It is the recurring tragedy of the world’s car industry that companies must bet the farm at the start of every new product life cycle. It is because the capricious consumer demands a new model at regular intervals that the manufacturers are doomed to replacing even their most popular vehicles with new offerings of unknown potential. Since the automobile industry paradigm shows that there is a monstrous production system to feed, the failure of a core model can put the company’s future in peril even after it has successfully defended its place in the industry over many decades.

Although the automobile paradigm prescribes a reasonably achievable level of output for exploiting the available economies of scale, this is contingent upon it being reached with production consistently at full capacity. Firms operating close to the minimum standards of the paradigm must stabilize demand by releasing highly differentiated models into market niches. Those that cannot push output to this level must cover their higher costs through premium pricing. One small manufacturer, Porsche, has even managed to use its premium profits to practice a strategy that I call “cuckoo-nesting.” This is when a small, highly profitable firm is able to take over a larger one in order to stake a claim on its choicest resources. In effect, Porsche is using VW as the unwitting host for much of its model development and production.

At the other extreme, the sheer size of the industry-leading firms gives them the additional benefit of spreading the risk of fluctuating demand over a wide range of model variants. This effectively insures the industry leaders against the effects of individual product life cycles and isolated instances of model failures. What this strategy cannot withstand is a multiple product failure. To the horror of the world’s automobile industry, this is precisely what happened in 2008 and 2009, as the economic shocks rattled through the markets like earthquakes. In combination, these convulsions have shifted the tectonic plates of the world vehicle markets and left the manufacturers desperately trying to restructure around the new
demand characteristics. We can have faith that the economic recovery will eventually come, or else this truly is capitalism’s Armageddon, but the question is which survivors will emerge from the rubble.

The automobile industry is all about mass production feeding mass market demand. In the pre-earthquake era, although some markets had already slowed to mature levels of modest growth, emerging markets were still surging ahead. The generally held view was that success lay in expansion so that, even if the developed markets stagnated, salvation would be supplied by the new developing markets. The first seismic jolt to upset this view was the financial cataclysm that came out of the United States and rumbled through the world markets at the beginning of 2008. While this unsettled many car manufacturers, it should have been survivable. The trouble was the shocks just kept coming. The collapse of Lehman Brothers plunged the credit markets into chaos just as recessionary pressures crushed the last vestiges of consumer confidence. Taking cover from the successive onslaughts, consumers shrank from the market and the car manufacturers were brought to a shuddering halt.

We would expect this to kill off some of the more bloated corporations as market shifts leave them marooned with model ranges suddenly no one wants. Most staggering of all, though, has been the way in which this disaster has swept the ground from beneath the Japanese manufacturers. Amongst their number, Toyota is preeminent and in the early stages it was able to draw on its broad product range to offer more attractive alternatives to its faithful customers. At the same time, its global production empire meant that it was able to supplement changing local demand in the US with exports from Japan to the degree that output at home actually rose. As far as anyone could tell at the time, it was situation normal with the Japanese showing their flexibility by rapidly exploiting the market shift away from heavy sport utility vehicles (SUVs). Presumably, if the markets had then stabilized, the Japanese manufacturers would have readjusted their grip on the United States to a stranglehold. Then, as 2008 staggered to a close, the Japanese edifice too began to crumble.

In assuming that future volume growth would come in the emerging markets, the industry had forgotten that the most lucrative value added sales are in the developed world. Furthermore, one market, the United States, is so stuffed full of acquisitive, wealthy consumers that all the cost advantages of mass production can be fully realized and handsome profits earned. Flexible manufacturing, using single plants to produce a range of products, may be emblematic of the most sophisticated manufacturers, but it is only by dedicating plants to the making of single, standard products that all the economies of scale can be fully exploited. When factories were