

MARUTI SUZUKI INDIA: DEFENDING MARKET LEADERSHIP IN THE A-SEGMENT

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Maruti Suzuki India Ltd. (MSIL), a subsidiary of Suzuki Motor Corporation Japan, had dominated the Indian automotive industry with an unchallenged leadership position in the “A-segment” since its inception in 1983. The Indian car market was normally divided into four product categories: hatch, sedan, sport utility vehicle (SUV)/multi-utility vehicle (MUV) and van. The hatch segment could be further divided into entry-hatch, mid-size-hatch and premium-hatch segments. The overall hatch segment was known as the A-segment (see Exhibit 1). Growth of the Indian car market was driven primarily by growth in this segment.

From 2008 to 2013, MSIL’s competition had made inroads in the A-segment with cars like the Hyundai Eon, the Hyundai i10, the Tata Nano, the General Motors Beat and the Honda Brio. During this period, MSIL’s A-segment market share declined from 61 per cent to 49 per cent. Industry sources estimated that the Indian car market would grow to annual sales of 4.7 million units — and the A-segment to 2.4 million units — by 2017/18. A continued drop in market share in the A-segment could jeopardize MSIL’s competitive advantage in the Indian car market. The company needed to reassess its strategy to sustain its market position (see Exhibit 2).

Among other initiatives planned in March 2013, the MSIL board had sought a product roadmap to sustain its dominance in the A-segment. Typically, new product development and introduction required four to five years to design, develop, test and produce with a budgeted spend of approximately ₹6 billion,¹ apart from associated opportunity costs; hence, it was an important activity for MSIL. The general manager of the product planning department was entrusted with the assignment.

THE INDIAN CAR MARKET

India’s total passenger vehicle industry (including passenger cars and commercial vehicles) was the sixth largest in the world, with annual production of more than 3.9 million units in 2011, while the country’s passenger car market was the seventh largest in the world, with sales of almost 2.7 million units in 2011. As a car manufacturer, India was growing at an exceptional speed; in 2003, for the first time, national production exceeded the 1 million mark, going on to exceed the 2 million mark in 2006.²

¹ All figures are in ₹ (INR or Indian rupee) unless stated otherwise; ₹1 = US\$0.02 on May 5, 2015.

² Society of Indian Automotive Manufacturers, “Industry Performance in 2014-15,” www.siamindia.com/statistics.aspx?mpgid=8&pgidtrail=9, accessed July 30, 2015.

MSIL utilized the findings of several macroeconomic studies to draw up its future plans. It also had a research wing that provided information to its planning, marketing and legal departments. Apart from that, it initiated its own research related to competition, dealership health, sales figures and market potential as well as consumer insights. Reports indicated a significant opportunity in the Indian passenger car market, in the form of growing gross domestic product (GDP), increasing income (i.e., more disposable income among consumers), increasing bank networks and credit facilities, and low car penetration (18 car owners per 1,000 people, whereas Brazil and China had figures of around 200 per 1,000). Major global players like General Motors, Ford and Toyota had initially offered only sedan cars and SUVs, but had eventually introduced products in the A-segment — typically, the most compact cars from their international portfolios. Most of these compact cars were in the premium-hatch category of the Indian market. Thus, the sedan, SUV and premium-hatch segments witnessed higher competition. These segments were also supported with some high-profile advertisements and consumer promotions from the car manufacturers, which fuelled growth.

As a consequence, the entire A-segment also became very competitive for well entrenched players like MSIL, Hyundai and Tata Motors. Stakes for the entry- and mid-hatch segments also increased among these competitors. Competition was expected to intensify with more multinational companies entering the Indian market, in addition to existing players introducing India-specific products (targeting the entry- and mid-hatch segment) (see Exhibit 3).

The Indian market saw increased proliferation of features from the luxury segment becoming available in the lower-end car segments. Features such as air conditioning, power steering and power windows were aspirational for the hatch segment in 2009, but became standard features in the hatch models by 2012/13. Similarly, features available in the luxury sedan segment during 2008, such as touch-screen audio, electric- and auto-foldable mirrors, and automatic air conditioning, were standard across the sedan segment in 2012/13.

The used car market in India grew at a compound annual growth rate (CAGR) of 22 per cent from a volume of 1 million units to 2.6 million units from 2007 to 2012. The market was projected to grow at a rate of 22 to 24 per cent from 2012 to 2017. Within the used car market, small cars accounted for 67 per cent of the total sales in 2011/12. The ratio of new car sales to used car sales in India was expected to reach 1:1.8 by 2016/17 (from 1:1.3 in 2011/12). However, even with this increase, India's ratio would be low compared to developed markets, where the ratio was 1:3.

COMPANY BACKGROUND

MSIL, formerly known as Maruti Udyog Limited, started operations in 1983, when the Government of India and Suzuki Motor Corporation established a joint venture company to sell small cars in India. Suzuki increased its equity from 26 per cent to 40 per cent in 1987, and further, to 50 per cent in 1992, and 56.21 per cent in 2012 (the remainder was owned by public and financial institutions). The company was listed on the Bombay Stock Exchange and the National Stock Exchange of India.

MSIL's vision statement was: "The leader in the Indian automobile industry. Creating customer delight and shareholders' wealth: A pride of India." Its core values were "customer obsession, fast, flexible and first mover, innovation and creativity, networking and partnership, and openness and learning."

By 2013, the company had established a strong brand image by offering solid, reliable products. MSIL's corporate communications emphasized emotional connection, using the message, "India comes home in a Maruti Suzuki." MSIL products enjoyed a sturdy, reliable and economical image in the minds of consumers, and A-segment consumers were proud to own a Maruti Suzuki car. The company's market share reached 85 per cent in 1997, before gradually reducing due to intense competition. By February 2012, the company had sold 10 million vehicles in India. In addition, it was ranked number one in consumer satisfaction for an unprecedented 13th time in a row in the J.D. Power India customer satisfaction index in 2012.³

³ J. D. Power, 2012, "Customer Expectations of Convenience during Vehicle Service Rises Significantly in India," <http://india.jdpower.com/press-releases/2012-india-customer-service-index-csi-study>, accessed November 17, 2015.

Indian consumers generally spent two times the cost of acquisition on repairs and maintenance over the lifecycle of a car, as per the research conducted by MSIL. MSIL products had lower overall costs of ownership. This was achieved by reducing product cost through localization, value analysis and value engineering (VAVE), and improved quality. The company had developed ancillary industries in and around its factory, indigenized the necessary components and increased the local content in its products.

In 2012/13, MSIL achieved revenue of ₹426 billion and a profit of ₹23.9 billion. The company had two state-of-the-art factories. In 2010, it rolled out 1 million vehicles in a year, which was a remarkable landmark for an automobile company in India.

The depth of MSIL's distribution channels played a key role in helping the company to maintain its leadership position in the Indian passenger car industry. By the end of 2012, it had a sales network spread across 878 cities nationwide and a service network spanning 1,422 cities and towns. However, establishing and maintaining distribution outlets in rural markets remained a key challenge for MSIL. Initiatives to maintain constant dealership motivation — through hefty trade promotions, attractive foreign trips and corporate recognition for smaller dealerships — were crucial to success. MSIL dealerships were confident of brand pull, good sales and service support, and fair dealings. Dealerships located in cities that were not in the top 50 cities of India (in terms of car sales) took great pride in being part of the Maruti Suzuki family and this association gave them greater recognition in their own business and social circles.

COMPETITION

With its aggressive tactics, broad product range, appropriate price points, attractive promotions and wide distribution, Hyundai was MSIL's greatest competitor in the A-segment. Its product range comprised the Eon, the i10 and the i20, which were designed to cater to the changing requirements of Indian consumers. Hyundai had the added advantage over MSIL of having successful products like the Verna in the premium car segment, which helped in building brand image and improving profit potential.

Tata Motors posed a different type of competition to MSIL. The brand was trusted across different consumer products and had good presence in the transport vehicle segment. Most A-segment consumers had travelled in Tata buses and experienced the sturdiness and ubiquity of the company's vehicles. Tata entered the hatch market with the Indica, which was an indigenously developed car and hence, had an emotional connection with many consumers. The product was a success in the hatch segment and it catered to personal and commercial segments. With its spacious interiors, sturdy structure and relatively cheap operating costs, the Indica was a preferred product for both short- and long-distance travel. The vehicle was very popular in the taxi segment, as well as with consumers who used it for their own businesses.

The Nano was Tata's most innovative product and had enjoyed a high-profile launch. It was conceptualized as a product that bridged the gap between two-wheeled vehicles and the entry-level A-segment car. It was expected to be a game changer in that it was completely designed in India using the frugal engineering⁴ methodology to provide an affordable alternative to two-wheeled vehicles, which constituted a huge market in India. Despite these selling points, the product was not as well accepted in the Indian market as was expected, which was reflected in the sales figures (see Exhibit 4).

Hyundai and Tata Motors had plant capacities of 600,000 and 1.1 million vehicles, respectively. Hyundai designed its vehicles in Korea and established a global image for its products. Tata motors had its design centres in India and Europe. MSIL had its research and development centre in India, which was Suzuki Motor Corporation's main research and development centre in Asia (apart from Japan). This gave MSIL an edge over its competitors, as it had

⁴ "The central tenet behind every frugal engineering decision is maximizing value to the customer while minimizing nonessential costs. The term frugal engineering was coined in 2006 by Renault chief executive Carlos Ghosn to describe the competency of Indian engineers in developing products like Tata Motors' Nano, the pint-sized, low-cost automobile." PwC, "The Importance of Frugal Engineering," May 25, 2010, www.strategy-business.com/article/10201?gko=24674, accessed July 8, 2015.

access to Japanese technical support but the autonomy to design and develop new products in line with local requirements.

DEALER NETWORK

Buying a car was a high-involvement purchase that required quality selling. MSIL operated through an exclusive network of dealerships, which provided sales, service and spares. Every sale had the potential to start a regular stream of revenue for the subsequent decade for the dealership and the car manufacturer. Sales and service support was critical for managing customer expectations, experiences and relations, apart from the initial sale.

Car dealerships relied intensely on infrastructure and working capital. Each required an investment of around ₹85 million (in rural areas) to ₹175 million (in major cities, excluding the cost of land). With such large capital investments and low margins in the small car segment, dealers were finding it increasingly difficult to break even, even after two to three years of operations. For these reasons, dealerships were appointed only after assessing long-term commercial viability (see Exhibit 5).

Since the cars could be located in any part of the country and reliable service was a basic necessity (human life could be at risk in case of product malfunction), all car manufacturers had a large network of authorized service stations to provide quality service. Sales and service channel development and maintenance were therefore major costs; hence, companies aligned their distribution strategies with their market realities and business strategies. MSIL enjoyed high network penetration with 1,009 dealerships and 2,946 authorized service centres. Market intelligence data for MSIL showed that Hyundai had 340 dealerships and 935 authorized service centres, while comparable figures for Tata passenger cars were 217 and 874, respectively (though it enjoyed considerably greater reach and presence in the commercial vehicle segment).

The dealer margin on A-segment cars was shrinking in 2013. The Maruti sales team had been tracking the data from the dealerships across the country and found that this drop was more pronounced for the entry-level than the premium-hatch category. Based on market intelligence by the MSIL sales team, while gross margins varied from 3.5 to 5 per cent, depending on the manufacturer and the product, net margins remained around 2 to 3 per cent across the industry. MSIL management expected the net margins to remain low across the segment because dealerships had to share part of the ever increasing consumer promotion expenses with the manufacturers. These expenses were typically much higher for the premium hatches as compared to the rest of the A-segment.

Considering the low sales margin in A-segment cars, dealership viability in new car sales remained problematic. With high sales requirements for channel viability, penetration in rural markets was a challenge for most manufacturers, since reaching break-even volumes on a regular basis was very difficult in these markets. Even companies like Maruti Suzuki and Hyundai had struggled to penetrate beyond the district level. The largest 20 cities in India in terms of car sales had dealerships of 21 car manufacturers, while the figure for the next 30 cities was 17. MSIL internal reports indicated that only nine manufacturers had dealerships beyond the top 100 cities (with respect to industry sales), and just two had dealerships outside the top 200 cities.

Dealerships had to develop their used car businesses, as many consumers were now buying a replacement car. These consumers typically wanted the dealership to also buy back the old car, which could act as a consumer retention strategy for the dealerships. Dealerships had to set up additional infrastructure for this business; however they also enjoyed double gross margins in the used car business as compared to new car sales. For instance, a four-year-old compact car could fetch a gross margin of 6 to 8 per cent, as compared to a similar new car that would fetch only 2 to 4 per cent.

There was intense competition in the used car business, as it included independent used car dealerships as well as the dealerships of other car manufacturers. MSIL had done its own internal research, which showed that independent used car dealerships were selling around 75 per cent of the total market. Their main value proposition was that they offered consumers the choice of switching their original brands as well as a 2 to 5 per cent price advantage as

compared to dealerships of car manufacturers. Conversely, dealerships enjoyed superior brand image, reduced hassle and no gap between the receipt of the new car and the sale of the old car.

CONSUMER BEHAVIOUR

The consumer base for the A-segment was evolving. In the past, only high-income consumers could afford a car but from 2000 to 2010, the threshold annual salary for consumers seeking an entry-level car reduced from ₹600,000 to ₹300,000. These new consumers tended to be younger. The change could be attributed to increased ease of accessing credit and finance options. Almost 85 per cent of the entry and mid-hatch segment was financed, while the figure declined to 70 per cent for the premium-hatch segment. Average financing in the industry was 75 per cent, while rural financing was 60 per cent (largely due to cultural aversion to credit and lack of credit infrastructure) (see Exhibit 6).

Historically, the Indian car consumer had been a price seeker; however, younger consumers were more trend conscious, and responded to lifestyle aspects of product and marketing stimuli. These consumers required products with value proposition and desired the perfect combination of styling, features and performance at an affordable price. However, although consumer requirements were changing with changing lifestyles, the desire for owning a “value-for-money” product was still prevalent. Thus, requirements like good fuel efficiency and affordable price were important to consumers.

Consumer buying behaviour was complex. First-time buyers went through a process of problem recognition, identification of alternatives, evaluation of alternatives, purchase and finally, post-purchase evaluation. Important considerations included customer experiences at the dealership, test drives, word-of-mouth recommendations by friends and relatives, and re-sale value.

In the top 100 cities and towns (with respect to industry sales), consumers’ professional circles (including colleagues) influenced their choices regarding brand and product. Alternatively, in other markets, immediate family, friends, acquaintances and village elders influenced the decision-maker. Influencers normally recommended based on their own prior brand experience. Since not all brands were available in smaller towns and rural areas, existing brands with much longer presence and greater distribution reach enjoyed better acceptance.

In the top 50 cities in India (in terms of car sales), brand name and brand-related associations played an important role in the purchase decision, as each product had lifestyle and status connotations apart from its functional and utility value. Consumers purchased different brands for meeting different psychological needs (see Exhibit 7). Raising brand equity was a key challenge for automakers and they invested heavily in advertising.

As per market research conducted by MSIL, consumers based their buying decision on the utility of the product and its features for meeting their needs. In general, new products with additional features at reasonable incremental prices were preferred across the country. Geographical location had a distinct effect on consumers’ product evaluations (see Exhibits 8 and 9). There were other geography-based variations as well — e.g., the percentage of women among car buyers was increasing in the top 20 cities (in terms of car sales). This trend increased the acceptance of automatic transmission in India. Similarly, increased traffic congestion in major cities had also been contributing to the shift towards automatic transmission models amid increased convenience. Interestingly, at the same time, the Indian market had witnessed successful launches of compact SUVs/MUVs, such as the Renault Duster and the Maruti Suzuki Ertiga. This trend could be explained by the changing lifestyles of urban consumers, who needed flexible vehicles and increased utility to manage everyday needs.

Consumers could be classified based on their purchase situations. First-time buyers were those who had no prior experience of buying or using a personal car. They mostly opted for entry-level hatch vehicles, while a few bought mid-level hatch vehicles. The second group comprised customers who already owned a car and were now buying an additional car. This group was equally divided between mid- and entry-level hatch vehicles. Yet another set of customers — those who had a car and were now seeking to replace that car — typically upgraded to premium-hatch cars, followed by sedans and, for a select few, SUVs (see Exhibit 10).