The Competitiveness Challenge of European Manufacturers: The Case of Michelin

By Karel Cool

Michelin has done it all. It was the innovator of the radial tire, which the world is still driving on today; Michelin's tires are very frequently voted the best tires by authoritative consumer surveys around the world; its Bidendum man brings smiles to young and old and is one of the best known brands around the world; Michelin was the single supplier of tires to the Space Shuttle during the entire life of the space program; and Chefs in restaurants around the world aspire to get a star from the same Michelin company. Michelin has set the standard for several decades.

Yet, in spite of its many accomplishments, Michelin faces a major competitiveness challenge. For most of the nineties, Michelin towered above the industry. In the past decade, it had to relinquish the global leadership position to Bridgestone. It has been losing market share in Europe in both passenger and commercial vehicle tires, and after more than a decade of targeting the Chinese market, it has only a minor position in both passenger and commercial vehicle tires. Michelin's financial performance is merely in line with the industry while its much-vaunted R&D prowess seems to be wanting. CEO M. Rollier in fact halted one of Michelin's much touted R&D accomplishments, its PAX run flat tire, after more than twenty years of R&D and marketing effort, for lack of market success.

Part of Michelin's competitiveness challenge reflects its strategic choice. The copy-paste strategy of its European and US strategy to China of targeting the aftermarket with premium branded tires and the commercial vehicle market with premium retreadable tires is not getting much grip. The Chinese market is different: the vast majority of tire buyers believe that most tires are very much alike and do not want to pay a premium. Most commercial vehicle owners do not have large fleets and are swayed by the price tag of the tire, not the total cost-in-use of the retreadable premium tire that Michelin pushes. Neither do the Chinese car manufacturers appear to be in a rush to roll out the red carpet for Michelin; they have a fragmented, competitive supplier base for tires, and will very likely do everything possible to keep it that way. Most likely, Michelin will have to adapt its strategy to the realities of the Chinese market, which by 2013 may become the 2nd largest tire market after Europe, and by the end of the century the largest market in the world.

However, part of Michelin's competitiveness challenge is structural and influenced by its European heritage. As it started its expansion from Europe, it built plants around Europe and exported. This left Michelin with too many plants and too many people in too many countries in Europe: By 2010, Michelin and Bridgestone had roughly the same market share, yet Michelin had 53 plants while Bridgestone had 42 plants. Moreover, by 2010, only about 40% of the labor of Michelin was located outside Europe while about 60% of its sales originated outside Europe, and growing.

The challenge is mounting as the industry is commoditizing, as evidenced by the rapid imitation of new products such as green tires and high performance tires, now offered by most competitors. Cost competitiveness is becoming a major issue, and Michelin's European legacy as well as its strategy of competing in almost all tire segments has saddled it with unfavorable scale economies. The 2011 graph of plant size (tires made per day) and labor cost (employees employed per tire per day) according to data of the European Rubber Journal shows most identifiable passenger tire plants around the world. In colour are shown the 10 most productive plants. In spite of its size and stature, Michelin does not have a top-10 passenger tire plant. If the data were expressed in labor cost rather than the number of employees, the comparison would be even more daunting.

The competitiveness challenge is compounded by the strategy choice of interlopers like Hankook of South Korea. Rather than pursing a multi-brand strategy, as Michelin and the other majors have, it has focused on competing with one brand only: Hankook. Moreover, it has embraced the commodity nature of the industry by building super-sized plants, raising economies of scale to a major new level, and focusing on value rather than mere technological excellence. By 2011, Hankook had about a 4thof the market share of Michelin, yet it had only 5 plants worldwide. Scaling this up to the size of Michelin, this would amount to 16-20 plants; Michelin is burdened with over 50 plants.

Michelin can be proud of its many accomplishments. It has faced major financial distress or several occasions, has had R&D setbacks, and also faced profound management challenges when Edouard Michelin died in a boating accident. Michelin overcame it all. Yet, it now faces the major challenge of many leading European manufacturers. Faced with decreasing marginal returns to R&D spending and diminishing marginal utility to consumers of new innovations, R&D based firms such as Michelin have to aggressively tackle the efficiency issue. The multi-brand strategy often provides an excuse to keep too many plants open, and is frequently creating diseconomies of scale because of the unwieldy complexity of brands, plants and SKU's. Unless the challenge is confronted head-on, differentiation based companies such as Michelin risk becoming cornered by the many new competitors. Once the Chinese branded cars will be entering the European and US markets mounted with Chinese tires, just as the Korean cars are taking the US market by storm today, it may be too late to respond. Michelin has technological and marketing prowess and may be better off significantly streamlining its product portfolio, creating substantial new economies by maintaining only the Michelin name in both production and in distribution, and adjusting its offer to the realities of the huge, new markets, rather than dogmatically applying its "European" solution.

Competing with excellent products and services is the best path to restoring European competitiveness. Commensurate branding is key, but is not a winning strategy for reclaiming competitiveness if world scale efficiency is not achieved. European firms need to rethink their production scale and strategy in the face of the new competitors that have access to markets of unprecedented size. Too often, Leading firms such as Michelin are embracing the technology challenge, but move at glacial speed when it comes to cost competitiveness. This drains competitiveness and slows expansion in the key growth markets.

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