chinese market is an economy that is friendly to United States’ investment.

ii. Political Environment

The Chinese economy is decidedly different from the rest of the world; it is a republic socialist country. However, the Chinese government has retained continuity and stability since the 1980s, amid a promise that China will continue to deepen its pursuit of a market economy. The Chinese government is loosening its control over companies to permit free market competition. At this point, even state-owned companies need to compete in the market. It is still the case that the government will guide the overall economy, and will encourage or discourage the development of certain industries from the government’s macro point of view.

China has a good political and economic relationship with most of the world’s countries, and has absorbed investment from and invested in countries all over the world. The Chinese government also has continued to improve its efficiency of government departments and governors to serve the economy.

iii. Legal Environment

The Chinese legal system is not as complete as other developed countries, but during and after China’s joining the WTO, the entire legal system has improved significantly. For example, there was no law and policy at all for automotive financial service industry, but now, there is a special law for this industry: *Administrative Measures for Automotive financial service companies*, and it is still in progress of improvement.

For the automotive financial service industry, the related laws and policies have already been developed. The final aim of these laws and policies is to guide and standardize market competition. The government’s legal departments are improving their efficiency and enlarging their services to companies. Also important is the fact that the legal consciousness of Chinese companies and people are improving as the legal system continues to develop.
II. Risks in the Chinese Market

With investment, there are always accompanying risks, and with differences in the Chinese economy, these risk categories are worth mentioning. Clearly, the Chinese economy has made significant strides toward that of a market system. However, gaps exist and to the extent that the gaps are understood, the inherent risks can be hedged from the onset.

i. Economic Risk

Since the Chinese economy is a public socialist economy, undoubtedly state-owned companies are the most important participants in the economy. After the China reform and opening-up\textsuperscript{29} policy of 1980, the monopoly power of state-owned companies has been significantly altered, and they now participate in free market competition. State-owned companies continue to have great advantages in size and power, as well as a strong relationship with the government, legal system, and with the financial service system.

Within the finance system, the most powerful banks are still the state-owned banks, which are supported and, to a large extent, controlled by the government. These banks reflect Chinese finance policies and such policies will surely influence the actions of other commercial banks. Some of the new commercial banks have relationships with the better established state-owned banks, but some of the new banks have assumed a strategy of self development. Regardless of whether the commercial bank is old or new, state-owned or independent, these banks are controlled to a certain degree and cannot be considered totally independent.

It must be remembered that the finance system is still in the very early stage, with lower levels of liquidity than is evident in more developed systems. The products being offered through the finance system are relatively traditional, such as loans and savings accounts, and the mindset of financial institutions is not yet conscious of the full range of services which they could provide.

Within the automotive industry, the situation is similar to that of Chinese commercial banks. In the beginning established, state-owned companies cooperated with foreign investment to become the most powerful companies in the market. The first five Chinese automotive manufacturers fit this image, including FAW-VW, SAIC, Shanghai VW, Dongfeng, and Chang’an. However, the automotive industry is not like financial service companies. For

\textsuperscript{29} Refers to Xiaoping Deng's "Reform and Opening-up" policy to reform and open the economy to the outside world and build a Socialist market economy with Chinese style, around 1980.
example, the self-developed automotive companies still have trouble competing against the older, more powerful companies in the areas of brand reputation, technology, manufacturing foundation, relationship with powerful financing resources, as well as with sales channels. All these factors make the strong companies stronger and leave the self-developed companies to struggle.

ii. Political Risk

The Chinese government has made the country’s policy and political system stable for a long interval and has promised to continue the stability. From a macro point of view, there is not likely to be significant changes occurring rapidly within the system.

Because the economy is developing, the Chinese government is improving and modifying their detailed policies regularly and frequently. The aim of these changes is to encourage progress toward a market economy, but unavoidably, there will be policies to protect the native industries and native investment, from China’s own point of view. The government may encourage particular industries while limiting others. These changes may affect foreign investment significantly. This may be true in the automotive industry which is a very important industry to any developed economy. The Chinese government has limits (for example: the percentage of shares held, the business areas that are open to foreign investment, etc.) in this area that will continue if not expanded for foreign investment.

The working efficiency of the Chinese government is another important risk category. Because the Chinese economy developed from a planned-economy, the government is used to a controlling position, and not nearly as used to a position of support and service. As a result, communication and operations with the government may be a slower and potentially more frustrating process.

iii. Legal Risk

When addressing risks, legal factors are likely to be the main factors which could limit the development of the automotive financial service industry. For example: the Law of The People's Republic of China on commercial banks, actualized by the National People’s Congress in 1995, states: Banks can set up joint venture or sole proprietorship automotive financial service company to supply automotive financial service.
Another law, *Administrative Measures for Automotive financial service companies*, from legislation passed in 2003 by the China Banking Regulatory Commission, states: automotive financial service companies can deal only with single automotive loan business and automotive loan transfer or sale; they cannot provide lease service (even though this could be a highly profitable, in-between type of service). Although the modified *Administrative Measures for Automotive financial service companies* legislation, passed in January 2008, states that automotive financial service companies can start a lease financing business, the coming *Law on Lease Financing* may state that the leasehold for individual or family use is not included in lease financing. This legislation would be a significant blow to consumer automotive lease financing. This is likely to happen because the Chinese government always adjusts their policy based on market performance. If the government perceives it is not the time to open the individual- or family-use market, they will limit it. Alternatively, if they consider the existing market to be well functioning, they may open further the individual- or family-use market.

iv. Cultural Risk

China is a country that has a different culture compared to the United States or Europe; their unique culture determines that their economic culture will be different as well.

Based on the average income level, (as shown in Chart 10) a vehicle is still considered a luxury consumption item for most Chinese families. Families will choose public transportation rather than purchasing a vehicle if they do not have extra savings available. However, individual and family purchases are the largest part of automotive sales, totaling almost eighty percent.

Chinese consumers prefer full-payment purchases; they are not as accustomed to installment purchasing practices therefore presenting a challenge in consumption options. They still have a strong preference of a certain vehicle style; typically small families prefer smaller, cheaper vehicles.
III. Competition in the Chinese Market

As of 2005, there were at least thirty thousand financial organizations in the Chinese market, include policy banks, commercial banks, financial service companies, and financial service organizations. Generally, it can be classified into three types that participate in the automotive financial service industry, which are the main competitors that investor should take into consideration when entering the Chinese market, it is important to learn from their experiences as to practices and problems in automotive financial service area:

i. List of Automotive financial service companies

There are nine automotive financial service companies in China: SAIC-GMAC (04.2004), VW (09.2004), Toyota (01.2005), Dongfeng Peugeot Citroen Finance (05.2006), Ford (06.2005), Hyundai (08.2006), Volvo (09.2006), Fiat (12.2007) and Nissan (01.2008). These dates reveal that most of the financial service companies are newly established; they are pouring into Chinese market to settle themselves down and compete to obtain the future market share.

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30 Month and year in which the company opened
These companies will be the major participants as almost all of them have the automotive groups as their parent company, and have the designated dealers as their customer. In all, they are the most powerful and direct competitors in this market.

ii. List of Commercial Banks by Type\textsuperscript{31}

There are three policy banks, four state-owned commercial banks, thirteen stock-owned commercial banks, one hundred fifteen Township and City commercial banks. As mentioned before, commercial banks offer automotive financial services also, even though it is not their primary business. However, they do have a significant impact upon the competition within the industry.

iii. List of Other Financial Service Organizations

There are two hundred thirty-eight foreign investment organizations, four financial asset management companies, fifty-nine trust investment companies, seventy-four financial service companies of enterprise groups, and twelve finance leasing companies.

These financial service organizations do not offer directly automotive financial services, but they are professional in nature and supply significant amounts of capital. Their support will be a great resource of capital power.

\textsuperscript{31} See Exhibit10
## Table 2

<table>
<thead>
<tr>
<th>Investment Environment</th>
<th>U.S Market Environment</th>
<th>Chinese Market Environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic Environment</td>
<td>Normal</td>
<td>Good</td>
</tr>
<tr>
<td></td>
<td>United States is the biggest and strongest economy.</td>
<td>The economy has kept a growth rate around nine percent annually.</td>
</tr>
<tr>
<td></td>
<td>As of the beginning of the sub-prime lending crisis, the finance market has lost its stability.</td>
<td>Automotive industry is emerging.</td>
</tr>
<tr>
<td></td>
<td>The automotive financial service industry is saturated.</td>
<td>Foreign investment is encouraged and has favorable policies.</td>
</tr>
<tr>
<td>Political Environment</td>
<td>Good</td>
<td>Normal</td>
</tr>
<tr>
<td>-----------------------</td>
<td>------</td>
<td>--------</td>
</tr>
<tr>
<td></td>
<td>United States is a presidential, federal republic. The President, Congress, and judiciary share federal powers. The political arena is relatively stable. The government operates a two-party electoral system. Change may occur with upcoming elections.</td>
<td>The Chinese economy is different from the rest of the world: a republic socialist country. However, it has retained continuity and stability since 1980s. The Chinese government has continued to improve its efficiency to serve the economy.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Legal Environment</th>
<th>Good</th>
<th>Normal</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A complete legal system. Protects property rights and enforces contracts. The legal system shared by federal laws and states’ laws.</td>
<td>Not as complete as developed countries. For automotive financial service industry, the related laws and policies are in progress. The soaring demand for individual purchases will surely drive the legal system to adjust, as well as the credit system.</td>
</tr>
<tr>
<td>Risks</td>
<td>Economic Risk</td>
<td>Political Risk</td>
</tr>
<tr>
<td>------------</td>
<td>--------------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>High risk</td>
<td>Low risk</td>
</tr>
<tr>
<td></td>
<td>Growth in GDP is currently less</td>
<td>Risk exists to the extent that policies and laws can be expected to change, especially in light of an economic bailout.</td>
</tr>
<tr>
<td></td>
<td>The sub-prime crisis will increase investment risk</td>
<td>Normal risk</td>
</tr>
<tr>
<td></td>
<td>Significantly.</td>
<td>Considerably less government efficiency than other developed countries. Relative stability over preceding thirty years.</td>
</tr>
</tbody>
</table>
Table 2 cont.

<table>
<thead>
<tr>
<th>Culture Risk</th>
<th>High risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low risk</td>
<td>Chinese culture is totally different than that of the United States. If the automotive financial services cannot adapt to Chinese consumption culture, the risk can be significant. This risk is naturally reducing as the Chinese have been exposed to foreign investors and products within their country.</td>
</tr>
<tr>
<td>Low</td>
<td>People of United States have an active attitude regarding financial services. The economic crisis may lead people to adopt more conservative attitudes.</td>
</tr>
<tr>
<td>High</td>
<td>Chinese culture is totally different than that of the United States. If the automotive financial services cannot adapt to Chinese consumption culture, the risk can be significant. This risk is naturally reducing as the Chinese have been exposed to foreign investors and products within their country.</td>
</tr>
<tr>
<td>Low</td>
<td>The market is mature and saturated. Various professional financial service organizations participate.</td>
</tr>
<tr>
<td>Low</td>
<td>Only nine professional automotive financial service companies. Commercial banks are powerful, but they are not professional. The market is still opening.</td>
</tr>
<tr>
<td>Low</td>
<td>The market is still opening.</td>
</tr>
</tbody>
</table>

The general economic environment for investment is excellent in China, as the economy has kept a growth rate of at least nine percent annually. The legal system is not yet complete, but it is an evolutionary process that will seemingly accommodate growth in financial services. Most risk categories in the Chinese market are considered to be at low or average levels, with the possible exception of legal risk. Higher legal risk is an important consideration, but may be worth taking in order to gain a foothold in the market - especially when considering that legal risks seem to be reducing over time. Competition is currently low in the Chinese market with most of the professional automotive financial service companies are newly established, and commercial banks, even though they are powerful, are not professional in this area. With all factors considered, the Chinese environment is very favorable to investment, whether internal or external, in the automotive financial service market.
CONCLUSION

The analysis indicates overall that a strong market opportunity exists in China in the automotive financial services sector. New financial institutions in China are not without inherent risks. The political, legal, and cultural system of China may impose barriers to entry to steep to overcome in the short run. The following conclusions and recommendations have been determined.

I. Cooperation for Professional Automotive Financial Service

At present, the automotive financial services industry in China is offered primarily by commercial banks. This provides a strong capital base as well as a broad settlement network, but comes at the disadvantage of the commercial banks having no strong ties to the automotive industry. Undoubtedly, a deeper level of competition would develop through the expansion of professional automotive financial service companies. Automotive financial service companies’ disadvantages are: a weaker capital base, lack of direct financing, and constraints with indirect financing. To overcome their joint disadvantages, it is expected that commercial banks and automotive financial service companies will join efforts in varying degrees, to the benefit of both groups, following with the analysis.

Commercial banks have the advantage in supplying automotive financial service: great capital power, broad business networks, multiple branches, and several years of experience which produces trained personnel, familiarity with the market, feasible operation services, a risk control system, and in general, an overall consciousness of automotive financial service. Very few automotive financial service companies have these advantages. These are all significant advantages that most automotive financial service companies or organizations do not currently have. The foundation of these advantages is: 1) commercial bank’s credit and evaluation system use “Scale Evaluation,” which represents an improvement over the “personal evaluation” used by automotive financial service companies. 2) Commercial banks’ evaluation system can help automotive manufacturers reduce the evaluation cost, where in comparison the evaluation system for automotive financial service companies is still being established. However, commercial
banks do have disadvantages in this market as mentioned above. Overall, commercial banks cannot provide an overall satisfactory service, other than providing the loan itself.

Integrating the advantages of the two main participants in the automotive financial service market, competitive cooperation may be the future of automotive financial service industry development: compete while cooperating, cooperate while competing, and win the market together. Furthermore, risks can be shared, and existing commercial bank’s nationwide branches can be a convenient platform to start automotive services.

Most of all, the automotive industry needs a large quantity of capital and an automotive financial professional background; neither commercial banks nor financial service companies alone are likely to own these resources. To combine the commercial bank’s capital power and financial service companies’ professional ability together will increase the potential for success in the market and create competition with other automotive financial service companies.

One method would include: internal cooperation, with the automotive financial service company in charge of credit evaluation, collecting loan payments, and guaranteeing repayments. Banks would be in charge of providing loans and charging the automotive financial service companies. Another method would be that of outside cooperation, with the automotive financial service company providing loans to consumers, and banks supplying services such as comprehensive authority, capital settlement, substitutions, etc. Realistically, the outside service of cooperation appears to be more feasible in China’s current environment.

The seven main automotive financial service companies in the Chinese market now are all joint ventures. They are rapidly supplying advanced technology and deeper management experience for the newly established automotive financial service companies. These changes will permit the industry to expand more rapidly and will also assist in sharing risk across participants.

II. Variety of Services will be Enlarged and Diversified

Compared to the international automotive financial service industry, the Chinese automotive financial service industry has more limitations, primarily from its singular business service variety. Based on international experience, the Chinese automotive financial service has huge potential for development in supplying traditional loans to automotive dealers and

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32 At beginning, foreign investment was limited in that they couldn’t hold more than forty-nine percent of total shares. After the Administrative Measures for Automotive Financial Service Companies legislation, passed in January 2008, it was no longer because of the law that foreign investors were restricted in percent ownership, but more because of the amount of capital, that was required. Only joint ventures have access to the necessary capital to start this business.
consumers. However, other aspects of automotive service also hold potential in China, with such services as automotive maintenance, insurance, gasoline stations, credit cards, trust financing, and, in general, the full range of business services to the automotive industry.

Compared to the international experience, Chinese automotive financial service companies or organizations will change their thinking about operations to enlarge the range of profit opportunities, and subsequently develop low-risk, stable-return intermediary businesses such as lease financing, trust leases, transformation of installment loan contracts into asset-backed securities, refinancing, insurance, and, separate from the automotive industry, mortgage financing.

The automotive financial service companies have recognized the importance of diversifying the service range, and the Chinese government has already started to release the legal environment to support this market’s diversification and development. As an example, they have released the lease financing service to the dealers and wholesale market beginning in 2008. It is a sign that the government recognized the necessity of encouraging the diversification of the financial services in this market.

III. Lease Financing will Catch Great Attention

Lease financing is the combination of sale and leasing, which has great flexibility for the consumer and the dealer by enhancing both their purchasing power and profit potential.

In the Chinese market, the biggest barriers to vehicle purchase by consumers are individual income in relation to the price of the vehicle. Most consumers cannot pay the vehicle fully by cash, and the complexity of vehicle purchase loans and high interest rates also prevents them from making the purchase decision. Based on these needs, various diversified financing methods will develop rapidly, and thus provide significant improvement for these problems. In this process, the profit potential for adaptable automotive financial service companies should be enormous.

With a weak foundation in the Chinese consumer market, it will likely be most profitable if the joint venture starts with basic services, such as consumer loans and financing services to dealers. After the establishment of basic services, the most important service to launch from a profit potential will certainly be that of leasing services.

33 See Figure 12.
With legislation being relaxed in 2008 for lease financial service, an opportunity exists to preempt the market, which will gain important market share. Entities with the advantage of abundant capital and experience in financial services might be offered a superior investment opportunity through preemptive entry into this market.

As it was mentioned that individual lease financing is under limitation, a question might be asked as to why lease financing would still represent a viable investment. Two significant reasons exist: First, the rationale for lease option barriers by the Chinese government is changing. In 2003, the booming yet immature market operated without controls, creating substantial bad debt (mainly from individual loans). Individual lease financing, which is riskier than individual loans, was considered ahead of the market development. Therefore, the government decided to freeze this service and wait for the market especially the credit system to be ready. Second, for lease financing service, the primary customer and greatest level of volume came from wholesale contracts to dealers. As long as no limitations exist in this area, lease financing can be conducted in a profitable manner.

IV. Credit Unions will start to Perform

There are no credit unions in the Chinese markets which invest specifically in automotive financial service area, but investors expect that movement in this direction could be a great source of profit for them. Credit unions have a relatively closed access to external financing resources, but their primary resource may be in their ability to evaluate personal credit and thus reduce the potential for loan defaults.

Credit unions are interested in the automotive financial service market. However, because they were not familiar with this complicated system, they did not seek early market entry. With the growth potential in this market it is assumed that at some time in the mid-term they will seek to enter the automotive financial service sector.

V. Start-up Limitation is Being Relaxed

As the automotive industry is best suited to large-scale production and marketing, the automotive financial service industry will be similarly suited, which means, the need for capital is significant, accordingly, the overall level of risk is higher.

However, through cooperation with a Chinese commercial bank, much of the necessary
capital can be supplied by them, while at the same time the business expansion will be better accepted by government and consumers alike. A foreign participant - for example a United States investor - will be able to enter a lucrative market with a reduced share of capital in return for offering their knowledge of financial service and their overall business management experience. An illustration of this possible foreign investment in the Chinese market is offered in the Appendix to this document.34

After the comparisons and conclusions above, this study concludes that a feasible opportunity exists to invest in the Chinese automotive financial service industry, through application of a United States-style system. As the market analysis indicated that China is a very unique market, any investment must be adjusted to the Chinese reality. Moreover, the United States’ system is not perfect, which can be observed from any number of recent situations. Even though the United States has a comprehensive system for credit ratings, it is still difficult to control while offering various services to customers with different credit ratings. The Chinese market should attempt to learn the appropriate lessons from developed countries, while attempting to avoid the ruinous levels of competition.

Although the investment process may not be free of obstacles, a willingness of both investors and the Chinese automotive financial service industry to adapt may provide both groups with what they seek - market share coupled with great profit potential, as well as an efficient system of consumer finance.

LIMITATIONS OF THIS STUDY

This study reveals the general picture of the investment opportunity in the Chinese automotive financial service industry. More details would be desirable prior to consummating the investment. For example, helpful information would include how to geographically locate the investment based on different local policies, how to evaluate and select cooperative commercial

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34 Based on the market strategy, a detailed developmental capital for start-up of this project can be generated. Appendix 1 and 2 are the three-year proforma schedule and its cash flow summary. But the start-up capital can be financed through other ways, like share with the joint venture cooperator, and also, because the required Capital Adequacy Ratio cannot be lower than ten percent, which means: the company needs only ten percent equity, so they have to put up seven million US dollars (7.2) of their own, and can conceivably borrow sixty-five million US dollars (64.8).
banks, how to manage the joint venture with different culture and values, or how to compete with other similar financial service organizations, etc.
APPENDIX A

Exhibit 1

<table>
<thead>
<tr>
<th>Factors Affecting Automotive Purchases by Percentage</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>19.10%</td>
<td>21.60%</td>
</tr>
<tr>
<td>Service</td>
<td>2.20%</td>
<td>2.40%</td>
</tr>
<tr>
<td>Insurance</td>
<td>3.10%</td>
<td>2.90%</td>
</tr>
<tr>
<td>Simplify purchase process</td>
<td>3.40%</td>
<td>2.90%</td>
</tr>
<tr>
<td>Traffic</td>
<td>7.90%</td>
<td>6.60%</td>
</tr>
<tr>
<td>Price</td>
<td>22.90%</td>
<td>21.80%</td>
</tr>
<tr>
<td>Income</td>
<td>41.50%</td>
<td>41.90%</td>
</tr>
</tbody>
</table>

Exhibit 2

<table>
<thead>
<tr>
<th>Chinese GDP (Unit: US Dollars Billion)</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>1566.50</td>
<td>1719.04</td>
<td>1940.33</td>
<td>2283.98</td>
<td>2615.50</td>
<td>3012.44</td>
<td>3564.71</td>
</tr>
<tr>
<td>Growth rate</td>
<td>10.52%</td>
<td>9.74%</td>
<td>12.87%</td>
<td>17.71%</td>
<td>14.52%</td>
<td>15.18%</td>
<td>11.90%</td>
</tr>
</tbody>
</table>

Exhibit 3

<table>
<thead>
<tr>
<th>Chinese GDP Per Capital (Unit: US Dollar)</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Per Capital</td>
<td>1231.71</td>
<td>1342.57</td>
<td>1506.00</td>
<td>1762.29</td>
<td>2005.71</td>
<td>1693.01</td>
<td>2670.86</td>
</tr>
<tr>
<td>Growth rate</td>
<td>9.72%</td>
<td>9.00%</td>
<td>12.17%</td>
<td>17.02%</td>
<td>13.81%</td>
<td>-15.59%</td>
<td>57.76%</td>
</tr>
</tbody>
</table>

Exhibit 4

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Income</td>
<td>4591.15</td>
<td>5222.76</td>
<td>6542.80</td>
<td>8112.56</td>
<td>8956.84</td>
<td>10081.90</td>
<td>11815.99</td>
</tr>
<tr>
<td>Growth rate</td>
<td>15.49%</td>
<td>13.76%</td>
<td>25.27%</td>
<td>23.99%</td>
<td>10.41%</td>
<td>12.56%</td>
<td>17.20%</td>
</tr>
</tbody>
</table>
### Exhibit 5

<table>
<thead>
<tr>
<th>Chinese Automotive Production And Sales (Unit: US Dollars Million)</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automotive Production</td>
<td>2.3415</td>
<td>3.2512</td>
<td>4.4437</td>
<td>5.0705</td>
<td>5.7077</td>
<td>7.2797</td>
<td>8.8824</td>
</tr>
<tr>
<td>Growth rate</td>
<td>12.81%</td>
<td>38.49%</td>
<td>35.20%</td>
<td>14.11%</td>
<td>12.56%</td>
<td>27.32%</td>
<td>22.02%</td>
</tr>
<tr>
<td>Automotive Sales</td>
<td>2.3711</td>
<td>3.2481</td>
<td>4.3908</td>
<td>5.0711</td>
<td>5.7582</td>
<td>7.216</td>
<td>8.7915</td>
</tr>
<tr>
<td>Growth rate</td>
<td>13.29%</td>
<td>36.65%</td>
<td>34.21%</td>
<td>15.50%</td>
<td>13.54%</td>
<td>25.13%</td>
<td>21.84%</td>
</tr>
</tbody>
</table>

### Exhibit 6

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>GDP</td>
<td>10171.40</td>
<td>10383.10</td>
<td>10857.20</td>
<td>11670.00</td>
<td>11217.30</td>
<td>11357.80</td>
<td>11646.00</td>
</tr>
<tr>
<td>Growth rate</td>
<td>4.16%</td>
<td>2.08%</td>
<td>4.57%</td>
<td>7.49%</td>
<td>-3.88%</td>
<td>1.25%</td>
<td>11.90%</td>
</tr>
</tbody>
</table>

### Exhibit 7

<table>
<thead>
<tr>
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<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Per Capital</td>
<td>36200</td>
<td>36300</td>
<td>37600</td>
<td>37800</td>
<td>40100</td>
<td>41600</td>
<td>44000</td>
</tr>
<tr>
<td>Growth rate</td>
<td>6.78%</td>
<td>0.28%</td>
<td>3.58%</td>
<td>0.53%</td>
<td>6.08%</td>
<td>3.74%</td>
<td>5.77%</td>
</tr>
</tbody>
</table>

### Exhibit 8

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance Industry Gross Income</td>
<td>2733.10</td>
<td>2758.80</td>
<td>2876.40</td>
<td>2910.60</td>
<td>3127.80</td>
<td>3286.40</td>
<td>3344.00</td>
</tr>
<tr>
<td>Growth rate</td>
<td>7.50%</td>
<td>0.94%</td>
<td>4.26%</td>
<td>1.19%</td>
<td>7.46%</td>
<td>5.07%</td>
<td>1.75%</td>
</tr>
</tbody>
</table>
### Exhibit 9

<table>
<thead>
<tr>
<th>U.S. Automotive Production And Sales (Unit: Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Automotive Production</td>
</tr>
<tr>
<td>Growth rate</td>
</tr>
<tr>
<td>Automotive Sales</td>
</tr>
<tr>
<td>Growth rate</td>
</tr>
</tbody>
</table>

### Exhibit 10

<table>
<thead>
<tr>
<th>Type</th>
<th>Quantity</th>
<th>List</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policy bank</td>
<td>3</td>
<td>China Development Bank, EXIMBC (The Import-Export Bank of China) the China Agricultural Development Bank</td>
</tr>
<tr>
<td>State-owned commercial bank</td>
<td>4</td>
<td>ICBC (Industrial &amp; Commercial Bank of China) ABOC (Agricultural Bank of China) BOC (Bank of China) CCB (China Construction Bank)</td>
</tr>
<tr>
<td>Township and City commercial bank</td>
<td>115</td>
<td></td>
</tr>
</tbody>
</table>

55
### Automotive financial service company

#### Proforma Start-up Capital

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registration required</td>
<td>$72,000,000</td>
</tr>
<tr>
<td>Capital needed for financial service</td>
<td>$650,000,000</td>
</tr>
<tr>
<td>Assets:</td>
<td></td>
</tr>
<tr>
<td>Office rental</td>
<td>$200,000</td>
</tr>
<tr>
<td>Office assets &amp; maintenance</td>
<td>$100,000</td>
</tr>
<tr>
<td>Vehicle stock for rent</td>
<td>$3,000,000</td>
</tr>
<tr>
<td>Labor cost</td>
<td>$200,000</td>
</tr>
<tr>
<td>Associated training</td>
<td>$100,000</td>
</tr>
<tr>
<td>Advertise &amp; promotion</td>
<td>$100,000</td>
</tr>
<tr>
<td>Insurance</td>
<td>$50,000</td>
</tr>
<tr>
<td>Legal accounting</td>
<td>$50,000</td>
</tr>
<tr>
<td>Consultant</td>
<td>$100,000</td>
</tr>
<tr>
<td><strong>Total start-up capital</strong></td>
<td><strong>$4,300,000</strong></td>
</tr>
</tbody>
</table>

---

35 The assets ownership and the expenses will be shared by the percentage of the share ownership.
## Appendix C
Automotive financial service company

### Proforma Income Statement

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Sales</td>
<td>$30,875,000</td>
<td>$33,345,000</td>
<td>$36,012,600</td>
</tr>
<tr>
<td>Less: Allowances 1%</td>
<td>$308,750</td>
<td>$333,450</td>
<td>$360,126</td>
</tr>
<tr>
<td><strong>Net Sales</strong></td>
<td>$30,566,250</td>
<td>$33,011,550</td>
<td>$35,652,474</td>
</tr>
<tr>
<td><strong>Expenses:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>$100,000</td>
<td>$105,000</td>
<td>$110,250</td>
</tr>
<tr>
<td>Amortization</td>
<td>$13,325,000</td>
<td>$13,325,000</td>
<td>$13,325,000</td>
</tr>
<tr>
<td>Associated training</td>
<td>$100,000</td>
<td>$105,000</td>
<td>$110,250</td>
</tr>
<tr>
<td>Consultant Fees</td>
<td>$100,000</td>
<td>$105,000</td>
<td>$110,250</td>
</tr>
<tr>
<td>Contract Labor</td>
<td>$600,000</td>
<td>$630,000</td>
<td>$661,500</td>
</tr>
<tr>
<td>Depreciation</td>
<td>$300,000</td>
<td>$300,000</td>
<td>$300,000</td>
</tr>
<tr>
<td>Insurance</td>
<td>$50,000</td>
<td>$52,500</td>
<td>$55,125</td>
</tr>
<tr>
<td>Office Expenses</td>
<td>$200,000</td>
<td>$210,000</td>
<td>$220,500</td>
</tr>
<tr>
<td>Legal accounting</td>
<td>$50,000</td>
<td>$52,500</td>
<td>$55,125</td>
</tr>
<tr>
<td>Maintenance</td>
<td>$100,000</td>
<td>$105,000</td>
<td>$110,250</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>$14,925,000</td>
<td>$14,990,000</td>
<td>$15,058,250</td>
</tr>
<tr>
<td><strong>Net Operating Income</strong></td>
<td>$15,641,250</td>
<td>$18,021,550</td>
<td>$20,594,224</td>
</tr>
<tr>
<td><strong>Income tax 25%</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Tax</strong></td>
<td>$3,910,313</td>
<td>$4,505,388</td>
<td>$5,148,556</td>
</tr>
<tr>
<td><strong>Net Income (Loss)</strong></td>
<td>$11,730,938</td>
<td>$13,516,163</td>
<td>$15,445,668</td>
</tr>
</tbody>
</table>

*Financial Assumptions for Appendix 1 and 2:*

1. The detailed amounts are based on facts and assumptions that come from similar related companies, for example, automotive dealer and other automotive financial service companies.
2. *Administrative Measures for Automotive financial service companies* requires foreign investment in Chinese automotive financial service company; the registered capital must be more than 500,000,000RMB (approximately 72 million US dollar). Capital adequacy ratio cannot be lower than ten percent.
3. Enterprise income tax 25%.
4. Will invest in Beijing. Beijing is one of the four largest cities for automotive sales. The others are Shanghai, Guangzhou, and Changsha. In 2007, sales in Beijing were 430,000 vehicles, with an average price of 200,000 RMB (30,000US dollars), which translates into market sales of 12.9 billion US dollars.
5. *Administrative Measures for Automotive financial service companies* requires: The loan rate of automotive financial service...

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36 *The Law of the People’s Republic of China on Enterprise Income Tax, 01.01. 2008*
37 China Automotive Technology & Research Center
companies can only float between 10% - 30% of the legal benchmark loan interest rate.  
6. In 2008, Chinese inflation rate supposedly will be controlled at less than 3% annually.
7. Assumes new company can achieve 5% market share the first year, thus translating into sales of 650 million US dollars of vehicle sales. Assuming an average interest rate of 4.75%, (computed as 25% from the individual customer interest rate of 7.0%39, 25% from the company customer interest rate of 5.0%, and 50% from the automotive dealer interest rate of 3.5%), it translates into 30.875 million US dollars of revenues.
8. Suppose investor invest 72million US dollars for registration. 650 million US dollars by financing, at a five-year amortized 2.5%40 interest rate which means 6.5 million interest payment every year.
9. Assumes company employs 50 employees, with average salary 7000RMB per month (1000 US dollars)41; the total labor cost for the start-up year will be 600,000US dollars.
10. All fixed and labor costs should rise annually at 5%.
11. All revenues should rise annually at 8%.

38 12. 2007, The People’s Bank of China announced the legal benchmark loan interest rate adjusted to: 6-month: 6.57%, 1-year: 7.47%, 1-3 years: 7.56%, 3-5 years: 7.74%, 5 years or more: 7.83%.
39 These figures are assumed based on the market average interest rates, based on a commercial loan of three year’s maturity.
40 Chinese Central Bank large quantity loan rate average 3%. Assuming this project will be a loan to a cooperating commercial bank, the rate can be lowered to 2.5%
41 China has a low labor cost, the main labor cost for a joint venture company will come from salary for management team.
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