PORSCHE

Porsche’s success in the automobile sector and its involvement in VW

Université Paris X | Nanterre

Master 1 | Statégie et Politique gérnérale

Professeur M. Benavent

Academic Year 2006 · 07

by Christina Dietz | No. 26 00 10 61

Summary

1 | Introduction

Strong growth, solid benefit: For years Porsche has been driving on the fast track. While Opel, Ford, VW and Mercedes need to cut jobs, the Swabians have the opportunity to create new jobs. What is Porsche CEO Wendelin Wiedeking doing differently? How does Wiedeking realize his strategy? And why should a small and highly profitable maker of sports cars suddenly invest its fortunes to a struggling mass-producer? That was the question that alarmed shareholders asked on September 25th, 2005 when Porsche announced plans to buy a 20 % stake in Volkswagen, Europe's biggest carmaker. Today in January 2007, Porsche holds 27.4 % of VW stocks (wants an increase to 29.9 %) and is the biggest VW shareholder.

2 | Presentation of the Group

The company's history

The Dr. Ing. h.c. F. Porsche AG is a German manufacturer of sports cars in the luxury segment with his domicile in Stuttgart - Zuffenhausen, Germany. Porsche was founded as an engineering office in 1931. Ferdinand Porsche gathered experience in the development of military vehicles during the First World War and worked for a number of companies as a constructing engineer (e. g. management board member and supervisor in the engineering office of the Daimler-Motor-Association).
On December 1st, 1930 he opened his first engineering office, which transformed into »Dr. Ing. h.c. F. Porsche GmbH, engineering and consultancy for engines and vehicle constructions« on April 25th, 1931. There his greatest successes were the construction of racing cars for Auto Union and his major impact on the construction of Volkswagen.

In 1937 the legal form of organization changed into »private limited partnership (German: KG)«. Between 1944 and 1950 the company evacuated the fabrication to Austria, where Ferry Porsche constructed the first Porsche named the 356 Nr. 1 Roadster. Ferdinand Porsche's son, Ferry Porsche, took over his father's chairmanship in 1947, while Ferdinand was in French imprisonment. Ferry inherited half of the shares and built up the sports car company under the trademark known today.

The daughter of Ferdinand Porsche, Louise Piëch, inherited the other half of the shares.
Her husband, Anton Piëch, was factory manager and director of the Volkswagen GmbH in Wolfsburg, Germany during the Nazi regime.

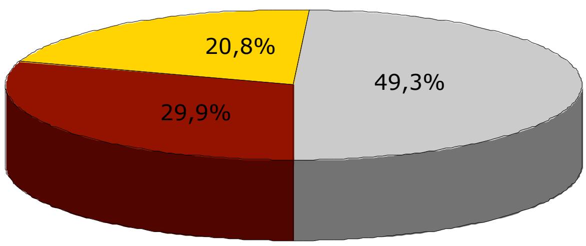
Over time, the personal interaction of the family members and their management functions led to controversy and family conflicts. Therefore in 1972, Ferry Porsche and Louise Piëch decided for future generations that no family members were allowed to participate in the management any more. The Dr. Ing. h.c. F. Porsche KG was transformed into a corporation
(German: Aktiengesellschaft AG).
One of the founders' grandsons, the young engineer Ferdinand Piëch, was forced to quit his service for the development of Porsche and needed to found his own construction office. Shortly after, he preceded his professional career at Audi and Volkswagen where he became chairman of the supervisory board.

Present situation | Porsche in numbers

The equity capital of 45,5 million Euros is divided into two halves: 8.750.000 ordinaries – held in equal parts by the members of the families Porsche and Piëch – and 8.750.000 preference shares listed on the stock exchange.

In autumn 2005 Porsche became the biggest shareholder of Volkswagen with a 25.1 % stake.
On January 26th, 2007 Porsche will ask for the increase of the shares from the recent 27.4 % to 29.9 % at the annual shareholders meeting. The acquisition costs of over 4 billion Euros were financed from Porsche's company assets.

The German federal state Lower Saxony is now only the second biggest shareholder.
Mr. Wiedeking denies rumors about an acquisition of VW. His company is satisfied with its 29 percent, does not believe in the sense of a total acquisition and also wants to stay independent, he explained to the Wall Street Journal during the Detroit Motor Show in Jan. 07 [1].
The reason for the percentage barrier is, that as soon as Porsche would own 30 % they would be forced to launch a takeover bid to the other shareholders of VW.



Percentage of shares in Volkswagen 2007

Porsche 29.9 % | Lower Saxony 20.8 % | Others 49.3 %

[1] Dow Jones Newswires, Finance, 10.01.2007

For a few years now, Porsche is the most profitable fabricant of automobiles in the world and at the same time one of the greatest taxpayers of Stuttgart. Porsche's profitability (Margin 2005) can be seen in the chart below, the comparison is made on the European automobile market.

Company Name	Country	Margin 2005	Sales 2005	Profit 2005	Margin 2004	Sales 2004	Profit 2004	Market Capitalization 2006
Porsche	**D**	**11,9%**	**6.574**	**783**	**9,7%**	**6.359**	**616**	**6.583**
Renault	F	8,1%	41.338	3.367	8,7%	40.715	3.551	25.559
Ford	TK	6,6%	3.801	250	8,1%	3.033	247	2.207
BMW	D	4,8%	46.656	2.239	5,0%	44.335	2.222	24.188
Audi	D	3,1%	26.591	824	3,5%	24.506	868	5.394
Fiat	I	2,9%	46.544	1.331	-3,4%	46.488	-1.586	11.469
Avtovaz	RUS	2,6%	4.261	113	2,6%	4.261	113	953
Daimler-Chrysler	D	1,9%	149.776	2.846	1,7%	142.059	2.466	41.425
Peugeot Citroën	F	1,8%	56.267	1.029	2,4%	57.038	1.357	11.637
Volkswagen	**D**	**1,2%**	**95.268**	**1.120**	**0,8%**	**88.963**	**677**	**15.454**

In Million Euros | actualization: 31.12.2005 (because annual reports for 2006 are not complete) | source: Handelsblatt.com

Last month, Porsche gave an outlook for the current financial year, which ends July 31, saying car sales and earnings will be around last year's level but it would be unlikely to match the 2.11 billion Euro pretax profit reached in the financial-year 2006 as that figure was inflated by several one-time effects (e. g. the sale of »CTS Fahrzeug-Dachsysteme GmbH« with a profit of 80.7 Mio. EUR and 203 Mio. EUR realized through the investment in VW [2]).

3 | The Macro-Environmental Factors (PESTEL analysis)

The PESTEL analysis categorizes environmental influences in six parts: Political, economical, social, technological, ecological, legal. There are various macro-environmental factors influencing the automobile industry. These global factors have an impact on all organizations working in the automobile sector and an analysis helps to identify the structural tendencies.

First – and most important – of all, the crisis in the gulf region, the unstoppable increase of oil prices and the decrease of global oil reserves show the industry's limits. New technologies will be needed in the near future to substitute the oil energy. Toyota, DaimlerChrysler and VW are craving for renewable energy sources to make the automobile ecologically competitive with other means of transportation.

The laws on exhaust fumes get tightened around the world to diminish the emission of carbon dioxide because of the increasing pollution. The legislative situation includes a lot of treaties and regulations by which manufacturers have to abide. Documents like the Kyoto protocol have worldwide impacts, e.g. on new engine-developments.

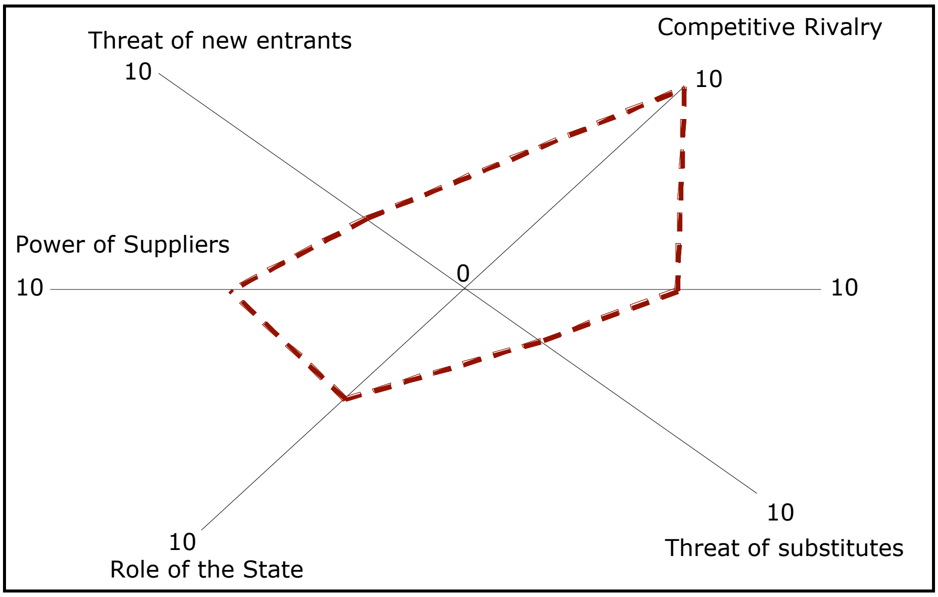
[2] www.finanznachrichten.de, »BörseGo«, article 23.01.2007

Politically, in Germany for example, the Ecological Taxation System augments the gasoline prices which forces the consumers' demand for renewable energy sources. High investments need to be made in Research and Development in order to find an effective and practical technology.
The Hybrid Technology tends to become the futures' solution to the problem and the first company that makes the technology applicable earns the profits of innovation.
Socio-demographically, automobiles developed into lifestyle-products and status symbols, transferring an image and families owning two or more cars are no rarity.

4 | Analysis of the Industry

Porter's 5(+1) Forces

The Industry's Hexagon



Concurrence situation in the European automobile industry | Intensity inside the red lines

Power of Suppliers | medium

The supplier industry of car manufacturers has experienced a concentration process during the last decades. High standards in quality have led to a situation where only the most profitable, high quality providers could survive. The result of this concentration process is, that the surviving suppliers have large ordering volumes and therefore notable bargaining power. Switching costs can be considerable and have an effect on the product quality. There is also a trend towards outsourcing large parts of the production cycle in order to reduce operational risk.

Power of buyers | medium

Single clients in the automotive industry have a medium bargaining power, there are substitute products as trains, buses and motorcycles, but the car itself is an integer part of European culture and a status symbol. There are relatively small transfer-costs imposed on the client and the development of leasing as a means of financing for the private market lead to consumers being more flexible in their decision to switch cars. Buying a car is often not a huge investment anymore, but the financing costs are part of a monthly budget. The over-supply of cars on the market leads to customers demanding good after-sales service, reliability and quality.

Threat of substitutes | small

As a means of transportation, the car is not subject to substitute threats, but the technology used is in permanent question. Therefore the industry is put under permanent pressure on innovation and research and development expenses are high.

Threat of new entrants | small

There are substantial commercial (distribution network and brand reputation) as well as competence barriers (advanced technology and experience) to enter the car market. The industry is capital intensive and economies of scale are important. Japanese companies faced large barriers when entering the European and American markets and only by applying a low price strategy was it possible for them. The development of a new brand is very difficult. The luxury sector has even greater entry barriers and except for some exceptions (e.g. Toyota with the introduction of Lexus) the attempt of entering the luxury sector often ends in failure (e.g. Renault-Peugeot's failure to launch premium models under their existing brands).
The strategy used by automobile companies to penetrate the luxury market has so far been to buy already existing brands (e.g. Jaguar by Ford, Bentley by Volkswagen, Rolls-Royce by BMW).

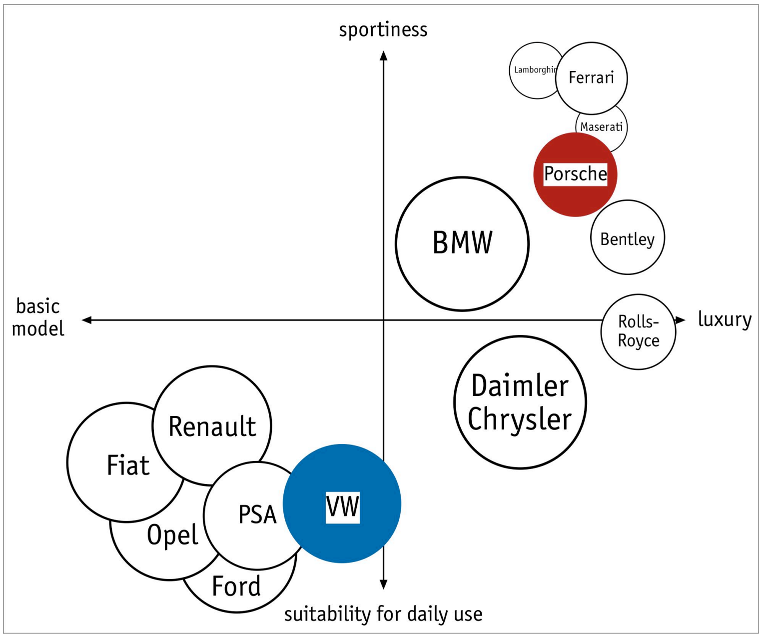
Competitive rivalry | very high

The car industry is very concentrated, fix costs are high, transfer costs are low and the market is considered to be mature. These factors attribute to a very high competitive rivalry among international carmakers.

Impact of the state | medium

The state has a considerable regulatory power and provides the infrastructure used by car-drivers. In addition, automotive companies are important employers in their countries and the state has an interest in maintaining them. Petrol prices are heavily dependant on the level of taxation. Another example of state involvement in the car industry is the so called »VW-Gesetz«, a special law that prohibits any single shareholder to gain more than 20 % of the VW-voting rights independent of the amount of shares in his ownership. As the German State of Lower Saxony holds a 20.8 % share in the company, the law is designed to protect VW from a foreign takeover bid. At the moment, the 46 year-old law gets arraigned at the European Court of Justice, decisions will not be made before June 2007. A possible abolishment of the law would increase the power of Porsche and would make a takeover possible.

Market segmentation



In order to identify Porsche's strategy and possible reasons for their investment in Volkswagen it is important to locate the companies in their industrial positioning and to segment the automobile market. While Porsche is known for being a very luxurious, individual and sporty car, a Volkswagen – independent of the price range – stands for daily practicability, reliability, quality and in general transports the image of »the car of the middle class«. Porsche's strategy is to focalize in the premium segment while VW covers the medium segment and tried to diversify into the luxury segment (e.g. Phaeton) but was not very successful. They project opposite images yet both being of German high-quality workmanship.

5 | Strategic Analysis of Porsche

The Porsche business model is based on a precisely defined, long-term invested product and brand strategy, which is called focalization on the luxury segment. In its center it focuses on performance, sportiness and emotion. Porsche builds automobiles, which are »the most beautiful combination between two points, the curve« – according to the Porsche advertisers. Porsche held on to its principles since its foundation.

Today Porsche's product portfolio consists of 4 main models, all designed for the sports car luxury segment and marketed under the same brand: 911, Boxster, Cayenne and Cayman. This shows that Porsche is following a niche strategy in the automobile industry. Porsche has diversified its portfolio but stayed within its niche.

Product diversification with strictly calculated risk

The Porsche product strategy is programmed to generate increase. A main element in the strategy of growth is the perfect balance between product variations and an »economic« expansion of the car model variety. The best example for this game of variation is the most typical Porsche product of all: the 911. The sport car was extended to a whole model lining with twelve independent models with two types of carriages (Coupé, Cabrio), two types of engines (rear end / 4-wheel drive) and four performance variations (Carrera, Carrera S, Turbo, Turbo S). With the 911-building set Porsche draws a price range between 74.700 EUR and 152.200 EUR. By using a single basic car model economies of scale and scope were generate.

The launch of new model lines are building the second part of the product strategy. The Cayenne, planned as a community project with VW, became price realistic through the conjoint use of the car's body shell. Porsche only had to invest 350 Mio. EUR in development expenses. Porsche takes care that each of its car models is highly profitable: no risk factors, no cross-subsidization, no model for image purposes only. This credo is also applicable for innovations, which are usually created by subcontractors.

Wiedeking's strategy is focused on the control of risk: Only technologies, which are able to survive on the market, are developed. There are no high investments in racing and Formula 1, because the risk of not being number 1 would be too high and would have negative impacts on the brand. Transfer risks get minimized through entire coverage of exchange rates and the capacity risk gets transferred to Porsche's subcontractors.

Capacity Management through outsourcing, low vertical integration

How profitable an automotive manufacturer can be mainly depends on how he can use his production facilities to full capacity – negative examples are Opel or Volkswagen, where over-

production leads to small profit margins. A complete concept for capacity utilization is needed. The former Volkswagen CEO Ferdinand Piëch believed in the »breathing factory«, which is a synonym for a flexible firm (working hours vary by production capacity, etc.). In earlier days, the production system at Porsche used to work night shifts, had an over-proportional intermediate storage and practiced over-engineering. Wiedeking follows a different course:
He cooperates closely with his external production suppliers. External production suppliers abroad build major parts of the models Cayenne and Boxster. Porsche's own part in the costs of fabrication is very low, especially compared with other automobiles in the premium segment, such as the Mercedes S Series and the 6 Series / 7 Series of BMW.

For the Boxster and its derivative the Cayman the Finnish partner Valmet is the »breathing« capacity part – if the demand decreases (e.g. caused by the life cycle of these models), Valmet bears the risk. As a result of this strategy Porsche was able to keep its high profit margins even though there was a loss in the selling rate of the Boxster in 2003 and 2004.

A similar strategy is used for the Cayenne, whose sales volume dropped on the US market in 2005 by 25 %. Porsche was still able to run high profits because the main part of the Cayenne production is outsourced in the VW factory in Bratislava, Slovakia. Parts for the Cayenne are increasingly bought in Europe's low-wage counties, get complemented there and only the final assembly takes place at the Porsche site in Leipzig, Germany. All together there are over 30 subcontractors working on the Cayenne, who receive approximately 50 % of the employed material from their subcontractors and of course these subcontractors also have their material-distributors. If a contractor has a German name, it does not necessarily mean that he also produces in Germany.

Communication and Image – Personalization of Porsche and Wiedeking

By adapting a smart communication strategy, Wiedeking is able to diminish any possible negative effects on the brand Porsche. At his public appearances, the top manager shows rough edges, tries to complete the image of manhood in the automobile business and sticks up for the production location Germany – even if those are only words and not facts. The media star Wiedeking is without any doubt the main sympathy carrier not only for Porsche clients.

6 | SWOT

The SWOT analysis summarizes the essential conclusions drawn from the environmental and the strategic capacity analysis of an organization. The strategic capacity (SW = strengths and weaknesses) results from the amplitude of the company's resources and competences, which allow them to survive and prosper. The model of the 5(+1) forces of the concurrence and the PESTEL model form the external part of the SWOT analysis (OT = opportunities and threats), which consists to identify the fundamentals of the concurrence to the firm in its industrial surrounding.

Strengths (Interne)	Weaknesses (Interne)
Strong Brand | Image High quality products Focalization on a profitable niche market Very high financial margin Effective risk management Operational Flexibility | Optimized value chain Personalization of Wiedeking and the brand	Focus on luxury segment leads to restricted growth in the luxury segment Relatively small innovation capacity -> dependence on external innovation suppliers Dependence on Wiedeking as a manager
Opportunities (Externe)	**Threats (Externe)**
Entering new segments through involvement in VW (diversification) Abolishment of VW law would lead to stronger influence Technological synergies with VW	Strong competitive rivalry in automobile industry High ecological standards Dependence on oil Association of Porsche's brand with VW

7 | Possible strategic reasons for Porsche's involvement in VW

Porsche's successful strategy resulted in high profits for the company. These profits need to be invested in order to make them even more profitable and create a solid future for the company.

One reason for Porsche investing in Volkswagen according to Mr. Wiedeking, was to secure Porsche's supply chain – considering the community project with VW (conjoint use of the Cayenne/Touareg body shell) – by preventing VW's breakup by investors such as hedge funds and therefore also to secure its future access to new technologies.[3] VW has a higher financial capacity to research these technologies and has already invested high amounts in Research and

[3] The Economist, »My way or the highway«, 6.02.2006

Development. Wiedeking says its involvement in VW is an explicit attempt to get more cooperation on technology matters.[4]

Another reason could be Porsche's will to diversify again. Indeed, Porsche cannot realize a diversification under its own brand name other then within the luxury automobile segment.
As mentioned above (Porter – entry barriers), the luxury segment has even greater entry barriers then the general automobile segment and often the attempt of entering it ends in a failure.
It can also be exactly the other way around: Porsche could degrade its high-class image if it tries to diversify into the medium-class segment (e.g. family 4-seater under 60.000 EUR).
The analysis of strategic groups shows that Porsche and VW would complement each other in terms of their product range.

The strategy used by automobile companies to penetrate the luxury market has so far been to buy already existing brands (Bentley by Volkswagen). Indirectly Porsche would apply this strategy by its involvement in VW's operational business. VW on the other hand does not have an influence on Porsche's operational business and a decrease in profitability rates for Porsche is unlikely if innovation or restructuring efforts fail at Volkswagen.

So far, Mr. Wiedeking denied all upcoming media announcements of a merger between Porsche and VW. As reported by the German magazine »Focus« and confirmed by Porsche, there is no will of complete acquisition. Despite his professed lack of interest in running VW, Wiedeking has a detailed knowledge of its operations. Productivity is VW's biggest problem, he says. Wiedeking already sits on VW's supervisory board, and though he spends a significant amount of time on VW's affairs, he insists he has no interest in running both companies.[5]

On the other hand, Porsche wants to use its influence on VW's supervisory board - the equivalent of an American board of directors – to improve productivity and profits. In the future VW should make profits with all of its models. Regarding information by the »Automobilwoche«, Porsche CEO Wiedeking is pushing to get Porsche at least one more seat on VW's supervisory board to add to the two it already has, to increase his influence in Volkswagen affaires. He told »Welt am Sonntag« that a Volkswagen AG stake just below 30 pct is sufficient for the sports carmaker to represent its interests at VW.[6]

[4] www.money.cnn.com, 9.01.2007
[5] www.welt.de/data/2006/12/11/1141702.html, 24.01.2007
[6] Frankfurt AFX Notes, 10.12.2006

Strategically – not an important matter – but still a very influencing one, are the ties of the families Porsche and Piëch. As mentioned in the company's history, Ferdinand Piëch one of Porsche founder's grandsons is today chairman of the supervisory board of VW. Porsche discouraged any possible attempt of an external takeover of VW through hedge funds by its investments.

8 | Conclusion

Porsche mastering VW

On the 25th of Sept. 2005, when Porsche invested in Europe's biggest carmaker Volkswagen AG, discreet voices came from Stuttgart, saying Porsche would not influence VW's operational business, its only wanted to save its German sister from an overtake of hedge funds. Only a few months later Porsche CEO Wendelin Wiedeking made his vision clear: »we will take care that all Volkswagen shareholders will profit from our investment.«

And indeed, financially, the entrance in VW businesses is a very profitable investment.
The afternoon before 25.09.2005 the VW share closed with 51.86 EUR and on Thursday the paper had increased up to 85.92 EUR. According to the recent price of the VW share (85.46 EUR | 24.01.2007)[7], the value of the package is worth around 7 billion Euros compared to the 3.5 billion Euro investment made.

Strategically, for their 29.9 % participation Porsche can influence everything it wants in order to raise its profits: all strategic matters of the VW group, the protection of their most important subcontractor VW, access to new technologies and a profitable return on their investment.

As dominant as Porsche might be at the moment, in the long-term future the stability of VW ownership is crucial. Porsche has common projects with VW and »Porsche cannot deal with the hybrid electric and fossil-fuel car technology itself« says a speaker from the institute of automobile economy (IFA). Porsche needs the aid of VW because globally, even with a production of 96.794 cars, they are still a small series producer.

[7] www.finanznachrichten.de

9 | Bibliography

Books & Annual Reports

Johnson, Scholes, Whittington & Fréry, 2004 | »Stratégique« | ISBN 2-7440-7089-0

Dr. Ing. h.c. F. Porsche AG | »Annual Reports« | 2005 & 2006

Volkswagen AG | »Annual Reports« | 2005 & 2006

Grant, R. M. 2004 | »Contemporary Strategic Analysis« | Blackwell Publishing, London

Websites

»Porsche drängt auf mehr Einfluss bei VW« | 22.01.2007

www.businessnews.com/business/art614%2C314620.html?fCMS=76caf180309289dde758793a8cf83a5b

»Porsche drängt auf mehr Einfluss bei VW« | 21.01.2007

http://www.handelsblatt.com/news/_pv/_p/200038/_t/ft/_b/1213282/default.aspx/index.html

Dow Jones Newswires | »Wiedeking will keine Fusion von Porsche und VW« | 10.01.2007

http://www.peopleanddeals.de/article/2739/wiedeking-will-keine-fusion-von-porsche-und-vw

Alex Taylor III | »Porsche CEO moves closer to VW« | 9.01.2007

http://money.cnn.com/2007/01/09/news/companies/porsche.fortune/index.htm?section=money_latest

Reuters | »Haben aktuell keine VW-Aktien gekauft« | 5.01.2007

http://de.today.reuters.com/news/newsArticle.aspx?type=companiesNews&storyID=2007-01
05T185600Z_01_HAG568146_RTRDEOC_0_DEUTSCHLAND-AKTIEN-VOLKSWAGEN.xml

»Porsche weist Gerücht über Aufstockung des VW-Anteils zurück« | 5.01.2007

http://moneycab.presscab.com/de/templates/?a=27017&z=3

»EU-Gerichtshof entscheidet über VW-Gesetz« | 12.12.2006

http://www.businessnews.com/business/art614%2C254981.html?fCMS=4202695f91d70f366a7701df7d5210db

dpa | «Porsche-Chef will die Macht bei VW« | 11.12.2006

http://www.abendblatt.de/daten/2006/12/11/650516.html

Jörg Eigendorf | »Warum Porsche VW komplett kaufen wird« | 11.12.2006

http://www.welt.de/data/2006/12/11/1141702.html

Alfred Kueppers | »Porsche CEO Wiedeking says roughly 30 pct VW stake enough to represent interests« | 10.12.2006 | http://www.finanznachrichten.de/nachrichten-2006-12/artikel-7433798.asp

»Porsche am VW-Steuer« | 10.12.2006
http://www.n-tv.de/742461.html

M. Kröger & A. Seith | »Familien wollen Exklusivrecht auf Stammaktien aufgeben« | 7.12.2006
http://www.spiegel.de/wirtschaft/0%2C1518%2C453155%2C00.html

Oliver Wihofszki | »Porsche fordert mehr Macht bei Volkswagen« | 7.12.2006
http://www.ftd.de/unternehmen/industrie/139221.html

Matthias Krust | »Porsche beziffert VW-Investment auf rund 3,5 Mrd EUR« | 7.12.2005
http://www.finanznachrichten.de/nachrichten-2005-12/artikel-5708214.asp

M. Krust | »Porsche bekräftigt: VW-Investment bringt 2-stellige Rendite« | 27.09.2005
http://www.finanznachrichten.de/nachrichten-2005-09/artikel-5394234.asp

W. Scheib | »HINTERGRUND: Porsche bremst mit Einstieg bei VW Hedge-Fonds aus« | 26.09.2005
http://www.finanznachrichten.de/nachrichten-2005-09/artikel-5389181.asp

»Spektakuläre Überraschung bei Porsche und Volkswagen« | 26.09.2005
http://www.finanznachrichten.de/nachrichten-2005-09/artikel-5386281.asp