



International Finance

Automotive Management

Navigating the next decade of auto industry
transformation

by
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and
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Foreword

The ongoing global economic crisis has resulted in the need for urgent change across the automotive industry.

The primary foci of the automotive industry include: adjusting for overcapacity in production, low profitability in new vehicle sales, stagnation of demand in the developed markets, and capitalizing on opportunities in the emerging markets. Auto manufacturers must now make significant investments in developing leading-edge, eco-friendly models, while applying the latest technology; both in vehicles and across their operations, in order to remain competitive. In addition, they must develop new revenue streams through innovative finance models. These finance models should be available to car buyers, and will be customized to meet the needs of consumers through local sourcing. They are also continuing to consolidate manufacturing operations worldwide, while automakers from India and China are simultaneously pushing their way into an already crowded market.

Automotive manufacturers across all segments are facing the demands of new market dynamics. In order to operate successfully, they must meet the challenges of this complex market with a multi-dimensional approach.

The book *Automotive Management in 2020: Navigating the Next Decade of Automotive Industry Transformation* provides a thorough, readable analysis, supplemented with extensive data. The analysis outlines options for strategic transformation within the industry, and also possibilities for innovative financial service products. The authors chose a provocative view point that lends itself to thoughtful debate. In this sense, this book will be a valuable contribution to navigating the right path for the global industry.

Dr. Alexander Scheidt

IBM Global Automotive Industry Leader

Foreword by the Authors

The text of *Automotive Management in 2020: Navigating the Next Decade of Automotive Industry Transformation* relates to the needs of automotive manufacturers over the next decade by examining a series of targeted questions, the broadest being: What are the central concerns of the automotive industry in the years to come?

Further, we at the German Institute for Corporate Finance, together with IBM (recognized for its vast practical experience from consulting projects and extensive market analyses across the industry), have deduced the following five questions for the industry:

- What does the market of the future look like for automotive manufacturers?
- What are the strategic levers for the future?
- What are alternative scenarios?
- What is the importance of Captive Finance Companies (CFCs) for the OEMs?
- What new business models will differentiate Captive Finance Companies in the future?

Currently, automobile manufacturers are faced with the challenge that they seldom recover their total capital costs. Greater profit margins are primarily achieved through aftermarket sales (parts and service) and financing. The hope of profits through growth in emerging markets has yet to be realized. Even the booming markets in the BRIC nations are not sufficient to counteract the lagging profits of automotive manufacturers, as they, too have been impacted by the strained global economy.

Automotive manufacturers will only achieve a solution to the profit dilemma by following a transformation strategy aligned to their business and marketing needs. Currently, the respective approaches of most automotive manufacturers are fundamentally similar, which offers them few possibilities for differentiation. As very few manufacturers can achieve sufficient cost control, it makes sense to focus on those areas where there are still possibilities for differentiation. The goal of this book is to analyze the strategic approaches for automakers in light of new market dynamics, and to show possible options for action.

Globalization-centric challenges, new technologies, and strategic refocusing, will accelerate a wave of consolidation for automotive manufacturers, especially among brands. In *Part I*, strategic options for automotive manufacturers are outlined. The case of Volkswa-

gen and Porsche, which examines horizontal integration and financing, is examined in *Part 2* of the book.* In *Part 3* we demonstrate why Captive Finance Companies should be an integral component of every manufacturer's strategy.

We have attempted to write this book in clear language for those interested in the economic and political aspects, of the industry. It is oriented toward financial managers, controllers, corporate strategists, financial services providers and consultants.

We wish to thank IBM for their exhaustive research efforts, and for the funding of this manuscript. Our thanks also extend to the publisher, Oldenbourg, and the employees thereof: especially Dr. Juergen Schechler, a specialist in economics and social sciences, for his consistently pleasant, proficient and constructive collaboration. Further, we thank the individual employees of the German Institute for Corporate Finance and IBM, especially Mr. Nikolaj de Lousanoff (Manager, IBM), who greatly influenced the structure of this book through his analytical approach. We also thank Mr. Eduard Ciorogariu, Mr. Oliver Elsoud, and Mr. Klaus Wassermann, who insured the completion of this book. Mr. Ciorogariu contributed the Porsche/Volkswagen Case Study, Mr. Elsoud led the analyses of Captive Finance Companies, and Mr. Wassermann developed reports on the fiscal strategies of the automotive manufacturers discussed herein. We also thank Ms. Susanne Tomassetti for her corrections, and Ms. Doris Sperber for her excellent illustrations; both played an important role in the development of this book.

Frankfurt am Main, February 2010
Jens Diehlmann and Joachim Häcker

* The case study "Porsche/Volkswagen" in particular, as well as all other remarks in this book are based on analyses conducted by the authors, to the best of their knowledge. They are based solely on literature research and on publicly available information. We have inspected the information to the best of our knowledge, but are not liable for it (apart from liability for gross negligence). We bear no responsibility for the completeness or accuracy of this data. These analyses and conclusions in this book should not be used as the basis for investments in the stocks of these companies. We bear no liability for any financial actions taken by the reader.

The illustrations given in the book can be downloaded from the website of the Deutsches Institut für Corporate Finance (German Institute for Corporate Finance) (www.dicf.de). We would love to receive your comments and suggestions at

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Contents

PART 1

Strategies: Automotive Manufacturers “Quo Vadis”?

1	Introduction	3
1.1	Problem Statement	3
1.2	Procedure	4
1.3	Definition	5
2	Overview of the Global Automotive Markets and Manufacturers	5
2.1	The Global Automotive market in overview	5
2.2	The European Automotive market in overview	7
2.2.1	What Distinguishes the European Automotive market?	7
2.2.2	Market participants – Europe	8
2.3	The U.S. Automotive market in overview	8
2.3.1	What distinguishes the American Automotive market?	8
2.3.2	Market participants – The U.S.	10
2.4	The Asian Automotive market in overview	10
2.4.1	The Japanese Automotive market	11
2.4.1.1	The Japanese Automotive market in overview	11
2.4.1.2	Market participants – Japan	12
2.4.2	The Indian Automotive market	13
2.4.2.1	The Indian Automotive market in overview	13
2.4.2.2	Market participants – India	14
2.4.3	The Chinese car market	16
2.4.3.1	Overview of the Chinese car market	16
2.4.3.2	Market participants – China	17
2.5	The Automotive manufacturers	18
2.5.1	Company profile – Volkswagen AG	19
2.5.2	Company profile – BMW AG	22
2.5.3	Company profile – Daimler AG	25
2.5.4	Company profile – PSA Peugeot Citroen S.A.	28
2.5.5	Company profile – Renault S.A.	31
2.5.6	Company profile – Fiat S.p.A.	34
2.5.7	Company profile – Toyota Motor Corporation	37
2.5.8	Company profile – Nissan Motor Co., Ltd.	40

2.5.9	Company profile – Ford Motor Company	43
2.5.10	Company profile – Honda Motor Company Ltd.	46
3	The strategic options for automotive manufacturers?	49
3.1	Geographic positioning	50
3.1.1	India	50
3.1.2	China	54
3.1.3	Chance and risk profile – India/China	57
3.2	Alternative motor power	58
3.2.1	Overview of propulsion alternatives	59
3.2.2	Challenges of alternative motor power – value creation & the suppliers	61
3.3	Horizontal and Vertical integration, as well as strategic alliances	62
3.3.1	Trends in the automotive supplier segment	63
3.3.2	Challenges of vertical integration	65
3.4	Financing strategies for OEMs	65
4	Which strategic direction will the OEMs take?	67
4.1	Quo vadis – Automotive industry	67
4.2	Quo Vadis – OEMs	69
4.2.1	Mass and premium class manufacturers	69
4.2.2	Where do the individual OEMs stand today?	71
4.2.3	Where will the OEMs be in year 2020?	76
4.2.4	Financing challenges	81

PART 2

Porsche and VW: A Case that Wrote History

5	Porsche's takeover attempt and financial strategy	83
5.1	The takeover attempt 2005–2009	84
5.1.1	Situation analysis: VW 2005	84
5.1.2	Situation analysis: Porsche 2005	86
5.1.3	Why did Porsche enter into VW?	87
5.1.4	Investor Reactions to Porsche's entry into VW	89
5.1.5	Wiedeking and Härter appointed to VW's Board of Directors	92
5.1.6	Build-up of interest in VW and obligatory bidding	92
5.1.7	Reforming Porsche AG into a European Societas Europaea (SE) joint-stock corporation	93

5.1.8	The ECJ rules on VW Law	95
5.1.9	Porsche achieves majority share in VW	97
5.1.10	What is Ferdinand Piëch's position?	100
5.1.11	The Change in Communication between Porsche and VW	101
5.1.12	Reactions of the Market Participants	103
5.1.13	An overview of Porsche's Takeover Strategy	107
5.1.13.1	Phase 1: VW Share under 20%	109
5.1.13.2	Phase 2: Edging toward the 30% mark	109
5.1.13.3	Phase 3: Crossing the 30% Hurdle and making Porsche Automobile Holding SE a holding company	110
5.1.13.4	Phase 4: Approaching the 75% mark	110
5.2	Porsche's Financing Strategy	111
5.2.1	Status Quo 2005: Liquidity from the Operative Business	111
5.2.2	Instating a Eurobond, Two Hybrid Bonds and Increasing the Subscribed Capital	113
5.2.3	Loan from an International Bank Syndicate	116
5.3	Porsche's Option Strategy	117
5.3.1	Technical Terms of the Option Trade	118
5.3.2	The Banks' Position	119
5.3.3	Porsche's Position	127
5.3.4	Effects on other market participants	133
5.4	The Failure of the Takeover Attempt	134
5.4.1	Conditions Surrounding the Refinance Endanger Business Operations	134
5.4.2	Creation of an Integrated Group	136
5.4.3	State Guarantee from Baden-Württemberg	137
5.4.4	Credit request at the KfW	138
5.4.5	Daimler as a Potential Investor	138
5.5	Financial Support from the Qatar State fund	139
5.5.1	Five Conceivable Scenarios	139
5.5.2	Qatar Holding LLC takes a share in Porsche and VW	141
5.6	Why the Takeover Failed	142

PART 3

Captive Finance Companies (CFCs): The Future Instrument of Manufacturers

6	How is the market for automotive financial services classified?	149
6.1	Manufacturer-affiliated vs. non-manufacturer-affiliated financial services providers	149

6.2	Financing OEM brands vs. non-OEM brands (foreign brands)	150
6.3	Integration from a corporate and legal point of view and legal demarcation of CFCs	152
6.4	The traditional product offerings of CFCs	153
6.4.1	Retail leasing	153
6.4.2	Retail financing	153
6.4.3	Dealer financing (wholesale finance)	154
6.4.4	Fleet business	154
6.5	Strategic importance of CFCs	155
7	An overview of globally active CFCs	159
7.1	Ford Motor Credit Company	162
7.2	Toyota Financial Services Corporation	164
7.3	Volkswagen Financial Services	166
7.4	Daimler Financial Services	168
7.5	BMW Financial Services	170
8	Which current business approach is pursued by CFCs?	172
8.1	The traditional captive finance approach	172
8.2	Advanced automotive banking approach	173
8.2.1	Mobility-related services	173
8.2.2	Mobility- neutral services	176
8.3	Comparative overview of services offered	176
8.4	Cross-selling and cross-over in the automotive financial services sector	178
9	How can CFCs strategically newly position themselves, in order to be well prepared for 2020?	180
9.1	Overview of current refinancing possibilities for CFCs	180
9.2	Equity capital on the CFC balance sheet	184
10	CFC – Quo Vadis?	186
10.1	Strategic options for CFCs	186
10.2	Fields of action for the developed markets of the Triad	186
10.2.1	Pushing financing solutions of used vehicles	186
10.2.2	Development and expansion of fleet customer business	187
10.2.3	Introduction and expansion of products with risk adjusted pricing	188
10.2.4	Establishment of bank branches	188
10.2.5	Transforming a CFC into a bank holding company	190

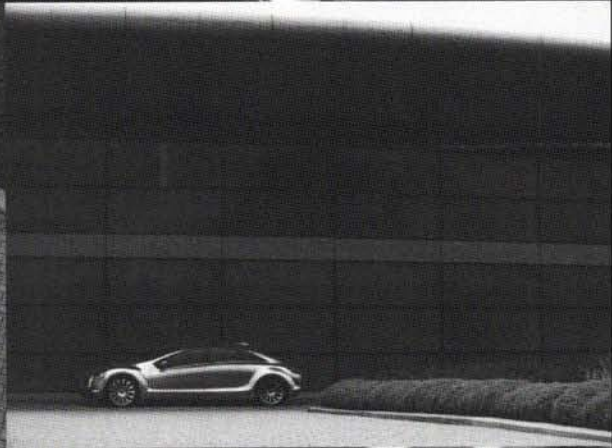
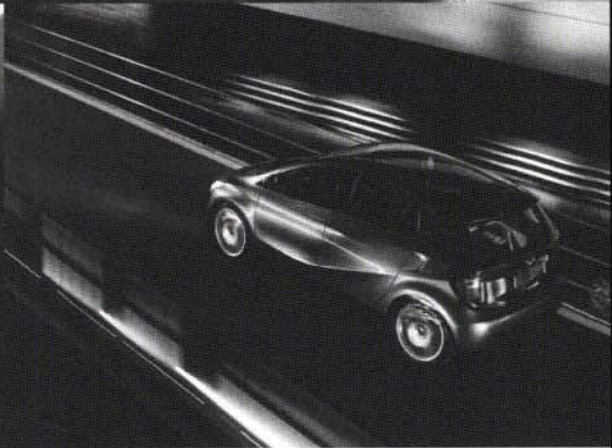
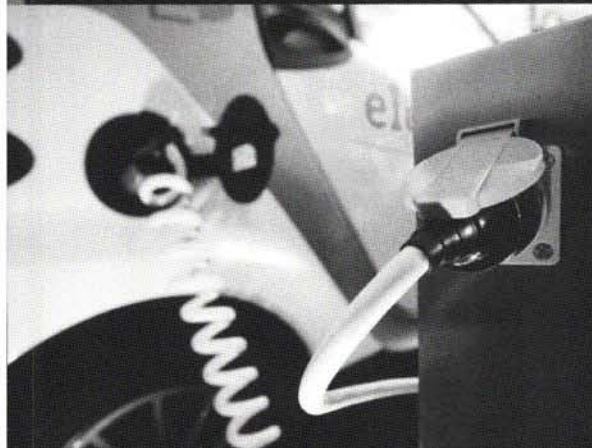
10.2.6	Revision of governance structures and operating concepts	192
10.2.7	Optimization in the areas of refinancing, liquidity management and risk management in concert with the OEM	193
10.3	Recommended procedures for the new emerging markets	195
10.3.1	Establishment of finance agencies in Russia, China, India and Brazil	195
10.3.2	New operation strategies for the growth markets	196
10.3.3	Establishment and implementation of financing solutions for the promotion of new mobility concepts	197
Glossary		199
Bibliography		205
Index		213

List of Figures

Figure 1: Utilisation of production capacities	4
Figure 2: Development of car sales in specific markets (in %)	6
Figure 3: Car density (by unit) as per world region	6
Figure 4: Expected car sales in Western Europe	7
Figure 5: Overview of market shares in Europe	8
Figure 6: Expected car sales in the the U.S.	9
Figure 7: Overview of market shares in the U.S.	10
Figure 8: Expected sales numbers for ultra-low-cost cars	11
Figure 9: Expected car sales in India	14
Figure 10: Overview of market share in India	15
Figure 11: Expected car sales in China (in mi. units)	17
Figure 12: Overview of the market share in China	18
Figure 13: Company profile Volkswagen AG	21
Figure 14: Company profile – BMW AG	24
Figure 15: Company profile – Daimler AG	27
Figure 16: Company profile – PSA Peugeot Citroen S.A.	30
Figure 17: Company profile – Renault S.A.	33
Figure 18: Company profile – Fiat S.p.A.	36
Figure 19: Company profile – Toyota Motor Corp.	39
Figure 20: Company profile – Nissan Motor Co. Ltd.	42
Figure 21: Company profile – Ford Motor Company	45
Figure 22: Company profile – Honda Motor Company Ltd.	48
Figure 23: Shifts in regional distribution	49
Figure 24: Growth of GDP and nominal per capita income in India	51
Figure 25: Number of potential buyers of an ULCC	52
Figure 26: Distribution of income classes	54
Figure 27: Growth of GDP and nominal per capita income in China	55
Figure 28: Comparison of the infrastructure of China and the U.S.	56
Figure 29: Chances and risk profiles for India and China	58
Figure 30: Overview of alternative motor power	59
Figure 31: Leading manufacturers of alternative propulsion vehicles	60
Figure 32: Value creation in the drive channel by the manufacturer and the supplier	61
Figure 33: Illustration of the horizontal and vertical integration	63
Figure 34: Structure of manufacturer-supplier relationship	64
Figure 35: Financing strategies of OEMs	66
Figure 36: Consolidation in world automotive market ⁴⁴	68
Figure 37: Transactions in the automotive branch in 2008 and 2009	69
Figure 38: Abstract of the key financial figures from the company profiles (2008)	72

Figure 39: Grouping of the automotive manufacturers in premium and volume segments (2008)	77
Figure 40: Grouping of the automotive manufacturers in premium and volume segments (2020)	81
Figure 41: P/B ratio of VW, Daimler-Chrysler and BMW, values rounded off (status: 2005 end)	85
Figure 42: Growth of turnover from 2000/2001 – 2004/2005	86
Figure 43: Growth of Net Profit Margin 2000/2001 – 2004/2005	87
Figure 44: Return on Equity Ratio, Porsche and the competitors (Status as of: 2004 or 2004/2005)	87
Figure 45: VW shareholding structure after the entry of Porsche (Status as of: Autumn 2005)	88
Figure 46: VW ordinary share, price movement from 12th Sep. 2005 – 30th Sep. 2005	89
Figure 47: Traded volume of ordinary VW shares, 12th Sep. 2005 – 30th Sep. 2005	90
Figure 48: Price movement of Porsche from 12th Sep. 2005 – 30th Sep. 2005	91
Figure 49: Traded volume of Porsche share from 12th Sep. 2005 – 30th Sep. 2005	91
Figure 50: SWOT analysis, Porsche takes over VW	98
Figure 51: Thresholds and rights of the shareholders	99
Figure 52: Development of VW common stock from Sept. 2005 – Sept. 2009, monthly key rates	103
Figure 53: Trading volume of VW common stock, monthly key rates	104
Figure 54: VW stocks structure (As in: 2009)	106
Figure 55: Trading volume of VW common stock, monthly key rates, Nov. 08 – Nov. 09	106
Figure 56: Development of Porsche's VW share quotes from media publications	108
Figure 57: "Cash and cash equivalent" as well as "marketable securities" 2003 – 2005 (in bn Euro)	112
Figure 58: Porsche's liquidity based on the financial year 2004/2005	112
Figure 59: Ratio comparison, Porsche 2004/2005 and VW 2004	112
Figure 60: Overview of Porsche's Eurobond, split into two tranches	115
Figure 61: Porsche's hybrid bonds	115
Figure 62: Increase in Porsche's liabilities to banks	117
Figure 63: Basic option terms of technique	118
Figure 64: Pay-off Diagram: Short Call Position of the banks	120
Figure 65: Short Call 1, Position of the banks	121
Figure 66: Short Call 2, Position of the banks	121
Figure 67: Bank loss at a stock price of 250 euro	122
Figure 68: Pay-off Diagram: Covered Call Writing of the banks	122
Figure 69: Covered Call Writing, Banks' Position	123
Figure 70: Maximum profit of the banks assuming Short Call 2 was in the money	124
Figure 71: Maximum loss of banks at a share price of 0 Euro	124
Figure 72: Pay-off Diagram: Covered Call Writing combined with Protective Put	125
Figure 73: Covered Call Writing Combined with Protective Put, Position of the Bank	126
Figure 74: Gain of the banks, if share price is 140 euro	127
Figure 75: Pay-off Diagram: Long Call Position of Porsche	128
Figure 76: Porsche's earnings from options	128
Figure 77: Porsche's profits from options 2007/2008	129
Figure 78: Long Call 1, Porsche's Position	129
Figure 79: Long Call 2, Porsche's Position	130
Figure 80: Pay-off Diagram, Long Call 2 and Short Put (Porsche's position)	131
Figure 81: Long Call 130 and Short Put 200, Porsche's position	132

Figure 82: vw common stock price	133
Figure 83: Integrated Shareholding, Porsche and Volkswagen	137
Figure 84: Porsche's car sales decline, comparing the first half of 2007/2008 with the first half of 2008/2009	143
Figure 85: Porsches proceeds from share stock option 1st half-year 2008/2009	143
Figure 86: An overview of the significant automotive financial services providers operating in the German market	150
Figure 87: Corporate group structure of Volkswagen AG, Daimler AG, and BMW AG	152
Figure 88: An overview of a fleet management' range of tasks	155
Figure 89: Summary of the strategic relevance of CFCs	157
Figure 90: The value chain of the automobile industry	158
Figure 91: Segmentation of the value chain by value contributions	159
Figure 92: CFC ranking by total number of leasing and financial product portfolio	161
Figure 93: An overview of the Ford Motor Credit Company	163
Figure 94: An overview of Toyota Financial Services Corporation	165
Figure 95: An overview of Volkswagen Financial Services	167
Figure 96: An overview of Daimler Financial Services	169
Figure 97: An overview of BMW Financial Services	171
Figure 98: Product offerings of CFCs	172
Figure 99: Schematic structure of full service leasing and fleet management	175
Figure 100: Expansion possibilities for CFCs	176
Figure 101: Product portfolio of different CFCs	177
Figure 102: Description of cross-selling and cross-over	178
Figure 103: Trend towards higher value vehicles	179
Figure 104: Purchase behavior in the segment for new cars	180
Figure 105: Typical CFC Balance Sheet	181
Figure 106: Asset side as a determinant of the present CFC business activities	182
Figure 107: The liability side as a source of refinancing for CFCs	183
Figure 108: Comparison of key interest rates and CFC profits in %	183
Figure 109: Refinancing structure of CFCs hy1/2008	184
Figure 110: The position of Equity Capital on the CFC Balance Sheet	185
Figure 111: Presentation of a typical OEM's Corporate Structure	189
Figure 112: Example of CFC-Bank holding	191
Figure 113: Development of credit default swaps (CDS) in the automobile industry	194
Figure 114: Worldwide new vehicle registrations and market shares between 2007 and 2008	195



Executive Summary

The goal of this book is to analyse the future strategic approach of automotive manufacturers in view of rapidly changing market requirements. Here, the focus lies on presenting options for action from which a strategic positioning can be derived for the year 2020.

We have approached this goal in three steps.

PART 1

Strategies: Automotive Manufacturers “Quo Vadis”?

The investigation into the global automotive market shows the following four relevant options:

- 1** Geographical positioning to exploit opportunities in growth markets
- 2** Development of alternative energy propulsion to obtain technology leadership
- 3** Attaining greater horizontal integration to access new markets; diversify product offerings; and achieve greater scale; as well as vertical integration, to optimise the supply chain
- 4** Strategic use of Captive Finance Companies, to attain a stronger hold on the market through expansion of the value chain; and greater customer retention

Although each of these four options play a significant role in the ongoing evolution of the automotive industry, the larger focus of this analysis is on the topics related to horizontal integration and the strategic use of Captive Finance Companies (CFCs). These two specific focus areas are expected to lead to major changes for automotive enterprises in the coming years.

In analyzing automakers, we found that their respective fiscal and strategic approaches varied widely. In fact, of the 10 premium and volume manufacturers studied here, only 4 followed a clearly defined fiscal strategy.

The analysis shows that the automobile manufacturers we analyzed must strengthen their activities with respect to market requirements and core competency in their respective segments.

PART 2**Porsche and VW: A Case that Wrote History**

The Porsche/VW case is an excellent current example of horizontal integration. Based on publicly available information we will document the chronology of this takeover battle, ongoing since 2005. This includes the finance and communications strategies. We especially focused on the issue of funding of the deal received through options, which has materially impacted the merger battle.

PART 3**Captive Finance Companies (CFCs): The Future Instrument of Manufacturers**

The strategic importance of the Captive Finance Companies to enable the strategic transformation of automotive enterprises is examined in the last part of the book. We have included a detailed overview of the most important actors in the market, the business model, and a review of various financial products. CFCs serve the manufacturers as a refinancing and customer retention instrument.

The current economic crisis has resulted in new challenges, even to this previously profitable business model. Against this background, the financial service providers are forced to strategically redesign/reinvent their business model to continue to be of use to automobile manufacturers. Some attractive options include developing foreign agency banks, used car financing, and extending finance companies to the emerging markets.

■ PART 1

Strategies: Automotive Manufacturers Quo Vadis?

1 Introduction

1.1 Problem Statement

Today, there are nearly 1 billion cars on the road worldwide. Since 2007, when global automotive production stood at its peak of 72 million vehicles, the demand for new cars has steadily decreased. Due to the global economic crisis, a sales decrease of 15 to 20% was projected for the year 2009. But, due in large part to government sponsored initiatives (such as Scrap Premium in Germany and Cash for Clunkers in The US) sales of new cars only dropped by 3%, to 67 million units:¹ Above all the global automotive industry has remained a strong growth engine and a huge contributor to the well being of people and society, with millions of people living from the automobile.² The automotive industry is also a critical economic growth driver to the other industrialized countries discussed in this book.

In recent years the market for new cars has become increasingly strained. Through the consolidation of manufacturers, market saturation, price wars, and global overcapacity, sales and profits in the traditional business of automotive enterprises have significantly decreased. Figure 1 illustrates overcapacity across a subset of the manufacturers that we studied.

1 Refer to the German Association of the Automotive Industry [VDA] (2009)

2 Refer to the German Association of the Automotive Industry [VDA] (2009)

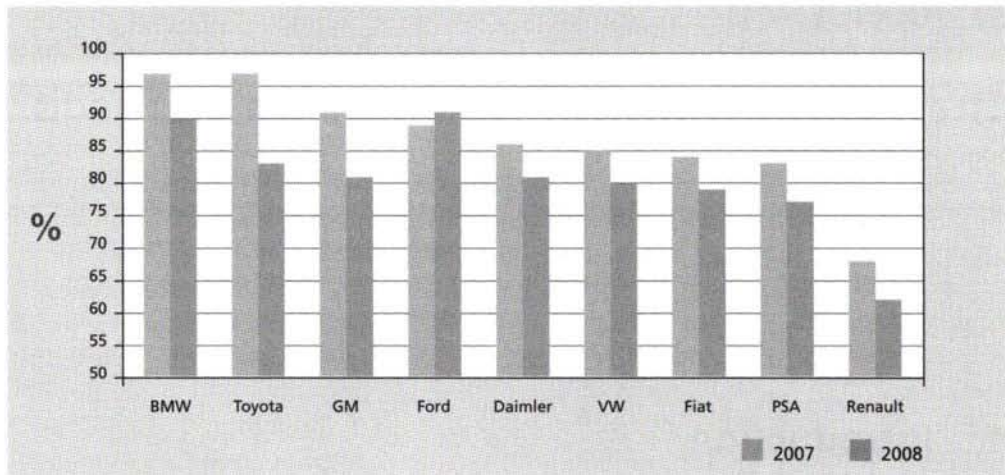


Figure 1: Utilisation of production capacities

Source: Credit Suisse Equity Research (2009)

In the coming years, the industry's emphasis will shift from the traditional emerging markets of the Triad (EU countries, North America and Japan) to the developed markets. Product focus is also moving from conventional to alternative propulsion technologies. These long-term trends that began at the end of the last decade have accelerated due to the worldwide recession and require an immediate and strategic response from automotive enterprises.

1.2 Procedure

In the following section, we examine these trends in greater detail. We first address the connections between the global automotive markets and their respective participants. Against the backdrop of globalization and a demanding economic environment, potential actions will be evaluated for the industry. We will also compare developmental scenarios in order to make recommendations for specific manufacturers and to assess their viability. Part one of this book will conclude with a vision of the industry in the year 2020.

1.3 Definition

Original Equipment Manufacturer (OEM)

An Original Equipment Manufacturer is a manufacturer that incorporates components delivered by outside suppliers into its own product, then markets and sells the delivered component under its (the OEM's) company name. The term 'original equipment manufacturer' and the term 'automotive manufacturer' are used synonymously in this analysis.³

2 Overview of the Global Automotive Markets and Manufacturers

This chapter will examine the automotive markets of Europe, North America, and Asia. The majority of manufacturers are in these markets and will serve the current and future global automotive industry.

2.1 The Global Automotive Market in Overview

The global vehicle market includes two segments: automotive manufacturers (cars, commercial and utility vehicles), and motorcycles. In 2008, motorcycles amounted to only 4.8% share of the total vehicle market. Given such an insignificant portion, we did not consider this segment in our analysis.⁴ The current economic crisis has significantly impacted the automotive industry. The global turnover of the automobiles and components industry amounted to 2.4 billion US dollars in 2008: a 14.5% deficit from the previous year.⁵

The BRIC markets, with the exception of Russia, continue to experience enormous growth, while the traditionally profitable markets of Western Europe, Japan, and North America are undergoing decreased sales. Figure 2 shows that negative growth rates (CAGR) are predicted through 2012 for the saturated markets of the U.S., Japan and Western Europe. Significant growth potential exists only in the growing and developing markets of China and India.

3 Refer to Gabler (2009)

4 Refer to Datamonitor (2009a), S. 11

5 Refer to Datamonitor (2009b), S. 9

Car sales YoY%	2008	2009	2010E	2011E	2012E	CAGR
China	7.3	7.6	2.2	6.4	10.0	6.7
India	1.8	6.3	7.6	5.5	9.5	6.1
Brazil	13.9	-2.2	-1.9	3.8	1.9	2.9
Russia	15.4	-33.3	5.0	16.7	16.3	1.9
Japan	-5.7	-15.2	0.0	4.8	0.9	-3.3
USA	-16.3	-19.7	17.9	10.4	5.1	-2.1
West Europe	-8.5	-6.2	-3.5	7.6	3.9	-1.5
Total	1.1	-9.0	3.9	7.9	6.8	1.5

Figure 2: Development of car sales in specific markets (in %)

Source: Credit Suisse Equity Research (2009)

A growing population and low per capita vehicle ownership in India and China have combined for an explosion of growth in their respective markets. Vehicle density (see figure 3) refers to the number of vehicles driven per 1,000 inhabitants. In the U.S., there are approximately 800 more cars per 1,000 inhabitants than in India or China. Europe and Japan also have a markedly higher vehicle density. Future sales in these established markets will consist mainly of replacement vehicles rather than new growth.

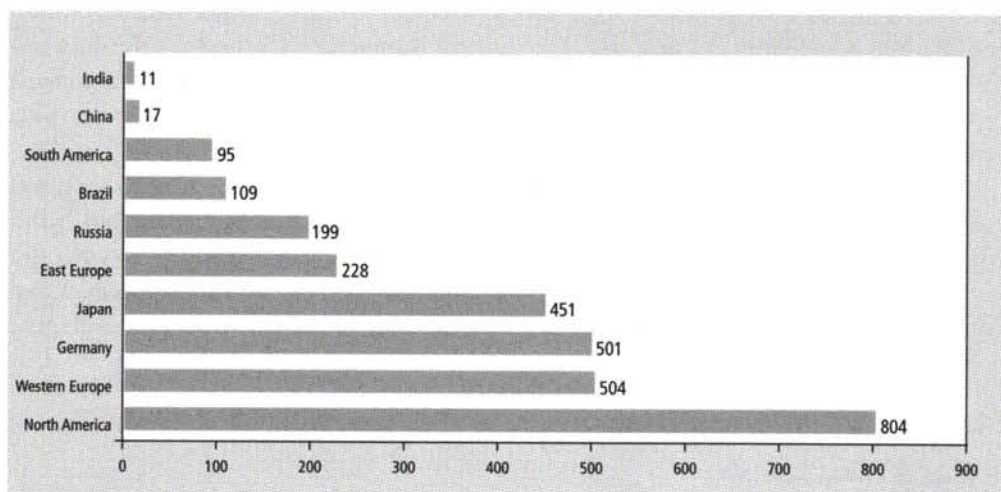


Figure 3: Car density (by unit) as per world region

Source: IWK – Institut für Wirtschaftsanalyse und Kommunikation (Institute for economic analysis and communication) (2009)