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[Is the luxury car market facing long-term decline?](#)

When you were little and you wanted to buy something your parents gave you the money, if you were lucky. Life was so much simpler when you didn't have to worry about where the money came from, you just had to ask nicely for it (and do your homework). For many adults the first few years of the 21st century have seen this easy approach to shopping return and if you wanted to buy a car, the manufacturer or the dealer would offer you the money to buy it. If you look in detail at the car industry you see how cheap and easily available credit oils the wheels of this particular brand of commerce at so many levels and it has been especially successful at elevating the luxury end of the market into the mainstream.

The premium car market has boomed during the last decade, to the extent that in the UK the BMW 3 Series now outsells the Ford Mondeo, the Vauxhall Vectra and the Renault Clio. Throughout Europe BMW only sold 5000 less 3 Series than Ford sold Fiestas. The cars in the premium sector, even though they are considerably more expensive than their rivals, have enjoyed huge sales increases at the expense of the more mundane brands as people have been able to upgrade due to easily available finance. Some of the main beneficiaries of this step change in spending habits has been BMW, Mercedes (owned by Daimler) and Audi, all of whom have seen their luxury car ranges move into the mainstream. BMW and Mercedes in particular have benefited from the increase in demand for SUVs with their popular X5 and ML models, with Audi coming late to the game. According to the Society of Motor Manufacturers and Traders either Mercedes or BMW take the top place for sales in the Upper Medium, Luxury Saloon and Executive sectors of the UK car market. 4 out of the top 5 Sports cars on sales in the UK are German. In fact, German-owned marques dominate the top of all these sectors despite the fact that they tend to be more expensive than the equivalent models from other marques.

The expansion of the German car manufacturer's sales in the last decade has come about as a direct consequence of rising aspirations and the ability to achieve them. Whilst ownership of a BMW or Mercedes used to signify a certain level of success, today these marques are accessible to a far more wide ranging section of society and they are a lot less exclusive than they used to be. In addition, new car ownership has increased in the UK so that we now have the youngest fleet of cars on the roads in Europe. This is probably best explained by the fact that the UK has the highest proportion of cars purchased with loans and it is this reason that explains why the premium car sector has been able to increase its market share.

Globally, *one in three* Daimler Group vehicles is bought on finance that is provided by the company itself. As well as being a major car manufacturer the Daimler Group is also the world's largest manufacturer of trucks, and as economic activity around the world has increased, so has demand for their trucks. At BMW, nearly *one in two* vehicles is purchased using BMW-supplied finance and they also offer their own credit cards, home insurance and savings accounts in certain markets. To drive expansion of the distribution network they lend money to dealers to enable them to make property purchases and to buy stock and equipment. Last year nearly 20% of BMW Group profits came directly from their own

financial services division. It's clear that the ability to lend and borrow money is a crucial part of the business model for the major car companies.

However, the credit crunch has changed the dynamics of car retailing. Buyers are finding it more difficult to get credit, the credit is more expensive when they do get it and there are less people who can afford the monthly payments for a luxury car. Buyers are trading down or postponing their purchase. In the US, used car prices have plummeted, especially for large luxury cars and SUVs that tend to consume more fuel than smaller cars. This means that when clients who leased their cars trade them in, the residual values are much lower than had been forecast at the outset of the lease period. This is bad news for the car companies as it means they sell each leased car at a lower price and they have been forced to write down the value of their leasing books. Leased assets at BMW totalled \$20 billion in 2007 and this year they have already increased their risk provisions for residual value risks and bad debts to €695 million.

BMW lent €8 billion to dealers last year and this money must also be at risk as car dealers fight weaker demand and higher operating costs. Pendragon, the UK's largest car dealership group, recently announced that trading conditions were deteriorating and they have been cutting staff and other overheads to reduce costs. National car sales were down 18.6% in August compared to a year ago. Potentially more worrying, according to their 6 month statement of results Pendragon has in recent years made significant profits from the sale of its properties but the credit crunch has cut a swathe through the UK commercial property sector and this source of revenue is likely to be very weak, if not non-existent, for at least the next couple of years. The dealer's best business hope is that revenue from parts and servicing continues to be strong but even this is likely to decline as people use their cars less frequently and more people take public transport rather than pay high petrol prices.

The modern day car business is one that is completely reliant on the availability of cheap and easily available credit. It drives almost every part of the business model, either directly or indirectly, and without this finance the industry could go into serious decline if the credit market fails to return to its former glory. The huge growth in the market for the luxury brands is going to reverse as people trade down and the major luxury manufacturers, especially the German marques, are going to see their business model come under severe pressure. It is possible to envisage a luxury car industry that experiences declining demand for years to come as UK consumers pay down debt, face rising unemployment and as a weak Pound pushes up import prices. A 'luxury' may once again become just that, rather than something that everyone can afford