Identifying new growth frontiers in Indian passenger vehicle market through digitization

Building a case to develop an online platform leveraging used-car sales data to penetrate tier-three cities in India

India may be the third-largest passenger vehicle market by 2020, clocking 5 million units in annual sales. A strong demand, growing market and a thriving supplier ecosystem have attracted several players in the Indian passenger market in the last 8 years, the most recent being Jeep and Kia Motors. Increased competition is healthy as it fosters innovation, productivity and growth however such is the case only when the competitors are balanced.This is not the case with the Indian car industry, which is dominated by Maruti Suzuki (MSIL: 47 percent) and Hyundai (17 percent) that control 64 percent of the market leaving only one-third for remaining players. Such a lop-sided distribution puts other players and entrants at significant disadvantage as these OEMs cannot match the specialized assets such dealer network, spare part availability and brand created by MSIL and Hyundai. While recent entrants have tried to establish new growth frontiers through efforts in tier-3 cities, none have been majorly successful. Arthur D. Little explores the market penetration in tier-3 city through a unique strategic lever: digitization. We recommend creating an online platform integrated with OEMs' new car business and dealers/OEMs used-car business.This would call for a different engagement strategy with tier 3 consumers that demand a personalized touch and interaction, opening avenues for differential pricing and personalized service packages

Introduction

The Indian auto industry is expected to be the third-largest industry by 2020, driven by India's robust economic growth and young population. India is already the sixth-largest car producer, with a good mix of local, European, Japanese and Korean OEMs competing in this space. The Government of India, too realizes the potential of developing the country into an auto hub. Initiatives such as the Automobile Mission Plan 2016–2020 envisages making India one of the top-three automobile-manufacturing centers in the world, with a gross revenue of USD 300 billion by 2026. The attractive market has encouraged several OEMs, such as Kia Motors, Jeep, Renault and Nissan, to enter India in the last five to six years. Existing OEMs, too, are betting big on India's demographic dividend, with many expanding capacities to cater to the demand.

However, if one views the performance of suppliers and downstream partners such as dealers and distributors, the picture is not very rosy. As per a JD Power study, only 42 percent of dealers in India are profitable. The operating expenses of dealers have increased: rentals for showroom and service

centers have more than doubled, manpower costs have tripled and interest costs have risen by 3 percent.

Not surprisingly, out of the 42 percent that are profitable, 60 percent make profits on account of the dealer owning the showroom premise. In fact, only 3 percent of the top dealers in the country are likely to post profit margins of 4 percent or more. Such a scenario is more problematic in a country where the top-two OEMs hold around 65 percent of the market share, leaving only one-third of the market for the remaining players.

The cost of manufacturing and operating dealerships is expected to increase, given India's economic growth, directly impacting labour and land costs. Such factors, combined with increased competition, affect viability and interest of dealers, making it imperative for OEMs to identify new growth frontiers, tier-3 cities holds the key. The current car penetration level in Indiais 20 per 1,000 people, compared to that in the US (797 per 1,000) and UK (519 per 1,000), indicating the inability to tap the growing tier-3 market. Industry experts reveal lack of credible data sources as a key reason for the under-penetration in

tier-three cities. Arthur D. Little India recommends utilizing the used-car businesses of dealers to supplement existing research by integrating dealers' used-car businesses at the back end with online platforms, along with a set of other features that can support penetration initiatives of OEMs in such markets.

The focus of this article is to identify online platforms as a tool to support market penetration initiatives in such cities.

Tier-wise city classification

City Category	Cities
Tier 1A	Mumbai, Navi Mumbai, Thane, Delhi, Gurgaon, Faridabad, Noida, Ghaziabad,
Tier 1B	Ahmedabad, Hyderabad, Kolkata, Pune, Cochin, Chandigarh
Tier 2	Mohali, Panchkula, Ludhiana, Surat, Indore, Jalandhar, Jaipur, Coimbatore, Calicut, Trivandrum, Nagpur, Lucknow, Ranchi, Bhopal, Guwahati, Patna, Bhubaneshwar, Cuttack
Tier 3	Others

Source: SIAM (Society of Indian Automobile Manufacturers

Tier-three cities will soon emerge as a growth frontier

From a demand perspective, the fact that tier-three cities constitute 65 percent of India's population reveals enormous demand that can be catered to, provided affordability and related clauses are met. Moreover, a Confederation of Indian Industry (CII) report on the MSME concluded that 55 percent of India's MSME businesses are now based out of rural areas, which contributes to stable income growth of workforces in tier-three cities. Even from a supply perspective, tier- three cities offer advantages compared with tier-one and -two cities. Tier-three cities offer cost competitiveness in a range of 25–40 percent over other cities: land costs are 50–80 percent cheaper compared to tier-one and -two cities, while labor costs are 50 percent less in tier-three cities. Such factors indicate the attractiveness of tier-three cities. Surprisingly, customer-purchase patterns and trends in tier-three cities are also keeping pace with trends in urban India. One would be surprised to know that tier-three cities are now becoming a key market for e-commerce giants such as Amazon and eBay. Industry sources reveal that 30 percent of current business for eBay comes from tier-three cities. E-commerce boosts in such cities are aided by the growing efficiency of "last-mile" logistics companies and proliferation of mobile handsets.

Passenger-vehicle manufacturers, too, realize the attractiveness of tier-three cities, a key reason almost 50 percent of dealerships of all OEMs (excluding Skoda: See Figure Dealership spread') are present in tier-three cities. However, despite being present in these cities, OEMs are not able to generate desirable sales conversions. **Passenger-vehicle manufacturers can wait for customer preferences for cars in these cities to turn**

favorable, or look at various customer-pull initiatives to drive the change. The merit in this argument may seem more logical given the fact that competition in traditional tier-one and two markets has become unsustainable from a long-term perspective. For new entrants, the situation is more precarious, given that the top-two OEMs control 64 percent of the market. **Hence, it's now imperative to strategically consider the tier- three market, the growth frontier.**

Dealership spread in tier-three cities

OEMs	Dealership spread in tier-3 cities
MSIL	48%
Hyundai	47%
Honda	51%
Tata Motors	52%
Renault	43%
Nissan	45%
Mahindra & Mahindra	43%
Volkswagen	38%
Fiat	56%
Ford	66%
Toyota	56%

Source: Primary research

Penetrating tier-three cities: The current situation and why it's a challenge

OEMs appoint area managers to manage the working of dealers and generate insight around new-car sales, as well as project future sales within an area. For this purpose, OEMs, through area managers, utilize all kinds of data, such as new-vehicle registration, customer surveys and insight from other dealers, to understand the trend and customer behavior. However when it comes to tier-three cities, OEMs struggle in terms of data generation as limited data exists for new-car sales. Two- wheeler data within an area and income levels are being utilized; however, these have limited usage since the purchase patterns for cars and two-wheelers are different. This limits the efficacy of such data points. Arthur D. Little's interactions with experts reveal a dearth of credible data points as a key hurdle to unleashing growth in these areas along with some key insights:

1. The degree of price sensitivity in tier-three consumers requires OEMs to offer more attractive discounts and promotional schemes than for tier-one and tier-two consumers. OEMs can structure warranty- and service-related discounts in concurrence with dealers. However, executing such a scheme would require OEMs to have customer-level data on service and product purchases of cars. At the moment, such micro-level data is absent, preventing its offtake.

2. Personal opinion versus opinions from the internet: Tier-one cities can be influenced utilizing marketing and media

campaigns, while tier-three consumers require interfacing with actual consumers within their associations or communities. This is also because tier-three consumers are more socially integrated compared with tier-one and -two consumers, for which the nuclear-family concept is more common. Virtually no or limited work is done to connect potential tier-three consumers with existing customers.

3. First-time buyers versus upgraders: Consumers in tier-three cities are first-time buyers, and hence require more personalized attention. Personalized marketing and engagement require more data bombardment around the prospective consumer or consumers of similar nature to handle atypical queries, requests and requirements. This ties closely to the points mentioned above. Clearly, the requirement for credible data around tier- three consumers is relevant for developing a personalized engagement strategy, a task with which OEMs have struggled to date. At present, OEMs are adopting a herd mentality with elements of a "wait-and-see" approach, which is static. Given the industry vibrancy and influx of multiple forces, a dynamic approach is needed to focus on a personalized customer engagement strategy.

To achieve this, Arthur D. Little recommends utilizing the used-car data in these cities to supplement existing research for bringing about the necessary customer pull

Importance of used-car data?

Before highlighting its importance, as a background we must understand the industry overview. The Indian used-car market is currently valued at USD 15 BN (GMV), and this is expected to triple by 2020. Used-car sales are growing by 3X in tier-three cities compared to in tier-one cities. Certainly, the low sales of new cars and lower price of used cars contribute to such an inflated figure; the fact that used-car business in tier-three cities is growing and significant in relation to new cars cannot be denied.

Market structure of used cars

- **Category 1:** Organized segment share is around 15 percent, and consists of players such as Maruti's True Value and Mahindra's First Choice. Average volume is sixteen per month.

- **Category 2:** Semi-organized segment constitutes another 30 percent market share, consisting of platform based systems that sell used cars of various dealers and stand-alone independent used-car dealers. The average volume is nine per month.

- **Category 3:** Unorganized segment constitutes another 21 percent, with independent dealers forming the bulk of the population at 55 percent. The average volume is three per month. The consumer-to-consumer segment constitutes approximately 34 percent of market share, in which

consumers directly interface with other consumers through networks and/or online to sell cars.

- **Category 4:** Peer to peer segment, constituting 34 percent of market share, in which consumers directly interface with other consumers through networks and/or online to sell cars.
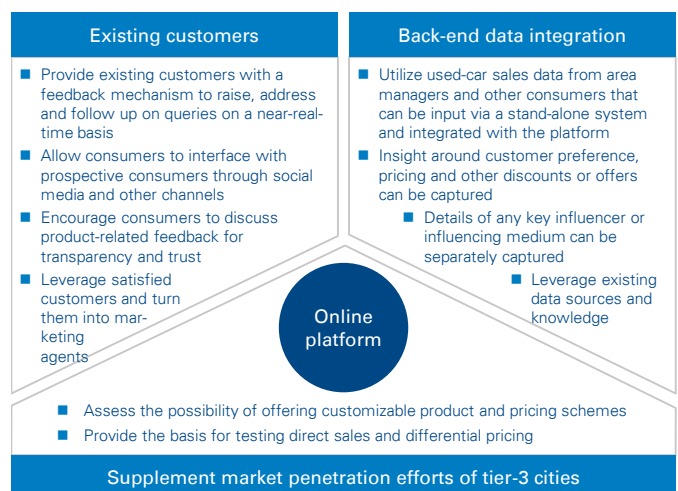
Irrespective of the structure, we recommend OEMs to tap into the data generated by used car industry within tier-3 cities. Integrating data from Category 1, 2, and 3 is possible provided some incentive structure is created within the OEM. Generally ground level data sourcing is done by area managers. We recommend giving additional responsibility to such individuals to liaise with used-car agents to source information on second-hand car sales originating from Category 2 and 3. Category 1 level data is easiest as several OEMs have entered the used car business (Maruti: True Value, Hyundai: Hyundai Promise, Tata Motors: Tata Motor Assured). For Category 4 data (peer-to-peer) we encourage OEMs to incentivize such data sharing through the platform and getting kick-backs in return. Such a data consolidation exercise may sound extreme, but given the recent industry dynamics, the benefit clearly outweigh the costs.

Conceptualizing the online platform and its use

Tapping India's vast geographical reach and diverse customer preferences requires new strategic thinking. Linking the used car business data with an online platform tool allowing consumers to give real time feedback is a key lever. The platform should enable the following:

- Access for existing customers to report any sales- or post-sales-related issues. This should be administered by the OEM with the objective of time-bound closure. Currently a feedback mechanism exists through voice-to-voice calling; however, in many cases customers are too busy to report the feedback or the closure, and follow-ups do not reach the consumers.

Overview of Online platform

Existing customers	Back-end data integration
■ Provide existing customers with a feedback mechanism to raise, address and follow up on queries on a near-real-time basis	■ Utilize used-car sales data from area managers and other consumers that can be input via a stand-alone system and integrated with the platform
■ Allow consumers to interface with prospective consumers through social media and other channels	■ Insight around customer preference, pricing and other discounts or offers can be captured
■ Encourage consumers to discuss product-related feedback for transparency and trust	■ Details of any key influencer or influencing medium can be separately captured
■ Leverage satisfied customers and turn them into marketing agents	■ Leverage existing data sources and knowledge

Online platform

- Assess the possibility of offering customizable product and pricing schemes
- Provide the basis for testing direct sales and differential pricing

Supplement market penetration efforts of tier-3 cities

Source: Arthur D. Little

- Giving prospective customers the option of directly interfacing with existing customers to get feedback and information on product and service satisfaction through social media.

- At the back end, the platform must also integrate the used-car data from various sources within the platform which can be readily combined with existing data points.

The platform would offer multiple benefits

- OEMs spend around 30–35 percent of their marketing budgets on customer research, which can be partially offset by the information gained through online tools and data from used-car sales. The online feedback tool would allow OEMs to leverage experienced and satisfied buyers to work as marketing agents via word of mouth. By directly contacting such buyers, new buyers can source information on the actual product, features and other hidden costs. The platform would allow experienced buyers to offer more direct, honest and credible information online.

- Data from used-car sales on service-related issues can be utilized to see the maintenance-related services that customers are outsourcing. If permissible, new-car sales schemes can be created around this to offer tier-three consumers pricing benefits in the form of service discounts.

- Finally the online platform, would address difficulties identified in penetrating tier-three cities:

  i. Tier-three consumers are not influenced by the internet and have their own opinions and prejudices with regard to products. In such cases, the more information one can provide to the sales executive about the customer type, preferences and categorization proven by data coming from used-car sales or social-media engagement, the higher the possibility of converting these customers into actual sales.

  ii. Tier-three consumers rely more on personal recommendations of friends and family: if the dealer sales staff can connect such customers with owners in similar localities or communities via the online platform, it would help bring greater credibility to a company's claims around the product and service.

  iii. Moreover, tier-three consumers are first-time buyers rather than upgraders, and require a personalized touch. Discussing and working on a more customizable offering to the customer around product-, pricing- or service-related discounts might help win the confidence of these customers and lead them to make a purchase.

Conclusion

Achieving desirable sales conversion rates in tier-three cities is possible by leveraging the full pool of data sources available to OEMs. Used-car sales is one such data point that is not being exploited. Challenges around tier-three consumers can be countered with different customer-pull initiatives, as well as by maximizing the network effects of existing customers. By creating pools of satisfied customers, OEMs are indirectly creating strong, reliable marketing agents to fuel growth from new customers and repeat purchases.

Big data-driven solution sets can also be utilized to drive customer engagement efforts in tier-three cities. Furthermore, the online platform may be a great source to test out customer willingness on customizable features direct from the factory, such as seating, entertainment controls and other add-ons.

The digitization tool would not only help penetrate these growth frontiers but would also open the Indian consumers to personalised products and offerings.

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