NEWS ANALYSIS

AQSIQ held a meeting in August to explain details of Three Guarantees.

Second, automobiles with potential safety risks after having been repaired twice can be either replaced or returned within two years or 50,000 km, whichever comes first.

Third, maintenance and repair is free within three years or 60,000 km, whichever comes first, except normal wear-and-tear.

For the first time in China and after more than 10 years of debates and modifications of its specific terms, a national warranty regulation is in place that specifies the obligations of automakers and their dealers and consumer rights. A number of automakers have announced to implement the *Three Guarantees* even before it goes into effect.

But consumers have been questioning the new regulation since it was published by the State Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) earlier this year. Close to 60 percent of consumers complain, for example, that the cost payable to dealer/manufacturer in case of replacement and return of an automobile was too high, according to a survey conducted by *autohome.com.cn.*

For example, car owners have to pay between ¥10,000-¥15,000 ($1,634-$2,439) if they want to replace or return a car priced at ¥200,000 with a mileage of 10,000 km, or based on a formula of (price x mileage)/1,000 x N, where N = 0.5-0.8 percent.

Another important issue is the inspection and determination of problematic cars. There are only a few quality inspection centers in China and the inspection of vehicles is very complicated. It may take consumers more than ¥100,000 to inspect even one major component of a car.

Consumers also question the fairness of vehicle inspection and tests because the inspection centers are all stakeholders of OEMs or suppliers.

Consumers argue that the penalty for manufacturers in the regulation is too little to be effective. Automakers are fined for no more than ¥30,000 if they break the *Three Guarantees* regulation.

Local analysts also point out that it would be very difficult to calculate and resolve the disputes in all kinds of taxes and insurance fees in case of a vehicle replacement or return. More detailed regulations are needed to substantiate the implementation of the *Three Guarantees*.

Consumers fear a possible price hike of new automobiles when the *Three Guarantees* goes into effect in October if manufacturers try to offset their possible added costs in the implementation of the *Three Guarantees*.

The new regulation also offers challenges to dealers and manufacturers.

The *Three Guarantees* regulation provides that dealers shall offer consumers spare cars or transportation expenses if vehicle repairs take longer than five days. This means added pressures on dealers to have more spare cars or operating expenses, especially to smaller dealers.

Skills of mechanics in 4S stores are also critical. More professional mechanics can help reduce maintenance time, but this would mean higher salaries and operating cost.

How to deal with returned vehicles is another problem facing dealers. If they cannot be returned to carmakers, dealers would shoulder the risks and responsibilities. Communications and cooperation between dealers and automakers are therefore crucial for smooth implementation of the *Three Guarantees*.

According to the regulation, returned can be sold as used after all quality problems have been resolved. And such used vehicles must be clearly labeled, indicating that they are returned in accordance with the *Three Guarantees*.

Analysts believe that few people will intend to buy such used vehicles especially in big cities where vehicle registration is limited through a license plate lottery system. Consumers in China like new things instead of old or used because of their possible loss of "face" or "mianzi."

Consumers in smaller cities may prefer local brands with a lower price rather than used cars. If returned vehicles are priced too low, it would mean a loss to automakers.

Automakers must also work with AQSIQ on details of specific parts and components to be covered by the *Three Guarantees*. To clearly identify what parts and components are covered in the *Three Guarantees* is a vital task for manufacturers and dealers.

The *Lemon Law* in the U.S. aims to protect consumer interests and rights. It remains to be seen whether the *Three Guarantees* will play a similar role in China in the protection of consumer rights. CBU/CAR

Mercedes-Benz announces at Chengdu auto show to implement Three Guarantees from August 30.

FEATURE

Making it big: large cars and government procurement


Red Flag H7

*– by Mark Andrews, **CBU/CAR** Guest Columnist*

At last year's Beijing Auto Show one of the major trends was the launch of large cars by Chinese manufacturers. Hongqi (Red Flag) was there with the H7, BAIC showcased their Saab derived cars and Roewe launched the 950. However as HIS Automotive analyst Sa Boni pointed out this was not entirely new as both Chery and Brilliance started sell larger models some years back. What was different this time, however, is that large cars were being offered by some of the largest SOEs.

Such efforts were obviously encouraged by new government regulations. Last year the Ministry of Industry and Information Technology (MIIT) published a draft regulation for the procurement of government vehicles. Included was a list of 412 approved vehicles that are priced less than ¥180,000 with engine displacement of 1.8 litres or less. Thanks to an additional requirement for manufacturers to spend more than 3 percent of revenue on R&D not one of the included cars was from a joint venture.

"When China regulates it does so in regard to the stage of its industry and with a certain set of outcomes in mind," says Bill Russo, president and CEO of Synergistics Ltd., a Beijing-based automotive consultancy. Both FAW (Hongqi) and SAIC (Roewe) have a history of providing government cars. Hongqi dates back to 1958 and was used for high ranking government officials until they switched to favouring foreign cars. SAIC built the Phoenix and later the Shanghai SH760 for

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officials not important enough for a Hongqi.

Precise government expenditure on official cars is difficult to pin down but is thought to be in excess of ¥150 billion annually. The Volkswagen group is said to sell around 10 percent of JV output in China for the government, compared to only around 1 for Chery.

In 2009 when then President Hu Jintao reviewed the troops for the 60th anniversary of the founding of the People's Republic he did so in the Hongqi HQE. This came at a time of increasing criticism of lavish government spending on items such as banquets and foreign luxury cars, a theme which the new administration seems to be furthering to address. While China's domestic auto industry is massive the local Chinese brands are failing to gain traction and are losing market share to the JVs – last year market share was just 27.3 percent. Traditionally Chinese producers have been stronger at the lower end of the market but they are now feeling the pinch as JVs also move into the segment.

SAIC with its Roewe and MG brands has tried to position them above other Chinese producers but sales have been far lower than anticipated. Government procurement could provide SAIC along with other Chinese manufacturers much needed government procurement sales and exposure which might lead to more sales to the public.

Roewe 950

For Chinese manufacturers it also makes sense to produce larger vehicles. Whilst the profit margin is unlikely to be better, by nature of the fact the car is more expensive the total profit per unit is far greater. Chery reportedly only makes around ¥100 from each QQ sold. "Larger cars or premium sedans could always result in higher profit if the vehicles sell well," says Sa.

While the Roewe 950 has been on sale since April last year, the Hongqi H7 and Beijing Senova have only been launched on the market this year and it seems that these two have been very specifically aimed at the government market. The H7 launched this March was initially only available for government procurement. Although it did go on sale to the public in May, the 2.5 litre V6 version is exclusively for official purchase. Under government regulations ministerial and vice-ministerial level officials are restricted to cars of 2.5 litres or less. China's Foreign Minister Wang Yi has already taken delivery of an H7.

BAIC's Saab-based car the Senova also went on sale in May. The 1.8T version is exclusively for government procurement. Curiously though the price doesn't fit within this year's reduced ¥160,000 cap and equipment levels are higher than for the consumer versions including features for rear occupants such as massage seats, LCD screens and a refrigerator.

With regard to government procurement the biggest issue lies in implementation. MIIT for a number of years has been putting out similar regulations which have then largely been ignored. "When such kind of new policies are released it's always difficult to strictly execute in the whole country. JAC's cars won some fleet orders in Anhui Province but we didn't spot any significant impact on either the Audi A6L or other domestic models," says Sa.

BAIC Sanova

It is also going to be difficult to persuade officials to drive domestic cars if they are perceived to be inferior. "The existing government fleet can hardly be downgraded," says Russo.

Sales of these large cars so far have not lived up to expectation. Last year the Roewe 950 sold 4,905 compared to 86,101 for the Buick LaCrosse, on which it is based. "It isn't about just having a product that meets the specifications but the esteem this class of buyer aspires to have," says Russo.

This may well be an uphill struggle with private customers but if the government really does start buying Chinese it will certainly help build exposure.