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## **Strategic Management**

**Case study H: Entry strategy of an Asian car manufacturer in the Swiss market**

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## 1 Phuket

Phuket is a leading Asian automobile manufacturer with its headquarters in Phuket. The company uses production facilities in Malaysia.

Phuket is looking to establish itself in Europe and has chosen Switzerland as a test market. Phuket intends to set up an import company in Switzerland to build up and manage a network of motor dealers. Although Phuket is aware that there are not many capable dealers who are not already contracted to other manufacturers or to importers, it seems that many of these, representing a range of different car brands, may be unhappy with their current contract positions. This is because the car manufacturers have been taking advantage of their solid market positions and strong brands to dictate strict conditions in their contracts, affecting such features as showroom arrangements, service performance, sales of demonstration vehicles, and stock requirements. Dealers regard this behaviour as unfair, and Phuket thus sees an opportunity to prise some of these motor dealers away from competitors. With friendly contracts and attractive financial conditions the company hopes to acquire capable dealers with good locations or alternatively establishes a number of new dealerships of its own.

In terms of its finance and staffing, the new import company will be set up in a similar way to competitor companies, using Honda, in particular, as a benchmark.

In the initial phase the following two models will be introduced:

- Phuket Saloon: 4 or 5 door (booted rear or fastback), 1.3 litre 4 cylinder engine with 75 hp or 1.5 litre 4 cylinder engine with 90 hp; average consumption 5.5 litres per 100 km, 6.2 litres for the larger engine; small car category, similar to VW Polo, Ford Fiesta, or Mitsubishi Colt
- Phuket Persona: 4 or 5 door (booted rear or fastback), 1.5 litre 4 cylinder engine with 90 hp or 1.6 litre 4 cylinder engine with 113 hp; average consumption 6.3 litres per 100 km, 6.8 litres for the larger engine (these are low values for this category of car); lower mid-size car, similar to Opel Astra, Ford Escort, VW Golf

For both models standard features are generous, and include ABS, double front airbags, and air conditioning. The retail price will be lower than for comparable low-priced vehicles from South Korea.

## 2 The automobile market

### 2.1 The international automobile market

The automobile industry seems to have overcome the crisis that reached its climax in 1993. In 1994 growth in production and distribution was achieved in practically all markets. Experts assume that this positive trend will continue. But the markets in the different continents will develop differently, for reasons which are apparent. New trading areas, above all in Southeast Asia, and Latin America, are gaining in importance. But even in traditionally important markets as Western Europe, North America, and Japan, the figures are likely to be encouraging. One study has concluded that demand will rise by about 30% to almost 43 million vehicles per year until the end of the millennium. Europe will be part of this trend, with a yearly growth rate of 6%.

### 2.2 The automobile market in Switzerland

With 450 vehicles per thousand of population, Switzerland has the highest rate of car ownership in Europe. In the seventies and eighties the market was volatile, with Japanese producers challenging their European and American competitors with lower prices and more standard features. Today it is the ambitious South Koreans, like Hyundai, who are driving competition in the market.

The turnover from new car sales is 7.6 billion Swiss francs in 1994. This represents around 266,000 new cars. **Figure 2.1** shows the market shares of the most important car brands in Switzerland.

Last year also saw a growth in used car sales. Over 643,000 cars changed hands representing a turnover of 6 billion francs. Of these, 380,000 were sold by motor dealers and 263,000 were direct sales by individual car owners. In recent years the demand has been mainly for lower priced vehicles, costing up to around 15,000 francs. Used vehicles priced above 25,000 francs were difficult to sell.

Opel	18.2%	Peugeot	6.4%	Audi	4.2%
VW	13.6%	Fiat	5.3%	Mazda	4.0%
Ford	9.0%	BMW	4.6%	Citroën	3.2%
Renault	9.0%	Nissan	4.3%	Chrysler	3.0%
Toyota	8.8%	Subaru	4.2%	Honda	2.3%

**Figure 2.1: Market share of the most important car brands for sales for new cars in Switzerland**

The area of Switzerland and Liechtenstein has 11,834 motor dealers, of which 6,648 represent one or more brands. Most of these dealers have grown from one-man companies: some have now become extremely large dealerships. However, the majority of these garages have only 18 employees or fewer.

Garages make on average 75% of their turnover on new cars, but with service and repairs 75% of their profit.

For basic garage businesses, with service and repairs plus used car sales, a future without new car sales does not look encouraging. Turnover in these areas remained at the same level as in the previous year. However, in the last four years workshop capacity use has been falling: in 1990 it was 83%, by 1994 it had fallen to only 74%. The main factors for this trend are longer intervals for service and exhaust checks, the increasing renouncement of the owner for service checks and a smaller susceptibility to repairs. It should be noted too that the repair and maintenance of many types of car now requires special software: this means that only authorised dealers can carry out this work.

Industry experts estimate that there are some 500 to 1000 garages too many, and that these will fall victim to the structural changes in the coming years. Importers are beginning to reorganise and tighten their dealer networks: only financially sound dealerships in strong locations are likely to survive.

In the Swiss market too, the forecasts for new vehicle sales for 1995 are upbeat. The number of registered vehicles is expected to rise to between 270,000 and 280,000. But this short-term growth cannot hide the fact that the Swiss market is nearing saturation. Increasingly it appears that new cars are bought only to replace existing ones.

People's need for individual mobility will continue, and the functioning of the economy will continue to depend on the use of both passenger and utility vehicles. However, the future of the automobile will increasingly be affected by changes in the environment: pressure will continue to grow for manufacturers to reduce petrol consumption and harmful emissions.

### **3 The distribution structure of the Swiss automobile market**

#### **3.1 Overview of the distribution system**

As private vehicles have not been mass-produced in Switzerland since 1975, earlier import restrictions intended to protect the home industry no longer apply, and the

Swiss market is open to all manufacturers. Like Phuket, many other manufacturers have used Switzerland as a test market.

Almost all new cars are imported by specialised import companies. Where these are not subsidiaries of the manufacturers, they have contracts with manufacturers guaranteeing the exclusive right to distribute the brand in Switzerland and Liechtenstein. The manufacturer undertakes not to deliver vehicles to any other Swiss business partner.

The Swiss industry has a traditional three-level structure: importer, regional dealership and local dealer. Originally these three levels were quite separate and independent, both legally and economically. However, recently importers have followed a policy of forward integration, setting up their own dealers in good locations. Increasingly, too, the importers control the strategic decision-making, while at the same time leaving the dealers to bear the entrepreneurial risks.

### **3.2 Importers**

There are basically two kinds of import company:

- Wholly-owned subsidiaries of the manufacturer, tied to the parent company brand: Honda, Mercedes Benz, GM, Ford, BMW, and Renault are imported by such subsidiaries.
- Legally and financially independent import companies working with one or more manufacturers. The manufacturer guarantees the company exclusive distribution for the Swiss market. Unlike the first type of importer, these companies are not committed to purchasing any specified number of vehicles, though they are required to promote sales. Important companies of this type include AMAG, the Emil Frey Group, and the Hugo Erb Group.

### **3.3 The dealer networks**

The importers are free to determine how the vehicles are distributed and thus to set up their own networks of dealers. The traditional network consists of regional dealers ("A"-dealers) and local dealers ("B"-dealers). With over-capacity amongst garages, the importers do not find it necessary to offer especially advantageous conditions or to try to persuade dealers to change brands. A large majority of the dealers have no choice: they need the authorized dealer status for their brand.

- a) The regional dealerships, or "A"-dealers, have contracts with the importers which give them responsibility for a clearly delimited regional market. Within these areas they are responsible for serving and supplying the local dealers, can sell directly to end-users (intra-brand competition with their own dealers), and must offer trouble-free customer service. There is a limited amount of competition between the various regional dealerships representing the same brand. Despite the clear borderlines, in practice 'passive' selling (no advertising or acquisitions) outside this area cannot be avoided. Often the importers will not allow dealers to represent more than one brand. Exceptions can be made if the brands are not in competition with each other, because they target different market segments, or if the importer himself represents more than one brand.
- b) Local dealers, or "B"-dealers, represent the lowest level in the distribution system. These are small garages which carry out maintenance and repairs, and represent one or two brands. Local dealers have no regional protection and have to engage in intra-brand competition, both with the regional dealership, and with other local dealers.

In addition there are a large number of independent garages which do not represent brands, and whose turnover comes mainly from repairs and used car sales.

If a brand has a low market share, or if a brand's market share is falling, the decision to change brand allegiance, or to deal with more than one brand, can be a survival decision for a dealer. But for "A"-dealers especially, it is an expensive undertaking. A large proportion of the dealer's investment will have been brand-specific and will have to be written off (special tools, stock of spare parts, visual and corporate identity).

### **3.4 Cooperation between importers, regional dealers and local dealers**

Usually the importers require the dealers to take over the visual identity of the manufacturer. National advertising is provided by the importers, regional advertising by the regional dealers ("A"-dealers) responsible for the area, and local advertising in partnership between the regional and local dealers. In 1993 the automobile industry as a whole spent 253 billion francs on advertising in Switzerland.

Some importers impose demands on dealers in terms of the product range; others leave this to the dealers. As far as stocks are concerned, the importers usually require the dealers to hold a certain number of new vehicles and demonstration vehicles in stock, and also impose requirements in terms of spare parts.

Usually the manufacturers and importers together determine the prices. The most important criteria are cost, elasticity of demand, and the behaviour of the competitors. In Switzerland prices are relatively high because price elasticity is weak and government requirements are relatively demanding. The importers price lists represent maximum prices. To offer lower prices and compete with each other, the dealers have to give up some of their margin. With high inter-brand and intra-brand competition, garages will offer up to 10% off list prices for a new car. With margins between 13% and 18%, dealers are unable to do better than this.

The importers take an active interest in making sure that dealers' personnel participate regularly in training.

Regional dealers are sometimes given the freedom to develop their own distribution networks, choosing their own local dealers; otherwise the importer stipulates the local dealers.

For efficient trouble-free business administration and information exchange importers generally recommend their computer networks to the dealers, and often require them to provide certain information.

### **3.5 The end user**

Cars have developed from luxury vehicles to items of practical utility, and more recently have become lifestyle products. At the same time consumers have become more demanding. Even for small and mid-size cars, customers today expect high performance and comfort: low-priced basic models find fewer and fewer buyers. For this reason it is more and more frequent for a car to be manufactured only after an order has been placed.

Brand loyalty is very high in the automobile industry. Garages estimate it at 70% to 80%.

End users have become more and more dependent on the services provided by specialist dealers; other garages increasingly lack the infrastructure and the know-how to deliver the same services.

#### **4 Tasks**

- a) Carry out an industry segment analysis for the industry market of the cheap automobiles.
- b) Select the future generic business strategy and identify the industry segment(s) and the customer group(s) which will form the primary target.
- c) State the network of the future competitive advantages.