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The Slump is an Opportunity *German luxury carmakers at the crossroads – By Ulrich Viehöver*

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The worldwide economic crisis masks the structural problems of German car manufacturers. If BMW, Mercedes & Co. want to keep pace, they must serve the global market better.

Is it working? The German government is paying drivers a bonus of €2,500 ($3,170) to scrap their cars over nine years old in favor of a new set of wheels. That will hardly boost sales at Audi, BMW, Mercedes and Porsche. Daimler boss Dieter Zetsche said customers initially thronged into showrooms to check out the deal for themselves but then the purchasing impulse soon dissipated because the resale value of nine- or 10-year-old Mercedes, Audis and BMWs still far exceeds the state handout. Owners even consider their VW Golfs, Passats and bigger Opels too precious for the junkyard.

So the billions from Berlin are primarily boosting sales of small, mostly imported cars. The misguided subsidy by politicians proves their limited understanding of the domestic car business because almost all brands made in Germany are either upscale compact cars or premium models.

The focus on luxury is also the core problem of Audi, BMW, Daimler and, partially, Opel. The pricey models from Stuttgart, Munich, Ingolstadt and Rüsselsheim are too good for the mass market. Few people in this world can afford luxury. That is why premium brands must make do with modest growth.

These gloomy prospects are currently being overshadowed by the economic slump. All standard models of the compact car and large family car segment – from Golfs and Passats to Astras, Saturns (GM), Toyota Corollas and Ford Focus up to the BMW 300 series and Mercedes A class – will lose increasingly more market share globally.

Robust, cheap cars will take their place. With billions of potential buyers, sales of these cars will expand swiftly. Sales projections for no-frills cars document that. They will be even cheaper than the Logan, the bare-bones model by Renault's Romanian subsidiary Dacia. These vehicles will expand in Russia, China and India just as strongly as in Europe, North America and Japan.

"More car for the money" will be the customer's motto in the future. Analysts like Ferdinand Dudenhöffer of the University of Duisburg-Essen say there is a "growth segment for the 5,000-dollar-car." He predicts that the market for no-frills cars will grow by 233 percent by 2015 to more than 10 million units per year – almost 10 times faster than the total market.

Can BMW, Daimler & Co. match this pace? Hardly, since, with 9 percent, their traditional compact car segment will see the least growth.

The German establishment is not rising to the "light car" challenge. It risks finding its top brands in the niche trap, marginalized at the exclusive edge of the mass market. German cars are in danger of sharing the fate of televisions, designer clothes and motorcycles made in Germany.

If the German brands shrink away from the cut-throat battle against the no-frills low-cost cars of the newcomers from China, India, South Korea (Hyundai) and Japan (Toyota, Honda), they will have already lost. Even the premium segment will suffer.

According to several projections, the market for that segment is gradually becoming saturated. According to Dudenhöffer, premium brands still have a significant growth potential of 40 percent meaning an additional seven million vehicles worldwide but the overall trend is that "the high end is moving downward." In plain language, price matters increasingly here too when it comes to purchasing decisions. "The price difference to the compact class remains. Nonetheless, the premium car prices will go down," Dudenhöffer said. Consequently, profit margins in the core product line will erode.

To make matters worse, the segment shared by Audi, BMW and Mercedes is attracting more competition. Peugeot/Citroen, Fiat/Alfa, Toyota/Lexus and Tata/Jaguar are all hoping for higher profits from expensive, comfortable high-tech cars. However, the chief designer of Pforzheim-based Hymer idc, Johann Tomforde, thinks it's "a dangerous course when almost everyone is storming in the same direction and neglects the customers who cannot afford such expensive cars." Managers are losing sight of millions of people for whom the cheap brands are more relevant than ever, Tomforde said. For many, the car is primarily an individual means of transportation, he said, "that meets all technological and safety standards, is low in consumption and reliable yet does not have to be an Asian no-name brand." Despite the fact that the innovation, technology and good reputation worldwide of Audi, BMW & Co. are all beyond question, the gloss is getting tarnished. The limits to growth are weighing especially on BMW and Daimler, which depend heavily on their premium sedans. The subsidiaries – Mini at BMW, Smart at Daimler, with annual sales between 140,000 and 250,000 cars – are dwarfed by the compact-car giants in Italy, China, South Korea and Japan. In the long term, Mini and Smart will cater only to specialty markets.

For BMW and Daimler, the strategy of establishing a brand for entry-level models below their umbrella brands remains the best option. But for that they would have to acquire a suitable partner.

That issue has already been resolved for giant Volkswagen and tiny Porsche. They will count as a single unit as soon as the Stuttgart-based sports car maker holds 75 percent of VW shares. That will be an opulent conglomerate of brands under the leadership of Porsche, able to sell to almost every budget, from the super-luxury Bentley, Bugatti, Lamborghini and Porsche to the premium label Audi to the subcompact VW Fox. The only adjustments the Porsche-Volkswagen group still has to make are in the lowest-price segment and in its own production in the United States.

BMW and Daimler will also have to earn their money globally more than ever while refining their glamorous profile. But "a single brand cannot cover everything from the low-cost sector to the luxury segment," said Carl-Peter Forster, vice president of General Motors and head of GM Europe. "Such a stretch would exceed the capacity of any brand."

That is why BMW and Daimler need an additional brand to ensure their future. They will hardly be able to cover costs for development, production and distribution with revenues from their flagship brands alone anymore.

Forster, a former top manager at BMW, surely knows a suitable partner for BMW or Daimler: the GM subsidiary Opel. But the bosses in Munich and Stuttgart aren't biting. They would prefer to cooperate in development and logistics and joint purchasing to save money.

But even if they close ranks, the two companies would still face the same dilemma on the market. If they merged, the BMW and Mercedes brands would even cannibalize each other. After the economic crisis, which will probably still linger for more than a year, there cannot be a return to business as usual. Otherwise, both BMW and Daimler would soon be facing very serious problems.

Picture above: Think differently or die: People want practical, cheap cars. Campanies that don't make them are doomed.