Volkswagen in the USA - Open Case Study

1. Introduction

The purpose of this paper is to analyze Volkswagen's operations in the USA examining the effects of globalization on Volkswagen (VW), and to describe the strategies that VW has developed or should develop in order to improve its position in the USA. This paper is based on a case study and has even been researched further by taking into account the current situation of VW in the US market.

The paper is divided into three sections where the first section provides a background on VW's global operations, with a particular emphasis on its promotion and distribution strategies in America. The second section contains a brief literature review on globalization within the context of the automotive industry wherein VW operates reflecting the first section of the paper. The third section explores the international structure most appropriate for VW based on its current position in the US market.

1.1. Overview of VW in America

The Volkswagen Group (VW) is one of the world's leading and most respected auto manufacturers, showcasing such premiere brands as Skoda, Seat, Lamborghini, Bugatti, Pasat, Touareg, Phaeton, Audi and the New Beetle to over 150 markets worldwide (VW Website, 2006). But at the same time the company's growth and expansion outside its home country in Germany has been met with a lot of challenges in the past particularly in the USA where it gets 20% of its total revenues (Welch, 2006).

Volkswagen's recent history in America has been quite bad because after selling 600,000 units some years in the U.S. in the 1960s, VW tumbled to just 49,000 sales in 1993 and seriously considered abandoning the U.S .market. But in 2005, VW sales have dropped to about a quarter-million in America, after a string of high-profile recalls and a swift aging of its product line losing nearly $1.3 billion in America. However in 2006, Passat and Jetta raised a small resurgence in the U.S. sales by 10% rise. Yet it is estimated that in 2007, VW will have just 1.4% market share in US. VW has now brought the Eos convertible to the States and is even mulling another model to sit in between the $17,000 Jetta and the $16,000 Passat (Padgett, 2006). It is a good strategic move indeed, but VW still needs to achieve a real strong presence in the U.S.

1.2. Overview of VW in the World

Looking at VW's worldwide operations within the contexts of globalization as defined and described above, it is quite apparent that VW can truly be considered as a global corporation that has, in one way or another, implemented global strategies in their pursuit of a world's share in the automotive industry. It is headquartered in Germany and the Volkswagen Group employs about 343,000 employees dispersed in its 47 production plants located across eleven European countries and seven others in Asia, Africa and the Americas producing over 21,500 vehicles annually. These vehicles are sold in more than 150 countries with the European Community (EC) being its largest market by far with sales comprising more than 60% of its total global revenues (Anonymous, 2006). **Appendix 1** highlights VW's global expansion history from its birth to the year 2002.

VW's annual global sales increase has been consistent from 1990-2004 (except in 1993) with evidence of growing proportion of foreign sales with respect to total sales. Vehicle production has also shifted from home-based to overseas. Consequently, this has reflected on the growth of its workforce, with reportedly more employees' working outside Germany in 2004 as compared to the 1990's when majority of employees were based in the home country. **Figures 1-3 in Appendix 2** illustrate VW's global presence 1) Worldwide, 2) In the North American region and 3) In the European area as represented by sales growth plots between the periods of 1998-2005 with respect to two other major automotive manufacturers, General Motors and Toyota.

VW sold about 3,617,000 vehicles worldwide in 1996 and total sales amounted to $52.85 in 1997 [Auto Case, 2000]. As conveyed in **Figure 3**, European countries have been its largest market followed by the U.S., Mexico and Canada as its three other major markets, with North America accounting for the bulk of purchases especially during the late 1990's when the New Beetle was introduced. Moreover, there is evidence of increasing dependence on the North American market towards the end of the 20th century (**refer to**

Figure 2). In 1997, despite meagre advertising budget allotment to the US market (compared to other automobile manufacturers and VW's overall global advertising budget), VW was able to sell 137,885 vehicles as opposed to 135,907 in 1996, showing a significant 1.5% in growth (Automotive News, 1998). Among the brands sold in the North American region are the Passat, Jetta, Golf and the new Beetle, the first two topping the sales charts and the last one coming in as the third bestseller. Box 1 in Appendix 3 shows VW's sales in the US in the last two years.

1.3. Globalization - Promotion and Distribution Strategy

Then turnaround in the last few years was achieved by the New Beetle and a string of sharp, savvy products like a popular Passat that also scored well with many c*onsumer Reports* magazine. Global Products and their related brand structures therefore become important to individuals due to their ability to carry and communicate cultural meaning (Belk, 1984; McEnally and de Chernatony, 1999). Global branding is a phenomenon created by international marketers (Albaum *et al*., 2002). Great TV ads and good cars helped boost sales in 2001 to 356,000 units, and the half-million mark seemed within reach again (VW, 2006; Padgett, 2006).

VW now has a strong promotion strategy but it still has a weak distribution strategy because the German auto maker has been creating big turnaround plans and still loses money on each car exported to the U.S. (TCC Industry Report, 2006). Improved technologies have enabled companies to expand their markets worldwide and intensified competition has compelled organizations to outsource some of their non-core activities to other firms possessing the expertise. Under the waves of globalization and outsourcing, it is evidenced that large manufacturing companies often develop their products in Europe and the USA, manufacture in Asia and Latin America, and sell worldwide. But VW still exports its cars from Germany paying approx. $1700 rather than making it cheaper in East Europe hence hampering price in the US market. Already, VW's six German factories run at only 60% of capacity way below a level that ensures profitability analysts estimate (Welch, 2006; Edmonson, 2006).

The Promotion strategy of VW to move the brand upmarket with an expensive Touareg SUV and a Mercedes Benz competing Phaeton had been disastrous to the U.S. brand image, a fact which was late admitted by the sales chief of VW-US. The luxury strategy worked brilliantly in Europe confused American buyers who once knew clearly what the brand stood for. The brand's volume vehicle, the Jetta, has been a poor seller in its current generation as it is only expected to sell 110,000 units in 2006, down from 140,000 unit sales in 2001 (Edmonson, 2006). This is due to brand or product overlapping since the Jetta is a compact car priced along the lines of a Toyota Camry or Honda Accord. With a price spread from approx. $18,000 to $30,000, it conflicts against base BMW 3-Series sedans - and overlaps Volkswagen's own mid-size Passat (Welch, 2006). In trucks the VW brand offers precisely only one vehicle in a class that represents 53 percent of all U.S. sales.

1.4. <u>Standardization vs. Adaptation Issues:</u>

While traditional marketing concepts regard varying consumer needs and wants as critical and important components of targeted marketing programs, the globalization phenomena provide market indicators that go against this view. Specifically, Levitt (1983), in his Harvard Business Review article, established the rationale for global standardization. He argued that by focusing on the homogeneity in the demands of world markets and standardizing the production, distribution, marketing and management aspects of international business according to these similarities, global corporations stand to gain the substantial benefits of economies of scale and cost efficiency.

Even before Levitt's article came about, VW's initial entry to the U.S. already had the inclination towards product standardization. In 1949, the Beetle was introduced in the U.S. as a standardized, relatively cheap, stable and reliable 'people's car'. Using a Fordist strategy of mass production (Jurgens, 1999), the vehicle became an instant hit in America capturing a 6% share of the market during the 1960's. Its popularity, however, declined during the 1970's as customers showed preference for newer vehicles with more modern designs, which was what the Japanese were starting to offer. In addition, the quality of the German car was also perceived to be suffering as it was made more affordable. In short, the vehicle badly needed a makeover both in design and in quality. At that time, the company was under the leadership of Heinz Nordhoff who did not believe in restyling the vehicle just to make sales. He founded Volkswagen on the principles of the 'Beetle Philosophy' which prioritized uniqueness and brand identity over style and design. While this trademark philosophy catapulted the Beetle as the best selling vehicle in the automotive history during the 1950's and the 1960's, the changing international business environment proved it to be ineffective with the strong entry of Japanese vehicles that offered greater flexibility in design without sacrificing reliability, quality and affordability.

The Japanese achieved their competitive edge in the US market through the implementation of the lean production method – a production system that enables a company to manufacture a large variety of high-standard products at reduced cost, labor and time. One of the most popular facets of the lean production is their Just-In-Time principle (Kotler, 2000).

It is therefore evident, that VW suffered from development blocks by strictly adhering to standards that were no longer relevant to the changing international business environment. VW wanted to duplicate their success in the domestic market without considering the possible impacts from other foreign competitors.

A brand goes global to sell more stuff and make more money. Beyond that, of course, is the desire to build brand equity (De Chernatory, 2001) such that users can find comfort in seeing their favourite brands wherever they happen to be in the world. But even with all these benefits, Asher (2005) argues that it may not be appropriate for brands to expand globally or the investment of time, money and effort may not pay off due to the following reasons with examples:

a) Lacking Demand. There is little or no consumer demand for this type of product or it is unacceptable because of cultural traditions.

b) Linguistic Considerations. Another problematic challenge of global marketing is the brand name and/or graphic elements being unavailable or inappropriate in a foreign market (McCall & Stone, 2004).

c) Brand Overlapping or Proliferation. If an excess of fitting products are already available that adequately meet consumers' demands, it is difficult to introduce another one just because it is a global offering.

Hence, VW must "*fit the U.S. market's needs…even if it means taking on a partner*," says VW-US sales chief Mr. Hallmark, while preserving the brand's heritage for driving fun and German design (Padgett, 2006). It becomes clear at this point that VW only requires recapturing the essence it has lost in the US many years ago. Over the last five years, VW has also lost share in its European market, apart from its U.S. share fall by one-third especially due to labour union problems which have been highlighted in the case study. VW had to tussle with the German unions and create a restructuring plan that targeted 20,000 jobs. The costs of that plan erased most of a $1.2 billion operating profit in the third quarter, but fortunately it stabilised.

2. Globalization (Literature Review)

At its most fundamental, globalisation refers to the world as one big market and source of information. It is characterised by a free flow of goods, people and information around the world, an internationalization of economic processes and the emergence of world markets (Lemoine, W. and Dagnaes, L., 2002). Consequently globalization has given rise to new concepts such as global industries, organizations and strategies used to market and sell global products, brands and services.

According to Hill (1997, 2003, 2005) the term globalization refers to the shift toward a more integrated and independent world economy. He further states that it has two main components – the globalization of markets and the globalization of production. Here, the former is being pursued by VW when it should be pursuing the latter. Authors like Douglas and Wind (1987) have offered a very strong and convincing counter argument: "*the design of an effective global marketing strategy does not necessarily entail the marketing of standardized products and global brands worldwide. While such a strategy may work for some companies and certain product lines, for other companies and products, market adaptation to local or regional differences may yield better results".* But problems arise due to the diversity of religious beliefs, customs, standards of living, legislation, and media availability. Product and promotion modification in the automobiles industry are often mandatory because of government regulations that set product standards, systems, and other requirements (Low & Mohr, 2000).

The automotive industry has been recognized as a global industry in the sense that business activities or transactions made by a multinational automotive enterprise would not likely follow the business model from its host country. In this view, the general concept of globalization as one big market place for homogenous products and services, has been regarded as a myth (Rugman, 2000; Rugman & Hodgetts, 2000)

Furthermore, Hamel and Pralahad (1985) 'defined a global company as a firm with distribution systems in key foreign markets that permit cross-subsidization, international retaliation, and world-scale volume' (Medina & Duffy, 1998; Wall & Rees, 2001). By this definition, emphasis is placed on strong brand positions and distribution channels, which constitute a critical part of a company's global strategy. Establishing one's presence worldwide demands management of a complex mix of marketing policies, manufacturing facilities, logistical systems and financial flows within an international context (Leontiades, 2001). As such, global companies like VW stand to face situational challenges specific to the location in which they have established their global operations (Rugman & Verbeke, 2004). In their book, *Managing Across Borders*, Bartlett and Ghoshal (1989) proposed three organizational strategies vis-à-vis the forces that favor 'global integration' as shown in

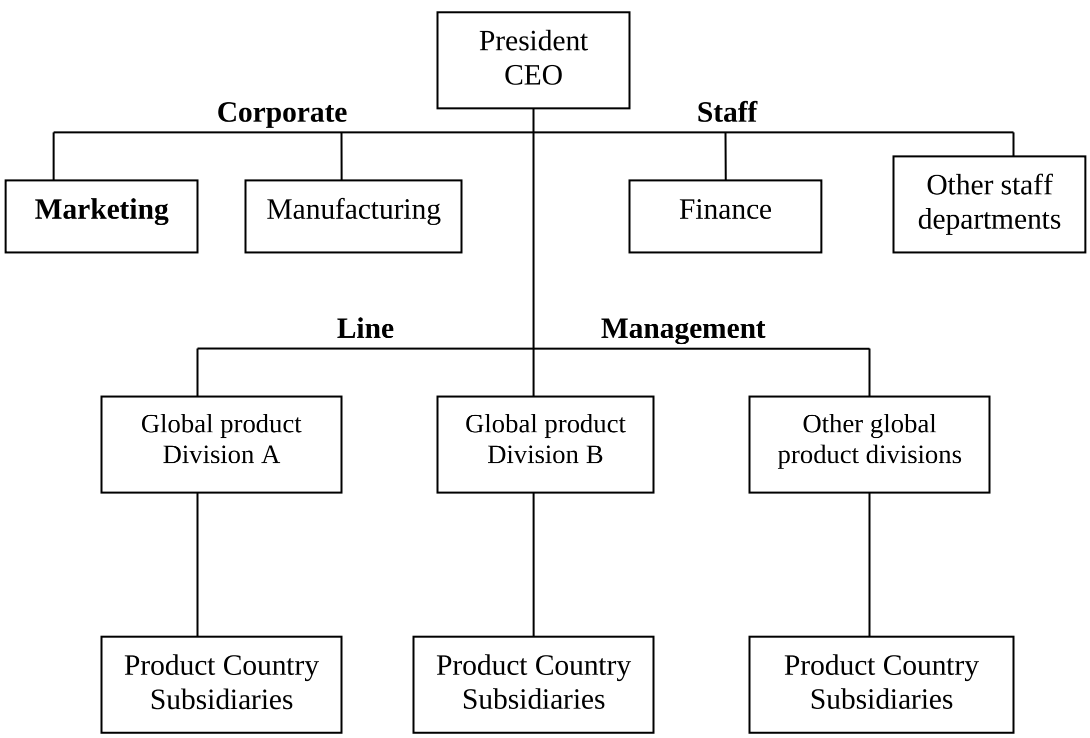
Table 1. *International Business Strategies as proposed by Bartlett & Ghoshal (1989) (Adopted from Kotler, 2000, p. 387).*

Strategy	Description	Global integration forces
Global Strategy	Treats the world as a single market	Strong for global integration; weak for national responsiveness
Multinational Strategy	Treats the world as a portfolio of national opportunities	Strong for national responsiveness; weak for global integration
'Glocal Strategy'	Standardizes core elements and localizes other elements.	Demand for flexibility in terms of localizing some parts or equipment is high while standardization of core components is permissible

3. VW's Form of International Structure in the US

The global business units develop and market products on a worldwide basis. This was a major shift from the old organization where country mangers set prices and handled products as they saw fit. Prior to VW's comeback in the US market with the success of the New Beetle, VW's corporate governance had been highly centralized to the Wolfsburg headquarters. Its stakeholder organization consisted of highly prominent representations form the state of Lower Saxony, the works council and the labour union (Jurgens, 1999). Production had also been highly dependent on the European labor force, which was getting more costly in terms of wages and other worker benefits expenses.

In a slow but steady turnaround of events, VW eventually changed its structure in 1994 by establishing three regions (Europe, North America and South America) which became profit centres and four differentiated brands – the Volkswagen, Audi, SEAT, and Skoda – which became and remained as independent companies represented in VW's corporate board (Ball, 1983; Jurgens, 1999). An International Organization structure based on product **(Kramer, 1994)** is applied as it fits VW's organizational structure shown below.



Global Products and their related brand structures therefore become important to individuals due to their ability to carry and communicate cultural meaning (Belk, 1984; McEnally and de Chernatony, 1999). Global branding is a phenomenon created by international marketers (Albaum *et al*., 2002). A branding strategy describes how (for *i.e.* VW) brands should be utilized and organized, whereby the relationship between corporate name and brand name is also determined (Jurgen, 1999).

The effects of VW's reorganization likewise reflected on the company's global brand development and production strategy. Whereas the former companies of each of the brands conducted their own product development activities, the new strategy implemented in 1995 advocated the platform approach, which significantly reduced the number of platforms to only four and eventually to two (developed by Volkswagen and Audi), the small car platform and the compact car platform. These platforms provided the bases for the establishment of new product development organizations within and production schedules that were targeted to reduce the 'time to market' to less than four years after the design was approved. Consequently, this meant a significant reduction in production costs that would lead to more competitive prices. An increase in the number of models was also encouraged by this strategic move.

The platform approach paved the way for the development of the New Beetle in 1998 which has proven to be increasingly popular among the US consumer market. The New Beetle was re-introduced to the US market through a high profile launch that sought to stage a "convincing comeback based on the needs and wants of U.S. customers" (*Automotive News*, 1998). The success of this re-launch, as evidenced by the sales performance shown in **(Box 1 of Appendix 3),** has shown that the strategy of niche marketing works well with VW's global operations in the US.

VW's new brand-based strategy has also shown positive effects in the performance of other models as well. The Jetta and the Golf have remained as the two highest sellers in the US. The renewed focus on Mexican production could be attributed to the success of VW's strategy. Mexico has proven to be a suitable production site for VW whose Puebla plant has been responsible for the production of most of the Volkswagens on the road in North America, with labour costs that are a small fraction (about 12.5%--$5/hr. in

Mexico versus $41/hr. in the U.S.) of those in the U.S. (Auto Case, 2000). Since Mexico has been the sole source of the new Beetle, VW has achieved a price advantage that has gained for it its competitive edge. Thus, in terms of the new Beetle product, VW's strategy of facing the competition has been effective, in so far as its sales growth has shown **(refer to Box 1).** As regards, the other vehicles however, such as the Golf and the

Table 2: VW's Brand Images (Source: Rädler, IIM Development, 2002)

Audi	Challenging the conventional
Bentley	Gentleman's sporty touring car
Bugatti	Masterpiece of automotive engineering
Lamborghini	Uncompromising sports car
Seat	Auto Emocion (automotive emotion)
Skoda	Creative solutions for smart customers
VW	The benchmark for automotive values

4. Recommendations

VW needs to adjust the cost and content of vehicles already in the pipeline, those on sales already or too near their on-sale date to be reworked, such as the Eos hardtop convertible. Then VW should add more range of profitable products like SUVs in the American market. There is also a major need to reorganize Volkswagen's structure around its luxury brands and mass-market brands. The premium brand group would include Audi, Bentley, Bugatti and Lamborghini, and the high-volume brand group would include Volkswagen, Seat and Skoda. The old assemblage which grouped Volkswagen and Skoda with Bentley, was artificial and contrived. And an increase in Germany's value-added tax scheduled to take effect in 2007 could also dampen auto sales in VW's home market. Hence, if VW seeks to be a market leader again in the U.S., it probably needs to shift its global strategy to the 'glocal strategy' if they could be flexible enough to permit localization of some of the parts while retaining the core features of its vehicles, especially focus on more SUV products in the US.

5. Conclusion

Overall, VW need to have lower cost targets and a stronger focus on U.S. customers if they wish to sustain competitively. While it cuts costs, VW it would have to return to its roots as a people's car, at least in the U.S. market, thereby its strategy would have to be global, yet local.

In light of the above recommendations, this paper shall conclude with a recommendation on the most appropriate strategy that is most likely to work for VW in the near future. It gets clear that Volkswagen needs to get out of the slow lane. Virtually every European automaker has set Toyota's production efficiency as its benchmark. Volkswagen costs are so high it loses money on every car made in Germany. Once the "value-for-money" brand, VW has lost its identity. The longer it waits to forge a new compelling strategy, the riskier.

5. References

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5.3. Internet

42. VW Website **(2006)** – Volkswagen website – US region [http://www.vw.com/]

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9. APPENDICES

Appendix 1: Volkswagen's history and key international expansion decisions (Source: Duke Ciber, 2006)

1937: Birth of Volkswagen
1947: First exports (to the Netherlands)
1952: Establishment Volkswagen Canada ltd.
1953: Establishment Volkswagen do Brasil ltda.
1955: Establishment Volkswagen of America Inc.
1956: Minority stake in South African Motor Assemblers and Distributors Ltd. (Importer)
1960: Partial privatisation Volkswagen (40% of the shares remain with the "Bundes" and "Landes" governments)
1964: Establishment Volkswagen de Mexico, S.A. de C.V
1965: Acquisition high-end car manufacturer, in 1985 to end up as Audi
1966: SAMAD renamed as Volkswagen of South Africa (Pty) ltd.
1968: Establishment Svenska Volkswagen AB
1971: Establishment Volkswagen Bruxelles S.A
1981: Acquisition Chrysler Motors do Brasil Ltda, to be renamed as Volkswagen Caminhões Ltda (production larger commercial vehicle)
1982: Trial assembly in China
1982: Start cooperation with Sociedad Española de Automóviles de Turismo, SA (SEAT)
1985: Establishment 50/50 joint venture Shanghai-Volkswagen Automotive Company, Ltd
1986: Volkswagen takes majority interest in SEAT
1988: Cooperation with First Automotive Works (China)
1990: Formation of number of companies in East Germany
1990: Takeover of KODA, automobilová A.S.
1991: Establishment 40/60 joint venture FAW-Volkswagen Automotive Company, Ltd.
2000: Acquisition 18.7% shares and 34% voting rights in Swedish truck manufacturer Scania A.B.
2001: Establishment Volkswagen Group Australia Pty. Ltd.
2002: Start operations Bratislava plant of Volkswagen Slovakia; Start building second plant in China

Appendix 2.

Figure 1. Worldwide Sales Growth 1998-2005 (Duke Ciber, 2006)

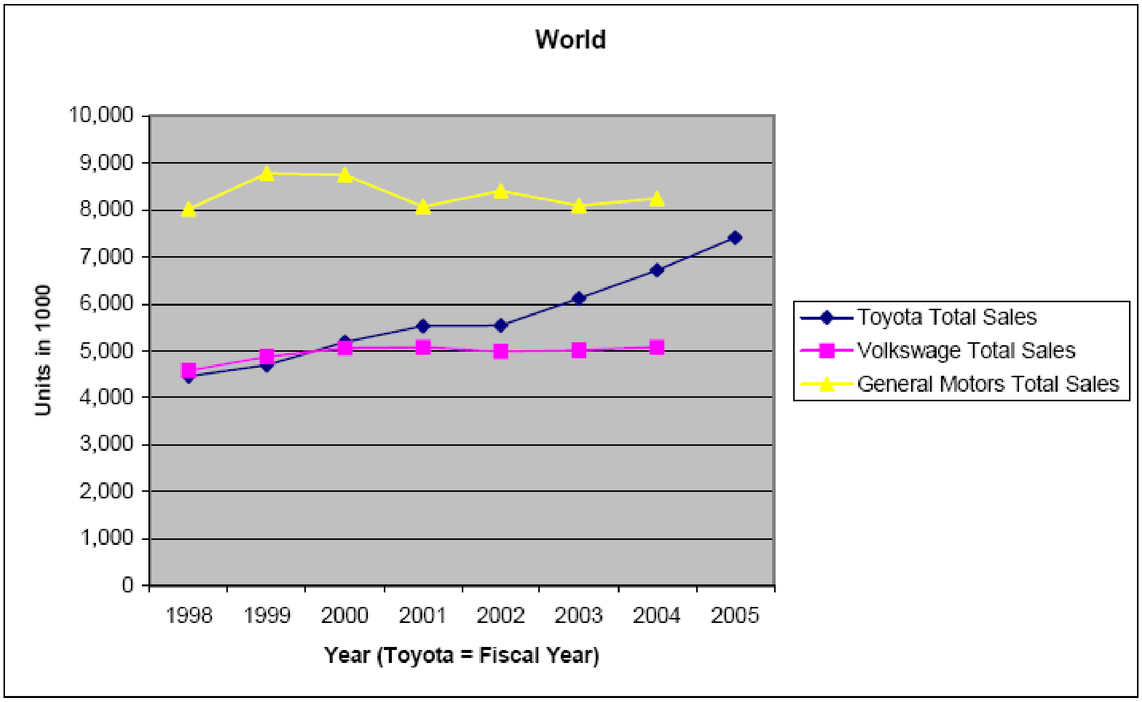

Figure 2. Sales Growth in North America (Duke Ciber, 2006)

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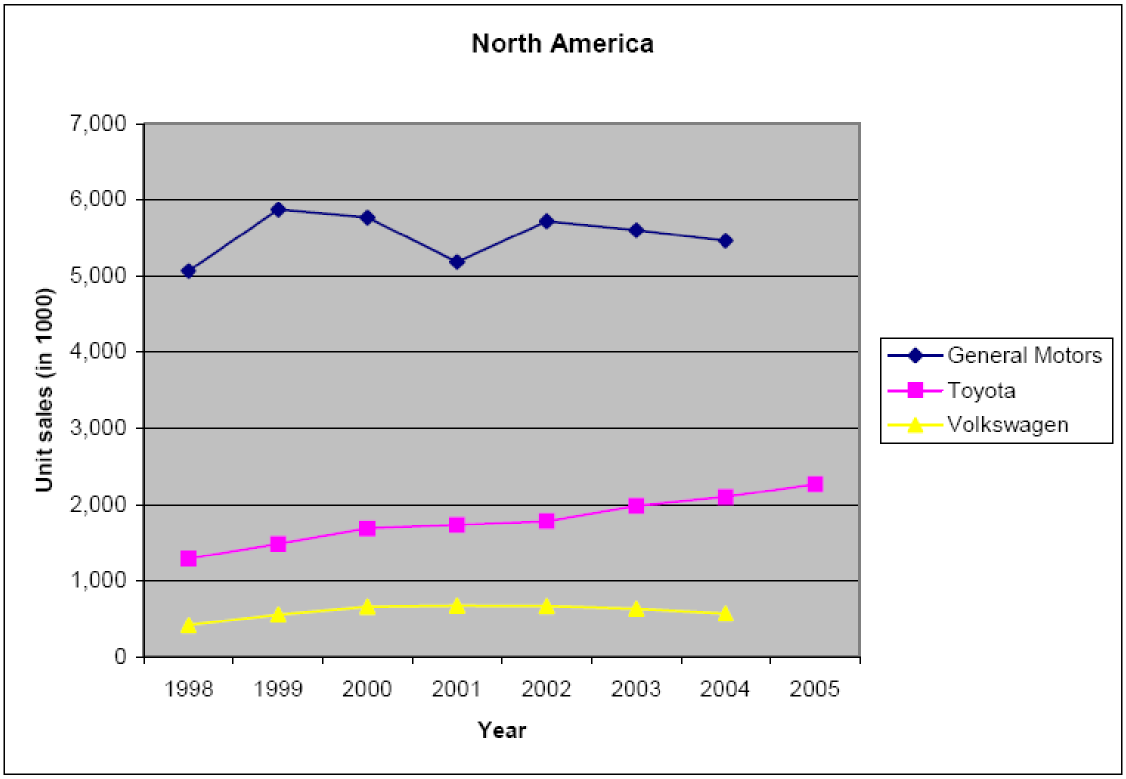
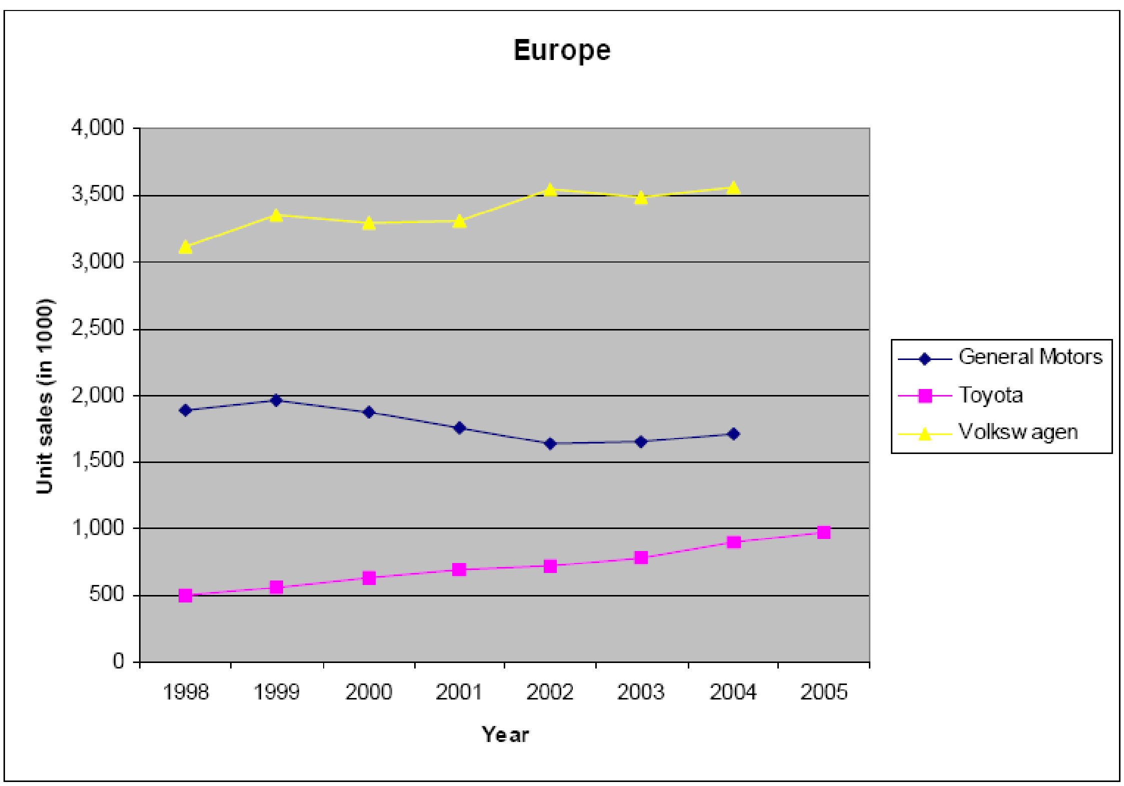


Figure 3. Sales Growth in Europe (Duke Ciber, 2006)



Appendix 3.

Box 1. Volkswagen Sales in America as of January 2006 (Source, VW Media Room, 2006)

	Jan-06 Actual	Jan-05 Actual	Yr/Yr % change
New Beetle Coupe	1,300	1,060	22.6%
New Beetle Convertible	936	914	2.4%
Total New Beetle	2,236	1,974	13.3%
Jetta Sdn	7,420	5,018	47.9%
Jetta Wgn	16	415	-96.1%
Total Jetta	7,436	5,433	36.9%
Golf/GTI/R32	1,035	821	26.1%
Passat Sdn	4,084	2,247	81.8%
Passat Wgn	130	605	-78.5%
Total Passat	4,214	2,852	47.8%
Phaeton	46	90	-48.9%
Touareg	1,270	1,513	-16.1%
TOTAL	16,237	12,683	28.0%