Cost Strategy *versus* Quality: a Brazilian Tannery Case

Costa, Luis[1,*]

[1] Rua Joao Gregório Barbosa, 56/01 – Pioneiro – Fazenda Rio Grande – Paraná/Brazil. Code: 82820-000

Abstract: The leather industry, like many others, subsists under a complex trade-off between how to be profitable and how to assure efficiency and low costs. To attain such a condition, it becomes essential to establish and follow a definite strategy. Michael Porter has proposed the concept of generic strategies: cost minimization, product differentiation and market focusing. Based on Porter's concept, this article reveals how one of the Brazilian largest exporters has found a way to reconcile stringent attention to costs with quality differentiation in their specific segment. The paper analyzes the last 3-year period during which the tannery had put forth a series of plans and actions: budget monitoring, intensive management of controls and processes, managerial engagement and strategic location near suppliers. It also kept the balance between the available resources (human, financial, raw materials) and the necessary skills to develop its product and to distinguish it from other competitors. This strategy was much influenced by the company's culture (cost centered) and, as the business expanded, the risk of losses also increased; fortunately the top executives had foreseen some of these problems and redirected the company's focus. This study displays what else should be considered to enhance the strategy and which aspects deserve improvement; for instance, higher investments in technology and automation, bigger allotments for research and development (nowadays assigned to a secondary role). It represents an interesting experience from a tannery that strives to survive and secure profits while immersed in a competitive world market.

Key Words: strategy; cost; tannery industry

1 Introduction

The company's strategy consists in planning and operating in a way that will set it apart in the market, in order to assure its survival and earnings. There are several models for designing and executing these strategies and they depend on many external and internal factors, including the culture of the company. But a businessman and his team must scope the scenario, take decisions and enforce them to have success in their dealings.

At the leather industry, as in many others, the competition is stiff. For the market boundaries are set by the whole world. Many countries have developed the art of leather processing and provide their companies with conditions for exporting to the main consumer markets. As one of these countries, Brazil has acquired a sizeable market share in this segment.

The present article purports to describe the strategy of a Brazilian firm whose share in the external market is growing while keeping a solid structure. Also, it will evaluate how could a tannery can endure sundry difficulties and still maintain its business focus. Finally, it will appraise how the owner's mentality and culture filters down and spreads among managers and operational teams.

From the analysis of different theories about strategy, one can surmise the company's perception about the environment and what actions are currently undertaken to reset the course. Besides discussing the theory of Strategic Planning (which includes many studies, concepts and viewpoints), the article shows

* Corresponding author. E-mail: luissergio.nunescosta@gmail.com

the way a Brazilian tannery is managed on a daily basis and the means to overcome the trade-off between cost and quality. What is the distinction between this tanning plant and several others, all partaking of the global market? How can they survive and grow?

The first part outlines the Brazilian market and the way national tanneries operate in it. The second part advances the chief concept of different strategies, presents a brief history and a list of the most common techniques in use. Next, one looks into some characteristics of the tannery under review and how this company, working in such an ambiance, has been managed and driven to reach the decisions that favored its growth. In which way did the low cost versus product quality outlook have an impact on the actions performed and teams involved?

The reported experience stems from the company's history and culture. Some of these facts and actions might well occur in other companies. But in the present case, the combination of multiple decisions provides an inside scenario to understand the company and the conditions to support its solidity.

The methodology comprised analysis of historical documents, interviews with the director and managers and bibliographical research.

2 The Insertion of the Brazilian Leather Industry into the Global Market

As one of the largest countries in America, Brazil is endowed with an extensive territory and a tropical climate that allows for a remarkable cattle-raising capability. Adding to that, a combination of entrepreneurial skills, economic stability and government incentives promoted the establishment of a strong meat-packaging industry during the last decade.

Concurrently, tanning works also obtained the conditions for increasing their production capacity. However such a favorable environment would not be enough for a company to become successful. The adequate planning of future actions and a healthy structure remain essential assets.

"Brazil is the second largest producer of leather in the world and the fourth biggest exporter. Leather processing is one of the pillars of the Brazilian economy, moving some 3.5 billion dollars annually and employing about 50 thousand people."[1]

More than 40 million cattle are slaughtered every year in Brazil and the commercial herd numbers over 190 million heads.

"By the late '90s, the Less Developed Countries (LDCs) share in the world bovine market attained 77.7%, against 22.3% for the Developed Countries (DCs). It was estimated that, by 2006, the LDCs portion would reach approximately 80% of the world's cattle breeding. And there is an expectation that by 2010, as the decade ends, the LDCs may be responsible for over 80% of the livestock in the planet while DCs will be limited to 19.1%. And the latter's share may further decline, to 17% by 2015, according to the "Centro das Indústrias do Couro do Brasil" (CICB) – Center for the Leather Industries of Brazil" [1]

All of the raw hides have been entirely processed at facilities installed in the Brazilian territory; salted material was restricted to less than 1% of exports. The country's tanneries are concentrated in two main regions: Vale dos Sinos (Rio Grande do Sul) in the southern area, for many years the manufacturing center for feminine shoes; and Franca (São Paulo) in Eastern Brazil, where masculine foot apparel was predominant. However, during the last decades, there has been a movement to settle tanneries closer to the bigger raw material suppliers in Central Brazil, comprising four states: Mato Grosso, Mato Grosso do

Sul, Goiás and Tocantins. These areas contain the largest bovine herd and the most important slaughter facilities.

Brazilian leather is exported to more than 85 nations and just ten countries represent 80% of total sales.

"The four chief destinations of Brazilian leather in 2007 were: Italy (28.5%), China (22.3%), Hong Kong (10.8%) and the United States (10.9%). A common aspect of these leather consuming markets was the significant capacity of their productive sector to add value to the raw materials" [2]

Tab. 1 Brazilian Leather Exports in hides

QUANTITY OF LEATHER EXPORTS 2000-2007			
Year	**Leather Category**		**Total of Exports**
	Wet Blue	**Crust e Finished**	
2000	10.328.196	4.340.410	14.668.606
2001	10.482.942	6.446.663	16.929.605
2002	12.535.585	6.302.096	18.837.681
2003	13.264.020	8.372.879	21.636.899
2004	15.839.417	10.344.276	26.183.693
2005	16.000.484	11.945.603	27.946.087
2006	17.783.172	16.450.822	34.233.993
2007	15.330.989	17.453.347	32.784.336

Source: SECEX/MDIC/CICB/AICSul

Among the leather types that were shipped abroad, the largest share belongs to the wet blue kind, in relation to the crust and finished varieties. Wet blue represents 59.57% of the export total. But the average growth in exportations for crust and finished attained 23.12% while wet blue was limited to 6.37%.

3 Strategy Concepts

The term "strategy" is currently fashionable in the business world. Scholars write studies about it, consultants are paid to provide it, and companies strive to apply it, whether in a conscious and organized way or even informally. Sometimes it is restricted to the proprietors and top leaders, eventually it gets spread and shared by all the co-workers in the company.

"The concern about strategy goes back for centuries, from the great ancient wars (it comes from the Greek ***strategis*** = the art of the general), but it was just 50 years that the term began to be applied to businesss and to be discussed about". Peter Drucker, in "The Process of Management" (1954), was the first author to bring up the matter. For Drucker, managerial strategy was nothing but an answer to these joint questions: "Which is our business?" and "Which could our business be?" [2]

This notion has evolved under the influence of the great modern thinkers, whose contributions helped to analyze and enrich the multiple techniques of the planning process.

"Some years afterwards, two other authors reasoned in an explicit and particular way about the strategy concept and about the processes by which it should be formulated and implemented. These authors were: Igor Ansoff ("The Corporate Strategy", 1965) and Kenneth Andrews ("The Concept of Corporate Strategy", 1971)" [2]

No consensus exist over the subject, but each scientist proposes a series of reflections which smart managers can use to support their decisions and to help their companies to live longer and get better profit.

"For Ansoff, strategy establishes a common link between the activities of an organization and the products/markets that define the essential nature of the business this company runs, and also what it plans to be in the future. Andrews, for his' part, defines "Corporate Strategy" as "the pattern of decisions in a company that determines and reveals its objectives, purposes or goals, produces the principal policies and plans for achieving these goals, and defines the range of business the company is to pursue, the kind of economic and human organization it is or intends to be, and the nature of the economic and non-economic contribution it intends to make to its shareholders, employees, customers and communities." [2]

The most renowned model proposes the analysis of internal and external factors: Internal Strengths and Weaknesses and External Opportunities and Threats. Previous and conscious regard to these factors enables the company to follow the right track, to discern its goals, with clearer and more precise objectives. This methodology permits the formulation of the Generic Competitive Strategies, according to Porter [3]:

1. Cost Leadership
2. Differentiation
3. Focus

"Cost Leadership" provides the industry with permanent actions which aim at keeping low costs, whether they be in materials, product designs and processes, or gains in scale production. This strategy requires, besides other features, an efficient factory floor operation, a rigid control of costs and expenses, a minimal outlay for R & D and marketing, and the dilution of costs by volume production. One should bear in mind that such an approach must not lay aside quality and attention to the client.

"Differentiation" implies the delivery of a product or service unlike any other. There are many ways to achieve that, as for instance: to design or to attach a brand to the company's image, to offer a product with different and unequaled characteristics, to introduce up-to-date technology, to provide differentiated services to accompany an ordinary product, to supply peerless quality. The company or the product should be recalled by standing out from their competitors. This method usually allows above average returns due to the higher mark-up, and it sets the company apart from other players. However, reduced costs are not a priority and, frequently, market share becomes limited [3]. It is fundamental to perform extensive research, to employ prime quality materials and to persist in continual advertising.

"Focus" means to take aim at a specific and very reliable buying public, using geographical criteria, economical / financial data, cultural aspects, age group and so on. It represents the segmentation of the target public. This target restriction also allows higher profits since market focusing increases the company's efficiency. Advertising is important, too, but with smaller expenses since the brand does not have to reach a large audience, as needed by the differentiation strategy.

This strategy model has received much criticizing from different authors, according to their analysis and viewpoints. In the present paper, the actions of the company were analyzed to find whether they fit the classical concepts above described and to check whether there was a practical application, conscious or unconscious, of said principles; also, if that attitude would guarantee the company's sustainability at the world leather production scene.

Therefore, after a short report of the company's history, the article will try to correlate the actions observed during the research with the model of SWOT Analysis and with Porter's Generic Competitive Strategies.

4 The Tannery and How it Manages the Trade-off Cost X Quality

Most of the Brazilian tanneries started as a family enterprise and so is our case. It was founded in 1960 and it is currently managed by the second generation. For the last 10 years, there was a dedicated effort to promote growth. To get it done, the directors decided to concentrate their production on the stage of Wet Blue leather. This was the moment when the first strategic decisions were taken into consideration. From this point on, the company increased its output to 8,000 Wet Blue hides and 1,000 Crust hides a day. It is still delivering finished leather but in a small scale. The working force amounts to more than 500 hands in three processing plants and a central distribution depot.

The politics of the company embodies its dearest values:

Vision: To render the best qualified services and deliver the most adequate volumes to the foremost markets of the world, employing top-notch technology and adopting a careful ecological program.

Mission: Permanent support for a strategic position that favors providing the market with the best products and at competitive prices.

Values: Teamwork; Ethics / Honesty; Enterprise; Compromise; Discipline and Respect.

Europe and Asia are the central markets for the company. During the last years, the firm earned the following positions at the export ranking: 2003 = 25º; 2004 = 17º; 2005 = 12º; 2007 = 8º.

As mentioned, the company focuses its activities on the manufacture of a commodity: wet blue leather. Consequently, it is quite clear and probable that the best strategy should be the lower cost. However, it is important to remember that there are a number of tanneries in Brazil operating at the same segment and they all have take care with costs. But when many competitors use the same approach to assure their income, they will have trouble in coexisting. Each one has to be different enough, if it expects to gain a special advantage. They may look alike but they are basically distinct.

The analysis of our case reveals several characteristics that identify it with the Cost Leadership parameter, according to Porter. Many of these features result from previous reflection and planning, some were informally applied.

a) Formal Planning, goals and objectives

The direction of the company views the strategic planning as “an answer to the environmental demands.”[4]

The formal process of planning takes place once a year, with one or two revisions during that period; all the area managers and the production unit chiefs have to attend these reunions. During the meetings, strengths, weaknesses, opportunities and threats are analyzed, according to the traditional model of Porter. Goals and actions are established, as indicated in the analyzed scenario.

However, the process does not end there. More than that, planning is regarded as non-continuous. The business ambiance keeps changing, so the strategic planning has to be set and reset once and again, in an uninterrupted way.

b) Transparent and effective budget

The budget process is devised by each area manager and each production unit manager, and then arranged in “packages” and “sub-packages” in order to allow a transparent and timely administration.

There is a system for visualizing these budget quotas and for approving the outlays. When the estimated value draws near, the system sends warnings indicating that the expense should be called off. In this case, it is not possible for an employee to remove a simple pen from the warehouse without the manager’s approval. The scheme helps to warn the manager that something must be done before the allotted value gets totally spent.

c) Rigid control of costs

Control reports are frequent and detailed, using budget figures, cost centers inputs and expenses type. There is a wide array of options and highly detailed data for ensuring adequate checking and management.

d) Relentless control of work

To gauge the execution of established goals, directors have to keep a close watch on the managers’ performance. And managers do the same with their own teams. This kind of intense supervision occurs on a daily basis and permeates the culture of the company.

e) Information System

Since the firm opted for the self-developed software, it maintains a group of system analysts and programmers to fit users’ demands to the company’s objectives. The downside is that eventually some effective bad practices can be applied to the system. Such risk may be reduced by analyzing the real needs and by consulting correlated areas of the company, in order to maximize the use of beneficial applications. This strategy may also fail to implement the best practices. To regain the lost ground, these practices are set as benchmarks and the Information Technology team receives a permanent update through technical releases and new tools used by other companies. The positive side of in-house software devising is that certain tasks and changes are swiftly introduced and put to practice. The IT group’s expertise about the production processes in tanning stands much above average. In the last three years, the company has attained a level of agility and customization that affords them total control over costs data, sales figures and financial status.

f) Low cost distribution system

This is a basic premise, stated in the mission of the company. It should be located near its bigger suppliers, in places where raw materials of highest quality are available. It is a chief requisite for guaranteeing the product quality.

The industry owns a vehicle fleet that takes care of transport duties from suppliers to the tannery and from the plant to the customers or port of shipping, thus ensuring a favorable cost and dedicated attention to the main business of the company. It operates more than 50 trucks to carry raw materials, chemical stuff and final products such as wet blue and crust leather to its clients or to the port.

The Distribution Center stands near the harbor, providing utmost convenience for the customers, as they have a single and easily accessible place to look over the goods. The Center’s location, only a few kilometers from the port, grants incomparable tranquility to the customers, for they know that their cargoes have been set apart securely.

g) Strategic partnership with suppliers

In connection with the previous aspect, it is not enough to be near the chief suppliers but it is necessary to establish solid partnerships with them. At least 60% of the current suppliers have been partners of the company for the last 4 years.

h) Managerial engagement

It is fundamental that the managers and key workers understand the company’s philosophy and assume a dynamic participation in its activities. These people, working closely with the Communication Program of the company and the human relations department, are responsible for transferring the strategy bases and the company's goals to all the employees. The strategy has to be formulated and understood by all the members of the organization. This allows that the learning process remains constant and collective.

i) Effective actions

The direction points out that devising the strategy is just the start and that their principal challenge is implementing such strategy. To succeed, it has to enter everybody's mind and must be practiced everyday, in every action. Making plans is not enough, you have to do it. That is the motto of the company's direction.

j) Fastness Decisions

Considering that the company has few levels (director, managers, assistant) in the hierarchy, the decisions are taking fasting.

Up to now, all the mentioned aspects refer to strategy and low costs. And yet, quality is extremely important for this market. Naturally, for commodities, there is always a specification to observe. Parameters such as tanner quality, pattern of color, trimming, touch and piece selection are the minimal features a respectable company should provide in its products.

Low cost strategy should not hinder the quality side. In the present case, several techniques are used to guarantee a high standard for its merchandise:

- Frequent training practices for the technical team oriented to product quality;

The entire technical unit is submitted to constant updates and the technical manager periodically checks the work in the production facilities.

- Chemicals furnisher support and process analysis;

Partners from the chemical industry pay frequent visits to the factory and perform analysis of their compounds and of the final product.

- Internal quality auditor for grading and selection of leathers;

This professional checks whether the grade and selection of the product is up to the desired standards. The auditor operates at the producing units, at the Central Distribution depot and in close contact with the customers. Routine factory inspections are also supervised by the auditor. The procedure is a guaranty that there will be no large deviations from the chosen selection.

- Frequent evaluation of the product from a commercial viewpoint;

The commercial area plays an important role in presenting the customers' opinion and a review of rival tanners' offerings. Such a market outlook helps to maintain the company's standards.

5 Conclusion

It is obvious that the case in study embraces formal planning in a traditional way. In the process, low cost strategy is the primary option but they realize that more is needed to stand out in a commodities market. Therefore, the company decided to dedicate its resources and efforts for survival and expansion at the market. The contemporary success derives from an association of superior resources and their correct organization. Fine quality, a *sine qua non* requisite for the products sold by the company, must be the main concern for all the proceedings, because its decline may ruin the market's position. Under no circumstances, should quality be assigned to a secondary rank.

Nevertheless, some aspects deserve special attention and should be the subject of deep questioning and improving efforts if the company wants to keep its leadership in costs.

Matricial Budget - the involvement of middle grade supervisors in budget matters has to be more effective than it currently is.

Improvement in Productivity and Efficiency - leadership in costs presupposes a stringent management of time. Workers' productivity increase and machinery efficiency is highly desirable and could be bettered.

Technology and Automation Investment - the implementation of advanced technology reduces the need for human labor and improves the manufacturing processes; it also decreases fixed costs with personnel.

Attention to Loss of Identity from Unrestricted Growth - Since the company has strived to expand in the last ten or twelve years, there is always the risk that the owners lose control of their enterprise. The direction has tried to avoid such an event by keeping a strong control over all affairs. That is not necessarily bad for changes are needed and possible but they should be executed in a cautious and professional manner.

Strengthening the Relationship with Suppliers – the company already has strong ties to some partners but it is important to establish new alliances with other suppliers, as chemical products and raw materials are fundamental for the firm's operation.

Improvement in the Equipment Maintenance Program - Prevention of unnecessary expenses is essential. The existing program is rather incipient and deserves enhancement.

Evidently, the company progresses with a strong hand at its controls and its mission is clear to see. The events that happened to the company and the actions it took to survive in the market, both merit high regard. This case serves to demonstrate that conscious actions are permanently required and that it is possible to get along with constant cost reduction while preserving quality of the final product.

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