How Competition Will Shape Indian Markets

Jagdish N. Sheth, Rajendra S. Sisodia, G. Shainesh

Competitive markets evolve in a predictable manner and, once mature, exhibit many similarities across industries and geographies. Most notably, each market tends to be dominated by three (not two or four) major, volume-driven firms, which we term "full-line generalists," surrounded by a constellation of smaller margin-driven firms that are either product or market specialists. The three large firms together control approximately 70% to 90% of the market; niche players serve the balance. Further, a company needs a market share of at least 10% to be viable as a full-line generalist. In between the generalists and the specialists is a gap, representing a market share of between 5% and 10%. It is in this "ditch" that efficiency suffers and financial performance tends to be weakest relative to other levels of market share.

The strategic implications of the "Rule of Three" are myriad. Marginal full-line players (those with market shares less than 10%) are in danger of being pushed into the ditch by the larger players. Specialists that grow unwisely are in danger of being pulled into the ditch by the lure of greater market share. Particular competitive strategies spell success at various levels within a market; we present distinct strategies that companies need to pursue, depending on whether they are No. 1, No. 2, No. 3, ditch-dwelling or specialist players.

Introduction

Over the past several years, the world economy, principally in the developed free market economies of North America and Europe, has witnessed a unique combination of economic phenomena: mergers as well as demergers (i.e., spin-offs of non-core businesses) at record levels. Every year between 1997 and 2000 saw new records established for mergers as well as demergers. As a result, the landscape of just about every major industry has changed in a significant way. Industries as varied as wireless, aluminum, banking, pharmaceuticals, petroleum and airlines are in the midst of rationalization and consolidation, moving inexorably toward what we call the *Rule of Three.*

In the increasingly interconnected and interdependent world economy, it is inevitable that the same forces at work in the West will spread to the rest of the world as well. This is especially the case as companies in the industrialized world look to the emerging economies of Asia, Russia, and Lain America for much needed growth.

Artificial market structures everywhere are giving way to the "natural" market structure

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represented by the Rule of Three. For example, the great trading houses of Japan (such as Mitsubishi, Mitsui and Sumitomo) have long participated in numerous business sectors, supporting weaker businesses through interlocking shareholdings (the "keiretsu" system, which creates a closed market within the overall free market). This has shielded many poor performing companies from market forces, and as a result has kept too many weak companies afloat in the market. In recent times, however, this system has finally started to break down. The discipline of a truly market-driven economy is forcing weak companies to exit or get acquired, often by global competitors.

In South Korea, the huge diversified "chaebol" such as Hyundai, Daewoo, Samsung and LG (Lucky-Goldstar) have traditionally used their enormous clout with the government to maintain their leadership in virtually every major economic sector. The Asian economic crisis of 1997 and the conditions of the subsequent IMF bailout of South Korea started the process of breaking down this cozy relationship, and bringing market forces to bear to a greater extent.

In India, most major industries have been dominated by the large industrial houses, many of them family controlled. Until a few years ago, foreign companies faced stringent restrictions on their ability to participate in the Indian economy. Capacity rationalization was nearly impossible to achieve as a result of licensing and the inability to "downsize" (reduce the labor force) when market conditions so dictated.

All of this is now changing for India, as economic liberalization and the demise of isolationist economic thinking have triggered a shift toward more freely competitive markets. We therefore fully expect to see the Rule of Three gradually become the norm in India as it already has in much of the industrialized world.

What is the Rule of Three?

Just as living organisms have a reasonably standard pattern of growth and development, so do competitive markets, and our research into approximately 200 product industries has revealed that markets evolve in a highly predictable fashion, governed by the "Rule of Three."

Through competitive market forces, markets that are largely free of regulatory constraints and major entry barriers (such as very restrictive patent rights or government-controlled capacity licenses) eventually get organized into two kinds of competitors: full-line generalists and product/market specialists. Full line generalists compete across a range of products and markets, and are volume-driven players for whom financial performance improves with gains in market share. Specialists tend to be margin-driven players, which actually suffer deterioration in financial performance by increasing their share of the broad market. Contrary to traditional economic theory, then, evolved markets tend to be simultaneously oligopolistic as well as monopolistic.

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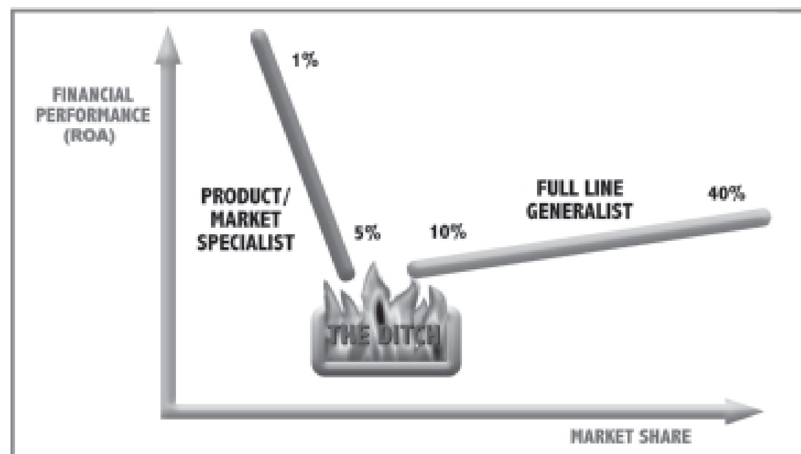

Figure 1: The Rule of Three

A useful analogy to mature competitive markets is a shopping mall. Mature markets are "anchored" by a few full-line generalists, which are akin to the full-service anchor department stores (such as Sears and JC Penney) in a mall. In addition, a number of other players are positioned as either product specialists or market specialists.

The accompanying figure plots financial performance and market share, illustrating the central paradigm of the Rule of Three: in competitive, mature markets, there is only room for *three* full-line generalists, along with several (in some markets, numerous) product or market specialists. Together, the three "inner circle" competitors typically control, in varying proportions, between 70% and 90% of the market. To be viable as volume-driven players, companies must have a critical-mass market share of at least 10%. As the illustration shows, the financial performance of full-line generalists *gradually* improves with greater market share, while the performance of specialists drops off *rapidly* as their market share increases.

There is a discontinuity "in the middle;" mid-sized companies almost always exhibit the worst financial performance of all. We label this middle position the "ditch," the competitive pothole in the market (generally between 5% and 10% market share) where competitive position (and, thus, financial performance) is the weakest. The rule of competitive market physics is very simple¾those closest to the ditch are the ones most likely to fall into it. Therefore, the most desirable competitive positions are those furthest away from the middle. Firms on either side of the ditch¾especially those close to it¾need to develop strategies to distance themselves. If a firm in a mature industry finds itself in the ditch, it must carefully consider its options and formulate an explicit strategy to move either to the right or the left.

The Rule of Three applies (and renews itself) at every stage of a market's geographic evolution¾from local to regional, regional to national, and national to global.

A useful analogy to mature competitive markets is a shopping mall (Figure 2). Mature markets are "anchored" by a few full-line generalists, which are akin to the full-service anchor department stores (such as Sears and JC Penney) in a mall. In addition, a number of other players are positioned as either product specialists or market specialists. In a mall, a store such as Footlocker is clearly a product specialist, while The Limited is more of a market specialist. While Footlocker sells only athletic shoes, The Limited has a precisely-defined target market¾young, fashion conscious, educated, professional women¾and caters to a wide range of their fashion needs. Store image, customer image and employee image all blend into one homogenous mix. The same company likewise operates stores such as Victoria's Secret, Lane Bryant and Limited Express, each a market specialist targeting a different customer group. This structure illustrates a maxim that we will discuss later¾that the best way for a specialist to grow profitably is through the spawning of new specialists.

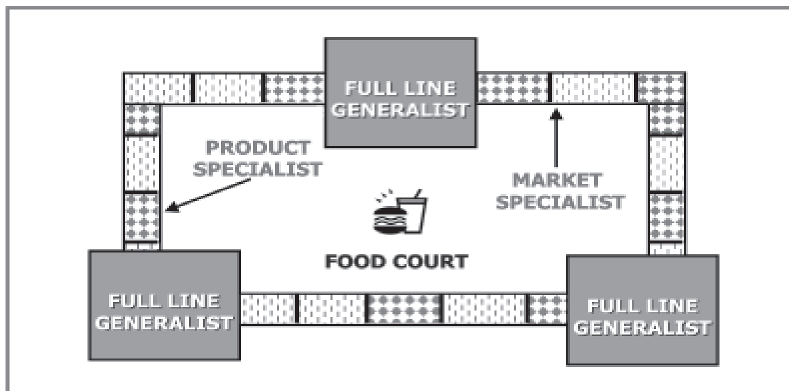

Figure 2: The Shopping Mall Analogy

The Ditch

The Rule of Three posits a model of market competition in which two diametrically opposed strategies can be viable and successful. However, a veritable Bermuda Triangle of competitive strategy lies in the middle. Firms can generate attractive returns regardless of where they fall on the graph in Figure 1¾except the ditch¾provided they follow strategies appropriate to their position on the chart.

Failing to do so has but one consequence: a slide into the ditch, and a long and possibly fatal attempt to climb back out. It is far easier to stay out of the ditch in the first place.

How Margin Players Get Pulled In

Margin-driven players are often lured into the ditch, tempted by the possibility of higher volumes. For example, in the global business of manufacturing writing instruments, Bic, a high volume French player driven by market share, dominates the mass market for ballpoint pens. The number two player in the mass market is PaperMate, followed by Scripto. On the other side of the graph are the margin-driven specialists: companies such as Mont Blanc, Waterman, Cross and many others, all of which operate with low volumes and high margins for their elegant offerings.

There are numerous examples of misguided attempts to grow out of specialty status. AMC, the automobile maker, went into the ditch after being a great niche player by trying to expand into a full-line of automobiles, though the Rule of Three was already in place in the industry. Lacking the resources to compete with the Big Three, AMC came up with a single car (the Rambler) masquerading as everything from an "econobox" to a luxury sedan. Not surprisingly, the strategy failed, and AMC was subsequently purchased by Chrysler, which was also eventually pushed in the ditch when Japanese transplants, especially Toyota and Honda, became mainstream volume cars. Chrysler eventually merged with Daimler Benz in what is evolving as the Global Rule of Three.

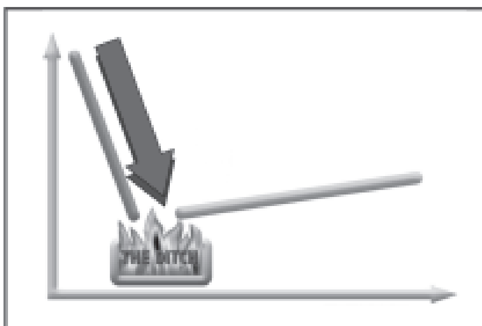

Figure 3: Margin Players in the Ditch

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How Volume Players Get Pushed In

On the right side of the graph, the most vulnerable is the No. 3 company, because it is closest to the ditch. In a growing market, the third full-line player continues to survive. However, when market growth slows, the two leaders aggressively fight for share. In the process, the No. 3 player (and any other aspiring full-line generalist) often gets pushed into the ditch. This is most common during tough economic times (such as the high inflation 1970s or the low-growth early 1990s), when overall market growth shrinks or is negative. This impels the No. 1 and No. 2 players to raise the competitive stakes and take market share away from the easiest target: the No. 3 player. For example:

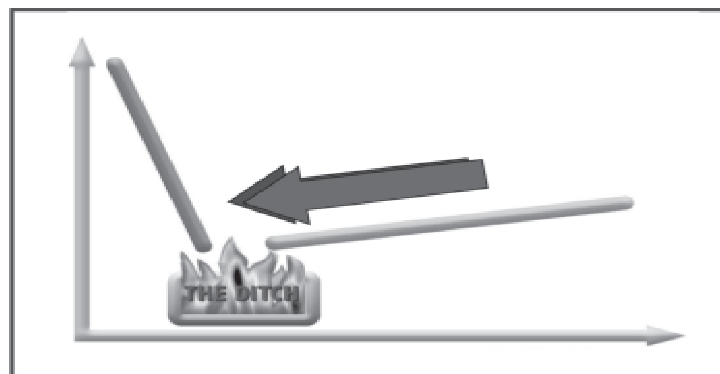

Figure 4: Volume Players in the Ditch

Aircraft Manufacturing: In the recession of the late 1970s, the intense fight for market share between Boeing and McDonnell Douglas pushed Lockheed into the ditch. Lockheed, which had been #3 behind Boeing and McDonnell Douglas before the emergence of Airbus, was

forced to exit the commercial aviation market, and focus on the military market. Trailing badly behind Boeing and Airbus in the globalized commercial aviation market in the mid 1990s, McDonnell Douglas sought a deal with Taiwan Aerospace to make the fast-growing Asian market its second "home" and particularly to position itself for the fast-growing China market (with its more than $20 billion in backlog orders at that time). When the US government disallowed this deal, McDonnell Douglas' options were limited; it could have emerged as a specialist producer of short-haul jets based on its MD-80 platform, or exited the commercial aviation market. In 1997, the company chose to accept a merger with Boeing, leaving the commercial aviation business without a third full line generalist. We believe this condition is temporary, and that a new full line generalist will eventually emerge, possibly from one of the BRIC countries.

In the short run, the third player may exit during market slowdowns or period of intense rivalry. At the end of such a period, there is usually another third player who emerges¾usually not the one that left. Importantly, niche players are not significantly affected by the competitive tumult among the generalists. The competitive challenge from full-line generalists primarily affects other generalists and would-be generalists. Successful specialists are generally secure in their own niches. For example, the beer battles left microbreweries unscathed, the cola wars had little impact on sports drink maker Gatorade, and corporate jet makers prospered even as the generalists fought for dominance in the commercial aviation market.

The Rule Of Three and globalization

The important and ongoing shift toward global markets leads to a significant corollary of the Rule of Three: *No matter how large the market, the Rule of Three prevails.* In other words, when the scope of a market expands¾whether from national to regional or regional to global¾the Rule of Three prevails, and further consolidation and industry restructuring become inevitable. Many nationally or regionally dominant companies find themselves trailing badly once the market globalizes.

When the market globalizes, many full-line generalists that were previously viable as such in their secure home markets are unable to repeat that success in a global context. When this happens, we usually find that there are three survivors globally¾typically, but not necessarily, one from each of the three major economic zones of the world: North America, Western Europe and the Asia-Pacific region. To survive as a *global* full-line generalist, a company has to be strong in at least two of the three legs of this triad.

If a country has a large stake in an industry, it may be home to two or even all three full-line players. This was true in the aerospace market in the U.S., where the Defense Department essentially bankrolled the industry's technological superiority. Japan targeted industries such as consumer electronics, automobiles , steel, shipbuilding and several others. In the long run, however, political considerations make it unlikely that one country could dominate a significant market globally. Thus, in the aerospace market, the historical dominance by U.S. companies led several European governments to boost Airbus to a position of global prominence.

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With globalization, the No. 1 company in each of the three triad markets is best positioned to survive as a global full-line generalist. Other players either go through mergers as a consequence of global consolidation, or they selectively exit certain businesses to become product or market specialist, often by geographic region.

In consumer electronics, the U.S. market is now experiencing a fierce fight for market share between the Japanese (Matsushita/ Panasonic and Sony) and the Europeans (Philips/Magnavox and Thomson/RCA/ GE). This battle will determine which players survive as global full-line generalists. The U.S. presents an ideal battleground because there is no company with a "home court advantage;" since there is no major domestic consumer electronics player, there is little danger of government intervention. In the airline market, globalization is proceeding simultaneously with the market's evolution towards regional competition after deregulation. Given the numerous restrictions on foreign ownership of airlines, and in the absence of true "open skies" competition, the global industry is organizing into three big alliances: Star Alliance (Lufthansa, United Airlines, Singapore Air and several others), Oneworld (American Airlines, British Airways, Qantas and others) and Skyteam (Delta, Air France, Aeromexico, and others).

The Rule of Three in India

As mentioned in the introduction, several factors are now triggering the Rule of Three across the Indian commercial landscape. The primary factors are the liberalization of the economy, leading to increased domestic competition, and the growing presence of global brands and companies for example LG and Samsung in consumer electronics and Suzuki, Hyundai, GM, Ford and Toyota in the passenger car industry. Other factors include the gradual withdrawal of the public sector from many industries, the explosive growth in national media (especially television), the growth of the organized retail sector, and the recognition by the large business houses that they must focus on their core businesses by exiting marginal business lines.

The application of the Rule of Three to the Indian market is moderated by two significant and persistent factors: the presence of a large unorganized and unbranded sector in many industries, and the presence of many regional players (given cultural and language differences between regions as well as logistical considerations). While we believe that both of these factors will gradually wane in coming years (as they have elsewhere in the world), they continue to be significant for now.

Below, we highlight a few sectors in which the Rule of Three is imminent or already here. As the examples show, the Rule of Three is operational for consumer as well as business products, durables as well as non-durables, and goods as well as services.

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Cement

The century old cement industry is the second largest producer in the world after China. Starting with only 10,000 tonnes of annual capacity and production of 1,000 tonnes per annum, the industry now has an installed capacity of over 140 million tonnes producing almost 120 million tones annually in 2004.

The industry was heavily regulated during the initial eight decades of its existence. Price and distribution controls were in existence till the early 1980s. The industry was characterised by low prices and a supply-demand mismatch, with the growth in production capacity always behind the growing demand. The sector was partially decontrolled in 1982, with the government freeing a part of the production from price and distribution controls. Over the decade of the 1980s, the industry witnessed a sharp growth rate, both in capacity and production, in sharp contrast to the virtual stagnation in the late 1970s. Post deregulation, the industry attracted a number of players, who set up capacities, to tap the latent demand and the benefits of price decontrol. Larger capacity plants, based on the more efficient dry process, were set up. The older plants were undersized as well as technologically

obsolete as they used the inefficient wet process. The industry was totally freed of all controls in 1989 and underwent a complete metamorphosis. The demand has grown at an average 8-10 per cent over the last two decades. The output, in the last decade, grew by nearly two-fold.

The industry had several diversified conglomerates. Many of them ventured into the cement industry after the government loosened its control in 1982. Some of the prominent diversified players included the Tata Group with interests in ACC as well as through Tata Steels' cement plants, Larsen & Toubro (L&T), Grasim Industries (Aditya Birla Group) Century Textiles (B K Birla Group), M P Birla Group and the Singhanias (Raymonds, JK Synthetics). A flurry of activity on the mergers and acquisition front has resulted in consolidation in recent years. The larger players are currently strengthening their base by restructuring and consolidation. In six years from 1998 to 2004, the share of the production capacity of the top five companies has increased from 33.5% to 55%[1]. Grasim Industries' acquisition of a 10 per cent stake in Larsen & Toubro (now Ultra Tech) and the 14.5 per cent stake acquisition by Gujarat Ambuja in ACC have led this consolidation efforts. International majors Lafarge and Holcim entered the Indian cement industry through the acquisition route. Lafarge has been the most active, acquiring cement plants of Tata Steel and Raymond's while the Italcementi Group took stake in Zuari Cements through its group company, Cements Francais. Holcim, by joining hands with Gujarat Ambuja, has taken a stake in ACC and emerged as the largest player in the industry with a capacity of over 35 million tones (MT) per year. Aditya Birla group occupies the second position with an annual capacity of 31 MT followed by India Cements, a distant third with a capacity of 8.8 MT. Out of the total capacity of approximately 140 million tonnes; the current Big Three control over 50%. However they control about 62% of the market share. The industry still remains fragmented with the installed capacity distributed over about 120 large cement plants owned by over 50 companies. We will witness many more mergers and acquisitions as the industry moves towards consolidation.

Table 1 : Cement Industry in India – Capacity and Market Shares (January 2005)

Sl. No.	Name of the company	Promoter Group	Capacity (Million Tonnes)	Marketshare in (%)
1	Gujarat Ambuja + ACC	Holcim & Gujarat Ambuja	35.5	29.58
2	Grasim+Ultra Tech	Aditya.Birla Group	31	25.83
3	India Cement	N.Srinivasan	8.8	7.33
4	Jai Prakash Industries	Jayprakash Gaur	7	5.83
5	Madras Cement	P.R.R.Rajha	6.1	5.08
6	Century Textiles Industries	B.K.Birla	5.5	4.58
7	Birla Corporation	M.P.Birla	5	4.17
8	Lafarge	Lafarge (France)	4.4	3.67
9	Italcementi	Italicementi&Zuari	1.7	1.42
	Total (for the Top Nine Players)		**105**	**87.49%**

Adapted from: " Cementing a New Landscape" BusinessWorld, 7th February 2005, pp. 42.

[1] INGRES, Building Materials – The Indian Cement Industry', ICRA Information and Grading Service, March 2005.

Likely market specialists, focusing on regional markets, include Madras Cements, with four manufacturing plants located in Tamil Nadu producing over 6 million tonnes per year, selling mainly in the southern states. Given the nature of the industry, the availability of raw materials and the cost of transportation, regional players will continue to play a prominent role. Product specialists are likely to include those focusing on specialty products such as white cement.

Airlines

The domestic airlines industry is dominated by Indian Airlines, the incumbent public sector company and Jet Airways, a successful private airline in India. They fly about 80% of the air travelers in India with the balance being carried by Sahara and Air Deccan.

The growth of the airline industry shares a lot of similarities with many regulated industries in India. After Independence in 1947, eight air transport companies were operating within and beyond the borders of the country. They were: Tata Airlines, Indian National Airways, Air service of India, Deccan Airways, Ambica Airways, Bharat Airways and Mistry Airways. In early 1948, the Government of India and Air India (formerly Tata Airline) established Air India International Ltd., a joint sector company, with a fleet of three Lockheed Constellation aircraft. J.R.D. Tata, a visionary who had founded the first airline in India in 1932, headed this joint venture.

The government nationalized the airline industry through the Air Corporations Act 1953 and set up Indian Airlines Corporation to take over the domestic and regional routes. Air India became the international carrier. Eight former independent domestic airlines; Deccan Airways, Airways - India, Bharat Airways, Himalayan Aviation, Kalinga Air Lines, Indian National Airways, Air India, Air Services of India, were merged to form the new domestic national carrier. The domestic aviation industry remained the sole preserve of Indian Airlines by virtue of the Air Corporations Act, 1953 for the next four decades.

In April 1990, the government announced the 'open-skies policy' which allowed air taxi- operators to operate flights from any airport, both on a charter and a non-charter basis and to decide their own flight schedules, cargo and passenger fares. East-West Airlines became the first private air taxi operator under this policy. In 1991, the government permitted scheduled airlines to operate and compete with Indian Airlines.

The repeal of the Air Corporations Act of 1953 in 1994 gave legitimacy to the private airlines. The market boomed with growth in the number of air travelers as well as the number of airline operators. In 1990, private air taxi-operators carried 15,000 passengers. This number rapidly increased over ten times from 4.1 lakh in 1992 to 4.89 million in 1995. In 1996, private air taxi operators carried 4.9 million passengers accounting for about 41% share of domestic air passenger traffic. By 2004-05, the three private airlines carried over 60% of the estimated 19 million domestic air travelers. Recently announced policy permits the existing private airlines to operate on international routes.

The liberalization policies of the early 1990s resulted in seven operators viz. NEPC Airlines, Skyline NEPC, Jet Air, Archana Airways, Sahara India Airlines, Modiluft and East West Airlines acquiring the status of scheduled airlines. In addition, 22 nonscheduled private operators and 34 private operators had no-objection certificates in 1996.

After 1991, many companies had jumped into the fray but most of them failed. Damania Airways was among one of the

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first ones to shut down. Though the company had an extremely high profile and a lot of customer goodwill, it was financially weak. In September 1995, Parvez Damania, the promoter of Damania Airways, decided to sell the company to NEPC airline. However, Damania's loss didn't turn out to be NEPC's gain. NEPC faced financial trouble and started defaulting on payments and soon shut down its shutters. By mid-1996, two other private airlines, East West Airlines and ModiLuft, had also failed. After the churn, the industry, resembled a duopoly, with Indian Airlines and Jet Airways sharing over 95% of the market and Sahara barely managing to make its presence felt.

Jet Airways is the biggest success story in the Indian aviation industry. Set up in 1993, it focused on becoming the "Businessman's Preferred Airline". Now it has emerged as the largest domestic airline in India. Air Sahara also began operations in 1993 following the Indian government's decision to open the skies to the private sector. Today it has an estimated market-share of approximately 15%.

The Rule of Three applies to the domestic airlines market which is dominated by Indian Airlines and Jet Airways with Air Sahara a distant third as shown in the table below -

Table 2 : Market share in Domestic Sector in India (based on % of passengers)

S.No	Name of the Airline	2001-02	2002-03	2003-04	2004-05 (upto August 2004)
1	Jet Airways	48	48.4	47.2	43.4
2	Indian Airlines	46.9	41.7	39.7	38.8
3	Air Sahara	5	9.8	13.1	14.5
4	Others	-	-	-	3.3

Source: http://www.indiastat.com

The domestic aviation sector operates at a very low scale compared to global standards. With about 600 flights and just over 60,000 passengers a day, it compares poorly with leading countries like the US where over 20,000 flights operate daily.

The industry is witnessing a lot of action with the entry of budget airlines inspired by the success of Air Deccan. Air Deccan, which entered the fray less than two years back in August 2003, offers air travel at 30-40% of the cost of the regular airline tickets. With revenues of about $90 million in its first full year of operations, it was expecting to break even in the financial year 2004-05. It is aiming to make profits in the financial year 2005-06 with revenue of US$200 million.

Air Deccan operates about 106 flights daily across India with an aircraft fleet of five Airbus A-320's and 13 ATR 42. With aggressive plans to add 30 new 72-seat ATR aircraft and 30 Airbus A- 320s over the next five years, Air Deccan is creating a new market of budget travelers flying between smaller towns and the metros. Air Deccan has been able to achieve low costs by adopting a value chain which aims at cutting costs on the supply side – procuring aircraft, maintenance, etc, and on the demand side – ticketing, on-flight services, cancellation policies, etc. (Patlibandla, M. 2005). Budget carriers Kingfisher Airlines, GO and SpiceJet are slated to begin operations during the latter half of 2005.

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encouraging trend has been the 30% growth in passenger traffic from about 15 million in 2003-04 to 19 million in the year 2004-05 spurred by the low cost offers including price promotions by the large carriers.

With growth in the overall market, we are likely to see new niches being created by regional players and the possible emergence of Air Deccan as a strong contender for one of the top three positions.

Two-Wheeler Industry

The two-wheeler industry is a fifty year old industry in India (George, S. 2002). It consists of three segments viz., scooters, motorcycles, and mopeds. In 1971, sales were around 0.1 million units per annum. But by 1998, this figure had risen to 3 million units per annum. In the calendar year 2004, the total sales exceeded 6 million units.

The two-wheeler industry in India has to a great extent been shaped by the evolution of the industrial policy of the country. Regulatory policies like Foreign Exchange Regulation Act (FERA) and Monopolies and Restrictive Trade Practices Act (MRTP) determined the structure and growth of the industry. Initially private investment was channelized and regulated through the extensive use of licensing giving the State comprehensive control over the direction and pattern of investment. Entry of firms, capacity expansion, choice of product and capacity mix and technology, were all effectively controlled by the State in a bid to prevent the concentration of economic power.

The industry took off (both in terms of overall sales volumes and number of players) after foreign investments were allowed in 1981. The reforms in the 1980s, permitting the entry of several new firms, attracted all Japanes majors viz. Honda, Suzuki, Yamaha and Kawasaki to set up joint ventures. It also resulted in many of the existing technologically outdated products to lose sales and /or exit the market.

With liberalization in the 1990s, the conditions required for the 'Rule of Three' to operate were put in place. Most of the regulations in the market were abolished. Manufacturers no longer had any exclusive rights and there was no major barrier to trade and foreign ownership to assets. As a result, in each of the three distinct segments of the two-wheeler market viz. motorcycle, scooter and moped, the 'Rule of Three' started to work. Bajaj Auto, HHML and TVS Suzuki have traditionally been the three big-boys of the Indian two-wheeler market. Despite a major shift in the customer preference from scooter and moped to motorcycle, the overall grip of these three players on the Indian two-wheeler market has only increased over the years. They controlled 67% of the overall two-wheeler market in 1996, 69% in 1998, 76% in 2000 and 88% in 2002. In 2004, the top three controlled about 83% of the market.

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Table 3: Overall Two-Wheeler Market Share (%)

Sl No.	Name of the company	No. of 2-wheelers produced	Market share(%) (%)
1	Hero Honda Motors Ltd	24,73,767	41.17
2	Bajaj Auto Ltd	13,94,426	23.21
3	T.V.S Motors Ltd	11,19,565	18.63
4	Honda Motorcycle& Scooters India Limited	4,52,233	7.52
5	Others	5,67,794	9.47
	Total	60,07,785	100

Source : IndiaStat.com, April 2005

Honda has emerged as the dark horse in the two-wheeler industry. It operated through two joint venture companies for more than a decade in the 1980s and 1990s - Hero Honda for motorcycles and Kinetic Honda for scooters. After the break up with Kinetic, it set up a 100% subsidiary in the year 2000 which started selling high-end scooters. While continuing in the joint venture with Hero Honda, it has made an independent entry into the motorcycle market too.

The market leader Hero Honda operates only in the fast growing motorcycle market unlike Bajaj and TVS. Thus we see a slight variation of our proposition in the two wheeler industry where a product specialist is actually the market leader. This can be explained by the shifting customer preference from scooters towards motorcycles over the last decade. The following table shows this shift in customer preference -

Table 4 : Share of Categories of Two-Wheelers

CATEGORY	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03
Scooters / Scooterettee	47.15	44.91	42.24	39.27	33.40	24.11	21.61	17.14
Motorcycles / Step Through	29.91	32.70	37.22	41.18	47.69	58.19	68.68	76.03
Mopeds	22.95	22.39	20.53	19.56	18.91	17.70	9.71	6.82

***Source*: Society of Indian Automobile Manufacturers (SIAM)**

Honda has emerged as the dark horse in the two-wheeler industry. It operated through two joint venture companies for more than a decade in the 1980s and 1990s - Hero Honda for motorcycles and Kinetic Honda for scooters. After the break up with Kinetic, it set up a 100% subsidiary in the year 2000 which started selling high-end scooters. While continuing in the joint venture with Hero Honda, it has made an independent entry into the motorcycle market too.

A combination of technological, economic, design and environmental factors has spurred growth in the motorcycle market. We briefly discuss these below -

Technological factor - Motorcycles are technologically superior to scooter. They typically have better pick-up, more power, give higher mileage, and have strong suspensions and larger wheelbase. Given the Indian road conditions, stronger suspensions and a larger wheelbase are preferred by the customers. These features are particularly helpful in rural areas where the condition of the roads is even worse. It is not surprising that in the rural markets there is a very strong customer preference for motorcycles.

Economic factor - The price differential between motorcycles and scooters have significantly narrowed down. Rising consumer expectations for superior technology and styling coupled with this narrowing down of price differential has resulted in shift of customer preference from scooters to motorcycles. The easy availability of flexible loan options have made owning a bike that much easier for the customers. Motorcycles are much more fuel-efficient vis-à-vis scooters. With rising fuel prices, driving motorcycles makes better economic sense for the customer and this is another important reason for the shifting of customer preference towards motorcycles. Moreover, motorcycles have a better resale value which acts as an added attraction for the consumer.

Design factor - Motorcycles have a macho image while scooters are viewed as traditional and boring. The stylish designs of the motorcycles have caught the imagination of the customers. While the design of scooters saw no significant change over the years, constant introduction of a plethora of motorbike models with better styling and superior aesthetic have kept consumer interest alive in motorcycles.

Environmental factor - With strict environmental norms coming into force, the four-stroke motorcycles are better suited

to meet the regulatory requirements than the two-stroke scooters. Moreover, the increasing environment consciousness of the consumers has resulted in their preference shifting towards the cleaner and more environment friendly technology like that of a four-stroke bike.

To sum up, the 'Rule of Three ' applies to the two wheeler industry in India. We believe that Honda will be a strong contender for challenging the dominance of Hero Honda, Bajaj and TVS in the near future.

Cellular Services

Telecom services in India achieved a milestone in April 2005, when it crossed 100 million subscribers. Cellular services account for approximately 56 million subscribers and the landline services account for the remaining 44 million. This amazing growth in cellular services has been achieved in less than a decade after the sector was liberalized and opened for private participation. Before liberalization, the government controlled Department of Telecom (DOT) was the monopoly service provider and it operated through two corporations namely, BSNL and MTNL. In 1994, private participation was permitted and one of the first areas to be opened for the private sector was the cellular services (Gupta, S. 2000). Licenses were awarded to the private sector in the metropolitan cities of Delhi, Mumbai, Kolkata, and Chennai in 1994. A year later, licences were given out in 19 more telecom circles. The first metro cellular network started operating in August 1995 in Kolkata.

As with other deregulated sectors, telecom saw a flurry of players in the initial years but now the industry is consolidating. India's rapidly expanding mobile telecom services has seen a spate of acquisitions. The pace of buyouts accelerated after the government scrapped the requirement of having only four operators in each circles and introduced unlimited competition with the aim increasing the tele-density. Unified licensing enabled limited mobility services providers such as Reliance Infocomm and Tata Teleservices to become full-fledged mobile carriers. Wireless is becoming a volume game with thin margins and therefore only large players with economies of scale and deep pockets are going to survive.

The Government's initiative to hike the Foreign Investment cap in telecom from 49 to 74 percent is also providing the impetus for the consolidation. Some of the consolidation efforts include Idea Cellular buying 100 percent equity in Escotel Mobile, Bharati's acquisition of Shyam's 67.5 percent stake in Hexacom, STT and Telekom Malaysia's acquisition AT&T Wireless's 33 percent stake in Idea Cellular, and Hutchison Essar Telecom's purchase of the mobile operations of Aircel (Source: India Infrastructure, October 2004)

Table 5: Market share of the Top 5 Mobile players in India

S.No	Name of the company	Subscribers(000)	Market share(%)
1	Reliance Infocom	10,521	22
2	Bharti Televentures	9,826	20
3	BSNL	8,880	18
4	Hutchison Essar	7,180	15
5	IDEA Cellular	4,696	10
6	Others	7,350	15
	Total	48,454	100%

Source: ICRA Sector Analysis Telecom March 2005 Page 35
" Subscriber base and market share of GSM and CDMA in India as on December 2004" Subscriber base includes both GSM, and CDMA.

As the table indicates, the cellular services market is consolidating and approaching the 'Rule of Three'. Currently the top three players account for exactly 70% of the subscriber base while the top five players account for 85% of the subscriber base.

Aluminum and Copper

The aluminum and copper industries have seen the emergence of a handful of dominant players following a remarkable phase of national and global consolidation and expansion within the industry. Aluminum manufacturing is largely an oligopolistic market with Bharat Aluminum Company Limited (BALCO), NALCO and Hindalco accounting for 88% of production. Sterlite Industries Ltd. - also a major player in copper - recently bought 51% of BALCO from the Government of India and a 55% piece of India Foils, the largest manufacturer of aluminum foils. Additionally, Hindalco acquired Alcan's 54.6% stake Indian Aluminum Company (IAC) in March 2000. Now the three players account for the entire installed capacity of the aluminum industry in India.

Table 6: Company-wise Installed Capacity of Aluminum in India
(2003-04 in tonnes per annum)

Company	Promoter Group	Installed	% Capacity
Hindustan Aluminium Corporation Limited Indian Aluminium Company Limited	Aditya Birla Group	345000	52% 117000
National Aluminium Company Limited	Government	288000	33%
Bharat Aluminium Company Limited Madras Aluminium Company Limited	Sterlite (Vedanta Group)	100000 25000	14%
Total		**875000**	**100%**

Source ; IndiaStat.com, April 2005

Aluminum's sister industry, copper, has settled down to the Rule of Three, following a spate of consolidations. Three major players in the organized sector currently control the copper industry: Hindustan Copper, Birla Copper, and Sterlite Industries. Recently, Sterlite Industries Ltd. acquired two mines in Australia, which makes it easy to source the raw materials.

Table 7 : Production of Refined Copper in India
(2003-2004 in tonnes)

Group	Installed Capacity	Production	% Share of Production
HCL	47500	30598	8%
Sterlite	165000	178746	45%
Birla Copper	250000	186611	47%
Total	462500	395955	100%

Source ; IndiaStat.com, April 2005

Tea

The Indian tea industry is facing a crisis in terms of consumption. This struggle is expected to end up weeding out many of the 125 small and medium-sized tea companies that exist.

There are several main companies in the industry, many of which have recently participated in mergers on both national and global levels. Tata Tea is the leading tea plantation company in India and the largest integrated tea producer in the world. During 2000, the company acquired entire shareholding of world's second largest branded tea company, Tetley Group Limited of the United Kingdom. The Tata Tea/ Tetley combination now ranks as the world's number two tea company in the world, with about 5% of sales. The purchase of the Tetley business, which is twice the size of Tata Tea, represents the largest cross-border takeover of an international brand by an Indian firm. Tata Tea faces competition from Hindustan Lever's Brooke Bond and Lipton brands, which command a 34% market share to Tata Tea's 20%. The Goodricke Group and the Assam Company are the other major players.

Hospitality

The boom in the hospitality industry in India has resulted in a spurt in capacity addition in the last couple of years and consolidation with global players looking for room in the struggle for control of the market. For survival, hotels in India are linking up with international chains, many of which are actively looking to acquire properties in India. Join ventures are sprouting as those with global ties seem likelier to become one of three in this competitive field.

Even though the industry has a large number of independent hotels, the hotel chains account for 70% of all sales. Most of the 5-star and 5-star deluxe hotels are part of hotel chains as shown in the accompanying table.

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Table 8: Hotel Value Sales by Independent vs Chained Outlets 1999-2003

Rs million

	1999	2000	2001	2002	2003
Total hotel sales	32,587.2	32,788.9	44,993.7	49,490.0	54,440.0
Chained hotel sales	21,567.8	22,430.6	27,671.1	34,593.5	37,944.7
Chained outlets' sales as a % of total sales	66.2	68.4	61.5	69.9	69.7

Source: Euromonitor based on FHRAI data and press reports

The Indian hotel industry chain is an oligopoly with few key players grappling for control. They include The Indian Hotels Company, Ltd. (IHCL, also known as the Taj Group), the largest hotel operator in India and EIH (East India Hotels) which owns the Oberoi brand. They own properties in various categories such as luxury, business, budget, heritage as well as beach and hill resorts. Other players include ITC hotels (linked with the Sheraton chain), Hotel Leelaventure, Asian Hotels and Jaypee Hotels. ITC Hotels is the fastest growing chain in India with 50 properties across 43 destinations nationwide, which includes hotels in all categories. IHCL and EIH contribute to 70% of the turnover of the hotel chains. The government's decision to divest the properties of public sector chain, ITDC and HCI,has resulted in a decline in their share.

Table 9: Main Players by Turnover in 2002-03 (*Rs million)*

Hotel Chain	Turover	% Share
Indian Hotels Co Ltd	7,093.50	43%
East India Hotels	4,355.20	26%
India Tourism Development Corp	1,687.60	10%
Hotel Leelaventure Ltd	1,469.90	9%
ITC Hotels	1,224.90	7%
Hotel Corp of India	664.2	4%
Total	**16,495.30**	**100%**

Source: Adapted from Euromonitor report

With the hotel industry acquiring the infrastructure status and India being rated as the ninth hottest tourist destination by the Conde Naste publication, capacity addition is going to increase in the future. There will be a further decline in the share of independent hotels. Mergers and acquisitions will help consolidate the industry and the Rule of Three will be evident.

Tobacco

The largest player in the global tobacco industry is the state-owned China National Tobacco Company, which produces over 31% of the world's cigarettes and has a near-monopoly of the huge and growing Chinese market, estimated at over 1.7 *trillion* sticks a year. The other global players are Philip Morris (17%), BAT (16%) and RJR (5%). India's cigarette market of 105 billion sticks a year is relatively small compared to China; 82% of India's tobacco is consumed in the form of beedis. However, the market is still attractive to multinationals, given its size (200 million smokers) and growth potential. The Big Three in India are ITC (65% of the market), Vizir Sultan Tobacco and Godfrey Philips. Philip Morris already owns 36% of Godfrey Philips, while BAT has 33% of ITC.

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Luggage Industry

The Indian total luggage market is approximately Rs 1,200 crore annually, of which Rs 700 crore comes from the unbranded unorganized sector. Within the Rs 500 crore branded luggage market, VIP has a lion's share of 64.7%, Aristocrat (a corporate sibling of VIPs) has 16%, Safari has 12.7% and Samsonite has 6.6%. Samsonite has positioned itself as a specialist targeting the premium end of the market. Samsonite arrived in India in 1997 and has since captured 60% of the premium segment, with sales growing at 40% per year.

The preceding examples illustrate that the Rule of Three applies to consumer as well as business industries, goods as well as services and durables as well as packaged goods. However there are several situations when the rule does not apply. These are described in the next section.

When The Rule of Three Does Not Apply

The Rule of Three applies wherever competitive market forces are allowed to determine market structure with only minor regulatory and technological impediments. It would, therefore, not apply in markets where the following factors are significant:

1. ***Regulation.*** If regulatory policies hinder market consolidation (as they have in Japan) or allow for the existence of "natural" monopolies (as was the case with the local telecommunications market), the

Rule of Three is not operational. With deregulation, it comes into play, as with the U.S. airline, trucking and telecommunications industries.

2. ***Exclusive rights.*** If patents and trademarks are major factors in a market, it must be viewed as a collection of sub-monopolies, and is thus not subject to market forces. In the chemical and pharmaceuticals markets, therefore, we are less likely to see the Rule of Three govern market evolution. However, in recent years, the pharmaceutical industry has seen a large number of mergers and appears to be gradually moving toward the Rule of Three; this is due to the fact that large pharmaceutical firms are now participating in the growing generic sector as well as patented drugs, and patent-based sub-monopolies are being eroded as firms target the same therapeutic class with multiple drug formulations.
3. ***Licensed economy:*** The Rule of Three cannot operate in economies in which companies are not free to adjust their production levels up or down based on market conditions. With the passing of India's infamous "license Raj" of old, market forces have come increasingly to the fore, leading many companies to achieve greater economies of scale through production growth as well as mergers. The WTO has been a prime driver in raising the competitive intensity of industries internally as well as from the outside.
4. ***Major barriers to trade and foreign ownership of assets.*** In this case, we are likely to see the Rule of Three operate at the national level but not at the global level. The Rule of Three may still be seen in the formation of global groups or alliances, as we believe is likely to occur in the global telecommunications market.
5. ***Markets with a high degree of vertical integration.*** To the extent that certain customer groups are captive to in-house suppliers or vice-versa, the emergence of three full-line players in the supplier market is unlikely. Vertical integration does not allow competitive market forces to operate. It ties up suppliers and customers internally so they are not free to buy or sell in the open market.
6. ***Markets with combined ownership and management.*** If ownership and management are combined, as in the case of professional services, the market process is not allowed to work. Ownership creates an emotional attachment, and inhibits rational economic decision-making.

When these barriers begin to fall, markets start moving towards the Rule of Three.

Conclusion

The Rule of Three is much more than an interesting theoretical construct; it is a powerful empirical reality that must be factored into corporate strategizing. Understanding the likely end-points of market evolution is critical to the ability of executives to develop strategies that will result in success.

Ultimately, the Rule of Three is about the search for the highest level of operating efficiency in a competitive market. Industries with four or more major players, as well as those with two or fewer, tend to be less efficient than those with three major players. The role of the government is to

ensure that free market conditions do indeed prevail, to allow industry rationalization and consolidation to occur naturally, and to step in when an industry seeks to consolidate too far, i.e., to a level where fewer than three players control the lion's share.

The greatest impact and potential dislocations arising from the Rule of Three occur when an industry makes a major geographic transition¾from regional to national, or even more dramatically, from national to global. The impact of this transition on a number of industries, including tires, appliances, automobiles, telecommunications and hotels has been the emergence of a new core of inner circle companies, with, at times, surprising winners and losers.

Finally, an implicit understanding of the Rule of Three lies behind General Electric's well-known "Number 1 or Number 2" approach to restructuring in the 1980s. When Jack Welch laid down these guidelines¾that GE would have to be No. 1 or No. 2 in any business that it remained in¾he was recognizing the constant pressures and pulls on businesses that are No. 3 in their market. The strategic implications of the Rule of Three are many and varied, however, and thus go considerably beyond this dictum.

As more markets become globalized or get transformed through technology in coming years, managers everywhere will have to reassess their corporate positioning and strategic goals. For some, this will spell a once-in-a-lifetime opportunity to seize the initiative and firmly establish their companies on a larger stage. For many others, it will require hard thinking about strategic choices, and the courage to make painful but necessary decisions about markets not served and products not offered.

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