

Case 12 After the Breakup: The Troubled Alliance between Volkswagen and Suzuki

“VW and Suzuki wanted access to each other’s crown jewels, so it was always a little doomed from the start.”ⁱ

—TIM URQUHART,

IHS Global Insight¹ auto analyst, September 2011.

“Clearly there are cultural differences between European or US-based (carmakers) and Japanese manufacturers and, with the exception of Renault/Nissan, alliances between Western and Japanese (carmakers) have often ended with- out tangible results.”ⁱⁱ

—CHRISTIAN AUST,
analyst, UniCredit,² in September 2011.

On November 18, 2011, the relationship between Suzuki Motor Corporation (Suzuki) and Volkswagen AG (VW) came to an end, with Suzuki terminating the framework agreement between them. Suzuki also demanded that VW return its 19.9% shareholding in the company.

In December 2009, VW and Suzuki made headlines when the German company purchased a 19.9% stake in the Japanese manufacturer. Both agreed to share their technologies and cooperate with each other. VW agreed to provide its larger-vehicle technologies to Suzuki; Suzuki, in turn, agreed to provide VW access to its small-displacement motors and Indian presence. While the proposed partnership goals spurred interest among industry observers, both the auto manufacturers failed to arrive at an agreement on any of their proposed goals. Since the second quarter of 2011, there were indications in the media that the partnership was failing. Suzuki claimed that VW did not give it access to the hybrid technology that it had promised to share when forming the alliance. Similarly, VW accused Suzuki of violating the agreement by procuring diesel engines from Fiat S.p.A.³ (Fiat). The partnership further soured because of their cultural differences and failed joint business proposals. Apprehensive that the issue might adversely affect their cooperation with other companies, the two parties finally terminated their partnership in November 2011.

After the break-up, Suzuki wanted to buy back its 19.9% stake from VW and sell the 1.5% stake of VW back to the German

company. However, VW made it clear that it would not forego its stake in Suzuki and that it was not legally bound to do so. As a result, Suzuki filed for arbitration with the International Chamber of Commerce’s⁴ (ICC) International Court of Arbitration⁵ in London. VW, on the other hand, was prepared to go through the arbitration process. While the partnership did no good to either party, both the parties stuck to their respective stands. Some industry observers opined that while Suzuki had lost huge financial and technological support, VW had lost the opportunity to leverage on Suzuki’s small car platform and its entry ticket into the fast-growing Indian market. They opined that both the companies needed to clear off the rubble and start afresh—which, while not impossible, would be a difficult task for both.

ABOUT SUZUKI

Headquartered in Hamamatsu, Shizuoka, Japan, Suzuki Motor Corporation specialized in manufacturing compact automobiles, motorcycles, all-terrain vehicles (ATVs), outboard marine engines, wheelchairs, and a variety of other small internal combustion engines. As of 2011, the company was the 9th largest automobile manufacturer in the world and the 4th largest in Japan after Toyota Motor Corporation,⁶ Nissan Motor Company Ltd.,⁷ and Honda Motor Company Ltd.⁸ The company produced 2,878,000 automobiles and 2,735,000 motorcycles during 2010–2011, earning revenue of ¥⁹ 2.6 trillion and making a profit of ¥45.17 billion during FY2011.ⁱⁱⁱ (Refer to *Exhibit I* for Suzuki’s key financials.)

Michio Suzuki founded Suzuki Motor Corporation (Suzuki) in 1909 as Suzuki Loom Works in the village of Hamamatsu, Japan. The company built weaving looms for Japan’s textile industry for 30 years and then diversified into manufacturing small cars. However, with the onset of the Second World War, the government declared civilian passenger cars

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This case was written by Syed Abdul Samad, under the direction of Debapratim Purkayastha, IBS Hyderabad. It was compiled from published sources, and is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation.

¹ IHS Global Insight provides economic, financial, and political coverage of countries, regions, and industries and is recognized as one of the most consistently accurate forecasting companies in the world.

² UniCredit S.p.A. is an Italy-based, pan-European banking organization.

³ Fiat S.p.A. is the largest automobile and engine manufacturer in Italy, with a production output of more than 2 million units, revenue of €35.88 billion, and a profit of €179 million in 2010.

⁴ The International Chamber of Commerce (ICC), the largest, most representative business organization in the world, was founded in 1919 to serve world business by promoting trade and investment, open markets for goods and services, and the free flow of capital. The organization’s international secretariat was established in Paris.

⁵ The International Court of Arbitration is an institution for the resolution of international commercial disputes. The International Court of Arbitration is a part of the International Chamber of Commerce that was created in 1923.

⁶ Toyota Motor Corporation (TMC) is a multinational automaker headquartered in Toyota, Aichi, Japan. In 2010, it was the world’s largest automobile manufacturer by production.

⁷ Nissan Motor Company Ltd. is a multinational automaker headquartered in Yokohama, Japan.

⁸ Honda Motor Company, Ltd. is a Japanese manufacturer of automobiles and motorcycles. Honda has been the world’s largest motorcycle manufacturer since 1959 and is the sixth-largest automobile manufacturer in the world.

⁹ ¥ is the symbol for the Japanese currency Yen. As on March 15, 2012, \$1 = 83.57 ¥ and 1€ = 109.15¥.

EXHIBIT I Suzuki Financials (2007–2011)

Years Ended March 31	Millions of Yen (¥) (except per share amounts)					Thousands of US \$ (except per share amounts)
	2011	2010	2009	2008	2007	2011
Net sales	2,608,217	2,469,063	3,004,888	3,502,419	3,163,669	31,367,622
Net income	45,174	28,913	27,429	80,254	75,008	543,283
Net income per share:						
- Primary	80.65	62.76	61.68	177.96	169.41	0.969
- Fully diluted	74.11	55.26	53.97	155.89	151.41	0.891
Cash dividends per share	13.00	12.00	16.00	16.00	14.00	0.156
Net assets	1,106,999	1,089,757	742,915	902,894	855,973	13,313,285
Total current assets	1,372,885	1,479,336	1,267,790	1,483,038	1,435,405	16,510,954
Total assets	2,224,344	2,381,314	2,157,849	2,409,165	2,321,441	26,750,988
Depreciation and amortization	138,368	141,846	141,203	161,600	149,910	1,664,088
Automobile Production (in thousand units)						
Year Ended March 31	Overseas		Japan		Total	
2007	1,199		1,212		2,412	
2008	1,418		1,219		2,637	
2009	1,355		1,139		2,494	
2010	1,586		959		2,545	
2011	1,884		994		2,878	
Motorcycle Production (in thousand units)						
Year Ended March 31	Overseas		Japan		Total	
2007	2,562		621		3,183	
2008	2,841		549		3,391	
2009	2,993		312		3,305	
2010	2,743		162		2,904	
2011	2,550		185		2,735	

Source: Adapted from "Annual Report 2011 – Suzuki Motor Corporation," www.globalsuzuki.com

as a "non-essential commodity" and Suzuki stopped producing cars. After the war, Suzuki was back to producing looms. However, the cotton market collapsed in 1951 and Suzuki again took up the production of motor vehicles. During those times, the Japanese had a great need for affordable and reliable personal transportation. Banking on this need, many firms were producing "clip-on" gas-powered engines that could be attached to a common bicycle, which could then be used as a motor vehicle.

Recognizing the need for motorcycles, Suzuki created its first two-wheeled motorized bicycle called the "Power Free" in 1952. This innovation was considered ingenious and the patent office of the new democratic government of Japan granted Suzuki a financial subsidy to continue research in motorcycle engineering. In

1954, the company officially changed its name to Suzuki Motor Co., Ltd. and was producing 6,000 motorcycles per month.

Over the years, many more innovations followed at the company. By 2011, the company had expanded its reach to all over the world, with 35 production facilities across 23 countries and 133 distributors in 192 countries. The company had three subsidiaries. Maruti Suzuki India Limited, formed in 1982, had a 54.2% stake owned by Suzuki, and the rest was owned by various Indian public and financial institutions. The other two subsidiaries of Suzuki were Pak Suzuki Motor Co. Ltd. in Karachi, Pakistan, and Magyar Suzuki in Esztergom, Hungary, which were established in 1982 and 1991, respectively. The company had also formed technological and sales

EXHIBIT II Volkswagen Financials (2007–2011)

Volume Data	2011	2010	2009	2008	2007
Vehicle Sales (units)	8,361,294	7,278,440	6,309,743	6,271,724	6,191,618
Production (units)	8,494,280	7,357,505	6,054,829	6,346,515	6,213,332
Employees as of December 31	501,956	399,381	368,500	369,928	329,305
Financial Data (IFRSs), € million					
Sales revenue	159,337	126,857	105,187	113,808	108,897
Operating profit	11,271	7,141	1,855	6,333	6,151
Profit before tax	18,926	8,994	1,261	6,608	6,543
Profit after tax	15,799	7,226	911	4,688	4,122
Profit attributable to shareholders of Volkswagen AG	15,409	6,835	960	4,753	4,120
Cash flows from operating activities	8,500	11,455	12,741	10,799	15,662
Cash flows from investing activities attributable to operating activities	16,002	9,278	10,428	19,710	13,474
Automotive Division					
EBITDA	17,815	13,940	8,005	12,108	
Cash flows from operating activities	17,109	13,930	12,815	8,771	13,675
Cash flows from investing activities attributable to operating activities	15,995	9,095	10,252	11,450	6,550
Of which: investments in property, plant and equipment	7,929	5,656	5,783	6,762	4,555
As a percentage of sales revenue	5.6	5.0	6.2	6.6	4.6
Capitalized development costs	1,666	1,667	1,948	2,216	1,446
As a percentage of sales revenue	1.2	1.5	2.1	2.2	1.5
Net cash flow	1,112	4,835	2,563	-2,679	7,125
Net liquidity at Dec 31	16,951	18,639	10,636	8,039	13,478
Return Ratios in %					
Return on sales before tax	11.9	7.1	1.2	5.8	6.0
Return on investment after tax (automotive division)	17.7	13.5	3.8	10.9	9.5
Return on equity before tax (financial services division)	14.0	12.9	7.9	12.1	16.1

Source: Adapted from Volkswagen AG Annual Reports 2011, 2009, and 2008, www.volkswagenag.com

tie-ups with many global automobile companies such as General Motors Corporation,¹⁰ Fiat, Nissan, etc. It also entered into a tie-up with VW for technological and sales cooperation in 2009.

ABOUT VOLKSWAGEN

Volkswagen AG, headquartered in Wolfsburg, Germany, was ranked as Europe's largest and the world's third-largest

¹⁰ General Motors Corporation is a U.S. multinational company headquartered in Detroit. It is the world's largest automaker and owns brands such as Buick, Cadillac, Chevrolet, GMC, Opel, Vauxhall, and Holden.

motor vehicle manufacturer in 2011. The company had sales of 8,361,294 vehicles, garnering revenues of €159.33 billion and a profit after tax amounting to €15.8 billion during 2011.^{iv} (Refer to *Exhibit II* for VW's key financials.)

Volkswagen, meaning "People's Car" in German, was established on May 28, 1937, as the *Gesellschaft zur Vorbereitung des Deutschen Volkswagens mbH* (Society for the preparation of the German People's Car) by the Nazi *Deutsche Arbeitsfront* (German Labor Front). The company was established to manufacture the Porsche Type 60, with the basic air-cooled, rear-engine, rear-drive platform, which later came to be

known as the Volkswagen Beetle. On September 16, 1938, the company was renamed *Volkswagenwerk GmbH* (Volkswagen Factory Limited Liability Company).

However, during the Second World War, Volkswagen primarily manufactured military vehicles, and the production of the Beetle was reduced to only a small number. After the war, the production of the Beetle started slowly, but, with the introduction of new models, the pace picked up in the 1950s and 1960s. In 1960, the German federal government acquired a stake in the company.

In addition to product development, the company was also actively expanding itself through mergers and acquisitions. In January 1965, Volkswagenwerk acquired Auto Union GmbH¹¹ from Daimler-Benz to produce Audi. In August 1969, NSU Motorenwerke AG was acquired and merged with Auto Union to form Audi NSU Auto Union AG (later renamed Audi AG in 1985). In September 1982, Volkswagenwerk expanded out of Germany by signing a co-operation agreement with the Spanish car manufacturer SEAT, S.A.¹² By 1990, Volkswagenwerk acquired SEAT's entire equity. In the meanwhile, the company again changed its name to *Volkswagen Aktiengesellschaft* (*Volkswagen AG*) on July 4, 1985. In March 1991, the company signed a joint venture with Škoda automobilová a.s.¹³ of Czechoslovakia, but gradually raised its stake in the company, making Škoda its wholly-owned subsidiary by May 2000.

As of September 2011, Volkswagen AG consisted of 342 Group companies, which were involved in either vehicle production or other related automotive services. The VW Group comprised eleven active automotive companies, and their corresponding marques—Volkswagen Passenger Cars, Volkswagen Commercial Vehicles, Audi, Bentley, Bugatti, Lamborghini, Porsche, SEAT, Scania AB, MAN SE, and Škoda—each with its own unique identity and operating independently. It also owned five inactive marques—Auto Union, Dampf-Kraft-Wagen (DKW), Horch, NSU Motorenwerke AG, and Wanderer. The VW Group operated worldwide with 62 production plants in 15 European countries and 7 other countries in the continents of the Americas, Asia, and Africa. The company had its reach in 153 countries, with China being its largest single country market followed by Germany, with sales of 1,924,649 units and 1,038,596 units, respectively, in 2010.^v The company's recent acquisitions included Wilhelm Karmann GmbH in November 2009, Italdesign Giugiaro S.p.A. in May 2010, and a 19.9% stake in Suzuki Motor Corporation in December 2009.

ABOUT THE INDUSTRY

Since 2009, there had been a decline in auto sales worldwide due to the economic crisis. This had prompted global carmakers

¹¹ Auto Union was an amalgamation of four German automobile manufacturers—Audi, DKW, Horch, and Wanderer—in 1932. The company has evolved into the present day Audi, as a subsidiary of Volkswagen Group.

¹² SEAT, S.A. was a Spanish state-owned automobile manufacturer founded on May 9, 1950. It is currently a wholly owned subsidiary of the Volkswagen Group.

¹³ Škoda Auto (founded as an arms manufacturer in 1859) is an automobile manufacturer based in the Czech Republic. Škoda became a wholly owned subsidiary of the Volkswagen Group in 2000.

to form partnerships and alliances to save billions and develop state-of-the-art powertrains. For instance, Europe's second-biggest carmaker, PSA Peugeot Citroen, and Japan's Mitsubishi Motors Corp. formed a strategic partnership involving an equity investment. Industry experts saw this pair-up as a union of the weak, to strengthen their positions in the global automobile industry. Carmakers were also shifting their investments to emerging markets that had withstood the economic slump.

Another tie-up was formed when Italy's Fiat S.p.A. acquired a 20% stake in Chrysler Group LLC in June 2009. General Motors and China's Shanghai Automotive Industry Corporation too announced that they would make small cars in India. Another alliance that tasted success during these tough times was that of Renault from France and Nissan Motor of Japan, which had developed low-emissions vehicles. Similarly, many manufacturers were keen to raise their presence in China and India to tap the soaring demand in the Asian countries.

While major Western markets suffered a setback, the emerging markets of China and India, with their booming sales, had become a lifeline for many automobile companies. However, the interesting aspect that had arisen amidst the crisis was that Asian automakers, too, were looking to buy into brands on sale from global automobile behemoths such as GM and Ford Motor Co. to strengthen their technological capacities and increase their global presence.

The emerging markets had a high demand for fuel-efficient cars. Even in the developed markets, particularly in Europe, there was a move toward more eco-friendly cars. With the introduction of stricter emission regulations and the introduction of incentives for manufacturers doing research in green technologies, the demand for green vehicles had increased. Vehicle manufacturers all over the world were trying to fit in with the EU's emission norms (Euro 5 and Euro 6¹⁴ standards). Automobile manufacturers were trying to acquire or indigenously develop such green technologies to tap the soaring demand.

THE SUZUKI-VW PARTNERSHIP

In its annual report of FY2009–2010, VW said that it intended to position itself as a global economic and environmental leader among automobile manufacturers and termed this plan “Strategy 2018.” Through this strategy it aimed to be the most successful and fascinating automaker in the world by 2018, using intelligent innovations and technologies to deliver customer satisfaction and quality, increase unit sales to more than 10 million vehicles a year, and capture major growth markets.

In line with the global trend of alliances and its own goals of becoming the world's biggest automaker, VW joined the flurry of realignments and alliances and discussed a partnership with Suzuki in June 2009. Battered by the falling demand in the U.S. and Europe and the stricter environmental standards, it hoped that the alliance would create a formidable new force in the global car industry. “This comes right after the Mitsubishi deal and shows that foreign carmakers are coming to take stakes in Japanese firms, raising expectations of a reorganization in the

¹⁴ Euro 5 are emission limits set by the EU for diesel vehicles. Euro 6 are emission limits set by the EU for vehicles using petrol, natural gas, or LPG.

autos sector,”^{vi} said Noritsugu Hirakawa, a strategist at Okasan Securities.^{vii} VW had performed better than its rivals during the recession and had taken a bold step to strengthen itself. However, analysts opined that the move had been made too early (the second in a week) after VW’s €3.9 billion (US\$5.8 billion) purchase of a 49.9%^{vii} stake in sports car-maker Porsche AG.

On December 9, 2009, VW and Suzuki officially announced that they had reached a common understanding to establish a “close long-term strategic partnership.” Both the companies opined that they would complement each other’s strengths and make a perfect fit in exploiting their advantages and rise to the challenges of the global automobile industry. According to the deal, VW would purchase 19.9% of Suzuki’s issued shares for €1.7 billion (¥222.5 billion or US\$2.5 billion) and Suzuki would invest up to half of the amount received from VW (about ¥100 billion or US\$1.13 billion) to purchase a 1.5% voting stake in VW. Owing to these developments, Suzuki’s shares rose 3.5% in Tokyo and VW’s rose 2.3% in Germany.^{viii}

VW’s chief executive, Martin Winterkorn (Winterkorn), had a 10-year goal of increasing VW-brand sales by 80% (6.6 million vehicles) by 2018 and with this purchase, VW became a top shareholder in Suzuki. Analysts, too, opined that the VW-Suzuki deal would be game-changing and would help them in competing head-to-head with Toyota. It was also expected to open for VW the doors to one of the world’s fastest-growing carmakers and give more visibility to Suzuki globally. Earlier, GM had owned a 20% stake in Suzuki (invested in 1981). However, since 2006, Suzuki had been cutting its ties with GM and had completed the purchase of its shares back from GM in 2008. After the deal with VW was finalized, the company planned to use ¥100 billion of the proceeds from VW to repay its debt and ¥122.5 billion on its research and development.^{ix}

THE RATIONALE FOR THE ALLIANCE

VW entered into this partnership to tap Suzuki’s strengths in small cars and its dominance in the fast-growing Indian market, as well as to allow the automakers to pool management resources, share auto parts to cut down production costs, and jointly develop the next generation of fuel-efficient cars. However, the companies were not in favor of the idea of sharing dealership or service center space. Industry analysts expected that the VW-Suzuki combined vehicle sales (3.265 million and 1.15 million in the first half of 2009) would easily take the numbers above Toyota’s (4.415 million).^x “Together, we can maximize our opportunities for growth. In partnership with Suzuki, the Volkswagen group can take a big step forward in the compact car segment, particularly in the emerging markets in Asia. In turn, Suzuki can benefit from our experience with efficient and environmentally friendly vehicles. In 8 to 10 years from now, we want to become No. 1 in the world. I believe we will be able to accelerate that with the cooperation with Suzuki,”^{xi} said Winterkorn.

VW was struggling to make its presence felt in the Indian market because it did not have small cars to offer and its only

mini vehicle, UP, was still under development. It hoped to crack the Indian and Southeast Asian markets through Suzuki’s Indian subsidiary Maruti Suzuki India Limited—a powerful player in India. (Refer to *Exhibit III* for some key statistics related to the Indian market.)

Suzuki was known for its minicar models, such as WagonR, the Swift hatchback, and Jimny, a small sport-utility vehicle that was sold mainly in Japan, India, and Southeast Asia. Suzuki was considered a world leader in the mini-car segment. It also had close to a 50% share of the fast-growing Indian market and a huge network of dealerships across the subcontinent. However, it lagged behind in gas-electric hybrids, electric vehicles, and other fuel-efficient cars.^{xii}

Suzuki’s chairman and chief executive, Osamu Suzuki, also highlighted the need for better economies of scale to keep up with the cut-throat competition, as mass production (by having common parts and components) and mass sales played a key role in controlling costs. However, he made it clear that his company would be an equal partner and would not become a subsidiary of VW. He also bristled at the idea of having a German CEO at his company and said, “I don’t want other folks telling me how to do things.”^{xiii}

Industry experts were of the opinion that the cross-border deal would have a positive effect on Maruti Suzuki, catapulting it into a global small-car hub for supplying these cars through VW’s strong network. “Volkswagen has looked at Suzuki obviously from a small car angle. India could become an original equipment manufacturer and supplier of small cars for Volkswagen. It is too early to speculate on its (deal’s) implications on India (Maruti). The deal means Volkswagen and Suzuki see much value in the arrangement in terms of technology sharing,”^{xiv} said Maruti Suzuki India chairman, R. C. Bhargava. The deal (sale of shares) was finally completed on January 15, 2010.

JOINT PROJECTS

A few days after the two companies announced their tie-up, VW sought to leverage on its partner’s R&D facility to jointly work on hybrid¹⁶ and electric car projects. Jochem Heizmann, VW board member responsible for production, said, “It’s too early to give out concrete details of our plans, but what is definite are common projects on hybrids and electro mobile cars. VW can offer hybrids and electric technology. Suzuki also has a fuel cell technology program going on at its end.”^{xv} They planned to develop cars together under both brand names and expected their first car—using parts from both manufacturers—to be introduced by the end of 2010. VW also intended to supply diesel engines to Suzuki in the future. The partnership also spurred some interesting thoughts of a VW motorcycle coming to fruition.

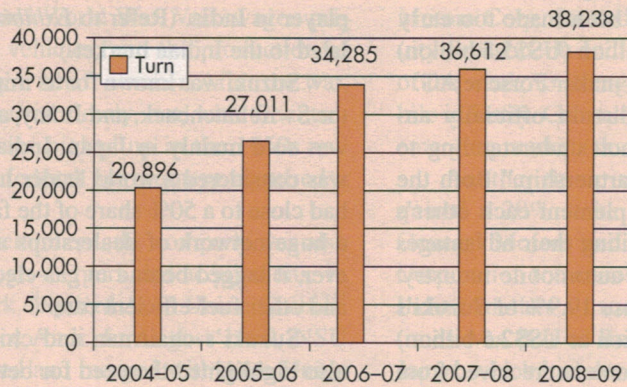
After the tie-up, Suzuki announced that it did not intend to sell more shares to VW, but was open to buying more stakes in VW. However, on the production front, it planned to increase the production capacity of its Indian subsidiary by 50% and

¹⁵ Okasan Securities Group Inc. is a securities company group established in 1923 and is committed to a wide spectrum of securities-investment and asset-management businesses.

¹⁶ A hybrid electric vehicle combines a conventional internal combustion engine propulsion system with an electric propulsion system, and is, therefore, more fuel-efficient.

EXHIBIT III Some Key Statistics Related to the Indian Automobile Market

Gross Turnover of the Automobile Industry in India (In US\$ Million)



Sales of Automobiles in India

Category	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Passenger Vehicles	1,061,572	1,143,076	1,379,979	1,549,882	1,552,703	1,951,333	2,520,421
Commercial Vehicles	318,430	351,041	467,765	490,494	384,194	532,721	676,408
Three-Wheelers	307,862	359,920	403,910	364,781	349,727	440,392	526,022
Two-Wheelers	6,209,765	7,052,391	7,872,334	7,249,278	7,437,619	9,370,951	11,790,305
Grand Total	7,897,629	8,906,428	10,123,988	9,654,435	9,724,243	12,295,397	15,513,156

Change in Market Shares of Different Automobile Manufacturers in India

	2011-2012	2010-2011
Maruti Suzuki	40.4%	44.9%
Hyundai	14.9%	14.3%
Tata Motors	12.3%	14%
M&M	9.2%	6.8%
Toyota	5.6%	3.3%
GMI	4.6%	4.2%
Ford	3.7%	3.9%
Volkswagen	3.2%	2.1%
Honda	2.0%	2.4%
Others	4.2%	4.1%

Source: SIAM

to boost its annual production to 1.5 million vehicles by 2015. VW, on the other hand, was optimistic about the positive influence of Suzuki's partnership on its future products—such as the concept car VW New Compact Coupe (NCC), the New Beetle Final Edition, the subcompact car Polo, the Phaeton Luxury sedan, the UP! Lite, the VW Jetta TDI, etc.—all with a clean diesel technology powertrain, which it intended to introduce in the U.S. market.

On January 20, 2010, Osamu Suzuki announced that a co-developed car would be released in 2013. He further clarified

that the companies were working on all models of common components like air conditioning, power steering, etc. The Japanese automaker was also interested in procuring VW's power plants (probably diesel and V6 gasoline engines) for its midsized Kizashi sedan, but was of the opinion that it might take some time to discover the synergies and then collaborate.

By April 2010, the two companies were planning to develop an eco-car in Thailand. These plans were developed as a result of Nissan's eco-car launch in Thailand followed by announcements from other Japanese companies like Toyota and

Honda. While it was not clear whether the eco-cars would be developed jointly or separately, cooperation between the two partners was expected in terms of supply chain, parts procurement, shared production facilities, and distribution. Suzuki's eco-car investment involved building the facilities for pressing, welding, painting, assembly, and engine production with production starting from early 2012 at 10,000 units per annum.

In August 2010, both the partners explored the possible synergies. While VW was keen on controlling costs by harnessing Suzuki's production practices and generating volumes in the small car segment, Suzuki decided that it would not share its car platforms in India with VW. "There is no possibility of platform sharing (with Volkswagen) as the German company's production and product development costs are very high and that could make our business unviable. There is a possibility of an original equipment manufacturing deal with Volkswagen, like the way we have with Nissan which sells hatchback A-Star as the Pixo in Europe. Volkswagen's cost of products is high whereas Maruti's product management costs are very low; so they can learn from us,"^{xvi} said Shinzo Nakanishi, MD and CEO of Maruti Suzuki India. Moreover, he made it clear that Maruti Suzuki did not want to use VW India's facilities to overcome its capacity crunch as they were too expensive. Later in November 2010, both companies were expected to design a mutually beneficial global business model and unveil joint projects by December or January 2011. However, by mid-2011, there were clear indications that the companies were not able to cooperate with each other and had not made any progress in terms of co-development of cars, technology sharing, platform sharing, etc.

THE PROBLEMS

In March 2011, VW, in its annual report, termed Suzuki as its "associate" and stated that VW could "significantly influence financial and operating policy decisions" of the company. This angered Suzuki executives, as the two companies were intended to cooperate as equals in the partnership. After that, the disagreements between the two partners only escalated.

CULTURAL MISMATCH

In addition to policy differences, the partnership faced a cultural mismatch in their working approach. (Refer to *Exhibit IV* for the differences in the work cultures of Japanese and German companies.)

While VW bemoaned what they considered to be the slow decision-making of the Japanese company, Suzuki criticized VW's high-handed approach to the alliance and the level of technological access being offered by the Germans. Winterkorn said that VW's managers were trying to build mutual trust but this was difficult as there were significant cultural differences in the working approach of the two companies. "Volkswagen and Suzuki had a different approach in taking decisions. Working with a Japanese partner is not easy. . . . European companies were fast in making decisions. In the West sometimes, we make decisions more quickly. In the Japanese culture, sometimes things are a little different."^{xvii} But analysts opined that issues such as decision-making structures, cultural differences, and

building of mutual trust should have been addressed before the alliance was formed rather than being discussed a year after.

DISAGREEMENTS IN TECHNOLOGY SHARING

There were disagreements in terms of technology sharing and cooperation as well. Since the framing of the partnership, the collaboration between the two companies was not progressing as expected. In almost two years of their alliance, there was nothing fruitful that emerged from it. During June–July 2011, Hans Dieter Poetsch, chief manager for finance at VW, announced that the company might have to rethink its agreement. In response to VW's announcement, Suzuki vice-president, Yasuhito Harayama, blamed the lack of progress in the collaboration on the fact that VW was hoping to influence Suzuki as a company. In addition to this, Osamu Suzuki also indicated that VW had nothing on the shelves in terms of technology that Suzuki immediately wanted.

The relationship further deteriorated when Winterkorn stated, "Suzuki wants as much modern technology as possible from Volkswagen, but is not willing to reciprocate. The Japanese still need some training in proper cooperation."^{xviii} Osamu Suzuki fired back through his blog stating, "Since the companies differ in size, people of Volkswagen may develop a mistaken impression that Suzuki is placed under their umbrella. The initial basic agreement seems to falter. We learnt about Volkswagen's technologies, but we did not find any one of them interesting enough to adopt immediately. If we are short of any technology, we have an option to ask other companies with which we benefit from technological exchanges."^{xix}

Earlier, in 2005, Suzuki had formed an alliance with Fiat to make diesel engines in Asia. In January 2011, the company entered into an agreement with Fiat to supply diesel engines for its Indian subsidiary, Maruti Suzuki. It further extended its partnership with Fiat in June 2011 to buy Multijet engines from the company in Hungary. This led to speculation in the industry that a new global alliance could be in the offing. "The general impression was that VW would be Suzuki's first choice for diesel engines and opting for Fiat instead sure set tongues wagging,"^{xx} said an automobile executive. VW accused Suzuki of a breach in the agreement for taking technology from Fiat. VW's reaction to this supply arrangement between Suzuki and Fiat—which pre-dated the VW alliance by several years—was the final straw for Suzuki and hastened the decision to part.

PROBLEMS IN POLICY AND COOPERATION

The media war between the companies got wilder by the day. While VW felt that it was not getting enough cooperation from its Japanese counterpart, Suzuki opined that VW was not giving it the respect due to it as an independent company. However, the industry experts opined that the partners were lacking in the areas of control and planning regarding the alliance and needed to do a reconfiguration of the stake-holding arrangement. By August 2011, rumors about the possible breakup surfaced but were quickly laid to rest by VW. "VW and Suzuki still are, and will continue to be, two independent companies with different business models from different cultural

EXHIBIT IV Comparison of Japanese and German Business Etiquette**Japanese Business Etiquette:**

- The “unhurried” Japanese concept is gone; decisions are made swiftly and efficiently.
- Making a personal call for a business appointment is more effective than sending a letter.
- Punctuality is essential; arriving 5 minutes early is good practice.
- Strong hierarchical structure in negotiation process; begins from executive and goes to middle level management; but decisions are made by the group.
- In business meetings, the Japanese will line up in the order of seniority with the most senior person in the front and least senior person closest to the door.
- It is important to show greater respect to the eldest members; age and rank are strongly connected; however, even a low-ranking individual can become a manager if he performs well.
- Personal space is highly valued; being silent at meetings is acceptable; it is considered to be a thought process.
- Business cannot start until the exchange of business cards or “meishi”; use both hands to present or take the card and examine it carefully before placing it away.
- Gift-giving is accepted with gratitude; but too big a gift is considered a bribe.
- Engaging in small talk about education and family and social life before business negotiations is a good practice.
- Business protocols are not necessarily final agreements; after-care and long-term relationships are positively encouraged.
- Greet your counterparts with a bow or handshake, use apologies and express gratitude frequently.
- Avoid confrontation and showing negative emotions during business negotiations.
- Don’t praise a single Japanese colleague; the group is more important than the individual.
- Don’t use first names unless invited to do so; use titles and their family names.
- Don’t use large hand gestures, unusual facial expressions, or dramatic movements.

German Business Etiquette:

- A personal relationship is not needed to do business; your academic credentials and experience in business will do.
- Germans work with their office doors closed, so knock and wait till invited in.
- Communication is formal and following the established protocol is important to maintaining a business relationship. Maintain direct eye contact while speaking.
- Germans are suspicious of hyperbole, promises, and displays of emotions.
- Germans require a great deal of written communication, both in English and German.
- They display great deference to people in authority, so it is imperative that they understand your level relative to their own.
- Appointments are mandatory and are to be made 1–2 weeks in advance; punctuality is taken extremely seriously.
- Meetings are generally formal. Initial meetings are used to get to know each other. They allow your German colleagues to determine if you are trustworthy.
- Meetings adhere to strict agendas, including starting and ending times.
- The eldest or highest ranking person enters the room first. Men enter before women, if their age and status are roughly equivalent.
- Do not sit until invited and told where to sit. There is a rigid protocol to be followed.
- Germany is heavily regulated and extremely bureaucratic. They prefer to get down to business and only engage in the briefest of small talk.
- Contracts are strictly followed. Once a decision is made, it will not be changed.
- You must be patient and not appear ruffled by the strict adherence to protocol. Germans are detail oriented and want to understand every innuendo before coming to an agreement.
- Business is hierarchical. Decision making is held at the top of the company. Final decisions are translated into rigorous, comprehensive action steps that you can expect will be carried out to the letter.
- Avoid confrontational behavior or high-pressure tactics. It can be counterproductive.
- Men should wear dark colored, formal, and conservative business suits and women should wear either business suits or conservative dresses without ostentatious jewelry or accessories.

Source: Adapted from “Doing Business in Japan- Japanese Social and Business Culture,” www.communicaid.com; and “Germany—Language, Culture, Customs and Business Etiquette,” www.kwintessential.co.uk

environments. The cooperation is marked by highest respect and acceptance,"^{xxxi} said Hans Demant, VW's coordinator for international projects.

According to analysts, a tiff that started over VW's statement had turned into a public feud and escalated into a spat threatening the alliance. Since the initial agreement, both companies had tried to move the partnership forward but had failed due to cultural differences and the ethos of the companies. Suzuki regarded its operational independence as sacrosanct and also opined that VW had acted in an arrogant and high-handed manner. Suzuki in its statement said, "Suzuki thinks that it is crucial to secure 'independence' in its operating policy decision for maintaining its competitiveness in the domestic Kei-car market and Asian markets including India. However, Volkswagen AG publicly reported that Suzuki was a company over which Volkswagen AG had significant influence where financial and operating policy decisions were concerned. Taking these facts into account, Suzuki concluded that it was difficult to attain its primary aim for of entering into the partnership. Also there was concern that the partnership would have a negative impact on Suzuki's autonomous decision-making in its operating policy."^{xxxi}

SERVING NOTICE: BREACH OF CONTRACT

In September 2011, VW served a notice of breach of contract on Suzuki stating that Suzuki had gone to Fiat for its engines instead of approaching VW. This upset Suzuki further and it demanded that VW withdraw the claim. However, according to Suzuki, "the matter of buying Fiat engines had been discussed with Volkswagen back in January and both sides accepted the terms. The reason behind the deal is Suzuki's need of an engine that would meet specified parameters for their SX4 compact. Fiat had such a 1.6 liter diesel engine available while Volkswagen did not."^{xxxi} Osamu Suzuki also stressed that the deal with Fiat did not violate any contractual agreements with VW and decided to dissolve the partnership and cross-shareholding deal as it would disrupt and disparage its honor.

Following these incidents, on October 13, 2011, Suzuki, too, served VW with a "notice of breach" of the Framework Agreement that was drawn up in 2009. The notice required VW to remedy the breach. Osamu Suzuki, said, "This capital alliance was intended to facilitate Suzuki's access to VW's core technologies. I remain disappointed that we have not received what we were promised. If Volkswagen will not allow access it must return Suzuki's shares. We are very encouraged by Suzuki's consistently solid performance. We remain on track for profitability and are excited about the potential for future growth."^{xxiv}

In response to the notice, Ulrich Hackenberg, Executive Vice President and Member of the Board of Management, VW Brand, explained, "The association with Suzuki Motor is purely financial and not technical. There has been some misinterpretation of the issue. The collaboration with Suzuki is financial only. The investment in the company has been positive so far. Stocks have gone up because of the collaboration. The collaboration was possible because they approached Volkswagen. Actually, we do not have the same interpretation of the

partnership."^{xxv} The company also insisted that a clause existed in the agreement that barred VW from getting more shares of Suzuki, but once the agreement was cancelled it was no longer bound to that clause and could start buying shares from the open market. Citing the development of the UP!, he opined that the small car had been conceptualized and developed without the help of Suzuki's small car platform and much before the partnership had been entered into.

THE BREAKUP

Finally, on November 18, 2011, Suzuki terminated its partnership with VW and demanded the return of its shares. In his statement on the termination, Osamu Suzuki said, "Today Suzuki terminated the partnership with VW. Suzuki will be seeking the return of its shares from VW in arbitration. I am disappointed that we have to take this action but VW's actions have left us no choice. They have continued to refuse our attempts on numerous occasions to resolve these issues through negotiation. I am more disappointed that having shaken the hand of Dr. Winterkorn in agreeing to this partnership, he has not honored his commitment to grant Suzuki access to what was originally agreed. In the absence of VW's cooperation and given its failure to do what was agreed, there is no basis for the partnership to continue. With the cessation of the partnership there is also no basis for VW to hold on to Suzuki's shares. We will now work to restore the relationship between Suzuki and VW to its original state as independent parties who do not restrict each other's business. I call on Dr. Winterkorn to honor this."^{xxvi}

The move had left VW baffled, opined an industry observer. "It's clear VW hoped to learn more about Suzuki's almost miraculous ability to engineer profitable low-cost cars, something VW struggles with. If the partnership is over, they're going to have to figure it out themselves. It's also going to cost them more to get into the Indian market that it would have done with Suzuki. But neither are insurmountable challenges for a company with VW's money, ambition, and, I would assume, patience,"^{xxvii} said Max Warburton at Bernstein Research.¹⁷

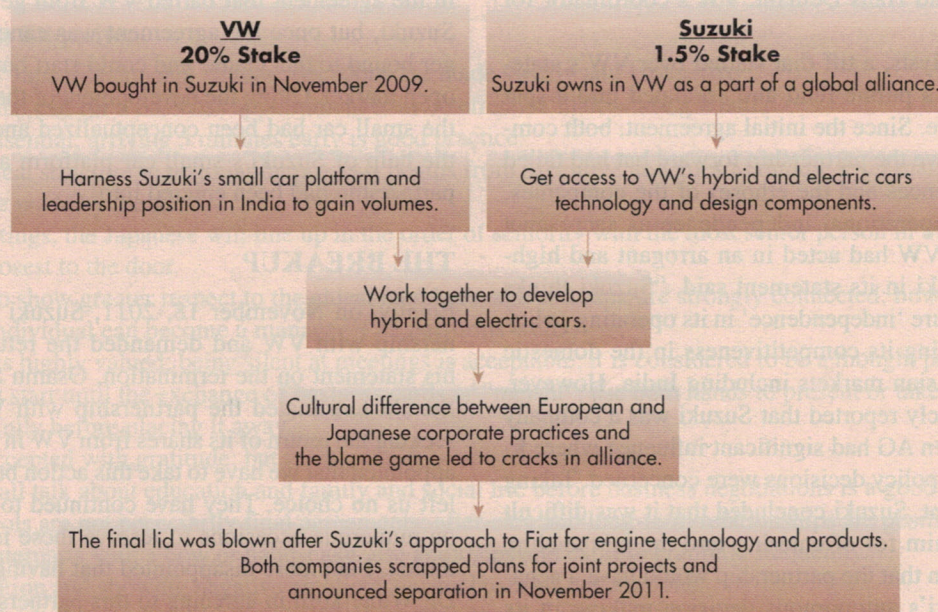
Industry analysts opined that finding another partner for VW to build small cars or entering the fast-growing Indian market on its own would be a costly affair for the German carmaker. They also described Suzuki's diesel engine deal with Fiat as a "snub" to VW, because Suzuki, in partnership with VW, would have gotten global scale and access and superior hybrid technologies. (Refer to *Exhibit V* for a diagram summarizing the VW-Suzuki Breakup.)

THE AFTERMATH

After termination of the partnership, Suzuki wanted VW to sell back its 19.9% stake. However, VW refused to acknowledge Suzuki's request, saying that it was not legally bound to do so. As a result, Suzuki filed for arbitration with the International Chamber of Commerce's (ICC) International Court of Arbitration in London. But VW braced up to fight all the way.

¹⁷ Bernstein Research, founded in 1967, is widely recognized as Wall Street's premier sell-side research firm.

EXHIBIT V Suzuki-VW Breakup



Source: Adapted from: Chanchal Pal Chauhan, "Volkswagen May Bring Special UP!" The Economic Times, Page 7, September 13, 2011.

"We won't sell our Suzuki stake. If the current management at Suzuki doesn't want to work together with us, then maybe the next generation will,"^{xxviii} said Winterkorn.

Frank Schwope, a NordLB¹⁸ analyst, opined that there was no urgent financial need for VW to return Suzuki's shares unless the arbitration court forced it to do so. Instead it could keep them as an investment and wait for Suzuki to weaken to a point where it would need a partner again. Other analysts argued that VW would retain the shares to ensure that no other competitor, such as Fiat, took a stake in Suzuki. "They will just keep the stake as a financial investment and see what they do with it. . . even if it's only to annoy them. They won't take a loss selling down their stake,"^{xxix} said a London-based equity analyst.

Industry observers debated on the possibilities of the outcome of the feud. They opined that the chances of VW selling its stake were slim, because the German carmaker had no immediate need for further liquidity. But Suzuki might be willing to pay a premium to put the partnership behind it, they felt. However, some analysts felt that the stalemate could be broken if both companies built up mutual trust. For instance, they opined that Suzuki could buy some diesel engines while VW could grant access to its alternative technology. However, if both the companies were adamant about their decisions, then analysts opined that the relationship between the two would be bitter even after Osamu Suzuki's regime. Observers did not rule out the possibility of a hostile takeover of Suzuki, but opined that it would be a tough battle for VW. Commerzbank¹⁹ analyst Daniel Schwarz said, "First of all, (Suzuki chairman and CEO) Osamu Suzuki would not want to sell. VW simply won't be able to take over all of Suzuki against his will."^{xxx}

¹⁸ The Norddeutsche Landesbank (abbreviated Nord/LB) is a German landesbank and is one of the largest commercial banks in Germany.

¹⁹ Founded in 1870, Commerzbank AG is the second-largest bank in Germany, after Deutsche Bank, and is headquartered in Frankfurt am Main.

THE ROAD AHEAD

Both the companies were pegged back due to the breakup of the alliance. According to Aleksej Wunrau, a Frankfurt-based BHF Bank AG²⁰ analyst, "Suzuki really needs a big manufacturer behind it, so the effect of a withdrawal would be far worse for them. Volkswagen could very well step back from Suzuki and either seek another partner or start afresh on their own in Japan and India, which would of course be a lot more expensive."^{xxxi} As the Indian market was central to VW's plans of becoming the world's number one automaker by 2018, analysts and top industry executives felt that the company needed a revamped strategy and a new alliance partner to compete in India's small-car market or it needed to develop a strong small-car product line-up on its own. In 2010–2011, VW India offered seven models across price points that included the Polo hatchback and the Vento sedan. VW planned to introduce a special variant of its UP! and more compact cars for India in 2012 to consolidate its position in the fast-growing small-car market, which constituted more than 70% of the total cars sold in the country.^{xxxii} The company expected that the UP! would take on Maruti's A-star and WagonR and help increase its market share in India. In 2010, VW had sold 53,300 cars in India and aimed to double that figure in 2011. It further aimed to raise its market share to 11% by 2015–2016. "The tie-up would have offered Volkswagen an automatic advantage as they would have got a strong local partner in Maruti Suzuki. The Indian market is skewed toward low-cost cars while Volkswagen's expertise lies in the premium cars. The (market share) target looks ambitious,"^{xxxiii} said Colin Couchman, a European automotive analyst at IHS Automotive.

²⁰ BHF-Bank is a leading German investment bank currently owned by Deutsche Bank.

After distancing itself from VW, Suzuki sought help from the Mitsubishi Group of Companies²¹ to power its hybrid cars. Meanwhile, Fiat CEO, Sergio Marchionne said, “Suzuki would be an interesting partner for Fiat in Asia. This doesn’t shock us because we have already speculated that Fiat was right partner for Suzuki and not VW.” He also said that Suzuki and Fiat had been working together for a very long time and were familiar with each other’s business methods and thus could leverage on the strengths of each other. Suzuki had made a deal with Fiat to

²¹ The Mitsubishi Group of Companies, or Mitsubishi Companies, founded in 1870, is a Japanese multinational conglomerate comprising a range of autonomous businesses including mining, shipbuilding, telecom, financial services, insurance, electronics, automotive, construction, heavy industries, oil and gas, real estate, foods and beverages, chemicals, steel, aviation, and others. The revenue and profit of the group for the FY 2010 were US\$ 248.6 billion and US\$ 7.2 billion, respectively.

supply the SX4 crossover in mid-2011. Later, the Maruti Suzuki SX4 was launched with a Fiat Multijet engine and it planned to deploy the same engine for the 2011 Swift and Swift Dzire. The VW TDi engines had proved to be too expensive to procure and had higher maintenance costs for Suzuki. Suzuki further offered to build the next generation Sedici (a rebadged SX4crossover) for Fiat in Italy and a small SUV for Chrysler (now owned by Fiat). With all these improvements in the Suzuki-Fiat relationship when compared to the Suzuki-VW alliance, analysts opined that Fiat would have been the right partner for Suzuki rather than VW.

While some industry analysts expected a full takeover of Suzuki by VW, there were others who trashed the idea and felt that both the companies should move on. Tim Urquhart, IHS Global Insight auto analyst, stated, “I don’t see what good it will do either company getting into a silly litigation either about what the terms of the alliance were supposed to be, or from Suzuki’s point of view a defamation case.”^{xxxiv}

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