GO OR NO GO:
NEW HOPE IN CHINA

by

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Abstract

NAPA is the largest aftermarket auto part chain store in North America. It is one of the largest divisions of Genuine Parts Company, a NYSE listed company established in 1928. The first NAPA chain store was built in 1928. In 2008, there were 5,850 NAPA AUTO PARTS stores and over 680 wholesalers in North America, and NAPA sales revenues made up 48% of GPC's total revenues.

This research project is trying to discover if it is feasible to establish NAPA stores in China by analyzing China's current automotive aftermarket, the main potential competitors for NAPA, and NAPA's financial situation. The author provides the final recommendations according to the above analysis in the paper also. Include a general idea of what the final conclusions and recommendation is.

Keywords: Chinese automotive aftermarket, competitors, risks, financial analysis.

Dedication

Globalization has changed us into a company that searches the world, not just to sell or to source, but to find intellectual capital – the world's best talents and greatest ideas.

---JACK WELCH, FORMER CHAIRMAN, GENERAL ELECTRIC

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Glossary

Auto Part Mall	A mall composed of several small auto parts stores that sell all brands auto parts; no maintenance and repair function.
Auto 4S Store	Franchised stores that only sell one brand of auto or OEM service parts of this brand; can provide maintenance and repair service for this brand. 4S refers to sales, spare parts, service and survey.
Pull System	A system where processes are based on customer demand. The concept is that each process manages each component in line with another department to build a final part to the exact delivery expectations of the customer.
ROI	Return on Investment. The return on investment formula: $$ROI = \frac{(\text{Gain from Investment} - \text{Cost of Investment})}{\text{Cost of Investment}}$$
SAIG	Shanghai Automotive Industry Group
GAIG	Guangzhou Automotive Industry Group
ISO/TS16949	The aim of ISO/TS16949 is the development of a quality management system that provides for continual improvement, emphasizing defect prevention and the reduction of variation and waste in the supply chain. TS16949 applies to the design/development, production and when relevant, installation and servicing of automotive-related products. It is based on ISO9001.
U-joint (Universal joint)	A linkage that transmits rotation between two shafts whose axes are coplanar but not coinciding. The universal joint is used in almost every class of machinery: machine tools, instruments, control devices, and, most familiarly, automobiles. The U-joint mentioned in this paper is used in automobiles.
One stop service	A comprehensive range of services available at one location, as in one-stop business services; a comprehensive range of products available at one location.

1. Introduction

NAPA is a popular aftermarket auto parts chain store in North America that belongs to Genuine Parts Company (GPC), a publicly listed company. NAPA focuses on the sale of auto parts, and car maintenance and repairs within North America. The first NAPA store was founded in 1928; now NAPA stores exist in most cities in the United States and Canada.

During the present recession, NAPA has faced a profit decrease in the first quarter of 2009, even though NAPA's financial performance has exceeded that of other companies in the industry.

This paper is an attempt to determine if it is feasible to maintain a similar business model to establish NAPA stores in China. The remainder of this paper is as follows. Chapter One gives an overview of the relevant industry. Chapter Two describes the potential opportunities for NAPA in China. Chapters Three and Four include an analysis of the separate external and internal environments within China for NAPA. Chapter Five recommends strategies for NAPA in China and Chapter Six details the expansion plan. Finally, Chapter Seven outlines the financial implications of this project.

1.1 Industry Overview

The automotive aftermarket industry is defined as that part of the automotive industry concerned with the manufacturing, remanufacturing, distribution, retailing, and installation of all vehicle parts, chemicals, tools, equipment and accessories for light and

heavy vehicles, after the sale of the automobile by the original equipment manufacturer (OEM) to the consumer (Performanceparts, n.d.).

This study focuses on the following two aspects pertaining to the China automotive aftermarket industry:

a. *Distribution and retail of auto parts for all vehicles, chemicals, tools, equipment and accessories.*

Auto parts include service parts, wear and tear parts, mechanical parts, tires, crash, repair and consumables, and accessories. Specifically, service parts include filters, wiper blades, ignition plugs, and engine oil components; wear and tear parts include batteries, emission systems, brake pads and discs, and ride control; and mechanical parts include those parts that are neither changed as part of a service, nor are considered to be wear and tear parts. These include transmission and power train parts. Further, consumables include cleaners, waxes, polishes, windscreen washes, and antifreeze; while accessories include in-car entertainment features, alarms and security, alloy wheels, storage, interior features (mats etc.), and exterior features (spoilers etc.).

b. *Maintenance and repair service for all vehicles.*

Maintenance means inspecting or testing the condition of the car subsystems (e.g., the engine) and servicing/replacing parts and fluids. Regular maintenance is critical to ensure the safety, reliability, drivability, comfort, and longevity of a car. During preventative maintenance, a number of parts are replaced to avoid major damage or for safety reasons, (e.g. timing belt replacement). Regular maintenance includes washing, checking/replacing the engine oil, replacing oil filters, and inspecting or replacing

windshield wipers etc. Repairing means diagnosing problems, troubleshooting and replacing the broken auto parts.

1.2 Players in the China Automotive Aftermarket Industry

Currently in China, there are several small- or medium-sized chains or independent private stores that retail or wholesale auto parts, and that provide maintenance and repair services. In Beijing, there are 5,500 small repair stores, while in Shanghai, there are 6,538 similar stores (China Scholars, 2008). Monopolies have not yet taken over these markets.

Some big auto parts suppliers like Delphi, Bosch and ACDelco have invested in China's Automotive Aftermarket since 2000; other big chain stores like Japan's Yellow Hat have already also established chain stores in China. Local automakers like Shanghai Automotive Industry Group have built stores with Shell China in Shanghai, which mainly provide professional repair services.

However, the whole market is still in the preliminary stage. Currently, a system that can provide omnidirectional maintenance, repair services and an abundant auto parts inventory has yet to emerge.

1.3 Market Segmentation

In China's current automotive aftermarket, there are four types of business model: auto 4S stores (4S stores), small repair shops, chain stores and auto parts malls. 4S stores only sell one brand of automobiles and OEM parts for this brand, as well as provide repair service; 4S represents sales, spare parts, service and survey. Small repair shops provide auto parts (most of these are not from the original manufacturers), in addition to

simple maintenance and repair services like car washes and replacement of wiper blades. Auto parts malls are similar to small repair stores in that they sell non-OEM auto parts, although they do not offer repair or maintenance services. Finally, auto parts malls consist of several independent auto parts stores.

2. Potential Business Opportunities for NAPA in China

2.1 General Information on NAPA

NAPA is the largest aftermarket auto parts chain store brand in North America. It is one of the largest divisions of Genuine Parts Company (GPC), a NYSE listed company established in 1928. The first NAPA chain store was built in 1928. In 2008, there were 5,850 NAPA auto parts stores and over 680 wholesalers in North America. As one of the largest divisions of GPC, the sales revenue of NAPA makes up 48% of the total GPC revenues. In 2008, despite weakening demand due to the economic downturn, GPC still reached $11 billion in sales, representing an increase of 2% as compared to 2007 in North America (Genuine Parts Company, 2008).

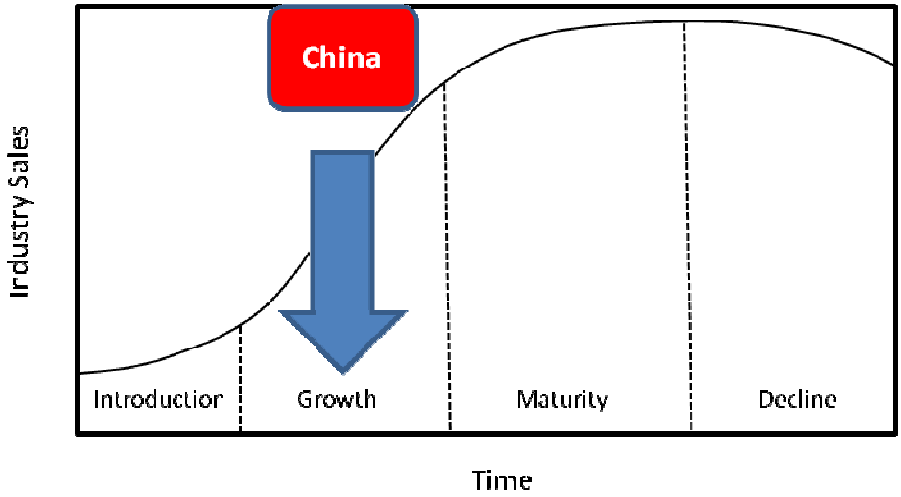
NAPA can offer a broad assortment of automotive related products and services to both Wholesale/Do-it-for-Me and Retail/Do-it-Yourself customers. Major products include over 380,000 items such as automotive replacement parts, farm and marine supplies, paint and refinishing supplies, tools and equipment, automotive accessories, and heavy-duty parts (Genuine Parts Company, 2008). NAPA has retained its market ratio in North America due to its large-scale distribution network, quality auto parts and convenient service. In China, NAPA outsources part of its automotive component needs through an office in Shenzhen, which is also responsible for quality control and logistics management. Is this office in Shenzhen an independent distributor, a JV, or wholly owned by NAPA? At present, NAPA has yet to establish an auto parts store in China.

2.2 The Automotive Aftermarket in China

The automotive aftermarket industry in China has grown rapidly together with the economic growth in China over the past 20 years. It is estimated that the value of this industry will reach US$30 billion in 2011, representing 11.61% of the global market value and 34.28% of the Asian market value, which will be the second largest market in the world, behind only the US market (Philip Parker & Eli Chaired, 2005).

Based on the Ministry of Chinese Public Security report from March 2009, there are 66,898,004 automobiles in China, 65.51% of which are private motor cars. The second largest group includes tricars and low speed trucks, which make up 20.24% of the total. The total quantity of registered automobiles increased by 3.44% in 2008. Although the quantity of cars is increasing, the average quantity per 1000 persons is still lower than that in many countries. Currently, there are only 30 cars per 1000 persons in China, much less than in developed countries, where the average quantity per 1000 persons is about 600 cars (The Ministry of Chinese Public Security, 2009). Figure 2-1 depicts the position of the automotive aftermarket industry lifecycle within China.

Figure 2-1: Position of the Automotive Aftermarket Industry Lifecycle in China



In a mature automotive market, auto sales lead to 20% of profit totals, another 20% comes from auto parts sales, and 60% is generated by providing services. In China, the aftermarket services profit amount reaches 40%, much higher than that in mature markets like the United States. (China Scholars, 2008).Obviously, there are significant business opportunities in the Chinese automotive aftermarket industry.

Worldwide, automaker profits have declined since 2000; GM announced bankruptcy, Ford has faced negative profits in recent years. However, big auto part chain stores such as NAPA and AutoZone have both experienced good financial performance even during the recession. In 2008, diluted earnings per share of GPC (NAPA) were US$2.92 (Genuine Parts Company, 2008). The US automotive aftermarket as a mature market provides signals for what might happen in the Chinese market.

China has exported large quantity of auto parts to US since 2000 (please see table 2-1). This table shows the automotive trade between US and China from 2000 to 2005. An conclusion can be easily drawn that there are enough domestic auto parts suppliers to enlarge NAPA's existing supply chain in China.,

Table 2-1: Automotive Trade between the US and China from 2002 to 2005

Auto Part Types (US Imports from China)	2002 USD in millions	2003 USD in millions	2004 USD in millions	2005 USD in millions
Auto Body Parts	272	365	456	612
Chassis/Drive Train Parts	602	778	1089	1609
Electrical/Electronic Parts	688	770	1044	1302
Engines and Parts	78	97	134	197
Miscellaneous Auto Parts	260	315	514	630
Total Auto Parts	2196	2704	3798	5309

Source: Stephen Cooney, 2006

3. External Analysis

The following chapter will analyze the external conditions for NAPA project in China including five forces analysis, key success factors analysis and SWOT analysis.

3.1 Five Forces Analysis

In practice, there are many features of an industry that determine the intensity of competition and the level of profitability. A helpful, widely used industry analysis framework for classifying and analyzing these factors was developed by Michael Porter of Havard Business School. Porter's five forces of competition framework views the profitability of an industry (as indicated by its rate of return on capital relative to its cost of capital) as determined by five sources of competitive pressure. These five forces include three forces of "horizontal" competition: competition from substitutes, competition from entrants, competition from established rivals; and two sources of "vertical" competition: the power of suppliers and power of buyers. The purpose of 5F industry analysis is to determine the sources of competitive advantage in an industry (often called key success factors of KSF) (Robert, 2008, p71).

Following is the analysis on these five forces in automotive aftermarket industry.

3.1.1 Competition from Substitutes

Start each 5F section by defining the nature of the F according to Porter, and then stating the strength of the F in this industry in China In the Chinese automotive aftermarket industry, there are 4 types of business models: large-scale auto parts chains,

auto parts malls, auto 4S stores (which refer to stores that integrate auto sales, spare parts sales, provide certain services and conduct customer survey together), and small scale repair shops. According to an investigative report on China's auto parts industry, sales at 4S stores and auto parts malls in China represent 75% of total auto parts sales at present (Hu Xiong, March 6th, 2009). In the next five years, sales at large chain shops will increase by 50%, while sales revenues at 4S stores and auto parts malls will decrease by 35%. The intrinsic characteristic of 4S stores is that they "only sell one brand of automobiles and service parts, and only provide service for that particular brand. 4S stores are the strongest model in Japan. In Europe, prior to the 1980s, 4S stores represented the majority of business revenues in the automotive aftermarket industry; however, since 4S stores focus on one automobile brand and related service parts, it has become difficult for them to survive in comparison with their competitors. In the 1990s, auto parts stores replaced 4S stores in terms of popularity by providing different brands of auto parts as well as all-around services for different brands. In the US automotive aftermarket, 4S stores only make up 20% of business revenues.(Hu Xiong, March 6th, 2009)

Normally in China, if you buy a new car from a 4S store, the shop will guarantee free maintenance and parts replacement up to 60000 km. After that warranty period, most consumers move away from 4S stores due to the high service and auto parts prices, and turn to repair shops. However, many repair shops use counterfeit replacement parts to cheat customers. In China there are no explicit regulations pertaining to repair shop business activities.

The price and quality gap between 4S stores and repair shops represents an opportunity for large auto parts chains like NAPA. The price customers are willing to pay for a product depends, in part, on the availability of substitute products (Robert, 2008, p72). In China's automotive aftermarket industry, substitutes for NAPA are discussed below. First, other large international companies plan to open similar chains, such as ACDelco and Bosch. Second, 4S stores provide good quality auto parts at higher prices; this option does not represent any price advantage for consumers. Third, small auto repair stores provide low-priced auto parts, but they are typically low quality. The situation in auto malls is similar: low priced auto parts of poor quality; moreover, auto malls do not provide repair or maintenance services. Therefore, it is easy to see that each of the substitutes suffers from a disadvantage in terms of limited inventory, equipment or related accessories.

In China, there are some auto parts malls, like China Northern Auto Parts Mall located in Changchun, and Changsha Nancheng Auto Parts Mall, located in Changsha. Auto parts malls do not provide repair or maintenance service.

At present, 4S stores retain a large part of the sales revenue in the automotive aftermarket industry. The quality of parts provided by 4S stores is normally quite high since all the parts are from OEM suppliers. However, their prices are too high, and car owners need to wait for a long time for replacement auto parts if foreign OEM suppliers produce them. After a two year guaranteed maintenance period, car owners need to pay high prices for maintenance and repair services, so they gradually move to the renowned chains.

Table 3-1 illustrates the differences between NAPA and three other auto parts sellers with regard to variety of inventory, price, quality and service.

Table 3-1: Differences between Various Aftermarket Automobile Industry Business Models

	Auto Parts Mall	**Auto 4S Stores**	**Repair Shops**	**NAPA**
Auto parts inventory	Different but limited auto parts for different automobile brands.	Only auto parts for one brand.	Various limited auto parts for different automobile brands.	380000 kinds of parts.
Price	Price is lower but may exceed a lot than the real price.	2 to 3 times more expensive than market price	Slightly higher than market price.	Large volume purchasing leads to good quality at a low price.
Quality	Most parts are from small factories that lack quality assurance.	Most auto parts are good quality OEM parts.	Most parts are from small factories that lack quality assurance.	NAPA has a robust quality assurance system.
Service	No maintenance or repair functions.	Provide maintenance and repair services for one automobile brand.	Provide simple maintenance and repair services for different brands.	Provide professional repair and maintenance services for different car brands.

NAPA's advantages in terms of various types of high quality auto parts at good prices could help it to gain a foothold in the Chinese market. Therefore, the threat of substitutes for NAPA is moderate..

Based on the above analysis, we can get the following key success factors for NAPA project in China: Competitive price, good quality, various inventory and reliable services, convenient locations.

3.1.2 Entry Threats

In the Chinese automotive aftermarket industry, the entry threats are low according to the following analysis.

3.1.2.1 Capital requirements

Massive capital requirements are a major barrier for new entrants. Establishing large-scale maintenance and repair chain stores holding a large spare part inventory requires significant capital, which discourages most investors. In China, only several carmakers or large tier one OEM suppliers have capital resources similar to NAPA. Therefore, at the same competition level, the number of potential new competitors is limited. However, for independent small stores, the cost of capital is low.

3.1.2.2 Economies of Scale

This is a high barrier to entry for most companies, which plays to NAPA's advantage. If new entrants want to get low cost auto parts, they need to buy large quantities from the same supplier. If new entrants only open a few stores, their buying power will decrease. They will not be able to get low cost auto parts from suppliers. In addition, if new entrants want to provide high quality maintenance and repair services, they will have to invest in a lot of equipment; without enough customers, the daily depreciation cost will exceed their profit. Only when enough customers are willing to buy large quantities of auto parts from them can stores expect to break even.

3.1.2.3 Absolute Cost Advantage

NAPA has a cost advantage over new arrivals in this industry, since they have already established their supply chain in China. Each year, large quantities of these auto

parts are shipped out to North America. Based on the Genuine Parts Company Global Sourcing Office statistical data, NAPA outsourced around US$36 million in parts in 2008, and has business relations with hundreds of suppliers in China (Genuine Parts Global Sourcing Office Business Recap for 2008). NAPA's cost advantage is supported by the total amounts purchased from their suppliers.

3.1.2.4 Product Differentiation

The product differentiation for NAPA advantage is not so obvious since all these companies sell the same auto parts for various types of cars. Nevertheless, NAPA can build on their established product differentiation. In North America, NAPA is famous for its 380,000 kinds of auto parts, and this represents one differentiation advantage. In China, NAPA can introduce environmentally friendly auto parts, such as hybrid alternators with low energy consumption, which can help NAPA further build-up their product differentiation.

3.1.2.5 Access to Channels of Distribution

Effective access to distribution channels represents a high barrier for auto parts stores, as they require extended periods to win customer recognition and loyalty. As NAPA is well known in China's automotive aftermarket, it should be easy for NAPA to win customers' trust. However, it will still take time for NAPA to build robust domestic distribution channels.

Current GPC Global Sourcing Office which is located in China Shenzhen, the management team have extensive cross culture management experiences. Some of them started to do business and travel to China since early 90s'. Since 2006, they have

formally worked in China and set up this new office in Shenzhen. The management team have good knowledge of the Chinese culture and have strong capabilities to adapt to the environment. This is one strength for NAPA to enter this new market.

3.1.2.6 Governmental and Legal Barriers

Economists from the Chicago School claim that the only effective barriers to entry are those created by government (Robert, 2008, P75). Fortunately, in China, there are no obvious governmental or legal barriers in the automotive aftermarket industry. The Chinese government only issue three kinds of certificates that guarantee the qualifications of different repair shops. The first level of certificate allows repair stores to provide all kinds of auto repair and maintenance. Shops with the second and third level certificates can only provide simple, low-end repair services.

In August 2005, the Ministry of Commerce in China issued *the Automobile Trade Policy* (2005), which encourages strong and experienced international companies to invest in China's automotive industry, including the aftermarket industry.

3.1.2.7 Retaliation

Expected retaliation against new entrants from incumbent companies in China's automotive aftermarket industry will be lower prices and more promotions. For NAPA, cost advantages and product differentiation are the two key factors that should negate these types of retaliation.

3.1.2.8 The Effectiveness of Barriers to Entry

Based on the above analysis, a large capital requirement and brand recognition represent effective barriers to new entrants in the automotive aftermarket in China.

Though many companies can open several small-sized auto parts and repair stores, it is difficult for them to build large-scale chain stores like NAPA. This is partly due to their shortage of financial resources, and partly due to their lack of a large supplier chain. Therefore, while many different auto parts chain stores exist in China, they remain small-scale and only cover one or two major cities.

According to the above analysis, we also get some key success factors for NAPA China project listed below as: capital resources, cost advantages, product differentiation, extensive distribution channels.

3.1.3 Rivalry between Established Competitors

Define rivalry and give strength Competitive characteristics in China include a vast pool of competitors with different backgrounds and a low degree of concentration. In Shanghai, there are 6,538 auto-repair stores, most of which are small, independent auto parts stores. Other channels that distribute auto parts and offer repair and maintenance services include auto parts malls, 4S stores, and branded chained stores or distribution channels built by OEM suppliers like Bosch. According to following analysis, we can see the competition among the existing competitors is fierce. All competitors can be grouped into one of two types: existing competitors and potential competitors.

Existing competitors can be classified into three major competitors:

a. Branded auto parts chains.

b. Small-size private auto parts stores.

c. Fake NAPA stores in Shanghai and Beijing.

Yellow Hat, founded in 1961, is a Japanese company listed in Tokyo stock market (stock code: 9882). They are an experienced auto parts chain and one of NAPA's existing competitors in China. Yellow Hat has a similar business model to NAPA, and their 2008 yearly revenue reached US$1.14billion. Yellow Hat entered the Chinese automotive market in October 2003. There are currently 479 Yellow Hat stores in Japan, 13 stores in China, 1 store in the United Arab Emirates and 4 distribution centres in Japan. Yellow Hat started with company owned stores, and then began franchising. They built one joint venture enterprise with Shanghai Automotive Industry Group and the other joint venture enterprise with local companies in Beijing. These two joint venture companies in turn established four stores in Shanghai and one store in Beijing, while eight other stores are located in Northern China. Store locations are mainly in downtown areas, and target customers are passenger car owners. On their website, we can see that compared with small-scale independent auto parts stores, Yellow Hat has a formal menu detailing the repair and maintenance services they offer. In total, there are nine types of auto parts and accessories provided, and all of them are low risk products like tires, maintenance oil, videos, and decorative parts. Their strategy is to provide quick and reliable repairs and maintenance service. They are planning to offer online shopping soon – we can see that they have a link on their web site that is currently empty (Yellow Hat, n.d.).

Similar to Yellow Hat, ACDelco is another strong competitor, and perhaps even stronger than Yellow Hat. ACDelco offers more than 100,000 parts across 37 product lines in North America, has nearly 100 years of experience the in automotive industry and is a brand of General Motors Service and Parts Operations, which in turn is a division of General Motors. ACDelco employs a two- or three-tiered distribution model, utilizing

a network of appointed wholesale distributors to service independent installers, ACDelco service centres, retail and fleet customers. ACDelco has already built more than 200 auto parts stores with repair and maintenance functions in China; these stores are located in 95 main cities including six stores in Beijing and four stores in Shanghai. In terms of the product information they list on their website, ACDelco provides more functional products than Yellow Hat, like brake pads, ignition system, starters, alternators, clutches, and switches, among others. ACDelco in China provides 21 different types of auto parts. It is easy to find ACDelco auto parts stores for consumers at their conveniences (ACDelco, n.d.). ACDelco's advantage is obvious; since they are a subsidiary of GM, they can buy quality auto parts from OEM suppliers at low prices, as GM has already built a large supply chain in China and purchases large quantities of auto parts for their own brand. Still, ACDelco does not promise that their products are all from OEM suppliers; they buy a large quantity of auto parts from OEM or non-OEM suppliers. Also, ACDelco does not provide online shopping. That said, ACDelco is currently one of the strongest competitors for NAPA in China's automotive aftermarket.

The famous auto part OEM supplier Bosch founded the Bosch Trading Company (Shanghai) in 1998. At present, they have 332 Bosch Car Service (BCS) locations in China covering all major cities, among which there are 61 BCS locations in Guangdong province, 25 BCS locations in Shanghai and 38 BCS locations in Beijing. All these locations are franchised stores that provide diagnosis, maintenance and repair services. Bosch manages these franchised stores by grouping them into three types: large scale BCS locations with investment of at least RMB1,100,000 have both a car diagnosis department and a repair department. Medium scale stores with investment of at least

RMB480,000 have two identical departments with similar functions as large scale BCS locations. The third is the small scale BCS locations with investment of merely RMB160,000. Bosch promises that they only sell branded parts, and stresses that their locations can provide all-round car diagnosis and repair services to customers on all types of cars. Bosch Trading Company (Shanghai) has another differentiation strategy in terms of their specific service and service parts for diesel motor vehicles. At present, they have 135 BCS locations for diesel motor vehicles covering most cities in China. On May 2nd, 2009, they built their first auto parts store for diesel motor vehicles in Tianjin. Bosch promises to provide professional training, technological information and marketing support to all its franchised BCS locations (Bosch Trading Shanghai, n.d.). The disadvantage for Bosch's business model is that it is difficult to control the purchasing sources for each BCS location and to guarantee that all the products sold by BCS locations are genuine; if these originally small private stores cannot provide reliable auto parts or servicing, Bosch's reputation and customer loyalty will both be affected negatively. The benefits of this strategy are that expansion is very speedy and does not rely on too much investment from Bosch.

Two other chain stores in Shanghai and Beijing deserve mention: NAPA Shanghai and NAPA Beijing. they are not authorized NAPA dealers, and in fact have different Chinese names, which use the Chinese pronunciation for NAPA: Lanba Shanghai and Lanba Beijing. The so-called Shanghai NAPA has three stores in the Shanghai area. They currently provide even less auto parts than Yellow Hat, their services listed on their website are vague, and they do not offer online shopping as of yet. The so-called Beijing NAPA does not have a website, but in interviews with other

websites, they said their inventory system is connected with NAPA's inventory system in the US. They have 11 stores in the Beijing area. Compared with Yellow Hat, those fake NAPA stores are weak competitors. While are still small in scale, they damage NAPA's reputation and mislead consumers.

In China, there are many small-scale auto parts stores. Most of these stores sell low quality auto parts. They do not have a clear price list for auto parts or services. These small auto parts stores struggling with fierce competition for survival, and only focus on short-term profit. Mostly, they buy the cheapest and poorest quality auto parts, and then sell those parts to consumers at high prices. Their reputation affects customer loyalty, such that these small-scale stores are even weaker than the fake NAPA stores in terms of competition.

Although each of these alternatives appeal to different types of consumers, companies cannot afford to focus on low quality products and services, as consumers are beginning to seek first-class solutions at competitive prices from one company. This represents a niche market for NAPA. With their existing large purchasing volumes, NAPA can purchase high quality parts at low prices from their suppliers. NAPA's famous brand and good reputation can gain customer loyalty in a short time.

Potential competitors include those who have similar resources as NAPA, like AutoZone, Guangzhou Automotive Industry Group or Shanghai Automotive Industry Group.

NAPA's strongest competitor in the US is AutoZone. While AutoZone has not set up an office in China yet and do not have their own local sourcing or quality team, they do business with Chinese auto parts producers via a trading company. Therefore, while

they remain a potential competitor for NAPA in China, AutoZone cannot currently compete against NAPA in terms of internal organization resources in the Chinese market.

In the local auto parts market, there are strong competitors such as Shanghai Automobile Industry Group (SAIG) and Guangzhou Automobile Industry Group (GAIG). SAIG has built a strong domestic supply chain that can provide high quality auto parts for all GM and Volkswagen brands, including 15 GM car brands and 6 Volkswagen car brands in total (Shanghai Automotive Industry Group, n.d.). If they want to compete with NAPA in China according to the same business model, their advantage lies in their strong capital resources and R&D strength. However, their cost advantages are limited to those auto parts produced by their OEM suppliers. They do not have experience in operating large-scale chain shops, although SAIG has already built one small-scale joint venture chain stores with Shell China.

The other potential competitor, GAIG, is similar to SAIG in terms of their large amount of capital, existing supply chain, and good reputation. In addition, GAIG has built joint ventures with famous Japanese companies such as Honda, Toyota and Nissan since the 1990s; they have price advantages for auto parts from those brands. However, for auto parts from other brands, they cannot compete with NAPA on price, because they do not have direct suppliers and need to outsource from scratch. Further, both SAIG and GAIG lack experience in terms of running an auto parts chain.

In China's automotive aftermarket industry, NAPA will have to face competitors like local small-scale chain stores, small independent auto parts and repair stores, 4S stores and auto parts malls. All of them have more experience in the Chinese automotive

aftermarket industry than NAPA. Figure 3-1 shows the potential opportunity for NAPA in the Chinese automotive aftermarket.

Figure 3-1: NAPA's Potential Opportunity in the Chinese Automotive Aftermarket

3.1.3.1 Concentration

Now in China, most auto parts stores are small scale, such that none of them can dominate the market. The whole market is in the early stage. While some companies do have the vision to expand their business countrywide, few of them have enough resources and the capability to achieve this target. As the market is large, even small stores can dig out their profit too. Also, there are no regulations in terms of qualifications or the price of auto parts or services, so high profits are common within the aftermarket industry.

3.1.3.2 Diversity of Competitors

The competition is fierce due to diversity. Some competitors actually belong to big companies, like the joint venture between Shanghai Automotive Industry Group and Shell China; some of them are from strong international chain stores like Yellow Hat.

Other indigenous companies are competitive too, as their local experience helps them to expand their distribution channels. The target customers for these various competitors are essentially the same – private car owners and business van owners.

3.1.3.3 Product Differentiation

There are no obvious product differentiations. Every company sells auto parts and/or provides repair and maintenance services. Basic differences between stores pertain to price and quality. Consumers perceive 4S store products as high quality at a high price. In terms of smaller stores, consumers cannot trust their quality even though the price is lower. Therefore, compared with its competitors, NAPA has quality and cost advantages. Further, NAPA can stress another differentiation advantage by selling environmentally friendly parts or low energy consumption products like hybrid generators. The main differentiation strategy for NAPA is to enhance their variety of inventory and provide convenient online shopping.

3.1.3.4 Excess Capacity and Exit Barriers

China's automotive aftermarket is large. The demand exceeds the supply in the current market, and the exit cost is high for chain stores. Building large-scale chains requires capital investments in hardware and software. However, for small-scale independent auto parts shops, the exit cost is low. For example, the original investment for a small auto parts store that provides maintenance and repairs is only US$150,000 or even lower. Therefore, there are many independent small stores in China, and fewer large-scale chains.

3.1.3.5 Cost Conditions

If a company wants to compete in the automotive aftermarket, and provide good quality products at a low price, they have no choice but to expand their distribution channels. Large-scale expansion is the only solution for automotive chain stores.

Variable costs are those cost that vary with changes in business activity. Variable costs in this industry mainly refer to the cost of the auto parts. Meanwhile, fixed costs are those costs that do not change even when the business activity volume changes. The main fixed cost for chain stores concerns the depreciation of equipment or property rent costs. When the business activity volume reaches a certain amount, fixed costs can be variable costs, too.

For auto part chains, the fixed costs are not too high compared with the variable cost if they sell enough auto parts and provide repair services to a certain amount of customers. However, if they do not reach a certain amount of revenues, their fixed costs will be higher than their variable costs, which will erode their profits.

In sum, the competition in China's automotive aftermarket is white hot. The easy barriers to entry encourage many new entrants, and the low product differentiation leads to price battles. Still, those who entered this market early will win the most profits.

We can get the key success factors according to the above analysis list as: on line shopping, good quality and competitive prices.

3.1.4 Bargaining Power of Suppliers

Based on Porter's 5forces theory, suppliers' power is one source of competition in determining the enterprise's failure or success in the industry. NAPA has purchased its

auto parts directly from Chinese domestic manufacturers since the 1990s. Running chain stores in the US for more than 80 years, NAPA has built a robust supply chain with more than 100 Chinese auto part manufactures. Most of the suppliers are centrally located in southeast China. The existing NAPA supply chain can enhance their power. The bargaining power of suppliers is relatively low as the large number of suppliers of identical products leads to low switching costs for NAPA.

For example, Gold Phoenix is one of NAPA's largest suppliers, and has done business with NAPA for over 12 years. Its annual revenue is about RMB 0.4 billion, which is profitable compared to other manufactures within the same industry. Because one third of Gold Phoenix's yearly revenue comes from NAPA, Gold Phoenix's sales rely heavily on NAPA's business; yet for NAPA, it is easy to find similar suppliers such as Xinyi Group in Shandong, which provides the same level of products. If any supplier tries to raise its price, NAPA can simply turn to another manufacturer without incurring a high switching cost.

Three types of buyers could potentially purchase auto parts from NAPA: repair shops, auto parts malls and car owners. Both repair shops and auto parts malls are NAPA's competitors as well as potential buyers, as NAPA is not only involved in retail business, but also in wholesale segmentation. The bargaining power of the above three buyers mainly derives from their low switching costs when they turn to other auto parts sellers. Their bargaining power is high since their switching costs are lower.

In terms of the above analysis, we can draw the conclusion that NAPA currently has many advantages in the Chinese automotive aftermarket. Gradually, as competitors grow stronger, NAPA's advantages will not be so obvious. Now is still a good time for

NAPA to enter this market. We can work out the key success factors based on the above analysis which are competitive price, extensive distribution channels.

3.1.5 Bargaining Power of Buyers

Bargaining power of buyer is another source of vertical competition addressed in Porter's five forces theory which will determine practitioners' competition power in the market like power of suppliers also. In both markets, the transactions create value for both buyers and sellers. How this value is shared between them in terms of profitability depends on their relative economic power. The strength of buying power that firms face from their customers depends on two sets of factors: buyers' price sensitivity and relative bargaining power (Robert, 2008, P78).

Costs of auto parts are pivotal to auto parts stores' profitability. The differentiation among the auto parts is minor. Therefore, the buyers' price sensitivity is high. NAPA, as an experienced buyer in China's automotive industry, has abundant information resources about suppliers, prices and costs; at the same time, NAPA's large quantity purchases within China enhance its buyer power. According the above analysis, we can get the following key success factor for NAPA project in China which are experienced sourcing team in China.

3.1.6 Summary of Five Forces Analysis

Based on the above analysis, we can see that in China's automotive aftermarket, the bargaining power of suppliers is low, the threat of substitutes is medium, the bargaining power of buyers is high, the threat of entrants is low and the rivalry among existing firms is medium. As China's automotive aftermarket is still more profitable and

therefore attractive than that of the US or other mature markets, choosing to enter this market now could be a wise decision for NAPA. The result of the five forces analysis is depicted in Figure 3-2.

Figure 3-2: Five Forces Analysis of China's Automotive Aftermarket.

3.2 Key Success Factor Analysis

Below is a key success factors analysis stemming from customer needs and company survival premises within the industry. In China's automotive aftermarket, customers look for low prices, high quality, and diversified auto parts for various types of cars. Customers also seek professional and reliable repair and maintenance services in convenient locations. To satisfy customer demands and survive the competition, firms have to reduce costs, control the quality of the auto parts and service, build a compatible

inventory of various auto parts and choose a convenient location. It is easy to draw key success factors for NAPA or other similar competitors who want to compete in this market.

Table 3-2: Key Success Factor Analysis

	What Do Customers Want?	How Do Firms Survive Competition?	Key Success Factor
China Automotive Aftermarket Industry	Competitive price	Cost efficiency	Build a win-win relationship with suppliers (Derived from 3.1.1)
	High quality	Good reputation for quality	(which will help to purchase auto parts in low prices) “
	Diversified auto parts for different cars	A wide range of products to satisfy different demands	Online shopping can reduce distribution costs “(Derived from 3.1.3)
			Purchase most auto parts from qualified plants (ISO/TS16949) to assure product quality “(Derived from 3.1.1)
	Reliable repair and maintenance service	Customers can easily get the services and products at their convenience	Expand the current supply chain to cover the market needs and build the matched inventory and build a experienced sourcing team in China.“ (Derived from 3.1.5)
	Convenient location		Choose locations close to towns where there are not too many traffic jams “(Derived from 3.1.1)

3.3 SWOT Analysis

A **SWOT analysis** is a strategic planning method used to evaluate the **S**trengths, **W**eaknesses, **O**pportunities, and **T**hreats involved in a project or a business venture. It involves specifying the objective of the business venture or project and identifying the

internal and external factors that are favorable and unfavorable to achieving that objective. The technique is credited to Albert Humphrey, who led a convention at Stanford University in the 1960s and 1970s using data from Fortune 500 companies. Table 3-3 depicts a SWOT analysis for NAPA's project in China.

Table 3-3: SWOT Analysis of NAPA in China

Strengths	**Weaknesses**
1. Good reputation in industry. 2. Already have an existing supply chain in China. Wholly owned or distributor? 3. Have experience building large distribution systems and stores. 4. Experience in building online shopping system in the US.	1. No sales experience in the Chinese automotive aftermarket. Do they have personnel with experience to open wholly owned stores? Or relationships suitable for JV? 2. Lack of flexibility compared with small stores. 3. High operation cost compared with small stores.
Opportunities	**Threats**
1. The huge demand in the Chinese automotive aftermarket. 2. Currently in China, no chain stores or other auto parts stores provide online shopping. 3. Existing competitors are not so strong.	1. No regulations in the current Chinese automotive aftermarket. 2. Fake products and stores may deteriorate the reputation. 3. Special customer preferences in China. 4. Global economic downturn, especially in the US, has affected the internal resources of NAPA.

3.3.1 Strengths

The NAPA brand is widely recognized for quality parts and quality services by North American consumers and professional technicians. Its competitive advantages in

terms of quality and service are built on strict quality control procedures and inventory management technologies. NAPA established its first purchasing office in Shenzhen in 2007. More than 20 years of industry experience in China has also resulted in solid supplier networks with more than 100 domestic automotive parts manufacturers.

A good industry reputation can help NAPA win customer loyalty even though they must build their distribution channels from scratch. The existing supply chains in China can enhance their buying power, as NAPA already buys a large quantity of auto parts in China. In addition, NAPA's suppliers have proven to be good quality suppliers in the North American automotive market. NAPA has a strict quality control system based on the highest quality system standard, TS 16949, which sharpens its price advantage and urges consumers to choose NAPA over its competitors. In the US, NAPA expanded its distribution base in 2008 to over 518 locations consisting of 472 branches, 10 distribution centres and 36 service centres throughout the U.S. and Canada. Through this extensive operating network, NAPA customers have access to over three million quality parts sourced from a global manufacturing base. NAPA has rich experience in building distribution centres and stores in the US, so they can likely copy their experiences or at least part of the experiences in the Chinese market. The strong distribution network also enables NAPA to "Deliver the Difference" to its customers. For NAPA stores in China, NAPA China will emulate NAPA's distribution model and establish distribution centres in China so that the distribution advantage can be transferred to the Chinese market. NAPA has a good computer network system to manage their inventory and daily operations, which will be used in China as well. In the US, NAPA's system supports

online shopping, while in China, no stores can provide this feature; this could result in a differentiation advantage that significantly decreases distribution costs and fixed costs.

3.3.2 Weaknesses

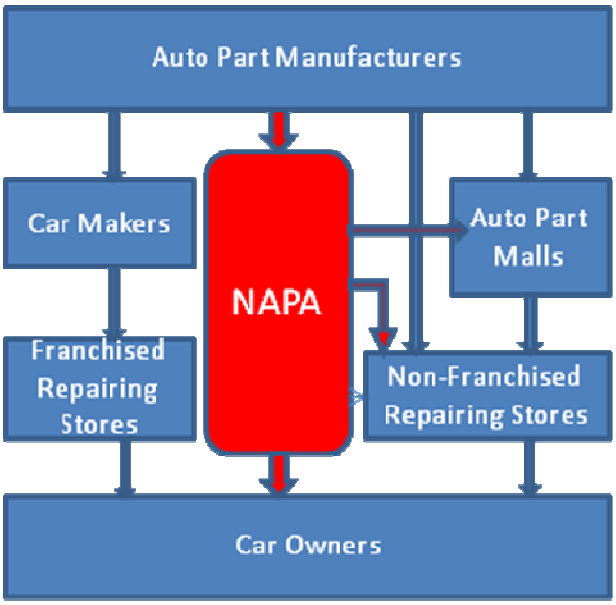
In the US automotive aftermarket, NAPA is experienced, while in China, NAPA is still a novice. The Chinese market is quite different from a mature market like the US market. In mature markets, there are explicit regulations to guide competition. Brand recognition is high and consumers focus more on quality instead of price. Compared with the small stores or small-scale local chain stores, NAPA is less flexible; to source a new part for NAPA, several levels of managers need to approve the request, which slows down the reaction to the market change. Moreover, as an international company, the total operational costs are higher than those of indigenous companies.

3.3.3 Opportunities

The Chinese automotive aftermarket has been booming in recent years, especially with the increase sales in low emission family sedans. As long as the market remains in the developing stage, there are more chances for greater profits. Opportunities will diminish, however, when the market becomes mature.. The schematic picture below shows that NAPA has a big potential market share in the Chinese automotive aftermarket industry. NAPA can directly sell auto parts and provide professional service to end users, and at the same time can serve as a wholesaler to other car repair stores or auto parts malls, as NAPA's brand recognition and good quality control will entice customers for those stores or auto parts traders. In March 2009, the Chinese government issued an automotive industry stimulus plan, encouraging families to purchase new cars with

emissions equal to or lower than 1.6L by reducing the tax by 5% and promising to maintain sustainable development in this industry. Under this stimulus plan, in June 2009, a total of 1,142,100 vehicles were sold in China, which was a 2% increase compared to May 2009. In fact, automakers in China have sold more than one million vehicles for four continuous months (China Association of Automobile Manufacturers, 2009).

Figure 3-3: NAPA's Position in the Chinese Automotive Aftermarket Industry



3.3.4 Threats

The Chinese market is quite different from mature markets like the US market. In mature markets, there are explicit regulations to guide competition. Brand recognition is high and consumers focus more on quality than price. In China, there are many small-sized stores trying to make short-term profits by ignoring the quality of their products and services. Due to the lack of regulations, the market is full of private stores that lack qualified workers, professional equipment, and guarantees for their products and services. As there is no price standard in the market, the price discrepancy between identical

products and services is sometimes very large. These facets have made consumers lose trust in these stores. To compete against these types of stores, NAPA needs to solve many problems pertaining to fake products, lawsuits or acquisitions of the fake stores. Thus, NAPA needs time to learn more about special business culture in China, and to build relationships with the local government. In China, car owners are not used to repairing their cars by themselves: even wiper blade replacements are commonly done in a store. These types of customer preferences show that the customer distribution map is quite different from that of the US market; the ratio of Do-It-Yourself customers is definitely lower than in the US. While the economic downturn has influenced the Chinese economic, the impact does not seem to be as large as in the US. Still, there is some uncertainty in terms of consumer demand.

4. Internal Analysis

Any successful business model are closely depending on the internal resources in addition to external opportunities. In following chapter, the author will analyze NAPA's internal resources, organization characteristic and management preference.

4.1 Resources

NAPA has abundant technology, an established supplier chain and other related resources to operate a new business in China. NAPA has been in the automotive industry for over 80 years. Therefore, it has access to professionals with rich expertise and experience in distribution management, logistics management, supplier chain management, and auto part product quality management in the US.

NAPA is known for their Unmatched Parts Availability system in North America, which is dedicated to having the parts the customer needs, when they need them. To prove it, NAPA built Marketplace Inventory Classification (MIC) which won the Polk Inventory Efficiency Award. The MIC system can analyze each store's inventory and tailor it to each shop's market; compare each shop's inventory with current vehicle registration and sales trends to determine which parts will move fastest in the area; and help ensure that each shop never loses money on the parts that don't sell. Through MIC, each store can return obsolete, slow-moving, or overstocked parts for 100 percent of their current value. TASM II, the store operating system for retail stores and NAPA TRACS, a shop management system for wholesaling, are both high technology programs that support NAPA in North America (Napa, n.d.).

All these NAPA US resources can provide strong support to any new business in China.

4.2 Organization

The management team of GPC has strong leadership. During the current recession, GPC has initiated many efficient actions to improve warehouse productivity, improve customer service, reduce supply chain costs and grow sales revenue. The effectiveness of these actions is validated by the stable share price from 2008 to the present.

4.3 Management Preferences

To develop a new business in China, NAPA needs internal initiatives from the organization. As a traditional American company, should Genuine Parts Company (GPC) begin this new adventure and dive into this emerging market during a recession? Obviously, this choice presents the management team with a dilemma. The GPC Atlanta management team is very cautious when making business decisions. Since most members of the team have served this company for more than ten years, the Atlanta management team tends to be conservative. Although some members have been to China many times, are already very familiar with the Chinese automotive aftermarket and recognize a huge opportunity in the Chinese market, the author think they still hesitate to push forward due to the different customer preferences, the special characteristics of the Chinese market, the lack of human resources and the risk of an uncertain investment return. Therefore, a low asset strategy is recommended, which focuses more on online shopping, establishing a distribution network and quality control.

5. Recommended Strategies

This chapter will introduce the recommended strategies based on the above analysis for NAPA project in China.

5.1 Timing to enter the market

China's automotive aftermarket industry lags behind mature markets by almost 40 years, and therefore a great potential opportunity exists in this developing market. In order to stimulate the internal demand, the Chinese government invested a lot of money in the auto industry in 2008 as North America was facing an economic downturn. By 2010, China will become the world's second-largest automotive market, only trailing the US market (China Aftermarket Industry Analysis, 2008).

Compared with the Chinese automotive aftermarket, the US automotive aftermarket is very mature. The definition of a mature market is one that has reached a state of equilibrium marked by the absence of significant growth or innovation (Investorwords, n.d.). The industry life cycle suggests that maturity has two principle implications for competitive advantage: first, it tends to reduce the number of opportunities for establishing competitive advantage; second, it shifts these opportunities from differentiation-based factors to cost-based factors (Robert, 2008, P321). It may be difficult for NAPA to find new exciting profit generators in the US automotive aftermarket especially during this recession: the GPC 2009 first quarter financial report showed that earnings per share decreased by 25% compared with the same period in 2008 (Genuine Parts Company, 2009). If GPC only focuses on cost reduction, newly generated

profits will be limited. GPC may have to innovate under the pressure of competition. The main innovation could consist of embracing new customer groups. One new customer group is ready and waiting in China. Based on the analysis of existing competitors in the Chinese automotive aftermarket provided in Chapter three, there are several strong international auto parts distributors like ACDelco, Bosch Trading Shanghai Company, and Yellow Hat that have already established their selling channels in most main cities. Therefore, even if NAPA now decides to enter the Chinese market, it will not be the first entrant. However, the existing quantity of competitors is still much lower than that in America. It is not too late for NAPA to enter this market, since the entire Chinese automotive industry is still in the preliminary stage, and needs time to develop.

In August 2005, the Chinese Ministry of Commerce issued *Automobile Trading Policy*. The fifth item in this policy states: To enhance the quality of automobile trading in China, the Chinese government encourages those offshore investors with strong capital, advanced management, business experiences and robust selling channels to invest in the domestic market. Also, the 24th item in this policy states: The Chinese government encourages business models like franchised or auto parts chains to facilitate the scaling, branding and networking of the automotive industry and encourages companies to integrate resources within the industry and increase the service level by a large scale of economies (Ministry of Commerce, 2005)

Obviously, the government of China wants experienced chains like NAPA to enter this industry and promote the quality and scale of the whole industry. It is a good time to take advantage of this policy. Similarly, twenty years ago the Chinese government opened the door and welcomed international companies to invest in China;

those who came earlier such as P&G have a dominant position in the Chinese market and the Chinese market is the second largest market of P&G now. (P&G China, 2008).The recent Chinese government policy is a signal to investors: now it is the time to enter this market.

5.2 Risk Management

A lucrative market does not mean zero risk. Other than market risks, NAPA must consider some specific issues related to China's automotive aftermarket. These issues are discussed in the following paragraphs.

5.2.1 Intellectual Property Issues

If NAPA auto parts are welcomed by the market, other local producers may embezzle NAPA's packages. To protect its reputation, NAPA can have the manufacturer engrave the NAPA logo and an exclusive serial number on the product's surface, so that consumers can check this product status online based on the serial number. In addition, the destination information for each part can be listed online, so that consumers can track and make sure the parts are originally from NAPA.

5.2.2 Strategy for NAPA Regarding Different Customer Preferences in China

DIY repair is not so prevalent in China, as people tend to have all types of maintenance done at stores. To prevent the loss of potential customers who do not want to repair their own cars, NAPA stores can sell auto parts and provide repair and maintenance services. Car owners will just need to bring their cars to the stores, and the NAPA stores can provide one stop service. At the same time, to make NAPA stores more

comfortable, each store should also provide a sitting room where customers can relax as their car is being repaired.

5.2.3 Strategy for NAPA to Compete in the non-regulated Chinese market

As an emerging market, China has many small-sized repair shops who earn profits by providing low prices and low quality auto parts. Actually, consumers recognize auto parts as high-risk products, and very few wish to take the risk associated with putting a defective auto part in his or her car. NAPA needs to continue to control their product quality and protect its reputation in China.

5.2.4 Light Asset Strategy to Avoid Losses during a Recession

Considering the current recession, NAPA can consider a light asset strategy in China: focus on web shopping and concentrate investment on building distribution centres and warehouses, as well as controlling the expansion of stores in the early stages. The online shopping system will be composed of both an online reservation system and an online purchasing system. People can reserve a repair time at home to ensure on time repair service at the store. Car owners, wholesalers or retailers can place orders online and NAPA will deliver the ordered auto parts to their places for free. NAPA will attract customers by offering high quality auto parts at lower prices, and at the same time provide immediate and convenient repair and delivery services to customers.

At present, no existing auto parts stores in China provide online shopping. If NAPA can begin in this area, online shopping will represent a specific differentiation advantage for NAPA.

5.3 Differentiation Advantage

To win a competition in the market, How to build the differentiation advantage and cost advantage are two main issues that enterprises need to raise. To fashion a solid differentiation advantage sometimes is even more pivotal in this more and more transparent market.

5.3.1 Customized Inventory for China's Automotive Market

NAPA is famous in the US for its inventory of 380,000 kinds of auto parts. But this is due to the many kinds of auto brands in North America; in China, auto makers started to produce cars only twenty years ago, so there are less automobile brands, and the required parts inventory is much smaller. Before building their inventory, NAPA should investigate the automotive market and collect information on:

a. The number of automobile brands in China

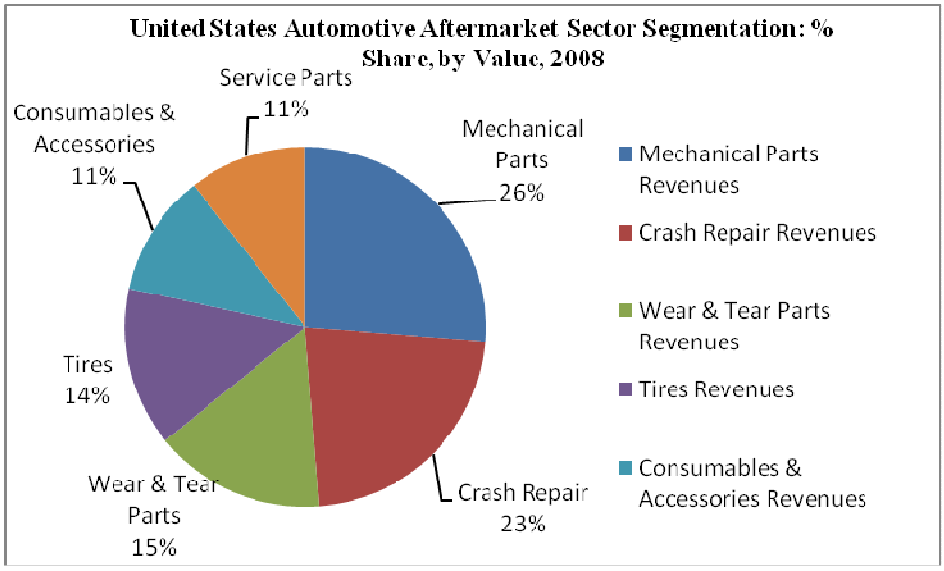
b. The most popular brands in China

c. Yearly consumption quantities for auto parts of different car brands and a sequence list of consumption quantities for the different auto parts of the various brands.

Based on the statistical data from the US automotive aftermarket, we can see Table 5-1.

Table 5-1: Share By Value for Different Sectors in the US Automotive Aftermarket

Category	**% Share (as of November 2008)**
Mechanical Part Revenues	26.30%
Crash Repair Revenues	22.50%
Wear & Tear Part Revenues	15.40%
Tire Revenues	14.30%
Consumable & Accessory Revenues	11.00%
Service Parts Revenues	10.60%
Total	100%



Source: Datamonitor, 2008

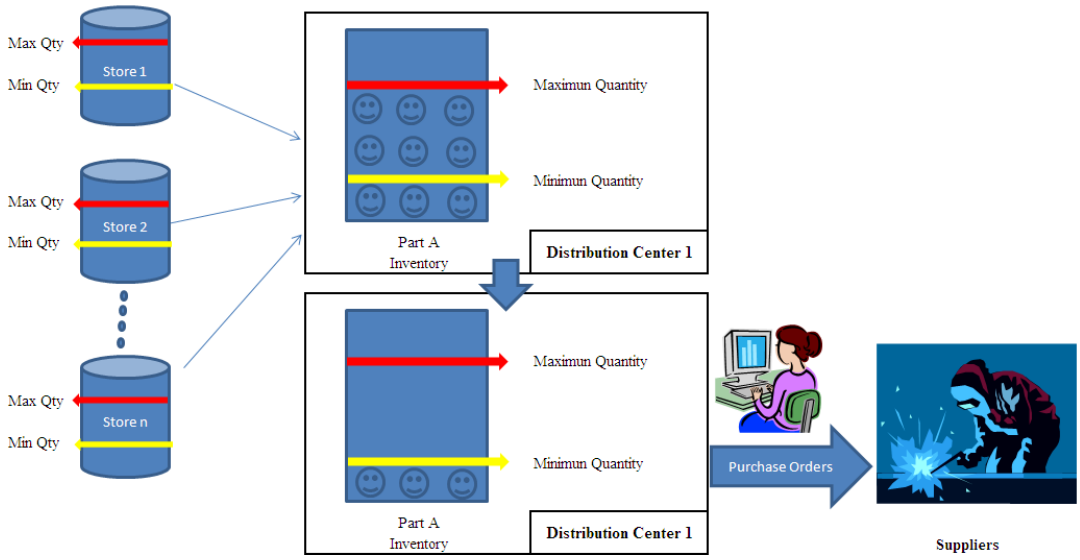
Based on the above data, in the US, mechanical parts make up most of the business revenue in the automotive aftermarket, while crash repair parts are second. This can be a reference for the Chinese automotive aftermarket. NAPA can make an investigation and determine which generates the most revenue among these categories. An even more detailed report for customer demand on a single auto part can be the priority list for NAPA to build its inventory which is applicable for Chinese market specifically.

5.3.2 Apply Pull System to Manage the Inventory

Because most auto parts are from domestic suppliers, NAPA can use this advantage to decrease the lot sizes for each type of auto part or accessory, and thereby maximize the inventory turnover rate and lower their working capital. Presently, NAPA's supply chain in China is mostly in Southern and Eastern China, and transportation time from these suppliers to major cities like Shanghai, Beijing and Guangzhou only requires two or three days by truck. Therefore, NAPA can forecast a detailed customer demand list for each store, as well as for each distribution centre. Based on these forecasts, the minimum and maximum quantity for each part in each store can be determined. When the inventory for one part is lower than the minimum, the nearest distribution centre will replenish it at once. The inventory for each part or accessory will not exceed the maximum quantity. In the distribution centres, inventory will be based on the historical consumption forecast for each store; for each individual part, the inventory quantity will be controlled within a minimum and maximum quantity. For example, if the store builds up a three-day inventory, the distribution centre will build up a one-week inventory, where three days or one week refer to the average number of days in terms of typical customer demand. All these figures will be based on precise calculations regarding the end user – car owners. Actually, this is the lean concept application of a supply chain; however, NAPA China can set a different inventory quantity for each part and eliminate any waste due to redundant inventory while still reacting to market changes. When the operators find that a part has exceeded the minimum, they will send an order to the supplier immediately. The best solution for NAPA is to migrate their original system used in the US to NAPA China. All inventory distribution in each store, as well as each distribution centre, will be controlled by this IT system.

Figure 5-1 is a schema to describe how the author recommends applying the pull system to manage the lean inventory and lean supply chain.

Figure 5-1: Pull System in the Distribution Process



An efficient and lean supply chain means the distributor can integrate the resources not only in supplier side but also in customer side. NAPA can show the inventory quantity for each part on line, the end customers can check the quantity and place an order on line. If their demand exceeds NAPA's current inventory (which is equal to current inventory minus minimum quantity), the system will have them in the waiting list and take two or three days to deliver to them otherwise the purchase order can be fulfilled at once. All the customers will be encouraged to use the on line shopping system to place their orders which can help NAPA to get the instant inventory information and have enough lead time to deliver the parts to customers.

5.3.3 Introduce High End Auto Parts to Enhance Differentiation Advantage

NAPA can introduce auto parts for high-end automobiles like Mercedes Benz and Lexus. Mercedes Benz only provides a two-year warranty for maintenance services, including parts replacement, at their 4S Stores. After two years, if customers want to buy a part from these 4S stores, they have to pay a high price and wait at least two weeks, even for parts produced by local suppliers. If the part must be imported, they have to wait even longer. NAPA can build up their inventory of these parts for high-end vehicles and fully satisfy customer needs with high OEM quality parts and a short delivery time.

People in China are gradually moving to cars with some distinct characteristics, and they enjoy modifying cars based on their own preferences. As this movement gains in popularity, NAPA can build up an inventory of decorative auto parts for these modified cars.

In addition, the middle class in China are starting to focus more on quality of life, and as such they are becoming more concerned about environmental issues. Families that have little kids are concerned about the air quality inside their cars; some have authority agents inspect the air quality in new cars. NAPA can introduce related products like air quality testing equipment, as well as low emission interior parts and air conditioners, together with guarantees that they do not harm passengers' health.

NAPA can introduce low energy consumption auto parts like hybrid alternators and other environmentally-friendly parts such as the new the model GH fuel pump produced by Denso, which is half the size of a conventional fuel pump and uses 25 percent less power. Purchasing capacity in China is getting stronger and stronger, so people are willing to pay more money for high quality products. NAPA can import

advanced auto parts into the Chinese market under a strategy called consumption under guidance by sellers. In this way, the inventory can be built not only based on customers' needs but also on the introduction of new technologies.

5.4 How to Deal with the Fake NAPA Stores

If NAPA enters the Chinese market, they must solve the problems related to the aforementioned fake NAPA stores: NAPA Beijing and NAPA Shanghai. NAPA Beijing has 18 chains in the Beijing area and NAPA Shanghai has 3 chains in the Shanghai area. According to Mr. Phil Hekman, Global Sourcing Director of GPC, these companies have not signed any formal contract with GPC.

First, NAPA should investigate their performance in terms of their product quality, their reputation in the industry and their profitability. If they are competitive, reputable, and conscious of quality control, NAPA can consider acquiring them. Otherwise NAPA may have to sue them, as this is a very serious issue; in the long terms, those fake stores will hurt NAPA's reputation in the industry, reduce their potential profits and lead to lost potential customers. This should be at the top of the to-do list for NAPA before they formally enter the Chinese market. An applicable case concerns Starbuck's entry into the Chinese market in 1999; a local coffee shop in Shanghai quickly copied Starbuck's name and designed a very similar shop. Starbucks sued this coffee shop in 2003, but it took two years to settle the case (Xiaohong Hu, 2006). Therefore, prior to 2005, Starbucks' profits were impacted by this event. In addition, while Starbucks eventually won the case, they lost time and money fighting this case over a five-year period. Thus the best choice for NAPA is to make a decision and then move on it quickly.

5.5 Overall Business Concept for NAPA Stores in China

The recommended business concept is to brand NAPA stores in China as high-end auto parts stores, and establish them in major cities such as Shanghai, Beijing, and Chengdu. A “one stop service” concept is appropriate, where stores provide both retail/wholesale automotive parts and automobile repair and maintenance services. According to NAPA’s successful experience in the North American market, online shopping will be integrated into the distribution process as well. In the early stages, NAPA will own all stores. After winning customer recognition in the major cities, NAPA can start to help investors build their own NAPA stores..

Most auto parts come from local suppliers, so NAPA can control the quality. The NAPA logo will be marked on the packages and products. Meanwhile, based on specific domestic demand, NAPA can outsource some auto parts from other countries. If it is an OEM part, the package will be marked “OEM”.

NAPA may hire local professional workers to repair and maintain motor cars for customers. At the same time, NAPA can build a technology centre to provide consultations on repair and maintenance services for each NAPA store, ensuring that the quality meets the high-level requirements of the customers.

6. Expansion Plan

In this chapter, the author will design an expansion plan for NAPA in China based on the above analysis.

6.1 Team Building

Building a highly efficient team is the key factor to any business's success. If NAPA starts its business in China, strong teams in sourcing and logistics, quality control and sales must be established that employ local professionals with sound experience in the industry. Local employees can receive systematic training from colleagues at the American headquarters.

6.1.1 Sourcing and Logistics Team

GPC has set up a global sourcing office in Shenzhen, and has a solid quality control team, sourcing team and logistics team. GPC's sourcing team is especially effective; when it started sourcing auto parts in China twenty years ago, a domestic medium-scale supplier chain already existed in China, which helped to support the inventory for inbound NAPA stores. To enhance the buyers' power, sourcing teams for different groups of products constantly search for new suppliers in China and Asia, and then source them around the world. There are at least three suppliers for each part, so it is easy for buyers to switch among them. However, the key strategy in supply chain building is establishing a long-term win-win situation with suppliers. Normally, NAPA does not change suppliers too often unless they perform badly. At the same time, NAPA

China will need a logistics team that can provide a real inventory information system, place orders to suppliers based on this information and guarantee on-time delivery to customers.

6.1.2 Quality Control Team

GPC has strong quality control team in China that helps suppliers improve their quality system and ensures that all auto parts meet required specifications or OEM requirements. With these strict quality control standards, NAPA is able to source quality auto parts at low prices. NAPA China can require all suppliers to get TS16949 Quality System Certificates and to work closely with their quality team. At the same time, NAPA quality engineers should inspect each lot in the suppliers' plants. If they find any defective products, they will reject the whole lot and ask the supplier to do a 100% re-inspection and rework the defective products. Those who fail three lots in succession will be place on an observation list; inspectors will check their products regularly. Any supplier that fails on four continuous lots will not receive orders for new shipments until the QC department confirms that they have taken effective corrective actions in terms of their quality systems. In the future, NAPA China will need more experienced inspectors and quality engineers who can work on-site with suppliers and can help suppliers to improve not only their product quality, but also their processes over the long term. Some supplier quality engineers should stay at the plants and supervise the daily production and quality control. Suppliers that perform well will receive more orders; currently, NAPA buy all their U-joints from Wanxiang Qianchao Company, as the quality of the U-joints is good and Wanxiang is one of the most competitive manufacturers in the industry. When more orders were placed with one supplier, buyers can get better prices from this supplier.

In return, suppliers will focus more on product quality. NAPA can also look to build long-term cooperative agreements with some small-sized plants that have good quality control and that match NAPA's management philosophy. In this way, NAPA will be assured of high-quality parts at a low cost.

6.1.3 Marketing & PR Team

Although NAPA enjoys a great industry reputation in North America, NAPA in China needs to deal with of all kinds of competitors. NAPA should hire local experienced people or fresh graduates from renowned universities in China to NAPA China marketing team. Sales managers from North America will train them, and their salaries and bonuses will be directly linked to their performance. At the same time, NAPA China's system will include a customer relation module to analyze customer demand, which can provide information for inventory building.

Since the execution of the open door policy, economic development in China has tended to be driven more by the market; however, to some extent, the government still plays an important role in terms of macroeconomics. To ensure NAPA's business activities conform to the government regulations, NAPA can integrate a Public Relations task into the marketing team to help build a good relationship with the Chinese government and consider their social responsibilities. In these ways, NAPA will gain goodwill and win more customers in China.

6.2 Where to Establish the Initial Stores

NAPA also needs to consider where to set-up their initial stores. Based on the statistical data of car quantity and population distribution in China's major cities, Beijing, Shanghai and Chengdu are the most attractive potential markets (please see Table 6-1).

Table 6-1: Population and Automobile Distribution in Main Cities of China

	City	**Population**	**Car Quantity**
		(millions)	(millions)
1	Beijing	16.33	3.6
2	Shanghai	18.45	2.681
3	Chengdu	12.21	1.938
4	Foshan	5.95	1.852
5	Guangzhou	10.05	1.82
6	Suzhou	8.1	1.771
7	Chongqing	32	1.628
8	Hangzhou	7.86	1.395
9	Qingdao	8.2	1.379
10	Shenzhen	8.46	1.287
11	Tianjin	11.15	1.25
12	Dongguan	8.69	1.225
13	Zhengzhou	7.35	1.2
14	Ningbo	6.89	1.12
15	Taizhou	5.73	1.03
16	Wuxi	3.71	0.998
17	Xian	8.3	0.94
18	Kunming	6.08	0.923
19	Nanjing	7.41	0.852
20	Wenzhou	7.9	0.88
Total		200.82	29.769

Source: Data extracted from web publications released by China Environment Organization, n.d.

In the beginning, NAPA can choose Shanghai, Beijing, Chengdu, Fushun and Guangzhou to establish their first auto parts stores. Later, NAPA can open stores in second level cities like Suzhou and Chongqing. At the same time, NAPA can build

distribution centres in these major cities. After a stable cash flow is generated, the expansion can be more rapid. Here, stable and strong cash flow means ROI is around 20%.

If the total return is lower than 5% (return of 30-year US bond is 4.524%) within two years, NAPA will have to redesign their strategy. This should be a constant and continuous improvement process, such that the ROI should exceed GPC's ROI (around 7%) in the US, while the mid-target is higher than 20%.

In the first year, 20 stores in urban areas of Beijing and Shanghai would be established, with two large distribution centres in suburban areas. In the second year, 10 more stores in other first tier cities such as Chengdu, Foshan, and Guangzhou would be built. By the end of year five, 100 NAPA stores cover major cities in China.

7. Financial Management

The following is a five-year financial analysis and forecast from 2010 to 2014. This analysis is based on the following assumptions:

7.1 Sales, Profits and ROI

About 90% of revenues will come from sales of automotive parts, and 10% from car maintenance and service. The expenses include Cost of Goods, Salaries, Office Supplies and Administration.

Based on market research, sales revenues for the first year are estimated to be $10,120,000, with a net income of $1,431,254. With a sales growth rate of 10% per year, by the end of 2014, total revenue is expected to reach $148,166,920, and net income $44,073,706.

According to the financial assumption, ROI for this project will be 12.52% in the first year. By the end of 2014, ROI will reach 37.53%.

7.2 Working Capital

To finance this project, the initial investment will require 30 million dollars in total over first three years. This investment will cover the cost of new office space rental, employees' salaries, equipment and part of working capital.

After the first three years, the cash flow generated by this project will gradually support the new stores. However, this project will still need 15 million dollars in working

capital loans from commercial banks to facilitate further expansion. The interest rate on short-term loans is currently around 7% in China.

These financial projections depend on NAPA's expansion speed in China. They apply if NAPA chooses to set up one headquarters office, 10 small stores and one large warehouse store in Beijing during the first year, and 100 more small stores and 10 warehouses in major cities in China after five years. The detailed financial projections are listed in Appendixes A and B.

Appendices

Appendix A

Financial assumption

Following data includes the projection of net income, balance sheet and cash flow for NAPA project in China

Table 7-1: Net Income Projection way too small. Try landscape printing sideways across a whole page

					(dollars)	
Years Ended December 31,	2010	2011	2012	2013	2014	Assumption
Revenues						
Autoparts	9,200,000	20,240,000	44,528,000	85,716,400	134,697,200	
Services	920,000	2,024,000	4,452,800	8,571,640	13,469,720	10%of Autoparts
Total Revenue	**10,120,000**	**22,264,000**	**48,980,800**	**94,288,040**	**148,166,920**	
Cost						
Variable Costs						
COGS	2,024,000	4,452,800	9,796,160	18,857,608	29,633,384	20% of Total Revenue
Other expenses	202,400	445,280	979,616	1,885,761	2,963,338	10% of COGS
Total Variable Costs	**2,226,400**	**4,898,080**	**10,775,776**	**20,743,369**	**32,596,722**	
Fixed Cost-Corp Level						
Salaries	50,000	110,000	242,000	532,400	732,050	
Office Space	1,400,000	1,540,000	1,694,000	1,863,400	2,049,740	
System	300,000	330,000	363,000	399,300	439,230	
Administration	75,000	82,500	90,750	99,825	109,808	
Office equip.&supplies	150,000	150,000	150,000	150,000	150,000	
Other fixed cost	101,200	222,640	489,808	942,880	1,481,669	1% of total revenue
Total Corp Overhead	**2,076,200**	**2,435,140**	**3,029,558**	**3,987,805**	**4,962,497**	
Fixed costs-local stores						
Salaries	500,000	1,100,000	2,420,000	4,658,500	7,320,500	
Office Space	2,800,000	5,600,000	11,200,000	19,600,000	28,000,000	
Office equip.&supplies	280,000	560,000	1,120,000	1,960,000	2,800,000	
Other fixed cost	101,200	222,640	489,808	942,880	1,481,669	1% of total revenue
Total local branch overhead	**3,681,200**	**7,482,640**	**15,229,808**	**27,161,380**	**39,602,169**	
Total overhead Costs	**5,757,400**	**9,917,780**	**18,259,366**	**31,149,186**	**44,564,666**	
Net Income Before Tax and Interest	**2,136,200**	**7,448,140**	**19,945,658**	**42,395,485**	**71,005,532**	
Income tax rate	33%	33%	33%	33%	33%	
Income tax	704,946	2,457,886	6,582,067	13,990,510	23,431,825	
Interest expanse				3500000	3500000	
Net Income	**1,431,254**	**4,990,254**	**13,363,591**	**24,904,975**	**44,073,706**	

Table 7-2: Balance Sheet same – landscape on a page

					(dollars)
Years Ended December 31,	2010	2011	2012	2013	2014
Assets					
Cash and Cash Equivalents	12, 024, 000	26, 476, 800	46, 272, 960	72, 130, 568	109, 763, 952
(funds received)	10, 000, 000	10, 000, 000	10, 000, 000	7, 000, 000	8, 000, 000
Other current Assets	2, 024, 000	4, 452, 800	9, 796, 160	18, 857, 608	29, 633, 384
Total Current Assets	12, 024, 000	26, 476, 800	46, 272, 960	72, 130, 568	109, 763, 952
Property and Equipments	3, 920, 000	7, 448, 000	14, 543, 200	24, 848, 880	34, 123, 992
Accumulate Depreciation	392, 000	744, 800	1, 454, 320	2, 484, 888	3, 412, 399
Total Non-current Assets (net PP&E)	3, 528, 000	6, 703, 200	13, 088, 880	22, 363, 992	30, 711, 593
Total Assets	**15, 552, 000**	**33, 180, 000**	**59, 361, 840**	**94, 494, 560**	**140, 475, 545**
Liabilities and Shareholders' Equity					
Short term debts	0	0	0	7, 000, 000	8, 000, 000
Other Liabilities	4, 120, 746	6, 758, 492	9, 576, 741	12, 804, 486	13, 711, 765
Total Current Liabilities:	4, 120, 746	6, 758, 492	9, 576, 741	19, 804, 486	21, 711, 765
Total Non-current Liabilities	0	0	0	0	0
Total Liabilities	4, 120, 746	6, 758, 492	9, 576, 741	19, 804, 486	21, 711, 765
Shareholder's Equity:					
Paid-in Capital	10, 000, 000	20, 000, 000	30, 000, 000	30, 000, 000	30, 000, 000
Retained Earnings	1, 431, 254	6, 421, 508	19, 785, 099	44, 690, 074	88, 763, 780
Total Shareholders' Equity	11, 431, 254	26, 421, 508	49, 785, 099	74, 690, 074	118, 763, 780
Total Liabilities and Shareholders'	**15, 552, 000**	**33, 180, 000**	**59, 361, 840**	**94, 494, 560**	**140, 475, 545**

Table 7-3: Cash Flow same – landscape on a page

					(dollars)
Years Ended December 31,	2010	2011	2012	2013	2014
Cash Flows from Operating Activities					
Net Income	2, 136, 200	7, 448, 140	19, 945, 658	42, 395, 485	71, 005, 532
Depreciation and amortization expense	392, 000	744, 800	1, 454, 320	2, 484, 888	3, 412, 399
Accounts receivable, inventories,other assets	-2, 024, 000	-4, 452, 800	-9, 796, 160	-18, 857, 608	-29, 633, 384
Accounts payable and accrued liabilities	-4, 120, 746	-6, 758, 492	-9, 576, 741	-12, 804, 486	-13, 711, 765
Net cash provided by operating activities	-3, 616, 546	-3, 018, 352	2, 027, 077	13, 218, 279	31, 072, 782
Cash Flows from Investing Activities					
Capital expenditures		7, 471, 152	7, 769, 083	5, 639, 329	5, 560, 602
Net cash provided by investing activiti	0	7, 471, 152	7, 769, 083	5, 639, 329	5, 560, 602
Cash Flows from Financing Activities					
cash from starup capital	10, 000, 000	10, 000, 000	10, 000, 000		
Increase (decrease) in short-term obligations,excluding current maturities				7, 000, 000	1, 000, 000
Net cash used in financing activities	10, 000, 000	10, 000, 000	10, 000, 000	7, 000, 000	1, 000, 000
Increase (decrease) in cash and cash equivalents	6, 383, 454	14, 452, 800	19, 796, 160	25, 857, 608	37, 633, 384
Cash and cash equivalents, beginning of year	5, 640, 546	12, 024, 000	26, 476, 800	46, 272, 960	72, 130, 568
Cash and cash equivalents, end of year	**12, 024, 000**	**26, 476, 800**	**46, 272, 960**	**72, 130, 568**	**109, 763, 952**

Appendix B

These tables include the investment assumption, break-even analysis and ROI analysis for NAPA project in China.

1. Investment Assumption

Table 7-4: Investment Assumption

assumptions					(dollars)
Years Ended December 31,	2010	2011	2012	2013	2014
small stores	10	20	40	70	100
large stores	1	2	4	7	10
Employees/headquarter	10	20	40	80	100
Employees/small store	5	5	5	5	5
Employees/larger store	50	50	50	50	50
salary growth rate	10%	10%	10%	10%	10%
average salary	5000	5500	6050	6655	7321
Sales growth rate	10%	10%	10%	10%	10%
Auto parts sales/small store	460,000	506,000	556,600	612,260	673,486
Auto parts sales/larger store	4,600,000	5,060,000	5,566,000	6,122,600	6,734,860
office space rent/large	1,400,000	1,400,000	1,400,000	1,400,000	1,400,000
office space rent/small	140,000	140,000	140,000	140,000	140,000
Start-up Capital/small stores	700,000	700,000	700,000	700,000	700,000
Start-up Capital/large stores	2,800,000	2,800,000	2,800,000	2,800,000	2,800,000
Start-up Capital needed	9,800,000	9,800,000	19,600,000	29,400,000	29,400,000
investment	10,000,000	10,000,000	10,000,000	0	0
working capital loans	0	0	0	7,000,000	8,000,000

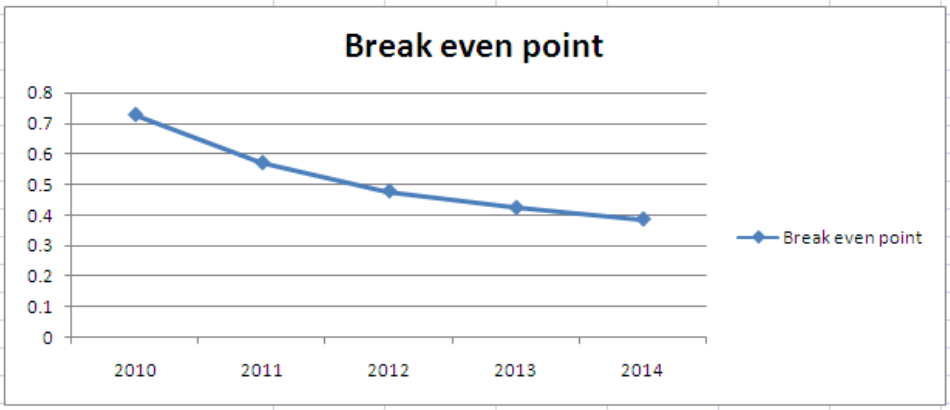
2. Break Even Analysis

The price of each auto parts will be an experiential value: 5 times of the cost bought from suppliers in China. It will ensure us to have a high margin. As projected, NAPA will easily break even during first year. We can see a positive cash flow and net income to support NAPA's expansion in the following year.

Table 7-5: Breakeven Points

(dollars)

Years Ended December 31,	2010	2011	2012	2013	2014
Break even point	0.729376	0.571106	0.477931	0.423541	0.385607

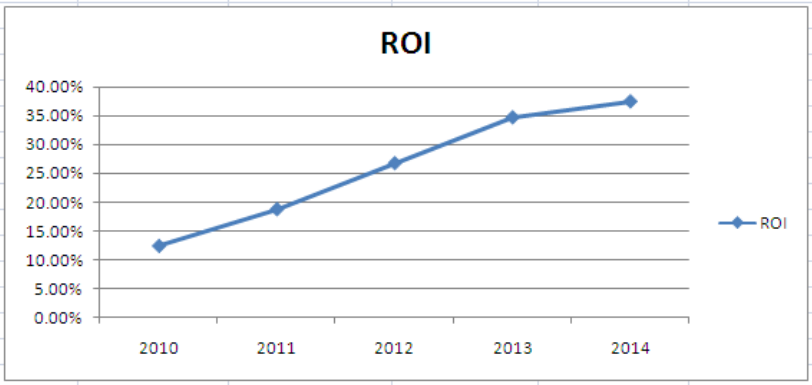


3. ROI Analysis

ROI analysis is based on the economic forecast in future. If the global economic climate is still gloomy, our expectation of ROI will be lower. However, because China is a growing market for automobile, we can still see a higher ROI than NAPA's bottom line 7%. If economic bounces back, the expansion can be far more quickly and ROI will be higher than we project.

Table 7-6: ROI Data

					(dollars)
Years Ended December 31,	2010	2011	2012	2013	2014
EBIT	2,136,200	7,448,140	19,945,658	42,395,485	71,005,532
Tax Rate	33%	33%	33%	33%	33%
Interest-bearing debt	0	0	0	7,000,000	8,000,000
paid-in capital	10,000,000	20,000,000	30,000,000	30,000,000	30,000,000
retained earnings	1,431,254	6,421,508	19,785,099	44,690,074	88,763,780
Shareholders' Equity	11,431,254	26,421,508	49,785,099	74,690,074	118,763,780
ROI	**12.52%**	**18.89%**	**26.84%**	**34.77%**	**37.53%**



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Interview

Mr. Philip Hekman Global Sourcing Director, Genuine Parts Company

Company Document

Genuine Parts Company Sourcing Part list for each subsidiary in China 2009

Genuine Parts Global Sourcing Office Business Recap for 2008