Analysis of the strategy development in the vsm group

6. Case analysis

Background to the analysis

The overall analysis of the strategy development in the VSM Group is fairly straightforward (in hindsight). In 1997, the new CEO joined the company. Given that the new owners Industri Capital did not seek long term ownership, his task was to make the VSM Group a profitable company that would be fit for an IPO within the next 5 years or so. At the time, the VSM Group still had a strong production focus and concerns tended to end at the factory gates. Like most other makers of sewing machines, it had been struggling with unsatisfactory profitability. Summing up the situation in a simple SWOT analysis shows that the VSM Group was strong on production and product development but had less proficiency in managing the parts of the value chain between production and the customer. Although the market as a whole had been declining for decades, the upper segments (computerised machines with embroidery capacity) were still profitable. Given its capacity for developing and producing high performance sewing machines, VSM opted for a strategy with the explicit aim of becoming the leading producer of premium sewing machines. However, the lack of competence on the market side was all too apparent to the new CEO. VSM needed to increase customer orientation in all parts of the value chain, so it started to work intensively with its independent retailers to train them and, optimally, induce them to deal exclusively with VSM's product lines. In addition, VSM started to expand the number of fully owned retailers to spearhead its products in profitable markets. Within the company proper, information and training was aimed at instilling the notion that the employees at VSM had only one source of income, regardless of position within the company: the customer.

The VSM Group was strong on both production and R&D but the product market options for sing only its production skills to seek low cost advantage in the mid and top segments of the market looked less promising. To become a market leader and achieve true differentiation, it needed to provide new superior products while developing new competence to manage the linkages between production and retailing. The new model ‘ Designer 1′ therefore played a crucial role in VSM’s new strategy, as does its efforts to extend its competence into retailing.

The Pfaff purchase can be viewed in light of this strategy. Although the acquisition of Pfaff was not quite in line with the new strategy of the VSM Group, it was aligned. When Pfaff came up for sale, the explicit goal of the VSM top management was to make an exit possible for their owner. The purchase of Pfaff would change the structure of the industry but the plans for an IPO of the VSM Group would have to be postponed. However, this was acceptable to the owner who previously had sought out structural deals in other industries. Further, the purchase of Pfaff did not include any production capacity in Germany. The target of the VSM Group was the Pfaff brand. In the process, VSM discovered the plant in Brno, which was not a part of Pfaff, but a subcontractor. However, its role in the production of Pfaff branded machines was so important that VSM decided to buy the plant and make it a fully owned subsidiary of the VSM group. This was not in VSM’s original plan and is a good illustration of how a process perspective helps us

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understand how strategic decisions are developed over time. A further important strategic decision was to keep Pfaff as a full-range premium brand parallel to the original Husqvarna Viking line. This decision was the result of a rather lengthy process and the final decision was far from obvious at the outset of the discussions. Overall, the VSM Group is staying with its strategy: premium products and controlling the value chain while staying profitable. However, the purchase of Pfaff has delayed several of these objectives. Although the number of fully owned retailers has increased, it has increased less than originally planned. Further, the work to integrate the retailer network for the Pfaff line started at square one and needed a lot of attention. Lastly, the underestimation of the severity of the German market has tied up the top management team substantially and drawn additional funds from the Group.

Turning now to the specific questions:

6. 1 There were a number of concurrent changes in the VSM Group in theperiod 1997-2003. Is the VSM Group still the same company?

The last 25 years of the VSM Group are a history of considerable contextual, organisational and market change. In 1977, the Husqvarna company, a large manufacturer of home appliances and forestry equipment, was taken over by its fiercest competitor Electrolux. In only a couple of years, the company was integrated into the giant Electrolux. Still, resources and competences actually changed surprisingly little through the years. The manufacturing plant barely changed and the product development department had a long tradition with department managers and employees serving long terms. The purchase of Pfaff added no production resources since the Karlsruhe plant was closed. However, the purchase of the Brno production facility did add to production capacity although not production competence. Consequently, a resource audit will show that few resources or basic competences have actually been changed during this period. (Note that we talk about change in quality rather than quantity.) Rather, the change process has been directed towards strengthening the linkages between functional areas in the value chain. To this end, several methods have been employed. The development of a mission statement (which actually did not exist prior to the arrival of the new CEO), organisational changes (composition top management team), the physical relocation of the R&D and marketing departments to the same building and the VSM programme for educating retailers are examples of this.

6. 2 How would you describe the strategic capability of the VSM Group in 1997? In 2001? In 2003?

The VSM Group has always demonstrated high technical proficiency compared to its competitors. This is briefly illustrated in appendix 1 where the antecedents of the present organisation are described. The VSM Group was e. g. the first to make a self- lubricating sewing machine through the use of sintered metal technology. Its streamlining activities during the 1980s were also successful in reducing the parts' count and cost. This meant directing design efforts not only to satisfy the consumer but

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During the period 1997-2000, the VSM Group took a number of actions to improve the linkages between functional areas. First, the managers of the international sales companies were brought into the top management team, which provided an arena for strategic conversation with other parts of the organisation. Second, the work on the formal strategy document (including the mission statement) brought together different parts of the organisation, both horizontally and vertically. The written documents also served to communicate corporate strategies and values in a new and coherent way. The carefully managed strategy process seemed to pay off in terms of organisational commitment. Third, moving the product development and marketing departments to the same building was another step to link technical expertise and marketing know-how to form a whole.

It is important to note that the change towards market orientation was an overall effort that involved changes in the top management team, a new financial accounting system, as well as the physical relocation of departments. Moreover, it should also be noted that the increased focus on managing linkages extends beyond the company's own organisation. The company's high involvement in the development of the independent dealers is another example of managing linkages. To spot this the students need to grasp the concept of the value chain (section 3. 6. 1) so as to not limit the analysis to resources and competence controlled through ownership.

At a casual glance, it may seem clear that the resource position of the VSM Group had changed markedly by 2003. It then owned the Pfaff brand and it had new in-house production capacity at the Brno plant, which was cost efficient and capable of consistent quality. On the " front end" of the value chain, new dealers had been added. However, on closer inspection the changes may not be that significant. Pfaff had established itself as a high quality brand and the new production facility in Brno did add capacity but no new or different competence to the company. As it was, the Pfaff purchase looks more like " more of the same" than genuine change. By 2003, VSM's strategic capacity had not changed appreciably in quality but in quantity. The company still possessed expertise in product development and had

Instructor's Manual efficient production facilities. In addition, VSM had two strong brands with a global presence. On the retail side, VSM is still continuing its quest to ' transform' its retailers to carry its brands exclusively. 6. 3 Are the core competences in 2003 more robust than in 1997? It is straightforward to single out the product development capacity of the VSM Group as a candidate for a core competence. The new strategic direction has increased the leverage of this competence as well as spawned the development of others such as managing linkages. However, it is questionable whether product development capacity in itself may be called a core competence; the Brother company has emerged as an innovative competitor with potentially deep pockets. However, the robustness of a core competence tends to increase when it is embedded in a specific organisational context; the conclusion is that the robustness has increased with the focus on building linkages within the value chain (section 3. 6. 1). Robustness also stems from ownership. The advent of fully software-controlled sewing machines has made software development very important for the sewing machine producers. The acquisition of the small software producer EMNET was seen as strategically important in view of the company's commitment to " enhance the joy of sewing". According to VSM, it saw the trend as going towards further integration between computer and sewing machine, making the use of a PC a redundant step for e. g. the construction of embroidery. If VSM were not in control of its embroidery software, it could mean that in the future it would be forced to rely heavily on outside parties in order to provide the full products. Interestingly, a similar situation was at hand in the early 1980s when electronic controls were introduced in sewing machines. The strategic options facing the organisation at that time were either to develop the necessary competence internally or to buy the services and parts from an outside supplier. Eventually, the company's decision was to hire engineers with degrees in electronics in order to develop the new technology internally. In hindsight, interviewees from product development acknowledge this as an important strategic decision since some competitors (e. g. Bernina) lost important ground in developing their own technology. Know-how in electronics has later proved to be a threshold competence for sewing machine manufacturers except for the lowest market segments.

6. 4 What are the important factors in the macro-environment that influence VSM and its industry?

The PESTEL framework may be suitable here. Some factors may be thought of as structural drivers of change, i. e. factors in the macro-environment that affect the whole industry, and some may only be of importance to the single organisation. A common error committed by students in this analysis is to try to fill each letter in PESTEL with some content, however insignificant. We have chosen to give a few examples that in the past have shown to be of importance. Focusing on a few salient factors gives the students a chance to gain deeper understanding of these factors instead of only rudimentary understanding of a long ‘ laundry list” of potential factors.

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Political

Although the political environment in Sweden is very stable, trade policy issues between the EU and the US have threatened the VSM Group in the past. In the so-called “ Banana War” in the late 1990s, US authorities threatened to impose a high (50%) surcharge on targeted products such as sewing machines, in response to EU protectionist practices discriminating against imports of American bananas. This threat was very real and would have meant serious losses in VSM’s key market for premium sewing machines. This illustrates the importance of accounting for political conditions between states, and not only within states. Another issue could be the general liberalisation of trade. Low or no tariffs on textile imports have made clothes much cheaper in the Western world, wiping out large parts of the textile industry in the US and in the EU. Cheaper clothing has completely undermined the old incentive to sew.

Economic

Once again, the economic environment in Sweden is reasonably stable for a small state. However, Sweden has not opted to joint the European Monetary Union (EMU). The Swedish krona therefore floats against both the US dollar and the Euro. In the short run, it is possible to hedge fluctuations in the exchange rates. In the medium run, these fluctuations will impact the income of the VSM Group in domestic currency. In the past, the profitability of the VSM Group has showed clear covariation with the exchange rate of the Swedish krona, both in 1982 (when the krona was devaluated by 16%) and again in 1992 when the krona dropped over 25% overnight as the policy of fixed exchange rate was abandoned. Even in 2003, the VSM Group had to cope with shrinking profits (in domestic currency) as a consequence of the drop in the US dollar.

Sociocultural

Under the rubric of sociocultural factors, we find some of the structural drivers of change in the sewing industry. LOMLOTs (Lots Of Money, Lots Of Time) were frequently used by the VSM Group to describe a growing group of retirees, particularly in the US, with plenty of time for leisure activities and money to spend. Sewing out of necessity is no longer important for generating demand: you can buy much cheaper than you can sew. Rather it is ‘ higher’ motives in the Maslowian sense that drive many consumers. This change in consumer tastes has had an impact on the industry: the sales of low priced simple machines have plummeted, while more advanced machines show steady sales. The fact that it is now possible to charge $5000+ for a consumer sewing machine (the Husqvarna Viking Designer 1) is also an indicator of this change. Given that sewing machines are no longer a necessity, there is no “ automatic” creation of demand. As such, the sewing machine is now competing with other types of leisure activities: fishing, golf, or travelling. The VSM Group has clearly recognised this and its mission statement contains the phrase “ creating demand for more creative uses of sewing”.

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Technological

The more and more widespread use of the Internet and its capacity for file transfer has made it possible to easily upgrade features of the sewing machines through a simple download of software upgrades. The top models from the leading manufacturers make use of the Internet to distribute embroidery patterns and software for the construction of custom embroidery. In addition, the VSM Group distributes upgrades of the operating system of the sewing machine proper. As of yet, no model has a direct linkage to the Internet. Rather, software has to be downloaded via a PC. In class discussion, this may open up informed speculation about what new features we might see, given the rapid development for new applications of information technology in other areas.

6. 5 What are the forces of competition in the sewing machine industry?

The case text contains enough information to make it possible to perform a Five Forces analysis. More ambitious endeavours might include external sources of information. From experience, it has been noted that students may have difficulties with understanding the difference between competitive rivalry within the industry, which is one of the five “ forces”, and the level of competition, the dependent variable in the model.

The information provided in the case (notably in part 3) makes it possible to perform a Five Forces analysis (section 2. 3. 1). Persistently low profitability over the business cycle basically defines the level of competition as “ high” (in the Porterian sense). Competitive rivalry seems to be moderate with moderate levels of product innovation, absence of price wars, or aggressive marketing towards retailers. However, changing buyer tastes have meant decreasing overall demand for sewing machines, especially on basic models. Buyers have high bargaining power due to low switching costs between brands since the industry is mature with a dominant design. In addition, the typical sewing machine retailer carries several brands. Thus, it could be concluded that it is the demand side that put downward pressure on the industry’s profit margins. From the analysis of the environment the students are asked to develop an idea of how the market will develop and what alternative positions the actors in the industry may take. Section 2. 4 in ECS will probably be helpful here, particularly the Strategic Group Analysis in 2. 4. 1. Also section 2. 4. 2, Market Segmentation, will be a key reading since

VSM's strategy is to go after a niche segment that is still profitable even though the total market for sewing machines is declining. Thus, the problem of defining the industry and to perform a dynamic analysis will come into play.

6. 6 What are the next strategic issues Viking will have to address? What strategic options might be considered?

For the VSM Group, two issues stand out: maintaining technical leadership and managing the value chain. Additional issues are brand management and managing the Pfaff acquisition. Issues of direction, methods and " success criteria" for strategy development are dealt with in chapter 7 of ECS. In the short run, this would be " protect © Pearson Education Limited 2005 Instructor's Manual and build on current position". However, in the medium to long run, issues of product and market development will enter the equation. The notes below should be considered in this light.

The technical proficiency of VSM has been a recurring theme in this case. It is true that capacity for product innovation is a key part of VSM's strategic capability, but it should not be construed as the source of competitive advantage for VSM. In recent years, its competitor Brother has introduced automatic threading, a useful feature presently not available from VSM. In all, Brother's capacity for engineering seems to rival that of VSM. Nevertheless, keeping technical leadership (as it manifests itself in new products) is one key to VSM's overall strategy. A good set of engineers is part of the equation but knowing how to produce the right kind of innovation is even more critical. Hence the emphasis on bridging gaps within the value chain to improve flows of information and resources in both directions. The case contains a fair amount of information on the process intended to increase customer orientation in all parts of the value chain. This goes for the R&D, production, and marketing departments as well as the retailers. The chain metaphor is fitting in this case: a chain is no stronger than its weakest link. The most difficult part to manage is the link of the value chain that VSM does not control through ownership: the retailers. The retailers have a critical role in the company's contact with the customer. Any change in the preceding parts of the value chain will be " filtered" through this final link to the customer. Therefore, VSM has put a lot of effort and money into training retailers and providing them with support such as brand specific shop interiors and auxiliary products such as instructional videos and patterns. This process is ongoing, for both brands. Customer relations are a resource that has to be managed by the company: they cannot be bought and they take time and effort to build. In comparison, engineering skills are less costly to develop. VSM's increased efforts in marketing and customer relations provide increasing robustness (ECS, section 3. 4. 3) to their strategic capability. The integration of the retailers into the VSM organisation is taken to its logical end in the case of the captive store-in-store concept developed for the US market. Exclusive dealership in the " Dealer-Partner" programme is also a move towards increasing control of the retailing business. The question is: will the concepts that have been proven successful in the US also be applicable to other markets, such as Europe and Asia? The transformation of VSM from a product-orientated company to one of market orientation has just started. From a " Mädchen für alles" covering all market segments, the objective is now to satisfy the selected customer group. This is also clear from the positioning of the newly acquired Pfaff brand. The aim is to build a relationship with the customer. A vital strategic issue is therefore to increase the knowledge about the targeted customer group. The target group is often described as middle-aged women with above average financial resources. In VSM's corporate jargon, the acronym LOMLOTs (Lots Of Money, Lots Of Time) seems to capture some of the essential characteristics of this customer segment. The marketing strategy is to make the customers think about sewing as an activity that makes good use of their spare time, all the while recognising Husqvarna Viking and Pfaff as the premium brands for this activity. 288 © Pearson Education Limited 2005

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By 2003, the Pfaff line of machines had not been re-engineered mechanically; the basic technology used is ' old' Pfaff. However, with new models designed by VSM's own engineers, integration between the brands will presumably be more pronounced both in production and in R&D. The question is, will VSM be able to uphold the distinctions between the brands? There are many parallels that could be made to the car industry on this issue, e. g. with the Volkswagen conglomerate. The selected strategy is costly; the introduction of innovative products and services is costly. These costs have to be passed on to the consumers and the latest models retail for about $2000 to over $5000. Consequently, the need for volume may only be satisfied by a global presence. Market penetration in the US is good and in Europe vital steps are being taken to increase it (the acquisition of Pfaff is one part of this). However, the case of Asia is more problematic. In 2001, the VSM Group established a small presence in Tokyo, Japan, but sales are marginal. This may be considered an attempt to grow organically but what other options are within reach? Is the Asian market “ worth” competing for or are resources better spent on consolidation and defence of VSM’s core markets?

VSM’s quest to “ create demand for creative sewing” means that it has started transforming itself into a company offering more and more services (after sales, embroidery, sewing classes). The balance of the company is changing. The acquisition of Emnet and the rapidly expanding number of software engineers underline the importance of a knowledge base in computing. The bid for expansion in education will also require development of new competences. In the words of one interviewee, the sewing machine in the future may work as “ an ordinary printer”, the important part being patterns, education and inspiring magazines. Consequently, an interesting strategic issue is how to balance the traditional strength of the company, product development, and the formation of competences in information technology and education. This is also a question of company identity. Take one example. In interviews with the key individuals in the top management team, the number of machines sold often surfaced during discussions on performance. The interviewees discussed the history as well as the future in terms of sales of hardware. The underlying picture was that the number of machines was decisive for the success of the company, and management should be focused on the relation between produced machines and sales of machines. The link between sales, production and logistics was emphasised. However, in a market-orientated company with the aim to build long-lasting relationships with the customers, the number of machines is merely an indicator of how many customer relationships are initiated. Rather, the goal must be to create an organisation that aims to increase customer satisfaction, promoting a continuous cash flow from each of these relationships. One possible scenario could e. g. be that VSM will sell its machines at a price that is heavily subsidised and instead reach profitability through the sales of patterns and education. In this scenario, completely new linkages between resources and competences would be vital for the success of the company.

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6. 7 How does the strategy of the VSM Group match its strategic capability with its environment? How did it change from 1997 to 2003?

A discussion of VSM's strategy and its development builds on the interplay between strategic stretch and fit – stretch in terms of considerations for existing resource positions and fit in terms of building new resources to capture a position on the chosen product market. In 1997, VSM already had several important resources and competences that served as the basis for the new strategy. First of all, VSM possessed an active R&D department and an efficient production facility. It also had a brand name that was well regarded in most markets. However, its marketing department mainly supplied product descriptions and sewing patterns and was little involve in product development. The market as a whole had been declining for decades but the top segment was healthy and VSM's product line was comparable to that of its competitors. Although the major actors were striving for differentiation, most of them were sporting full product ranges with similar features on their models. VSM's strategic analysis suggested that focusing on the more expensive designs (computerised sewing machines with embroidery capacity) would make sense in light of the changing sociocultural factors influencing the potential customers for sewing machines. VSM's strong position in the US market probably influenced this conclusion considerably. Clearly, following a differentiation strategy in terms of the " strategy clock" (ECS, section 5. 3), VSM seemed to move clockwise towards a position of focused differentiation. The new top-of-the-line model " Designer 1" was instrumental in achieving this goal. However, achieving a role as market leader was not as simple as launching a new superior product and then just producing it; it needed to reach its customers. The sewing machine business is dominated by small independent retailers, usually carrying several brands. Controlling the marketing efforts of the retailers was therefore particularly important when trying to sell a product at almost double the price of any machine from the competition. Further, VSM's mission to create demand for its products necessitated closer control of the communication with its clients. To manage the link between the production of sewing machines and the marketing of sewing machines, VSM started an extensive programme where independent retailers were invited to the Husqvarna plant. On site, they toured the premises, received training on the new models and information on VSM strategy. In addition, VSM also started to provide complete shop interiors and training programmes for end users. It also closed contracts with selected retailers to become exclusive dealers of the Husqvarna Viking range of products. In exchange, these retailers received extensive marketing support.

The strategy development process combines elements of both stretch and fit. VSM’s original resource position had a lot of influence on its new strategy and in this respect, we have a case of “ strategic stretch”. However, some of VSM’s resources were not adequate for this strategy. This was clear in relation to the marketing functions of the value chain. In 1997, VSM has very little control over the marketing activities pursued by its local dealers. The value of proactive changes earlier in the value chain therefore threatened to be suboptimal since the potential benefits would not reach its clients. Building this new resource (i. e. managing the linkage between various parts of the value

chain) was deemed necessary to capture the targeted position on the product market. In addition, VSM had inadequate co-operation between the R&D and marketing departments. In an effort to encourage increased co-operation and communication, the R&D and marketing departments were moved into the same building. Previously, the R&D department had been located close to the production line. In this respect, the strategy development was a question of fit. The purchase of Pfaff meant adding new resources similar to what already existed in the VSM Group. The Pfaff brand was strong and perceived as high quality. But managing two global brands needed clear delimitations. The choice to view the Pfaff brand as being on a par with the Husqvarna Viking brand was in line with the corporate strategy. The differentiation between the brands is founded on the insight that perceived value and prices are by far the only dimensions on which we map strategic groups (see ECS, section 3. 3) on the market for sewing machines. Turning to characteristics of the clients rather than the product itself enabled VSM to use the value of the brands in terms of being perceived as technologically advanced and reliable, while catering for a larger customer group in its market communication. Adding the Pfaff brand allowed the VSM Group to reach new customer groups without stretching the brands too much. Again, similarities with the car industry, e. g. Volkswagen, may be interesting to discuss. 6. 8 The case starts with the arrival of the new CEO. What role did Mr.

Runnquist play in the transf