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## Trouble at Home: Negative Trends in the Family Vehicle Segment

The spotlight on compact cars and crossover utilities seems to brighten in lock-step with hikes in the price of crude oil, while sales of large SUVs and their ilk are inversely proportional to same. What gets lost in the news cycle is that one of the market's mainstay segments - a stalwart of Canadian vehicle sales since the postwar period - has undergone a dramatic decline in recent years. For better or for worse, it appears as though Intermediate Passenger Cars have lost the favour of Canadian buyers.

The Intermediate is a traditional meat-and-potatoes dish that has been forgotten in a world of fusion cuisine. Segment heavies like the Honda Accord, Toyota Camry, and

Chevrolet Impala - all four door sedans, all between 185 and 200 inches long, all available in relatively-efficient or relatively-powerful versions - no longer make so much sense to their traditional buying demographics. This Observation will examine why this has happened.

We divide the Canadian automotive market into four broad segments, each containing a number of specific vehicle types: Entry Level, Mid-Size/Family, Large/Luxury/Sport, and Primarily Commercial. Intermediate Passenger Car falls squarely into the Mid-Size/Family bucket. A glance at the past decade's sales reveals that major segment shifts have taken place. As the market has

### Market Structure by Major Players

**Canadian Light Vehicle Market 1997 - 2006**

Year	Total Market	Entry Level	Entry Level Share	Mid-Size/Family	Mid-Size Family Share	Large/Luxury/Sport	Large/Luxury/Sport Share	Primarily Commercial	Primarily Commercial Share
1997	1,387,950	432,918	31.2%	605,770	43.6%	113,156	8.2%	236,106	17.0%
1998	1,389,126	435,705	31.4%	592,599	42.7%	124,746	9.0%	236,076	17.0%
1999	1,501,099	476,927	31.8%	647,882	43.2%	142,236	9.5%	234,054	15.6%
2000	1,549,441	536,797	34.6%	623,570	40.2%	154,435	10.0%	234,639	15.1%
2001	1,570,629	598,691	38.1%	599,990	38.2%	153,729	9.8%	218,219	13.9%
2002	1,703,246	648,709	38.1%	650,341	38.2%	169,583	10.0%	234,613	13.8%
2003	1,593,506	610,554	38.3%	585,870	36.8%	166,980	10.5%	230,102	14.4%
2004	1,534,415	609,622	39.7%	512,712	33.4%	170,769	11.1%	241,312	15.7%
2005	1,583,291	677,142	42.8%	488,572	30.9%	184,576	11.7%	233,001	14.7%
2006	1,614,700	735,048	45.5%	456,205	28.3%	188,855	11.7%	234,592	14.5%
Change	2.0%	8.6%		-6.6%		2.3%		0.7%	

Source: DesRosiers Automotive Consultants Inc., AIAMC and CVMA

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grown, Mid-Size volumes have shrunk. Buyers vacated this segment in large numbers, dropping total Mid-Size market share from 43.6 percent of Canadian sales in 1997 to just 28.3 percent in 2006.

At the same time, impressive growth has taken place in the Entry Level sector, with market shares rising from 31.2 percent to 45.5 percent during the same period. Some growth has also been recorded in the Luxury market, as this smaller segment has grown from 8.2 percent to 11.7 percent of the market in the most recent full year of sales. Former Intermediate buyers have either downsized or traded up, hollowing out one of the market's old standards of reliable sales.

So: Mid-Size is down significantly, Entry Level is up, and answers are not immediately forthcoming. This sort of major change can't be explained away with one big answer, but we can attempt to understand it by examining two important factors: product (what people are buying) and purchase motivation (who's buying and why they're buying).

## The Products

What's clear is that Intermediates are not the attractive bargains they once were. Given the increased

market share of Entry Level vehicles - particularly Compact Cars - one could make the claim that Compacts are the new Intermediates.

This claim is borne out in fact. Current generation Compact

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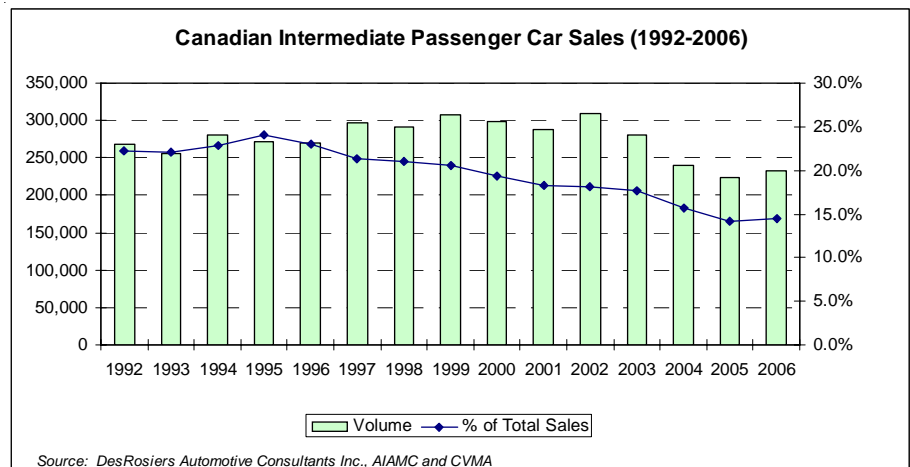
***Given the increased market share of Entry Level vehicles - particularly Compact Cars - one could make the claim that compacts are the new Intermediates.***

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cars are bigger, faster, and better-equipped than they've ever been. Civic buyers can now option their vehicles with navigation systems and 197 horsepower engines, while Mazda3 owners can potentially enjoy leather seats and rain-sensing wipers. In every category of measurement, the new Mitsubishi Lancer has a more accommodating interior than the 1990 - 1993 Honda

Accord, one of the most successful Intermediates of the past two decades.

Where the new-gen Compacts win out over Intermediates is at the gas pumps. Through careful electronic engine management and tall overdrive gear ratios, GM can coax its V6 Impala to deliver 7.0 L/100 KM on the highway, but don't expect such frugality during the daily grind. A Cobalt or Civic can achieve nearly that level of consumption in the combined city/highway cycle, and it does it without the kind of hair-shirt compromises required in decades past. Furthermore, as the sales figures show, Canadian families are content with smaller cars. As Intermediates grew larger, buyers transitioned to Compacts. At the same time, manufacturers began devoting more time and thought to their Compacts, resulting in sparkling entries like the new Nissan Sentra - certainly a more



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formidable competitor than the dowdy lozenge it replaced.

Traditional family vehicles, including Minivans and Intermediate SUVs, have also lost a great deal of ground to the recent influx of crossover utilities - so much so that Ford and GM have removed themselves from the Minivan market, choosing instead to concentrate on large crossovers. While a crossover of any sort provides less maximum utility than a Minivan, they generally strike a good balance between ride, handling, performance, interior package, and looks. That last factor - aesthetics - is also a primary driver of crossover conquest sales, as they presently lack the

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tremendous "image baggage" tied to Minivans. One could easily make the claim that crossovers are both the new Intermediates and the new Minivans.

Crossovers - most of which are segmented as either Compact or Intermediate SUVs - do nearly everything that traditional ladder frame SUVs can do, but they

generally do it with greater dynamic capabilities and better fuel economy. Of the 21 Intermediate SUVs registering volume sales in 2006, eleven were full-frame while ten could be considered unit-body/crossover models. That ratio is set to shift considerably over the next few years, as GM and Ford continue excising full-frame trucks from their SUV portfolios. The sport-ute revolution begun in the early 1990s has run its course, while its successor vehicle - the medium-to-large crossover - is still gaining steam.

### The Motivation

The traditional family vehicle has been caught flat-footed in the present marketplace. It is an accountant at an actor's party - a versatile, sensible purchase that can be equipped with grand horsepower and posh options, but just doesn't seem so fun or desirable when contrasted with the competition.

Buyers sense this. They smelled the desperation when GM grafted SUV snouts onto its aging minivans. They understand that a 3,500 pound vehicle with a four cylinder engine is not going to get the same fuel economy as a similarly powerful 2,800 pound model. They want hatches, not trunks - ground clearance, not great handling. Most of all, they

want to feel as though they're making no compromises in their purchase decisions, and the increasingly niche-oriented vehicle marketplace caters specifically to this whim.

More to the point, the whim in question is not one of simple vanity or pretension. It is the wish to have something that works well and provides value beyond A-to-B transportation. It needs to perform that function efficiently, or it needs to be efficient and spacious, or efficient and cool.

Nearly every 'state of the union' address given by a major vehicle company executive in recent memory has touched on the fact that flexible manufacturing technology (i.e. the ability to produce different products on the same assembly line) and platform sharing has made it possible to expand product lines into niche territory without ballooning development and tooling costs. Now that it is easier and cheaper to provide car shoppers with exactly what they need, what motivation exists for the industry to return to the "one size fits all" model? Most new platform programs now include three or four potential variants, each one filling a carefully-considered role and appealing to a carefully-considered demographic. With highly-targeted vehicles being pitched

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at specific groups of people, it has become difficult for family vehicles to lay claim to anything but broad cross-sections of the market. Buyers see this as a compromise: why wear off-the-rack when tailor-made is the same price?

Perhaps the greatest indicator of a segment's waning popularity is when its institutional sales base - the daily rental fleet buyer - begins to alter its purchasing behavior. During the first half of 2007, Intermediate Car fleet sales were down 24.7 percent compared to the same period last year. Sales to fleets - including daily rentals, government and utility organizations, and corporate fleet programs - accounted for just 31 percent of Intermediate sales during the first six months 2007. This represents a major hit for popular fleet vehicles like the Chevrolet Impala, and it functions as a time-delayed mirror for the developments that have occurred on the retail side of this industry over the past five years.

### The Future

The industry is currently seeing a number of high-profile product renewals in the Intermediate segment. We believe that the excitement generated by new versions of the Toyota Camry, Honda Accord, Chevrolet Malibu, and Ford Taurus - along

with GM's upcoming rear-wheel-drive Intermediates - will mitigate further market share slides in the short term. That prosperity will be short-lived, however, since a novelty spike

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associated with new product introductions should not be confused with long term health.

Sales of Entry Level models have benefited from the presently high energy costs, but it's important to remember that small vehicles were popular with Canadians before gas prices spiked. These vehicles are likely to remain popular going forward, and it is entirely reasonable to assume that crossover utilities of various stripes will continue to usurp market share from their Intermediate Car, Minivan, and Intermediate Sport Utility stablemates. Intermediate sedan share of the total market will hold around 13 percent in the near term, likely declining below 10 percent over the next decade.

### The Reality

One of the basic theories upon which we operate is that the

major market share declines experienced by GM, Ford, and Chrysler have not been driven entirely by substandard products or an inefficient cost structure, but primarily by the stark reality of an overly-crowded marketplace. When a mature market operating comfortably with three competitors suddenly transitions to an eight-or-nine competitor landscape, it is only natural to expect a period of negative adjustment.

We believe that a similar situation is occurring in the Mid-Size/Family vehicle segment. Thirty years ago, family car buyers had two major choices: relatively large four-door sedans or relatively-large four-door station wagons. Twenty years ago, they were still faced with two choices: Intermediate four-door sedans or minivans. In 2007, however, car shoppers have a number of distinct choices: small, medium, and large SUVs; small, medium, and large crossovers; "space wagons" and small vanlets (e.g. Mazda5); Minivans; Compact Cars; and finally, Intermediate sedans. With so many new choices vying for the same dollars, a "family megasegment" has arisen in the Intermediate's stead, preventing the Mid-Size sedan from attaining the market share it has traditionally enjoyed.

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