Winning the Battle for Autonomy

Is there an independent future for industrial companies from South-east European countries or will they become victims of the next consolidation wave?
In their recent best-selling book the A.T. Kearney experts Graeme K. Deans, Frith Kroeger and Stefan Zeisel (see Mc Graw-Hill 2002: Winning The Merger Endgame; also see Harvard Business Review December 2002: The Consolidation Curve) describe the results of their long-term analysis of 25,000 international companies in 53 countries and 24 industries with a detailed analysis of 1,345 large mergers completed over the past 13 years. This analysis proves that all industries across the world have similar life cycles.

Strategies for medium-sized companies in South-east Europe to survive the next wave of mergers & acquisitions

As was known before, most new industries are fragmented and consolidate as they mature. The research found that the analysed 24 industries progress predictably through a clear consolidation life cycle – and that companies can plot with some precision where they fall in the cycle and when the next mergers & acquisition wave can be expected. Once an industry forms or is deregulated, it will move through four stages of consolidation with an average of 25 years to progress through all four stages. This period could become even shorter in the future!

Every company in every industry will go through these four stages or disappear. The four stages are 'Opening' as the first stage, 'Scale' as the second stage, 'Focus' as the third stage and 'Balance' as the fourth stage.

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Newly deregulated or privatised industries throughout the world such as energy, telecommunications, railroads and insurance companies currently occupy the first 'Opening' stage. Start-ups in new fields such as biotechnology and online retailing also reside here, along with spin-offs that come from completely consolidated industries – as sports drinks and bottled water did from the soft-drink industry. Companies in this industry stage are aggressively defending their first-mover advantage by building scale, creating a global footprint and establishing barriers to entry by protecting proprietary technology or ideas. The successful companies achieve fast growth and enter the second 'Scale' phase of international industry consolidation. The intensity of mergers & acquisition increases in this stage. Major players begin to emerge, buying up competitors and forming empires. The top three players in this stage own 15% to 45% of their global market. Typical stage 2 industries include airlines, hotel chains, automotive suppliers, banks and pharmaceuticals. Pfizer, with its acquisition of Pharmacia and Warner-Lambert, is a textbook example of a stage 2 company successfully positioning itself for the later rounds of consolidation that will yield the industry's giants.

Stage 3 is the 'Focus' stage. After the ferocious consolidation of stage 2, stage 3 companies focus on expanding their core business and continuing to aggressively outgrow the competition. The top three industry players control between 35% and 70% of the global market. This is a period of megadeals and large-scale consolidation plays. The goal is to emerge as one of a small number of global industry powerhouses. Typical focus-stage industries include steel producers, car manufacturers, shipbuilders and distillers. General Motors' acquisition of stakes in Isuzu, Subaru, Suzuki, Daewoo and Saab is an example of a solid stage 3 strategy. In this stage, there are still generally five to 12 major players in an industry, entering stage 4 of 'Balancing and Alliance'. This final stage of industry consolidation is characterised by consolidation rates of between 70% and 90% of the market. Large companies are forming alliances with their peers because growth is now more challenging. Companies do not move through stage 4, they stay in it. Typical industries in this stage are tobacco, soft-drinks and defence.

A company's long-term success depends on how well it rides up the consolidation curve. Speed is everything, and managers' merger competence is paramount, particularly during the middle stages of consolidation. Slower firms are likely to disappear. Most companies simply do not survive through to the industry endgame in stage 4 by trying to stay out of the contest or by ignoring it. Therefore, companies have to grow fast in total global markets or define a sustainable niche.

Defining sustainable niches

A niche is characterised by the distinctive advantages of a competitor to differentiate itself and its products from giant global competitors. Typically, this distinctive strategy (over whom, with what, how,) is combined with a coherent value proposition and brand development.

A. T. Kearney recently analysed the business models of several national competitors who have developed sustainable niches. As a group, they are creative and flexible and take advantage of their familiarity with the 'local' conditions. With these qualities, they attract and retain customers by differentiating their products, marketing those products coherently, and crafting cogent business models that serve core strategies and competencies. In particular, national firms skilfully identify *where* (in what segments) and *how* (by what differentiations) they intend to compete. They rely on specific competencies more accessible to them than to global rivals, and focus on customers they can serve in a superior way.

As the result of our research we have identified four major strategies, how successful smaller companies have defined sustainable niches to grow autonomously and to avoid a take-over by their giant competitors:

- Creativity
- Flexibility
- Home-field advantage
- Combined creativity, flexibility and home-field advantage

1. Creativity

Ever seen a Ducati motorcycle? Unless you are an avid motorcycle enthusiast you have likely seen few of them. So how can Ducati compete against the prestige of BMW machines, the reliability of Triumph motorcycles, or the ubiquity of Japanese bikes from Honda and Suzuki?
Federico Minoli, President of Ducati declared 'We are not about motorcycles. We are about motorcycling…My plan was to take Ducati from metal mechanics to entertainment, from motorcycles to motorcycling.'

This vision has positioned Ducati as a symbol of passionate, performance biking. There creativity advantages are based on the five following elements:

a) *Selective distribution*. The owners more than halved the number of dealers from 1996 to 2001. The remaining stores became 'Ducati stores' selling only the Ducati brand and promoting its values.
b) *The Ducati lifestyle*. To create a sense of community among customers, the new owners promoted the Ducati brand and values by sponsoring social events and activities. The firm sponsored Ducati owners' clubs, promoted races and hosted events. These initiatives strongly bolstered brand fidelity.
c) *Customer relationship management (CRM)*. Ducati launched a vigorous CRM campaign to make every interaction with customers an opportunity to enhance their buying experience, enhance their perceptions of Ducati, and enhance Ducati's corporate image. For example, Ducati launched a brash, tribal website (www.ducati.com) where it promotes 'Ducati World' identity, information and activities. In 2004, Ducati was one of three

finalists for the Gartner CRM Excellence Award for the regions of Europe, Middle East and Africa.

d) *Sell few models*. Ducati never sought to compete with Honda on product innovation and instead focused on two highly differentiated models, the '999' and the 'Monster., and on its unique desmodronic 2 cylinder engine.

e) *Strong merchandising*. Around the two bike models Ducati developed a wide range of accessories to highlight and complement the biking lifestyle and the accompanying emotions.

The strategy was hugely successful. Ducati increased its revenues by 20 percent annually from 1996 to 2000, gaining an extra 2 percent of market share during this period at Honda's expense. The proportion of sales of accessories and apparel grew from 1 percent to 16 percent of overall revenues. The increase in revenue was the key to the company's successful turnaround.

2. Flexibility

Let's look at how Merloni flexibly responded to international competition and market changes, especially to its global competitor Whirlpool.

Beyond low-cost production and quick delivery, Merloni's flexibility advantage encompasses three themes:

a) *Produce multiple brand names and position each brand uniquely.* Merloni retained the national champion brand as a high-end product in each specific market. Indesit and Ariston became pan-European brands with distinct images. Merloni positioned Indesit as the value brand for 'simple and young' products, while Ariston became a brand name promoting innovation, elegance and 'built-in' products.

b) *Distribute and price each brand differently.* Set prices in terms of brand status and the specific characteristics of the local market.

c) *Introduce cutting-edge technology as a marketing tool.* Merloni incorporated innovative technologies in flagship models not to develop 'killer products' but to increase the perceived value of the brand.

Merloni's creatively flexible strategy doubled its revenues and tripled its profitability, thereby becoming a leading European producer of household appliances. After expansion through acquisitions, the new Merloni enjoyed a 4-percent rise in international market share compared to the cumulative market share of the various brands when they had each been independent.

3. Home-field Advantage

Let us now look how Lavazza is able to compete against the global giant Kraft by marketing to national tastes and familiarity.

In the early 1960s Lavazza became the first firm to market coffee to the whole of Italy. Lavazza introduced coffee in vacuum packaging and ran a national advertising campaign. The company soon controlled almost 50 percent of the Italian coffee market and became synonymous with coffee 'the Italian way.' However, the arrival in Italy of giant multinational food firms threatened Lavazza's strong market share. For example, in 1992 Kraft acquired Splendid, the second-largest coffee producer in Italy with around a 10 percent market share. Lavazza responded by highlighting the brand name's superior strength in the Italian market The strategy involved three themes:

a) *Umbrella brand.* Lavazza became an umbrella brand. Under this banner the firm launched differentiated sub-brands to address prominent customer segments. Customers readily recognise the sub-brands and strongly associate with the firm and its products. Rivals typically focus on fewer groups of customers or advertise only their umbrella brand.

b) *Strong advertising budget.* Lavazza and its rivals devote a similar percentage of revenues to advertising, but Lavazza focuses only on the Italian market. As a result, Lavazza's advertising budget is, in absolute terms, three to five times bigger than its competitors.

c) *A successful advertising campaign.* Lavazza has been advertising in Italy for more than 40 years. Although its campaigns have been improved and updated over time, the same basic theme drives the ads. This formula is so hugely successful that Lavazza ads and phrases have entered Italy's national pop culture.

With its nationally centred strategy Lavazza maintains an incredibly high share of the Italian market but also, more recently, the firm has taken full advantage of the growing success abroad of Italian espresso to gain market share internationally.

4. Combining Creativity, Flexibility and Home-field Advantage

Zaras positioning against the global giant Hennes & Mauritz is a perfect example of the fourth strategy for defining a sustainable niche. Although Zara is now a large multinational firm with more than 500 stores in 35 countries, its success arose from developing a remarkable strategy for defending its position in the national market. Only later did Zara's founder, Amancio Ortega Gaona, realise that the strategy and competencies developed for the national market were applicable to the wider European market. Purchases by European customers now account for 95 percent of Zara's sales.

Zara's founder Gaona concisely declares his success formula: 'Today it is more important to respond to quickly changing fashion trends than to have low costs.' To thwart rivals and pursue this single corporate goal, he acted creatively, imposed highly flexible and responsive production, and relied decisively on a home-field advantage.

Three immediate implications arise from Zara's strategy:

a) *Short product development cycles.* To shorten the production cycle for new fashion items, Gaona concentrated production in a single location. Although Spain had higher labour costs than other locations, Gaona intimately knew the national conditions and opportunities so he was confident he could realise his larger goal in Spain. As a result, Zara's development cycle is approximately three weeks rather than the industry standard of five months. The benefits are staggering.

b) *Corporate focus.* Gaona organised Zara to minimise the development cycle: Zara owns its stores directly. Compared to industry averages, Zara shuns most out-sourcing in favour of extensive 'in-sourcing.' Zara committed substantial investment to a top-class logistics centre and a sophisticated information technology infrastructure.

c) *Strongly manage costs.* To counterbalance its relatively high labour costs, Gaona severely contains the costs for design and advertising. Zara stores, each situated in prime locations, attract customers not by advertising, but by changing inventory several times during each season. Customers arrive and return to see what is in stock. Further, Zara does not order create or hold its collection in advance. Thanks to the short development cycle, Zara copies what customers are actually buying elsewhere. Indeed, 85 percent of all items sold in Zara stores are created after the beginning of the season in response to customer interest and demand. In this way, Zara sells not what it has but what customers want. Zara sells a service – the quick development of desired fashions – as much as a product.

In recent years Zara has grown by 25 percent per year while rivals in the European apparel market have grown over the same period by a mere 3 percent. Zara's profitability is at the market average – that is, in the 15 to 16 percent range.

Ducati responded *creatively* to its rivals by marketing to niche customers and vigorously differentiating its products from its competitors. It produces high-performance goods and conveys a distinctive lifestyle. Merloni *flexibly* responded to industry consolidation and competition, altering its production and marketing strategies while relying upon its central expertise in low-cost engineering and manufacturing. Unlike Ducati, Merloni serves a broad market rather than a niche clientele. Merloni developed multiple brands and differentiates its products across price ranges and customer segments. Lavazza responded to rivals by building upon its unique advantages as national firms with a *home-field advantage*. It possess a keen understanding of national conditions and tastes and advertises to Italian tastes, culture and lifestyles. Further, Lavazza, like Merloni but unlike Ducati, serves a broad national market rather than niche customers. Using distinctive packaging and popular advertising campaigns, Lavazza, like Merloni, markets to distinct customer groups distinguished by taste, price and locale.

Zara dramatically combines the best of all of them.

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