

# From one uncertainty to the next: capped funding overtakes the global financial crisis

Patrick Jonas, EuPD Research, Bonn, Germany

## ABSTRACT

The upper and lower houses of the German parliament took their time finding a compromise on the degression of PV tariffs. Cutbacks were finally decided on at the start of July. The German PV market is now headed for another record-breaking year in 2010 despite or maybe even as a result of these reductions. EuPD Research, the market research institute, is making a conservative projection of approximately 5.5GW in newly-installed capacity. Nevertheless, pressure is set to increase, particularly on German solar companies. New marketing strategies have to be developed in the mid-term in order to survive and explore new segments in the long term.

For a long time it was unclear just how high the extraordinary degression of the German solar electricity funding would be. Finding a compromise took months. Both the branch and investors were left in the dark as to the amount and timing of the cutbacks. Finally, at the start of July, the mediation committee tabled a compromise that was acceptable to both the upper and lower houses of parliament. Remuneration is to be reduced in two phases. The first reductions will be retroactively implemented to July 1st, 2010. Rooftop systems will be reduced by 13%, open-space by 12% and areas such as former military or industrial sites by 8%. All tariffs are to be cut by a further 3% in the second phase which comes into effect on October 1st, 2010. As originally intended, farmland will no longer receive financial support from the funding program as of July 1st, 2010.

The suggestion can be seen as a concession to the German federal states, represented by the lower house of parliament. The initial announcement of the government's plans at the beginning of the year was greeted with a chorus of disapproval and protest. A subsequent call for a mediation committee brought the legislative process to a halt. Opposition was led in particular by the federal states in the east, an important PV location, as well as the states of Bavaria and Baden-Württemberg where solar installers and solar wholesale are strongly represented. According to a suggestion made by the federal states, the remuneration for all system sizes should only be reduced by 10%; the withdrawal of the intention to stop all funding for farmland was not planned. The compromise agreed upon means that the cutbacks remain moderate, at least until October.

What impact will these (partially) drastic cuts have on the largest sales

market in the world? Unlike the Spanish market of two years ago, it is safe to say that the German market is not about to collapse: the conditions set by the PV funding scheme are stable enough to prevent that. A capping of the market is also not in sight. Despite the extraordinary degression, the rate of return yielded still appeals to several customer groups. The dates, July 1st and October 1st, from which the changes become effective are certain to lead to a surge in demand as well as pull-forward effects, the result of which is likely to be a new record in newly-installed capacity that could top even the previous year. However, the cuts will probably cause a shift in market segments in 2010, and intensify competition especially among German companies. EuPD Research believes that the amendments will lead to a decline in demand in the segments where investors focus most on the returns of a PV system, particularly in commercial open-space systems.

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Following a short-lived run on large-scale systems up to July 1st, the second half of the year is likely to be dominated by smaller rooftop systems. The next date to be watched is October 1st. The sector is bound to enjoy a sizzling third quarter. A first indication of the coming record year was published by the Federal Network Agency, which shows that an impressive 714MW was installed in the first quarter alone. EuPD Research analysts estimate

that the second quarter will also profit from the pull-forward effects and show record newly-installed capacity, before the amendment takes effect on July 1st. The figures of approximately 450MW published for the month of April give a first impression of what is to come. A conservative projection for the whole year predicts newly installed capacity at 5.5GW. EuPD Research forecasts modest growth for the following year as a result of the increasing degression, based on newly-installed capacity in 2010 and the changes made to funding in the open-space segment. Nevertheless, the German market will remain one of the most important markets worldwide.

## The private customer segment: further expanding market share

In its current study, “The German Photovoltaic Market 2010 – Gigawatt Crisis or Way to Promotion Parity”, EuPD Research assumes that the amendment to the German renewable energies law will lead to a shift in market segments. The small system segment will continue to grow in the future and expand on their position as the most significant segment. This trend should become particularly apparent in the second half of 2010 when open-space systems no longer have great appeal to investors and farmland is completely removed from the funding program. In contrast, the expected returns from smaller rooftop systems for private customers have not been affected to the same degree. The remuneration set in the amendment is still of sufficient interest to them. Moreover, the new own-consumption regulation equips this segment with a further growth driver.

The segment with the most growth will be system sizes from 10 to 50kW, a segment that had the largest share of newly-installed capacity in 2009. Little

Fab & Facilities

Materials

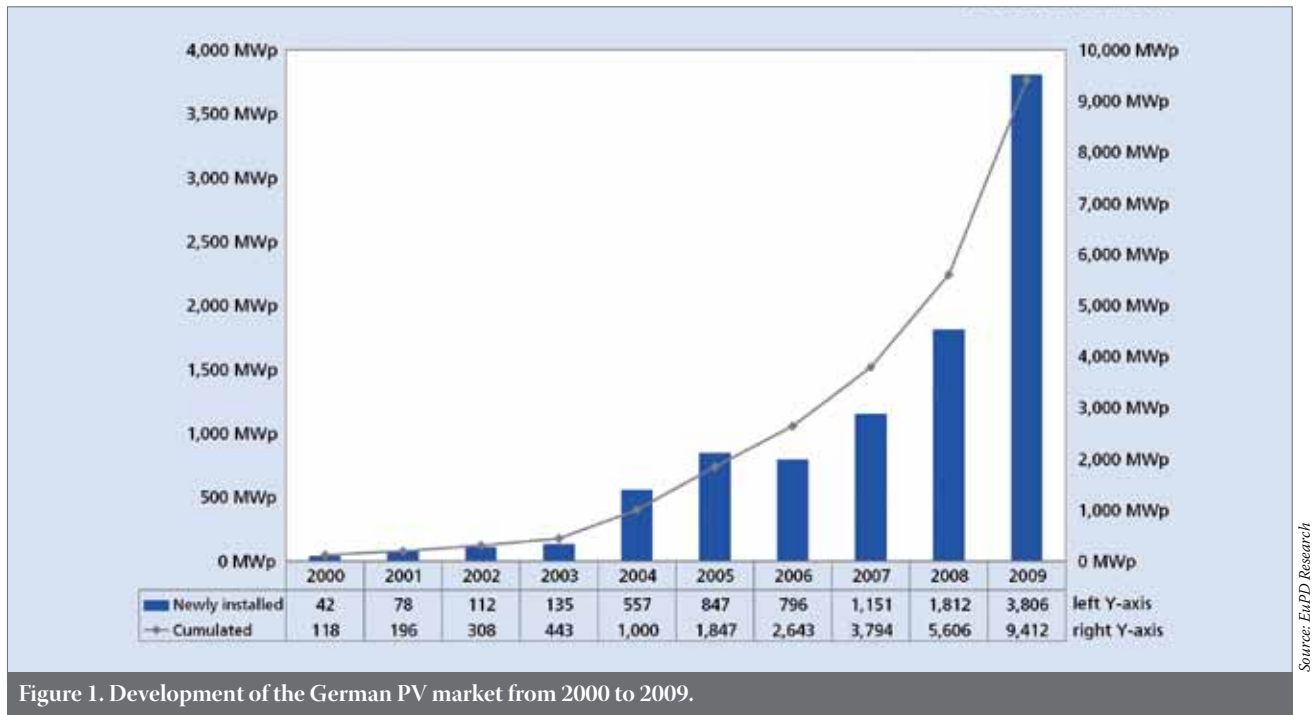
Cell Processing

Thin Film

PV Modules

Power Generation

Market Watch



Source: EuPD Research

will change here in 2010, with EuPD Research predicting newly-installed capacity of almost 2GW. These systems would therefore make up the largest part of newly-installed capacity in the current year, thus increasing their market share further.

### No recuperation in sight for installers

With the introduction of the new amendment, the government has put pay to the brief lapse in business some installers may have been looking forward to around the middle of this year, following record growth of 3.8GW in 2009 and a strong first quarter in 2010 (see Fig. 1). The two key dates, July 1st and October 1st, are likely to ensure that installers are in constant demand. The next boom could follow in October when the degression rates for the year 2011 will be announced. Should the German market, as assumed, achieve record growth in the first three quarters, the degression rates for 2011 will be calculated accordingly and the next round of investment will be just a step away.

However, the astonishing amount of newly-installed capacity, pleasing as it might be in the short-term, also harbours danger for market participants. The resulting high rate of degression in the coming year coupled with the extraordinary degression in 2010 could put the German solar branch under enormous price pressure. The amendments adjusted remuneration to the levels of price development and achievable returns of 2008. Should new installations, as assumed, reach a minimum of 5.5GW, this would lead to a degression of 12% at the turn of the year 2010/2011. This would be way beyond cost cuts expected in the second half of 2010. German companies

will be affected most by this development. Companies that produce crystalline modules have production costs which are on average 20 to 30% higher than their Asian competitors. American thin-film producer First Solar sets the benchmark for the thin-film PV industry. Considering the expected record amount of newly-installed capacity in 2010, the problems facing the German PV industry in terms of a possible reduction in the degression rate could prove difficult to communicate.

### Diversification strategy for German manufacturers

The major issue facing German companies in the coming months will be the question of how best to deal with the ensuing pressure on prices. The fact that they have time to react to these developments as degression in the following year can already be anticipated is to their advantage. While companies concentrated on their pricing policy in the first half of 2010, other factors in the marketing mix are certain to play a greater role in the second half of 2010.

In the short term, EuPD Research assumes that price pressure will increase particularly in the fourth quarter and that companies will be forced to sell their products at a price close to production cost. Against the backdrop of a shift to a buyer's market, manufacturers need to develop marketing strategies to enable their continued success in the long term. This requires the successful addressing of intermediaries between the manufacturers and end customers such as the electro-installers, solar installers and roofers. They are familiar with the requirements of the end customers and recognize trends on the buyers' side in the shift from a supply- to

a demand-driven market. Consequently, their significance in the market increases.

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A suitable marketing strategy could be developed under the aspects of product management and positioning whereby the USPs of the company or product in question would play a central role. A distinction can be made between a competitive approach that employs a cost leadership strategy where the price becomes the USP or a strategy of differentiation that focuses on a particular market niche. The latter could use extremely high efficiency modules and inverters, the quality of technology, a well-established brand name or a niche market e.g. building integrated photovoltaics as a USP.

Cost leadership is probably difficult for German companies to implement on the German market. The main reason for this is the aforementioned cost advantages enjoyed by Asian producers in the crystalline segment and by the Americans in the thin-film segment. This applies in particular to the open-space system where the price/performance ratio is of great importance to professional investors and agricultural customers. The returns to be yielded as a result of the cutbacks or rather elimination of funding in July and October

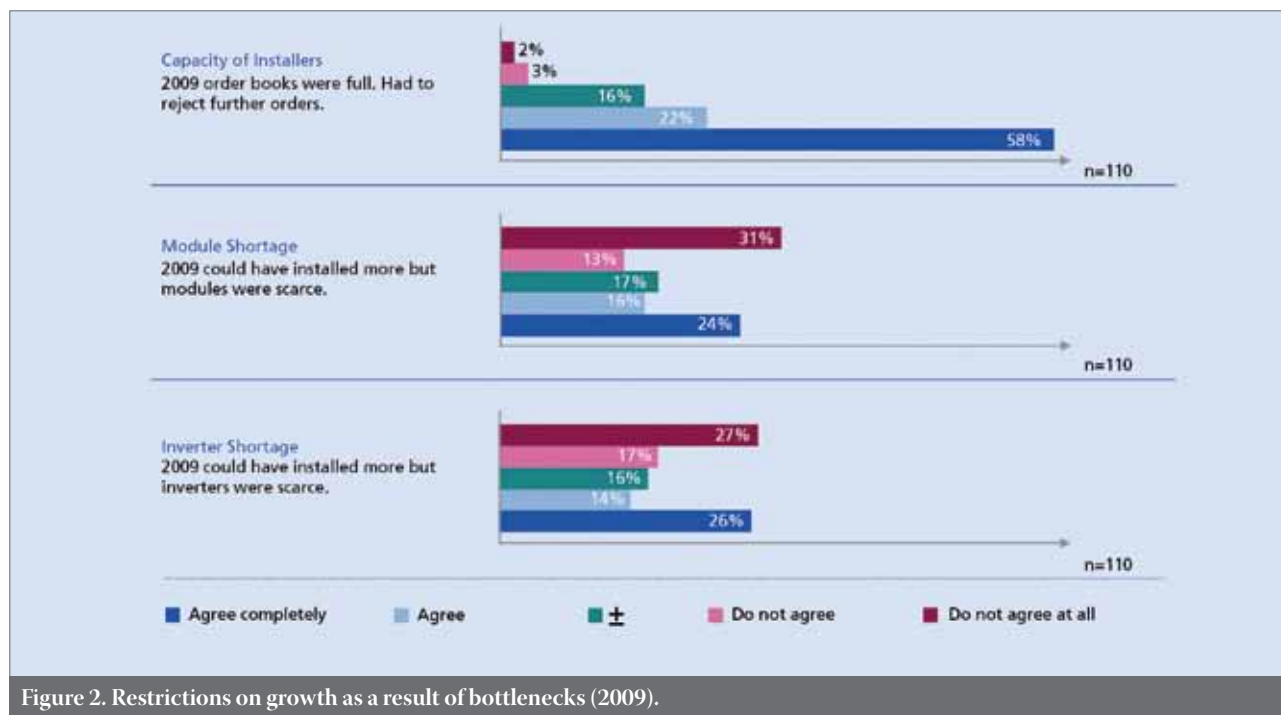


Figure 2. Restrictions on growth as a result of bottlenecks (2009).

are likely to be of interest to professional investors. Producers that can provide modules at lower costs per watt are at an advantage.

EuPD Research estimates that a strategy of differentiation is the best way to guarantee higher margins and a better market position for German companies in the long term, which is particularly of interest to the private system segment and the public sector. The price/performance ratio is not necessarily an essential buying criterion here. The significance of the largest segment which, to date, has been made up of smaller systems sold to private customers and the public sector is set to increase and win market share. Such bolstering is rooted in the extraordinary degression for open-space systems and the elimination of farmland remuneration.

Furthermore, in spite of the degression, the current and future module and system prices still offer sufficient return on investment to both of these customer groups. The private customer segment ranks the origin and brand of a system higher in their purchasing criteria than the price/performance ratio. Ecological components play a major role in the public sector. The portfolio of an installer does not only focus on the best price/performance ratio but also offers products which satisfy alternative preferences such as ecological and brand awareness. Access to the portfolios of installers would be greatly alleviated if companies highlighted the USPs of their products.

### Possible bottlenecks in further growth

Two issues could lead to a bottleneck in the German market this year. Where growth was affected particularly by the

silicon bottleneck in the past years, this year has seen an artificial restriction resulting from the capacity limitations of installers and inverter producers. In contrast to the production capacities of module producers which were ramped up in previous years, the number of installers – particularly qualified installers – has increased at a much slower pace. The results of a survey among installers carried out in the fourth quarter of 2009 by EuPD Research show how full their order books were. Of those questioned, 60% said they were unable to accept new orders as they were already working at full capacity, as illustrated in Fig. 2. A similar situation was observed for inverters. Although market leaders expanded their capacity, it was too late to absorb demand at its peak in the first half of the year. Moreover, suppliers were not able to supply components at the pace needed for the newly-expanded capacity.

### Own-consumption as a new business interest

One of the areas of business that is bound to see substantial growth is the household use of own-generated electricity. This regulation was put in place in 2009, and brings further incentive whereby operators with systems up to 500kW in size receive a bonus for the own use of electricity generated. If more than 30% of the electricity generated is used, the bonus increases accordingly. This new regulation offers solar firms an attractive alternative for differentiation. As is often the case, this new business segment offers both opportunities and challenges. The own-consumption regulation offers scope for a differentiation strategy which could stop turnover shrinking, provide a

competitive edge, and foster new business opportunities.

But product development poses a challenge, and intelligent storage and energy solutions have to be developed in combination with solar systems. However, a transfer of technological know-how with regard to storage applications and the grid has to take place in order to develop products which can be quickly integrated into a company's product portfolio. Companies can now take the opportunity to be the suppliers of integrated and systematic energy solutions for the future. Several new ideas were shown at the Intersolar Europe event in Munich earlier this year that combine solar systems with lithium-ion or lead-gel batteries, so it is clear that at least some companies have already taken hold of this opportunity.

### About the Author

**Patrick Jonas** studied business economics at the University of Applied Science in Koblenz, Germany, and holds a degree in business administration. A particular focus of his degree was on marketing. As part of his thesis he developed a communication strategy for a photovoltaic company on behalf of EuPD Research. Since completing his studies, Patrick has been employed in the communications department of EuPD Research.

### Enquiries

EuPD Research  
Adenauerallee 134  
53113 Bonn  
Germany  
Tel: +49 228 97143 0  
Fax: +49 228 97143 11  
Email: [press@eupd-research.com](mailto:press@eupd-research.com)  
Web: [www.eupd-research.com/intersolar](http://www.eupd-research.com/intersolar)