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Competing with Dragons

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A functioning industry-government ecosystem is essential to compete with China in the electric vehicle market.

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In December 2023, Dr. José Muñoz, President and CEO of Hyundai and Genesis Motor North America and Global President and Chief Operating Officer of Hyundai Motor Company turned his attention to discussions around the future Customer Experience (CX)

Muñoz and his team planned to deliver as part of Hyundai's new *"smart mobility"* initiative in the rapidly changing landscape of the US automotive market.[1,2] Muñoz's focus was on how to engineer Hyundai's CX line-up and value delivery system so that it would continue its transformative growth trajectory and deliver profitable value in an increasingly competitive US market.

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In 2021, Hyundai announced it was investing $7.4B in its US *"smart mobility"* initiative. The kicker—recent moves by China were putting at risk the venture's potential return.

Why?

It has become fashionable to blame loss of competitiveness to China on unfair competition. Theft of intellectual property, distorting government subsidies, low labor costs with which the West cannot compete, asymmetrical market access and so forth. While there is truth to all these claims, and it's maybe convenient for Western manufacturers to blame their loss of competitiveness exclusively to Chinese 'cheating', it is far from the whole story.

China's threat to these Hyundai, and other manufacturers', investments was the result of a government strategy to invest in a carefully architected industry-government ecosystem aimed at dominating the electric vehicle market, a market designated as a priority that Chinese auto companies must dominate.[3,4,5]

Like other strategic industries it targeted, China saw EVs as a far more level playing field where new entrants could win. It did not see EVs as an evolution of the traditional auto industry in which incumbent firms from the West had a significant advantage. Rather it was approached as a totally new industry up for grabs.

China believed that if it focused all its efforts in EVs, it would be far harder for mixed Internal Combustion (IC)/Electric Vehicle (EV) players to deliver profitable value vs. the more pure-play EV line-up China envisioned — akin to IBM trying to compete in the '90s with multiple operating systems vs. Microsoft who put all its resources into one OS, Windows.

Moreover, China did not have focus on 'protecting' a legacy auto industry. It also wished to get away from oil and gas where it was dependent on foreign suppliers. Its focus was on dominating the future rather than sustaining an obsolescent past. It was not about companies being reluctant to shift to making 'a better car' in an age of climate change. It was also about a revolution in our understanding of the customer experience in personal mobility—something that takes its cues at least as much from advanced consumer electronics as from automobile engineering.

In other words, China and its companies took an entrepreneurial rather than a bureaucratic approach to the EV market. Bureaucracies—whether government bureaucracies or the bureaucracies of large corporations—tend to start from the world as it is and explore ways of making it better, step by step. Those with an entrepreneurial mindset on the other hand start by imagining a totally different, and better, world and set about creating it, as Elon Musk did with Tesla.

EVs are not an evolution of internal combustion (IC) vehicles. Rather they completely disrupt the existing Tier 1 and Tier 2 supply chains and existing dealer networks for IC vehicles. EVs make it possible to treat the entire chassis as a Tier 1 supplier-outsourced-play to firms like Foxconn. This allows new players like smartphone maker Xiaomi—which just launched its own SU7 EV—to focus on brand, CX and networked services like Navigation, Media, Automotive Collision Avoidance Systems, Communications, and

"Limited Autonomy", which protects drivers who are less attentivefor extended periods of time. This will initiate a disruptive well-spring of differentiating CXs for established vehicle markets of all classes, creating opportunities for lifetime revenues and profits.

In forging an industry-government ecosystem to dominate the global EV market, China took a page out of the playbook of best practices in CX engineering in how to attack incumbents. China focused its efforts and resources on mitigating the CX trade-offs in the value propositions offered up by EV incumbents that represented the most significant barriers to the mass market adoption of EVs—affordability, range anxiety and ease of ownership. The emergent EV companies in China focused on providing a strong and comprehensive customer experience at affordable prices.

To win, China made huge investments in all the various pieces that make up the complex jigsaw around EV production and use. The government provided support to domestic EV and battery start-ups while investing in supply chains and public charging infrastructure, established control of the supply chains of critical commodities for electrification. It gave big purchasing subsidies to citizens and allowed free vehicle registrations at zero cost for EV buyers. Chinese companies also acquired foreign brands such as Volvo and MG, investing heavily in converting them to EV only manufacturers while riding on the brand equity built up over decades.

In other words, efforts were not piecemeal. The government focused companies on building the whole ecosystem that supports the emerging EV market.

One of the issues with Western style 'industrial strategy' has been its producer centric rather than consumer centric orientation. After all, it is the producers who are in the room arguing for specific types of support (while splashing out campaign finance dollars), not the consumers. All too often, that results in mollycoddling individual companies and creating 'national champions' that become lazy, uncompetitive, politically protected, and delivering an inferior customer experience - as was the case with Western industrial policies of the 1970's. In contrast, as early as the 1990's, China established an ecosystem on which different companies would compete ferociously with each other, boosting productivity and competitiveness. According to Bloomberg,[6] there were 500 EV

manufacturers in China in 2019. What whittled those down to around 100 by 2023 was competition rather than government 'picking winners.' The top 10 surviving companies were the most productive, the most competitive, and the ones delivering the best CX.

The results of China's ecosystem strategy speak for themselves.[7,8,9,10] China is now the world's largest EV market. Chinese companies have established or are establishing market dominance across many global markets with products that are attractive, competitively priced, and technologically advanced. They continue to benefit from China's dominance of the supply chains for critical raw materials. BYD has overtaken Tesla as the world #1 EV automakers while Western brands' market share continues to erode – both in China and elsewhere.

Failing to Join the Dots

Let us compare the above approach to Western responses:

As a matter of policy, the Biden administration had told Hyundai that its cars, including those it produced in Korea, would qualify for a $7.5K tax credit if it committed to producing EVs in the US. Hyundai in turn announced in May of 2023 it would invest $6B in US EV manufacturing facilities. Then the US turned the tables. The final version of the Democrats' bill, passed 3 months after Hyundai's May announcement, included several changes to EV tax credits such as new materials sourcing and assembly requirements and income caps for eligible customers. This meant Hyundai would lose the tax credits it was promised for plug-in vehicles that Hyundai currently makes in Korea until it could start up its production in the US.[11,12] It also meant that cars produced at its future plant in Georgia wouldn't be fully eligible for credits until Hyundai started to produce batteries.

Muñoz was quoted publicly as saying that, *"Just a few months later we saw this (law) and were a little bit surprised".*[13]

Both in the US and in Europe, Chinese EVs have now been hit with substantial tariffs. While this may provide some breathing space, they may not 'protect' local manufacturers for long as Chinese companies will build cars in Europe and in Mexico.[14,15] Such tariffs may also catch Western companies manufacturing EVs in China.

Further, some European manufacturers of luxury brands such as Mercedes have opposed such tariffs fearing that retaliatory action by China will damage exports on which they have become dependent. Maybe an example of short-term concerns getting in the way of an effective longer-term industrial strategy given that China's 'Made in China 2025' program is, and will likely continue, to erode Western brands' market share there.

It is hard not to be astounded by how the disjointed incoherence of Western responses to the EV threat stands in sharp contrast to the multi-faceted, comprehensive, carefully designed and well-executed Chinese industrial strategy.

Maybe in a symbolic sign of how far things have moved, BYD replaced Volkswagen as the main sponsor and mobility partner of the 2024 European men's soccer championship, hosted in Germany.

Path Forward from Here

The threat to the Western automobile industry is now clear, substantial and immediate. Such a threat cannot be met effectively by individual corporations acting alone or by manufacturers' focus on short-term imperatives at the cost of long-term competitiveness. Neither will uncoordinated shoot-from-the-hip public policy interventions be sufficiently effective.

Luca de Meo, CEO of French automaker Renault sounded the alarm when he called for a coherent response from Britain, France, Germany and the rest of Europe to the threat posed by imports of cheap foreign EVs. Whereas China has an industrial strategy pursued with ruthless effectiveness, in Europe *"there are just deadlines and fines"* stated de Meo, going on to boldly say in *The Telegraph* that: *"If we don't wake up and recognize soon that we have to figure out a better way...our industries are about to get wiped out.*[16]

What is now clear is that addressing the new-game environment will require the development of a well-functioning, well-aligned, strategically focused industry-government ecosystem. One that focuses on building long-term competitiveness rather than chasing each quarter, or mere finger-in-the-dike public policy initiatives that are too little, too late, and may be counterproductive.

We have entered the age of a New Political Capitalism "*Where private and public sectors are aligned in delivering to common socio-political objectives."*[17]

Yet there are challenges.

Decades of financialization and neo-liberal ideology led us to believe that the best government is the one that keeps out of everybody's way. As a result, neither government officials nor corporate executives have the expertise, or maybe even the appetite, patiently to build such an ecosystem and sustain a coherent long-term direction across multiple electoral cycles each of which ushers in a different political and economic ideology.

It is however encouraging that some industry leaders are starting to argue for exactly that. Said CEO De Meo: "*I believe that we can achieve our aims through joint efforts and partnerships between the public and private sectors."*[18] It is time to start defining what such partnerships should look like and urgently start to build them. Otherwise, our industrial future is starting to look bleak.

Endnotes

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