

Orbea¹

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One morning in January 2002, Jon Fernández, the CEO of Orbea, and Miguel Ocaña, the vice president of the Mondragon Group, were sitting in Orbea's central offices in Mallabia (a small town in the Basque Country) thinking about the conversation they had just had with Martin Lafont, one of the purchasing managers at Mercadi.

Mercadi was a multinational distribution chain with one of the highest sales volumes in Western Europe. Like other large-scale retailers, Mercadi had recently entered the market of distributing less expensive bicycles and had taken advantage of their large volume to compete with traditional distributors by creating their own brand.

Lafont, who was a sporting goods buyer for Mercadi, had spoken to Fernández about the possibility of Orbea manufacturing a mountain bike to sell in Mercadi's shopping centers in Spain and France. Mountain bike sales had grown a great deal during previous years (in 2001, they represented 35% of the bicycle market worldwide). Mercadi was planning to introduce a new mountain bike, the "Explorer," with requirements that corresponded to the less expensive mountain bikes that Orbea manufactured, so Lafont placed a call to Mallabia to talk about a possible agreement. The contract with Mercadi could mean a substantial increase in Orbea's sales volume and the consolidation of their sales to large-scale retailers, so the proposal was worth considering.

History of the Company

In 1847, the Orbea Murua brothers (Juan Manuel, Mateo, Casimiro and Petra) founded an arms factory in Eibar (an industrial town close to Mallabia). In 1930, family problems caused the company to break up. Two different companies were formed: the first, called *Orbea y Compañía*, began manufacturing bicycles and the second, *Hijos de Orbea Sociedad en Comandita*, was dedicated to manufacturing ammunition.

¹ Some names and figures have been changed for reasons of confidentiality and for pedagogical purposes.

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In 1969, after an internal crisis, Orbea became an industrial cooperative as part of the Caja Laboral Group and was later incorporated into the Mondragon Corporation. During the 1990s, the company acquired two of its competitors that had gone bankrupt: Zeus and Veneto (the first was a Spanish company, the second was French). In 2002, Orbea had 189 employees, 140 of whom were members of the cooperative. The other 49 employees signed temporary contracts (normally for six months) to carry out production work. There was no significant salary difference between members of the cooperative and the workers with temporary contracts; the main difference was that members of the cooperative shared in the company's profits.

The Industry

The bicycle industry in Spain had developed erratically during the 20th century. At the beginning of the nineties, various factors contributed to a sharp increase in bicycle sales in Spain: the 1992 Olympics in Barcelona, Miguel Indurain's successes,² an increased interest in health and fitness and the desire to promote a more sustainable society. Another important factor that boosted the industry was a successful commercial strategy in which financial institutions decided to give away bicycles as incentives to customers who opened savings accounts. That all contributed to a tripling of bicycle sales in Spain, from 500,000 units to 1.5 million units between 1990 and 1993. Unfortunately, the economic crisis that threatened the global economy in 1993—Spain in particular—caused sales to drop drastically from that point forward. In fact, from 1996 until the beginning of the following decade, the demand for bicycles on the Iberian Peninsula had hit a plateau at 600,000 units per year. This drop in demand caused a number of Spanish bicycle companies to shut down, including Torrot, GAC and Rabasa.

At the end of the 1990s and the beginning of the 2000s, there were important changes in the competitiveness of the industry. In 2002, new U.S. (Trek, Specialized), Italian (Bianchi, Pinarello) and Asian (Giant, Merida) competitors entered the Spanish market (Spanish manufacturers maintained about 40% of the domestic market share). On the other hand, the mountain bike, which had been introduced in the 1980s by the U.S. company Specialized, gained a lot of ground in the market. Lastly, there was a very relevant surge in cycling in important markets like the United States, Australia and England. The emergence of successful cyclists in those countries (especially Lance Armstrong) was a decisive factor in the globalization of cycling, which had traditionally been a European sport (and market) up to that point.

At the time, the market for road bikes and mountain bikes was divided into three large segments:

1. High-end bicycles for serious enthusiasts, priced between €1,000 and €3,000.³ Certain manufacturers (Look, Pinarello, Cervelo and Colnago) had focused on this segment, but most brands that manufactured high-end bicycles also made mid-range models. The most exclusive models (used in competitions) could cost upwards of €5,000.
2. Mid-range bicycles with prices between €500 and €1,000. The bicycle manufacturers with a significant presence in this segment included Specialized, Trek, Cannondale, Giant and Merida. Those brands also manufactured high-end models.
3. Less expensive bicycles, with prices ranging from €100 to €500, for which there were many different manufacturers, including store brands.

² Miguel Indurain won five Tours de France, two Giros d'Italia and a gold medal at the Olympics in Atlanta.

³ These figures correspond to the recommended retail price (RRP), which included 15% of VAT.



There were other market segments, such as children's bicycles and leisure bicycles, which could be included in the low-end range. In many cases, they cost even less than the less-expensive standard bicycles.

One curious characteristic of the bicycle industry was that brand prestige was generally constituted by associations with the racing bicycle segment. In contrast to mountain biking (also called BTT), which was a relatively new sport, road cycling had an established tradition and a long history including legendary, hard-fought competitions like the Tour de France, the Giro d'Italia or the Vuelta a España. Aside from the technical characteristics of the bicycles (especially their weight), a key element in positioning for the most prestigious manufacturers was outfitting the professional teams. The same brand image could later be used to create the BTT brand image. Good positioning in the racing bicycle market had a high rate of parallelism in the BTT market.

Another critical element in the bicycle industry was the relationship with the sales channel. Initially, sales had been handled by multi-brand stores; only recently large-scale retailers (general or those specialized in sports equipment) had begun to represent a significant part of sales. However, whereas multi-brand stores sold bicycles from all different price ranges, large retailers concentrated on mid-range and low-range products and, unlike smaller stores, they did not offer maintenance services.

Orbea

Orbea's range of bicycles included 50 models of city bicycles, road bicycles and mountain bikes. In 2001, the company's sales had reached €31 million (see **Exhibits 1** and **2** for the company's financial statements from 2001). During that year, Orbea sold 180,000 bicycles across a range of different models. Their products were sold mainly out of small sports equipment stores and other establishments that specialized in sporting goods. Sales in this channel made up 80% of their turnover. The other 20% was through large retailers. Traditional retailers usually had a margin of 30% over the sale price, whereas large retailers' margins tended to be closer to 25%. Exports made up 46% of their sales; France was the principal destination, representing 67% of exports (see **Exhibit 3**).

In terms of production technology and supply strategy, Orbea was similar to its peers. Bicycle manufacturers typically purchased all of the necessary components and assembled the bicycles in their factories. Most of the component manufacturers were in Asia. The frame (the most important part of a bicycle) was the only element that underwent a different process. The manufacturers purchased and welded all the tubes. For medium- and low-end bikes, the frames were made of steel; high-end frames were made of aluminum, which required a more complex welding process. A few years earlier, Orbea had acquired TIG welding skills in order to be able to include high-end aluminum bicycles in their product catalog. There was the possibility of eventually using carbon as a substitute for aluminum and Orbea was intent on amassing enough design knowledge to create carbon frames.

A decisive factor was the fact that Orbea supplied bicycles to some professional teams, particularly Euskaltel Euskadi, with whom they had established a stable, long-term supplier relationship. Euskaltel Euskadi had been active in the professional circuit for eight years and the team's cyclists were increasingly successful. In 2001, Roberto Laiseka won the queen stage of the Tour de France for the first time and the team boasted a group of cyclists with very promising futures, including Iban Mayo and Haimar Zubeldia.