Ford motor company: the product warranty period

[Business](), [Company]()

Overview

This particular case takes place in the United States during the time of the 1980's, when owning a vehicle was a social norm that almost every adult who could drive owned a car. Majority of these vehicles were made by Ford, who was known as the world's second largest manufacturer of automobiles. However, in 1986, first time in Ford's history, they had the highest sales and net income at $62. 7 billion and $3. 3 billion. Ford also successfully exceeded the profits of General Motors, who was one of their main competitors, for the first time in 60 years. Ford's net income in the US market had increased 14. 9% from the year before and was seeing a major turnaround from their net losses of $3. 5 billion from 1980-1982. During this time, the auto industry was struggling with new car sales since they were declining due to the oil shock in 1970 and an economic depression.

The United States automobile industry was also dealing with the external pressures of losing market share by an international competitor entering and gaining a decent portion of the market. The good news was the industry was starting to recover in 1983, yet majority of the new car sales were for imported cars. The US market was dealing with more competition than ever, because international automobile makers were offering upscale, attractive cars. Ford's management decided General Motors, Chrysler, and Japanese auto companies were their main competition. GM obtained 41% of the US market share in 1986, which was more than double Ford's market share at 18. 2%. However, Chrysler came in under at 11. 4% of the market, they were continuously growing, and their market share was increasing for the sixth year in a row, so they needed to be taken seriously as a rising competitor.

Over the past few decades, the warranties offered in the auto industry varies, but were used as a marketing strategy to try and differentiate from their competitors. However, as time went on the competition with the warranty plans between Chrysler, GM, and Ford had grown more aggressive and fiercer. During the 1980's, Chrysler was gaining more market share while Ford and GM each lost 0. 5% of the market share. As a part of their new and improved marketing strategy GM announced a new competitive warranty plan on January 1987.

The Main Issue

One of the main issues that has been presented in this case is to weigh out Ford's options in recommendations of how to strategically respond to General Motors new product warranty plan. A key profitability factor that Ford needs to consider when creating a more competitive warranty plan is the Extended Warranty Plans (ESPs). An ESP was a customer option that could be purchased when buying a vehicle that provided more coverage on repairs that went above the standard warranty period. The ESP plans brought in substantial amount of revenue for Ford and were a huge aspect when examining their overall profits. Ford was now faced with having to create a competitive standard plan without compromising the worth and profitability of the ESP plans they could sell to customers.

Ford's Options in Recommendations

Five recommendations were proposed by Ford's management as potential avenues to exploit.

1. Do not respond to General Motors

2. Exceed General Motors' Terms

3. Offer equal to Chrysler but less than General Motors

4. Use the European approach that gave the same corrosion warranty for all models, but different warranty plans for the powertrain on luxury and non-luxury vehicles

5. Match General Motors' terms

If Ford was going to make a warranty change they also needed to decide to implement the new warranty for 1988 model cars or make if effective immediately and retroactive for previous models.

Evaluating Options

In order to evaluate all options, I decided to use deductive marketing reasoning to decide which options were not viable, and then proceed to use evidence to back up the final recommendation.

1. Not Responding to GM and not changing warranty terms at all would be negative option for Ford. It is anticipated that GM's move is going significantly increase their growth and become the biggest warranty provider among the top competitors within the US market. If Ford doesn't follow market trends and what the customers are proving they want from a company, which is improving warranty plans, it could significantly impact their market share. Automobile warranty options in the US market are

important purchase factor for customers, which could be used to sway customers to another brand, especially since consumers are very comparative with reliability and warranty options. By not doing anything this could be detrimental to their business and give GM the upper hand.

2. It seems unnecessary for Ford to attempt to exceed GM’s new warranty terms. It would be beneficial in the sense that it would make them the market leader in standard warranty, yet it would dramatically increase their costs. Ford may gain more by offering a better warranty for the customers perception of their brand, but it does not warrant the extra costs and potential loss of ESP sales. However, Ford should remain competitive they need to take into consideration their financial position and try to become the warranty leader in the market with positioning not financial leverage.

3. In the same light if Ford only matches Chrysler’s term they are lowering their standards to their lower level competitor, and not be able to compete with GM. With choosing this option, Ford would be taking a major risk of losing a significant portion of the market share and sales to General Motors. Although Chrysler is gaining more market share, GM should be Ford’s main focus. Since GM holds 41% of the market, while Ford has 18. 2%, and Chrysler 11. 4%. Chrysler’s share is growing due to aggressive marketing tactics but increasing at a slow rate of roughly 3% over the 5-year period. Chrysler should be on Ford’s radar in the future once they have the opportunity to pose a significant risk, yet that time is not now.

4. Adopting the European’s strategy to implement better warranty terms seems like another negative decision. Although this may differentiate

themselves from their competitors because no one has adopted this policy it doesn't make the most sense. The US domestic car market the luxury cars sector is steadily decreasing at about . 4% per year. In 1985, luxury cars only made up 9. 8% of sales and 9. 4% in 1986. It is also projected that they will decrease to 9% in 1987. It is also assumed that offering multiple warranties may confuse customers, which could negatively impact Ford's brand loyalty, because of the lack of transparency. While offering higher warranties on luxury cars might attract more luxury customers, it may have the opposite effect on non-luxury car owners. Ford is not in the position to lose the non-luxury car market, so it is a waste of time since it won't significantly improve their position in the market and remain competitive with GM.

Recommendation

The best option for Ford is to match Gm's new warranty terms of 6 year/60, 000-mile powertrain warranty and a 6 year/100, 000-mile corrosion warranty. This would also change their warranty from a vehicle warranty terms to an owner warranty, where if the original owner sells the car, the person who decided to purchase the car will have the option to transfer the warranty to them for $100 fee. This gives Ford the opportunity to create a new stream of revenue, because if you look at Exhibit 4 it shows that up to 5 years after buying a new car they'd like to purchase a newer version. When trading in the car for their new purchase dealerships can offer to transfer the warranty for $100 fee, while also getting two new car sales creating a new stream of consistent revenue from loyal customers. If Ford matches this new warranty, they will remain competitive with GM. GM may have more market share over

Ford in every model except subcompact, where Ford is the leader. Overall, GM has over twice the market share in comparison to Ford and cannot afford to lose any more. This may not help gain more market share for either company, but at least Ford will not lose any market share as they would if they did nothing.

A major concern presented in this case was what would happen to sales and growth of ESP if they offered a better standard warranty plan. It may initially be a little harder to sell the lower end ESP plans and sales of these specific ESP may decline I do not think it is significant enough to deter Ford from moving forward. Over the years 1984-86 the sales from ESPs have increase dramatically from $140 million in 1984 to $195 million in 1985, and $265 million in 1986. Additionally, ESP profitability is actually declining even with the huge jump in sales in 1986. When doing the gross margin for 1985 Ford's gross margin was . 996 (52. 77 B – . 195 B= 52. 575 B/ 52. 575). However, in 1986 the gross margin decreased to . 995 (62. 71 B – . 2654 B = 62. 4446 B/ 62. 71B).

Now the decrease in the profitability of ESP's is not significant, but it is in a downward trend, which should be a factor to consider. The ability to come out with a new standard warranty will give Ford the opportunity to expand its portfolio by adding an additional stream of income that creates an attractiveness to consumers and has the potential to offset the downward trending profitability of the ESP's. The new warranty is appealing to the market, but not as good as the ESP warranty and the strategies used to sell to customers can be built upon since there are so many options to be somewhat custom to the consumer. Since they will be selling more cars with the enticing warranty it should offset the potential loss in ESP sales. Implementing this new warranty will also solidify customer brand loyalty, which will in turn lead to a higher customer life time value.

According to Exhibit 7, Ford’s current warranty costs for each non-luxury car of $284 ($157 basic for first year + $33 powertrain after 1 year + $1 corrosion after 1 year + 93 emissions after 1 year). If Ford matches GM’s new terms, their warranty costs for non-luxury car will now equal $319 ($157 all basic for the first year + $66 powertrain after 1 year + $3 corrosion after 1 year + 93 emissions after 1 year). Their warranty costs will only increase $35 per non-luxury car ($319- $284), well worth the price to stay competitive within the market, and maintain/gain customer loyalty, while increasing car sales.

Ford’s sales increased from $52. 77 billion in 1985 to $62. 71 billion in 1986, which is about a 15. 8% increase. If we use the same percentage for the following year, their projected sales should be $72. 62 billion in sales. If measure on a conservative basis, a reasonable goal in 1987 for Ford to work towards after implementing the new warranty plan would be around $70. 24 billion, about a 12% increase. The difference between their net income and sales in 1985 is roughly 4. 8% ($2. 51/$52. 77), and the difference between 1986 ($3. 33/$62. 71) is about 5. 3%. If we assume that the percentage will increase at least 2% due to the new appealing warranties and apply that to our projected sales in 1987 at $70. 24 billion, our net income should equal

$3. 86 billion (5. 5% x $70. 24 billion). This increase is close to . 53 billion from the previous year, which seems like an achievable goal.

By matching this new warranty Ford should be able to gain more of the market share until at least 1988 or longer. Their market share dropped from 18. 8% to 18. 2% from 1985 to 1986, but with a more attractive warranty they should be able to gain 1-2% of the market by 1988, which would equal 19. 2-20. 2%. Ford cannot afford to wait another year to bring this warranty plan into action when they launch their 1988 models. Although it will increase warranty costs, it would also leave them in a very vulnerable position to General Motors to not respond at all. Ford will not only miss out on the opportunity to remain competitive with GM, but also the potential to gain sales, profits, market share, expand their revenue streams, and increase brand loyalty/awareness. The losses Ford will face by not acting far outweigh the costs associated with implementing the new warranty plan.