

SYNERGIES THROUGH COOPERATION

Cooperation arrangements with other vehicle manufacturers are becoming more and more important when it comes to tapping smaller market segments. By joining forces with other companies, we can keep development and investment costs low and minimize business risks. In 2006, we continued a number of successful joint projects, for example working with Porsche in the production of the Volkswagen Touareg, Audi Q7 and Porsche Cayenne models. In order to optimize our cooperative work with other manufacturers in future projects, we have clearly defined responsibilities and established new organizational structures.

INTEGRATING EXTERNAL R&D KNOW-HOW

The Volkswagen Group will continue its significant work on the development of new models in the coming years. This not only places substantial demands on our own development capacity, but also highlights the need to integrate the know-how of our suppliers and individual development partners in our innovation work to an even greater extent than before. Only in this way is it possible to successfully complete the increased number of projects in spite of shorter development times and rising quality requirements. At the same time, we can use this approach to concentrate our own resources on core competences in the area of technical development.

Particularly when it comes to developing modules and components, we draw on the expertise of the subsequent system suppliers. When developing vehicle derivatives, the complete series development can be outsourced to a general partner; needless to say, this partner would work in close cooperation with the Volkswagen project team at all times. This bundling of resources allows us to adapt future technical development activities even more flexibly to changing customer, market or legal requirements.

YEAR-ON-YEAR INCREASE IN CAPITALIZED DEVELOPMENT COSTS

2006 saw a year-on-year increase in research and development costs in the Automotive Division. Capitalized development costs also increased compared with the previous year, albeit at a lower rate. For this reason, the capitalization ratio fell to 34.9% (35.1%). The proportion of research and development costs recognized in the income statement in accordance with IFRSs remained unchanged over 2005 at 4.8% of the Automotive Division's sales revenue.

The Research and Development function employed 21,447 people Group-wide at December 31, 2006 (-1.9%), corresponding to 6.6% of the total headcount. This figure includes the vehicle production investments Shanghai-Volkswagen Automotive Company Ltd. and FAW-Volkswagen Automotive Company Ltd. These companies are accounted for using the equity method.

RESEARCH AND DEVELOPMENT COSTS IN THE AUTOMOTIVE DIVISION

€ million	2006	2005	%
Total research and development costs	4,240	4,075	+ 4.0
of which capitalized	1,478	1,432	+ 3.2
Capitalization ratio in %	34.9	35.1	
Amortization of capitalized development costs	1,826	1,438	+ 27.0
Research and development costs recognized in the income statement	4,588	4,081	+ 12.4

- Business Development
- Net Assets, Financial Position
and Results of Operations
- Volkswagen AG (condensed, according
to German Commercial Code)
- Value-Enhancing Factors
- Risk Report
- Report on Expected Developments

PROCUREMENT

In 2006, we further developed our supplier management, working more closely together with suppliers with a view to optimizing processes, costs and delivery quality. In addition, much of our work involved investigating procurement sources worldwide.

INTENSIFICATION OF SUPPLIER MANAGEMENT

The supplier workshop meetings introduced in 2005 proved to be very effective. At the two events held in 2006, Procurement and Technical Development employees came together again with selected suppliers to identify improvement potential. This includes technical measures for reducing costs as well as process optimization approaches that are continuously implemented.

In addition to the supplier workshop meetings, the platform for working together with suppliers, primarily with a view to optimizing material costs, was extended to include the areas of quality and innovation management.

In the new "Supplier Quality" forum, employees from Procurement, Quality Assurance and Technical Development join with selected suppliers to define measures for improving the quality of parts and components supplied. This allowed considerable advances in quality to be achieved within a very short space of time.

The "Innovation" forum is a further instrument we have established for strategic cooperation with selected suppliers. The open dialog and mutual trust

that characterize this forum are instrumental in finding new approaches for developing innovations together with our supplier partners. Suppliers are involved early on in the product development process in order to generate maximum benefits for the end customer.

GLOBAL PROCUREMENT ACTIVITIES

In addition to the traditional markets of Germany and Western Europe, emerging countries such as China, India and Russia are increasingly attractive for us as supply sources. Firstly, they are in a position to supply our local production directly, and secondly, they offer cost advantages for vehicles manufactured in Europe and destined for export. Central to the evaluation of procurement markets are factor costs, exchange rate developments and local supplier expertise as regards quality and development. In order to tap the potential of these markets more effectively, we have stepped up our research and scouting activities throughout the Group. The procurement teams that formerly operated at a local level have been restructured and developed into Regional Sourcing Offices.

PURCHASING VOLUME

The purchasing volume of the Volkswagen Group increased by 4.1% to €68.8 billion in 2006. The proportion attributable to German suppliers was unchanged over 2005 at 52.1%.

PURCHASING VOLUMES BY BUSINESS LINE AND MARKET

€ billion	2006	2005	%
Volkswagen brand group	43.0	43.2	-0.4%
Audi brand group	23.2	20.8	11.6%
Commercial Vehicles	2.6	2.1	22.9%
Volkswagen Group	68.8	66.1	4.1%
Europe/Remaining markets	56.3	53.7	4.8%
North America	3.0	2.8	7.1%
South America/South Africa	5.0	5.1	-2.2%
Asia-Pacific	4.5	4.5	0.4%