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## M&E BDO ASIAMONEY STARS INDEX

ASIAMONEY is proud to have teamed up with Management & Excellence consultancy and accountancy firm BDO to create the first Hong Kong-focused stock index based upon tracking management performance. Each month we will reveal how the 18 companies being tracked by the index perform compared to the Hang Seng Index.

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# Picking the best performer in China's auto industry

**The compilers of the M&E BDO ASIAMONEY Stars Index hone in on China's automobile sector to ascertain which companies are best managed when compared to international stalwart Volkswagen. The results throw up some unusual outcomes. Richard Morrow reports.**

Automobile manufacturers around the world consider China to offer the most opportunity for years to come, but the country has been doing its best to create its own car makers.

However according to research done by BDO Financial and Management & Excellence (M&E) these homegrown companies have a long way to go in terms of quality management systems and business processes when compared with international rivals.

The two companies, which alongside *Asiamoney* publish the M&E BDO *Asiamoney* Stars Index, have focused their attention on China's auto sector. This is both because of the sector's growth opportunity and the fact that many local businesses have partnered with international companies in

of the German company's listed market value is down to its management operations.

The closest Chinese company to this is Geely Automobile Holdings, whose management structure and processes accounted for 51.4% of its market value.

William Cox, founder and CEO of M&E, says that the difference is in large part down to Volkswagen's transparency.

"Volkswagen in terms of transparency is exemplary. Compared to other sectors and companies in Europe and even the best in the US it publishes huge amounts of data; how much the company invests in R&D [research and development], the financial returns of investments, corporate governance efforts; these are all illuminating details that sug-

gests the company does reasonably well.

"Geely got a score of 51 compared to VW's 75. That suggests that it is moving in the right lines, and inputting the correct sort of management systems and processes."

Patrick Rozario, head of risk advisory at accountancy firm BDO in Hong Kong, adds that Geely largely scores well because of its sta-

## AUTO COMPANIES ACCORDING TO MANAGEMENT VALUE

Auto company	Stock code	Market cap (RMB)*	Relative management value (RMB)**	Percent of mgt value to market cap
1 Volkswagen Group	VOW.DE	€68,204,029,038.8	€50,783,947,736.0	0.745
2 Geely Automobile Holdings	175:HK	30,408,131,029.0	15,628,258,942.0	0.514
3 Great Wall Motors Company	2333:HK	27,172,633,212.0	10,590,669,658.0	0.390
4 Guangzhou Automobile Group	2238:HK	14,541,382,812.0	5,425,971,582.0	0.373
5 Qingling Motor Company	1122:HK	2,588,782,292.0	929,450,506.0	0.359
6 SAIC Motor Corp	600104:CH	167,919,431,100.0	57,561,101,787.0	0.343
7 Brilliance China Automotive Holdings	1114:HK	45,835,016,243.0	14,899,305,149.0	0.325
8 DongFeng Motor Group	0489:HK	31,127,477,711.0	9,994,721,818.0	0.321
9 BYD	1211:HK	19,629,255,000.0	3,878,722,352.0	0.198

\* MARKET CAP ON 28 MARCH 2013, BLOOMBERG.

\*\* TOTAL VALUE OF ALL MANAGEMENT & BUSINESS PROCESSES BUT WITHOUT STRATEGY. VOLKSWAGEN'S MARKET CAPITALISATION IS QUOTED IN EUROS

\*\*\* ALL COMPANIES ARE ON THE HONG KONG STOCK EXCHANGE WITH THE EXCEPTION OF SAIC MOTOR CO. LTD WHICH IS ON THE SHANGHAI STOCK EXCHANGE AND VOLKSWAGEN GROUP, WHICH ARE LISTED ON THE FRANKFURT STOCK EXCHANGE.

SOURCE: M&E, BDO

an effort to expand their product offerings, which offers a unique opportunity to see whether such joint-ventures have led to improved management practices that benefit the share valuations of these companies.

M&E and BDO used German automobile maker Volkswagen as an international benchmark against these companies, and used 290 data points of compliance with good management practices, financial performance and the volatility in that performance to calculate the result.

This analysis revealed that most Chinese companies fall well short of the standard set by Volkswagen, with their respective managements and the services by which they operate providing far less value to their companies.

BDO and M&E estimated that Volkswagen's management processes and operations effectively contribute 0.745 of management value to market capitalisation, meaning that 74.5%

ability, which comes with pluses and minuses.

"Geely doesn't go into interesting joint-ventures unlike some of the other companies on this list. It builds four-door sedans at a low price to cater to the mid to low end market, which is the real growth segment right now," he says. "This allows Geely to use older technology which is stable and predictable, while it has developed good distribution channels which ensure the sustainability of its earnings. On the other hand it's not innovative and the company could face a volatile future once the car market evolves in China and more people begin to demand higher quality cars."

Companies with joint ventures with international companies might better weather such changes. DongFeng Motor Group has one with Japan's Nissan and another with Volvo, Brilliance China Automotive Holdings works with BMW, SAIC Motor Corp. is allied with General Motors and

Guangzhou Auto operates a joint venture with Honda.

## BYD AT THE BACK

The study of the Chinese automobile companies uses the same method as the one used to rate and weight companies within the Hong Kong Stars Index, a portfolio of 18 of Hong Kong's best run companies.

The index focuses on analysing data covers financial performance, corporate governance and research and investment criteria, in an effort to ascertain how much value companies' management and operating processes adds to their value and performance. This is distilled into a management value, and those companies with a higher score are rewarded with higher weightings in the index, which also considers their market cap.

An important lesson from the research done on Chinese companies is that while many of them enjoy some form of cooperation with international peers this has yet to greatly penetrate the manner in which they run their companies, according to M&E and BDO.

"You have to remember that Geely's score of 51 means that almost half its value should be effectively discounted by investors; the data is not there to justify that much of its total market valuation," says Cox. "And the drop from Geely to the other Chinese companies is quite marked, meaning even more of their valuations are even more difficult to justify today, based upon available data."

Almost all of the other China's based auto manufacturers after Geely have a management score sitting in the thirties, suggesting that their management processes account for well under 50% of the public value of their company. The true outlier is BYD, whose relative management value of Rmb3.88 billion (US\$630 million) is only 19.9% of its total market capitalisation.

This suggests that it has a very long way to go to improve its management performance, but Rozario says that there are mitigating factors for this.

"BYD is one of China's more innovative auto companies, building electric cars. However it has very volatile revenue and earnings which brought its score down. This is largely because it is in this niche segment whereas the others can rely on more traditional stability of operating in the standard car space," he says. "That said BYD is receiving a lot of interest among investors as it is investing into several interesting projects, while the demand for cars means that the country may well have to start considering alternatives such as electric cars instead."

While BYD is at present a risky investment to make due to its balance sheet uncertainty, its scores in specific management areas were better and it offers more potential for investors willing to take on some risk than some of its more traditional rivals.

"We looked at the greatest risk factors in terms of highest volatility and BYD's was its cash position, which fluctuates a lot due to it investing a great deal, having volatile expenses and using cash to pay for debt," says Cox. Companies in the process of innovation and expansion often have to deal with such volatility but this does make it a more risky investment at this time, according to our criteria."

## RANKING OF RISK FACTORS OF AUTO MANUFACTURERS

Auto company	Risk score (lower is better)*	Greatest risk
1 Guangzhou Automobile Group	0.116	Net income
2 Volkswagen Group	0.12	EPS
3 Geely Automobile Holdings	0.16	Results from financing activities
4 SAIC Motor Corp	0.33	Cash position
5 Qingling Motor Company	0.38	Results from financing activities
6 DongFeng Motor Group	0.39	Cash position
7 Brilliance China Automotive Holdings	0.40	Results from investments
8 Great Wall Motors Company	0.45	Results from financing activities
9 BYD	0.53	Cash position

\*MEASURES THE VOLATILITY OF THE FINANCIAL PERFORMANCE FIGURES OF THE PAST 2-3 YEARS.  
SOURCE: M&E, BDO

The ability to measure the management processes of the Chinese car manufacturers was limited in part because they release a great deal less information than international companies like Volkswagen, and are penalised for this lack of transparency.

However, of the information that they do provide, M&E and BDO were able to compile the areas in that they feel comprise the most risk to each company. The cash positions of many of the companies including Geely Automobile and DongFeng Motor were assessed as being of some concern, while the results of financing activities were also a common risk.

## AUTO EVOLUTION

The car market in China is continuing to rapidly grow, which is to the benefit of nearly all players right now as it means they don't face too much direct competition.

But these companies will eventually face the need to adapt once incomes rise and tastes change. The key for future winners in China's automobile industry will be those companies that start seeking out efficiencies and improve the ways in which they operate.

This spans everything from attracting better mid- and high-level managers, investing into R&D, sharing more information and improving supply chain lines and customer preferences. Cox believes that these car companies should take note of the evolution of some of their older international rivals.

"Volkswagen is applicable as a case study for many of China's local car makers," he says. "After World War II it only produced one or two models, and these were made in very large batches. They were low tech, reliable and reasonably efficient but undiversified and had an image of being unsexy. They had to evolve their image 25-30 years ago, diversifying their product line and going for top quality. If China's car market goes they will need to consider similar lessons."

The good lesson for China's relatively low management scores is that there is a lot that they can do to improve themselves and the reliability of their businesses. That will make them more secure and efficient going forwards, and in turn mean that they become less risky investments for investors.

The ones that apply these lessons first will be the most likely to succeed domestically in China, and possibly beyond. Car makers around the world will be watching the evolution of this dynamic sector with great interest. ▲