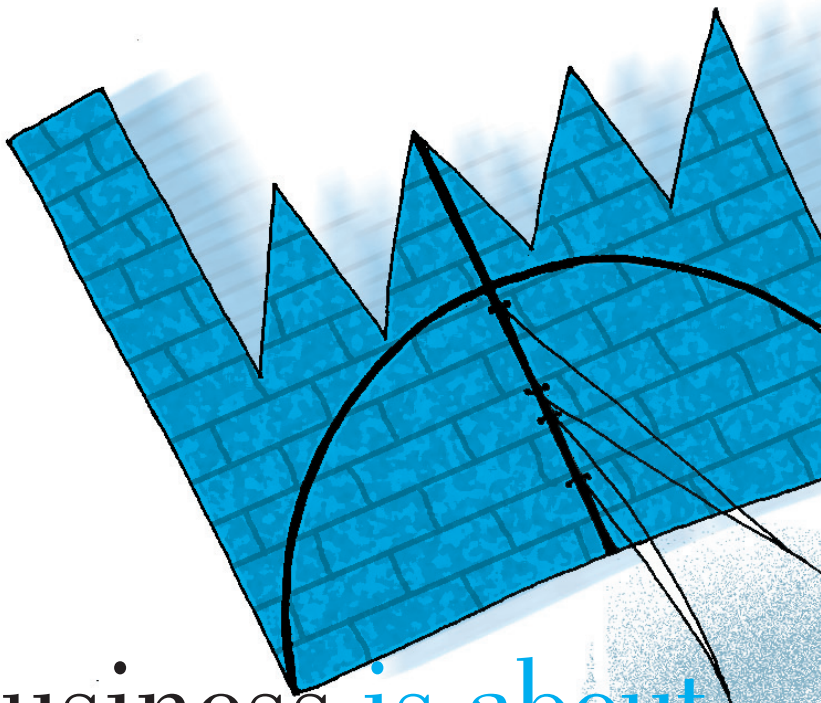
[CASE STUDY]



Ethics in business is about who you are

If owners fail to back business managers on bonafide decisions, it's a case of ethical deficit. Ethics demands that you put the interests of the company above your own

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What happens when you allow collateral objectives to decide the future of a company? The chances are you will end up with failure. In this real-life case study from southeast Asia, the author describes how vested interests within a family-managed group sabotaged the revival of a joint venture machine tools company that had finally found the right formula to succeed with a new CEO.

BMT – a joint venture company between a US machine tool company (the collaborator) and a south-east Asian business house (the local partner) – was started in 1994-95 with a view to building milling machines and CNC machining centres. Both partners came with high reputations in their industries. The initial arrangement between the two partners was that the collaborator would bring in the machinery and the components required and supply a person to head the operations. The local partner, on the other hand, would provide the land, building and manpower.

When rivals are selling quality products at low prices, can you succeed by buying higher cost inputs from a group company? This was the dilemma facing the new CEO

The people required for the operations – both engineers and operators/fitters – were trained at the collaborator's factory in the US. The local partner had an in-house foundry, and the intent was to supply castings from within the group. The collaboration was to be enacted in phases, with a start being made with the milling machine, which was to be followed by the manufacture of the machining centres in-house. However, even after the passage of five years the first machine prototype was not produced. Meanwhile, the people had been hired and were being paid salaries. One reason for the delay was a brief period of uncertainty in 1997, when there was a change in the government.

In early 1999, the local partner initiated a global search to find a director/CEO to head for all machine building and marketing activities – machine tools and textile machines. The search ended in May 1999, when it was decided that

the businesses would be headed by a person based in India. The new CEO had had hands-on experience in running machine tools businesses with many successes to his credit.

While companies face difficulties at the start-up stage for various reasons, this case study is intended to give insights into how one can develop start-up projects quickly and successfully. Also, how it helps to develop competencies and market-oriented strategies quickly. There are many who start machine tools businesses thinking that their knowledge of designing a machine will bring them success. But the reality is that most enterprises never grow or die. This case can perhaps throw up some ideas on the roadblocks, and how to negotiate them. The path to success is paved by following processes. There can be more than one approach, but in this case study we will see the choices made by BMT.

The central problem

Five years had passed since the inception of the joint venture and not even one machine had been produced – not even the first prototype. Some castings had been developed and some machining done, but these did not find their way into the complete machine. Why was BMT not able to produce a single machine even after five years? What processes were going wrong? What was going on? What could be done to change this situation?

The new CEO had to identify the factors responsible for BMT's failure so far. The project was conceived to include a brand name. But focus on the product market matrix and the price of market entry were missing. Although the collaboration was intended to provide the company with technical knowhow and an opportunity for diversification, proper buyback arrangements with the collaborator were missing. The company thus lost sizeable potential business.

Target markets were not clearly identified, although everybody knew that there was a market for these machines. The core competencies required to build this business were not identified.

The pricing factor was probably a key rea-

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son why the project faced death. A dark fog seemed to have blurred the vision here. There was total disconnect between expectations and reality. The marketing people expected to sell these machines at US$ 10,000 apiece because the collaborator had in the past sold them at a little over that. But nobody seemed to notice that Taiwan was selling them in the range of US$ 1,800-2,200 apiece. And while Taiwan was selling about 35,000 machines a year, the collaborator's numbers were merely in the hundreds. Triple digits. Against this backdrop, what were the company's expectations rooted in? Ignorance or ego?

The castings probably weighed down the project, too. The group's own foundry was dictating the price, quality and quantity of casting supplies. The foundry expected to be reimbursed US $ 1.40 per kg of casting, when globally they could be sourced at US $ 0.3-0.55 per kg – and in fully machined conditions. Since the previous years had gone by without testing a single product, the speed, accuracy and reliability of the equipment, tooling and people had not been established even after five years.

The first few samples of milling heads or initial requirements were to be purchased from the collaborator. The prices were not competitive.

There were advantages in building assemblies in-house. Even the CEO wanted it. But the disadvantage in manufacturing these parts was the lack of proper equipment

They were, if anything, exorbitant. The brand had a name, but knowledgeable customers were aware of more cost-effective sources for products with similar features. Why was the milling head design put into a delayed phase of development? Confidence or lack of knowledge? The opportunities in machining centres presented more exciting possibilities. But this was put on the backburner for some inexplicable reason.

Other questions also begged answers. What was the strategic intent of the local partner? What was the over-riding philosophy? Was there an intent to make this company profitable or was it only to acquire a brand name in a joint venture?

The plant and equipment supplied by the collaborators were replaced with modern machinery at their end. Although these were rebuilt machines, they were never really put to test. They were never tried for production. The capacity, capability and reliability of this line had not been proven and established. Whereas one could buy all the components required for as little as $1,200, assemble the machine and sell it at competitive prices, the cost of in-house supplies of castings and gears was sure to exceed this benchmark and render the product uncompetitive. Did the owners have intent to flourish in this business?

Alternatives

Although there were diverse factors to be dealt with, there were different options available to the new CEO.

◆ **Buy gears and castings from in-house group companies.** Was BMT equipped to produce all components in-house? Could they develop them all simultaneously? Were they geared up for it? The head was a critical component and had intricate machining. Among the machinery installed, there was no machine available to finish this part. The spindle is a critical part too. And among the installed machines there were no grinding machines to grind the spindle and its tapers. The hardening facilities for the spindle were also not installed. A group company that had a gear shop could have been asked to supply gears, but they did not have proper equipment to produce gears of quality class IT-6. So, in the CEO's assessment, the factory was not ready to produce the 'heads' in-house.

The group foundry was ready to supply castings. They had received the patterns – of parts other than the head – from the collaborator and made some sample castings. Quality issues on casting defects had not been licked, but these could be resolved and overcome. The foundry was selling the castings at US $1.40 per kg. It wanted to be the final authority on salvaging standards. These factors would render BMT uncompetitive in the global market and hence were not acceptable to the CEO.

The advantages of building these assemblies in-house were obvious. Even the CEO wanted to get to this stage and bring in all that value addition. But at the beginning stage his priorities were elsewhere. The initial disadvantage in manufacturing all these parts in-house was the lack of proper equipment.

◆ **Source from points of cost advantage without sacrificing quality.** The product was not a high-tech one. A differentiation strategy was ruled out. The joint venture partner had been using this strategy for years but had still lost the market almost completely in comparison to its

size. Besides, the machines were neither new inventions nor discoveries; in sum, a cost-based strategy would have been the right approach. At BMT, they saw an advantage in adopting the following strategy: begin to develop all the major castings, their machining processes and assembly methods in-house. Source the head and electricals from high-quality and cost-effective sources. The CEO knew that the price at the time of market entry was critical to the success of the business. And this was possible only by using a concurrent dual strategy. While the advantages would be mainly in terms of cutting the lead-time for start-up, quality and cost, the disadvantage would be in not vertically integrating the business within the group and reaping the benefits.

◆ **Combined and concurrent strategy.** The critical issue was that even after five years since inception the joint venture had failed to produce machines, bag orders, establish a market, and corner a share in it. At BMT, everybody was eager to begin playing the game of building and dispatching machines.

The dual concurrent strategy served the following advantages and overcame all the problems in-between: It would mean that, to start with, BMT would commence manufacturing all components other than the 'head' and work on perfecting the supply chain, procurement cost and quality, manufacturing processes, cycle times, documentation, etc. This would also allow for the flow of components.

Initially BMT would not be constrained by the need to establish in-house processes for component manufacture. This was just as well because the process capabilities of the used machines handed down by the collaborator were not established or proven. But, it could respond to market demands and fulfill them using outsourced components.

One of the dominant challenges here was to build the core competencies, systems and processes required to succeed in this business. This was BMT's top priority. The outsourcing strategy was to gain time to build these competencies and yet not lose the present market. It could begin building a brand name and image.

The CEO, having earlier tasted success in setting up low-cost outsourced resources, had established competence in these areas. He knew what to buy and from where to gain a cost advantage. BMT's negotiating skills brought them huge cost advantages, which looked something like this: Complete raw material in fully finished and ready-to-assemble condition at $1,180 per set. With internal fixed costs and painting and packing adding $350 per set, there was a clear surplus of $670 per set. Which meant that at 100 machines per month, BMT would generate a surplus in excess of $800,000 per year.

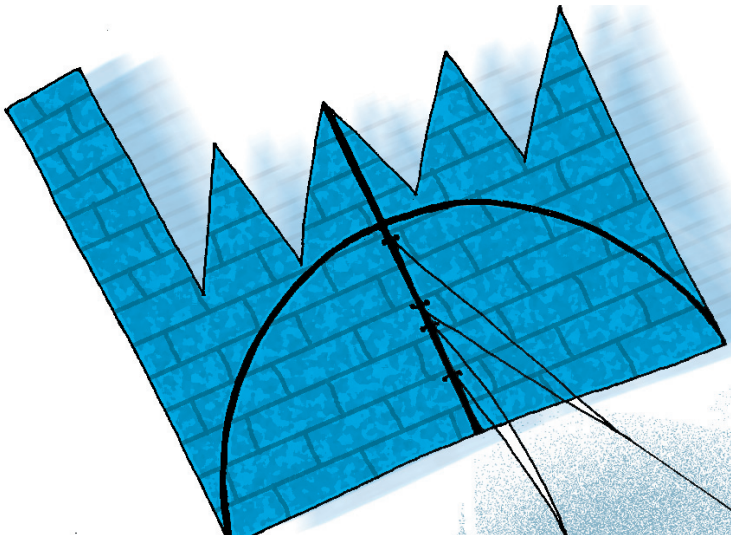
This was fantastic news for any factory that was struggling to produce its first machine for five years. Naturally as in-house production of components took over, the contribution would only increase. The advantage of this strategy was that BMT would be able to start manufacturing and delivering machines with short lead times, enabling it to establish a network of dealers and build an image.

◆ **Bring in machining centres and CNC milling machines.** BMT's strategic intent was not to lose out on present markets while quickly moving on to future ones. The CEO knew that he had to compete with Taiwanese manufacturers to gain a share of this market. With the exception of Singapore, south-east Asian countries were not known to be machine tool producers. To make money in this market one had to produce at high volumes with low costs. The CEO saw that sales volumes and contributions could improve by enriching the product-mix. Since the collaborator had a range of CNC machining centres and CNC milling machines, the CEO saw bigger opportunities, greater markets and better contributions from these products. This would result in better diversification, better technology acquisition and better profits. BMT's sights were set on machining centres and a buy-back arrangement to be entered into with the collaborators some 18-24 months down the line.

The business issue was clear: Should one outsource key parts to reduce time-to-market or wait for costlier in-house vertical integration to work?

An analysis

From all the alternatives discussed above, the dual strategy action taken by BMT was perhaps the best. The ownership of the group and the management at BMT were divided on this issue. People who had either become part of the family or were in future sight of it influenced the owners' opinions. Unfortunately, such people neither had professional training in business management, nor did they possess any leadership qualities. Not only did they lack the vi-



BMT had booked firm orders from around the world. But the Quixotic culture of local partners posed a roadblock. They ruled that BMT could not sell these machines to customers

sion, but they also had no knowledge of real markets either. One such person managed the foundry, and so there was a mighty effort inside the family to kill the dual strategy. They perceived this strategy as a threat to the group's foundry and failed to see how this benefited the business in getting off the launch pad.

The negative family culture and attitudes were the main reasons why the business had not taken off even after five years. Ego and talent were on opposing sides of the net. At BMT, the management wanted to roll out machines like any other world-class machine-building outfit. They believed this was the best and fastest way to achieve it. If they encountered problems and delays with indigenous development, this strategy provided a solution instead of stagnation. More importantly, this was the quickest way to get to the next step – CNC mills and the machining centres.

Pressing ahead with its dual concurrent strategy, BMT quickly had the assembly and dispatch bays in the factory full with completed, tested and certified machines. Almost every minister in the government and other dignitaries were brought in to see this miracle. In less than six months after adopting its new strategy, BMT had worked out contracts with dealers around the world, booked firm orders for the next two years, received letters of credits for payments and was now ready to rock and roll. The Quixotic culture of the local partners posed a roadblock: they imposed a ruling that BMT could not sell these machines to customers.

What does one make of a decision like this? The local group had, in its other factories, apparently copied prototypes of different types of machines and built them. These contraptions were far from acceptable to outside customers. They were thus sold in-house and the users were not allowed to complain.

What, then, was the intent of the local ownership? Whom were they trying to fool? Who was being harmed here? Was there ever any intent by the joint venture's local partners to produce machines for the global market? Thanks to this unethical conduct, BMT had to return all the letters of credits and apologise for the imposed decisions. Supplier orders had to be cancelled.

Ethics in business is really about who you are. The indifferent attitudes of owners or principal shareholders have sometimes led to the closure of business and loss of revenues and jobs.

Conclusion

The best strategy for BMT was the dual approach one. Had the local partners not interfered in the professional running of the business, it could well have flourished. Had the man in charge of the foundry business (also a close family friend to the local partner) kept his hands off, his foundry and BMT would have benefited. If owners are not the best leaders, it's best to let business managers run the business. BMT's competence development strategy involved the following steps: establishing and winning markets (dealerships), establishing a winning supply chain (what is to be bought from where and at what price), and then starting the in-house manufacturing processes and training. The strategy had a high chance of success in the quickest possible time, but the owners proved to be a hurdle. Instead of tackling the issue of clashing cultures, they participated in it. The collaborators, therefore, decided to withdraw from the partnership. After initially approving the strategy, the owners declined to support the systematic development of core competencies and the building of strong core values. Lack of accountability to anybody, including themselves, drove the business backwards from the point of a successful re-engineering of business processes. ■

ABOUT THE AUTHOR

Sanjeev Baitmangalkar is CEO of Stratmann Consulting, a management and strategy consulting company that works with clients in India and abroad. He has worked with the Kirloskar group of companies as vice-president and SBU head and the Texmaco group in south-east Asia as director/CEO.