

# Gates Corporation: Scanning for Competitive Threats

*Paul R. Seaborn, University of Denver*

As she drove to her office one day in Fall 2015, Carol F. Weber, Director of New Technology and Innovation at Gates Corporation, thought about the changes that were occurring in the diversified industries in which the company operated. At Gates Corporation, Weber worked with engineers who advanced the design and performance of power transmission and fluid transfer products in a number of market segments including automotive and oil & gas. Weber was particularly concerned about the potential threats posed by Gates Corporation competitors, such as the introduction of innovative products or services. Keeping an eye on the existing and emerging trends in the industry was a reasonable way to address her concerns. But the question was, which specific trends or potential threats should the company focus on? Was it to know the company's most vulnerable areas for competitors, seeking divestiture or acquisitions, or expanding into new markets? Weber was worried that if Gates Corporation continued without preparing for potential disruptors, competitors could sweep away market share and potentially put Gates out of business as had happened to other longstanding corporations such as Kodak and Blockbuster. The question of what threats were of greatest priority needed to be answered before a competitor's action threatened Gates Corporation's market position.

## **Carol Weber**

Weber had only been with Gates for two and a half years, having previously held a similar position as Innovation Director with Newmont Mining Corporation. Weber had extensive mechanical design, test, and management experience and a Ph.D. in Operations Research (mathematical optimization). Spacecraft propulsion, life support, life sciences, telecom, healthcare and energy were some of her areas of expertise. Weber had received the Denver Business Journal's Outstanding Woman in Business for 2015 Award for her contributions to Architecture, Engineering, and Construction.<sup>1</sup>

## **Gates Corporation Background**

Gates Corporation, was founded in Denver, Colorado in 1911 by Charles C. Gates.<sup>2</sup> At that time, the company consisted of a one-room shop with one 18-year old employee and a typewriter. Gates manufactured a single product - Durable Tread tire covers, a studded leather band that extended the life of tires when attached to them.<sup>3</sup>

Gates Corporation remained a family-owned company for 85 years, during which it experienced considerable expansion and innovation (see **Exhibit 1**). In 1996, Charles Gates, Jr. sold privately held Gates Rubber Co. to Tomkins plc for \$1.16B. Tomkins plc. was a world-class global engineering group, and the market and technical leader, that dealt with industrial and automotive products. Gates Corporation's ownership changed again in 2010 when Onex and the Canada Pension Plan (CPP) acquired control of Tomkins in a \$4.5 billion deal and in March 2014 when Blackstone Group LLP, the world's largest buyout firm, and one of the world's leading investment and advisory firms, acquired the company from Onex and CPP in a \$5.4 billion deal. Under Blackstone, the organizational structure changed considerably and Gates introduced many automotive aftermarket parts, new belt education displays and entered into new markets with a focus on growth.

## **Gates Corporation in 2015**

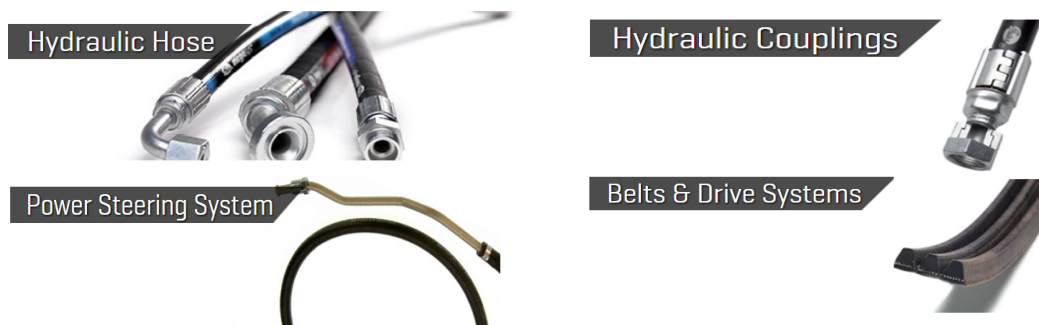
Gates Corporation was headquartered in Denver, Colorado and was one of the largest manufacturers of automotive and industrial belts and hoses in the world. The company operated in the world's major markets such as North and South America, Europe, Asia, Australia, and the Middle East.

Gates Corporation served customers in the oil and gas, construction, transportation, automotive, and manufacturing sectors. The company's three top markets were automotive manufacturing, industrial

and agriculture, and automotive aftermarket—with automotive aftermarket being the largest sales segment. In the latter two markets distributors and retailers moved the products to end users—which had proven to be an effective model built on great relationships across the world. However, the automotive manufacturing segment saw little annual growth—in part because auto makers preferred to diversify their supplier selection rather than rely on a single supplier.<sup>4</sup> According to 2015 Top 100 Automotive Aftermarket Suppliers, global automotive sales for the company amounted to \$1.6 billion. Out of \$1 billion total global automotive aftermarket sales, \$541 million came from North American aftermarket sales.<sup>5</sup>

Internally, Gates Corporation was organized regionally around a number of separate business units. Gates products included drive belts, timing components and kits, hydraulic hose, couplings and adapters, automatic belt tensioners, pulleys and idlers, coolant and fuel hose, water pumps, fuel and radiator caps, thermostats, power steering hose and assemblies, turbo charger hose and assemblies, emission tubes (see Figure 1). Some of the brands include Gates, G-Force, FleetRunner, DriveAlign, Micro-V, and PowerGrip.

**Figure 1: Various Products of Gates Corporation**



Source: Gates Corporation website

The products and services were being used in diverse industrial and automotive applications where the cost of failure was very high relative to the cost of the products. The industrial products and services such as industrial belts, hoses and hydraulics were generally used in the areas of agriculture, food and beverage processing, mining, oil and gas, transportation and other markets. Gates Industrial also provided engineering support for Oilfield Engineering Services for North America. A full line of products and services were also offered for Flexible Hose Assemblies (FHA) in the oil and gas industry. These products and services included hydraulic, industrial, and rotary hoses, large bore cut and couple, MobileCrimp 4-20, hydraulic fluid flushing, breathing air manifolds, hose rental.

Given the industrial nature of Gates Corporation’s products and the wide variety of industries in which they were used, Gates sold through distributors rather than directly to end customers. This meant that each distributor relationship provided a crucial means of access to a large group of end-customers. With quality as one of their core values, the company prided itself on the strength and longevity of their products—allowing for a higher price point in most markets including the automotive aftermarket.

### Senior Management

Significant recent changes had taken place within the senior management of the company. In May 2015, Jim Nicol, who had served as Gates CEO since 2002, was replaced by a new outside CEO, Ivo Jurek. Nicol was quoted in the announcement of Jurek’s appointment saying, “I remain fully committed to the success of Gates and look forward to supporting Ivo and the team in my continuing role as Vice Chairman of the Board”<sup>6</sup>. Top executives of Gates Corporation included:

- Ivo Jurek, CEO (since May 2015, formerly Eaton, Cooper)

- David Naumura, CFO (since March 2015, formerly Danaher Corporation)
- Walt Lifsey, COO (since Aug 2015, formerly View, Inc. and Atmel)
- Dave Carroll, President, Americas Region (formerly Tomkins, Magna)
- Open, President of Europe, Middle East and Africa Regions
- Wei Shen Vice President and General Manager – Greater China
- Teng Seen Khoo (TS), Vice President East Asia

## Human Resources

The number of employees at Gates Corporation had expanded to over 14,000 people who worked across 106 locations in 30 countries (**Exhibit 2** in Appendix). Gates operated three Global Technical Centers in Europe, Asia and North America, which served the needs of worldwide customers. These Technical Centers facilitated component and systems testing and development. Some of the disciplines include metrology, component durability testing, engine and transmission development, and full system testing. Some of the quality standards include ISO / TS 16949, QS 9000, Gates – S1 and Ford – Q1. Over 215 patents had been issued to the company.<sup>7</sup>

Gates Corporation described itself as encouraging employees to take risks and think outside the box and claimed that the executive team and company culture empowered employees while making sure that their business decisions were supported.

On public websites such as [www.glassdoor.com](http://www.glassdoor.com) and [www.indeed.com](http://www.indeed.com), employees provided mixed but generally positive reviews regarding their experience with Gates Corporation, as shown in **Table 1**. The company provided varied projects to employees, enabling them to broaden their skill set and climb the ladder of success. It also provided a lean culture and opportunities for continuous improvements in operations.

Some employees felt that the recent ownership changes had lessened the focus on employees. Suggestions proposed by the company employees included more communication of ideas between senior and middle level management, and more career progression at higher levels.

<b>Table 1: Gates Corporation Online Employee Feedback</b>	
<b>Pros</b>	<b>Cons</b>
Career progression	Less employee focus since ownership changed
Local and international presence	At middle-management level career progression takes place at a slower pace
Downtown Denver location of corporate HQ	Salary is from low to middle range
Good customer base	Limited communication between senior and middle level management
Lean culture and continuous improvements in operations	Low public profile, limited company information available on Internet
Opportunity to work on different projects	Confusion with Bill & Melinda Gates Foundation

**Source: glassdoor.com, indeed.com**

## ContiTech and Other Gates Competitors

The key competitors of Gates Corporation were from the Truck/Bus Engine Hose and Truck/Bus Hydraulic lines categories. In the belts/tensioners category, the key competitors included ContiTech, and Flexfab, while in Truck/Bus Hydraulic lines category, major competitors included Eaton, ContiTech, and Parker.

ContiTech, a division of Continental Corp. with total global automotive sales of \$45 billion, represented the strongest current competition to Gates. According to 2015 Top 100 Automotive Aftermarket Suppliers, ContiTech ranked first overall. Its global headquarters was in Hannover, Germany, while the U.S. headquarters (ContiTech North America, Inc.) were in Fairlawn, OH.<sup>8</sup>

ContiTech's products included: tires, power transmission, belts, vibration control, electronic stability control, blower and radiator fan motors, cooling fan assemblies, engine management components, fuel supply components, and many others. Their brands included Continental, ATE, Barum, Continental, ContiTech, Galfer, General Tire, REDI-Sensor, and VDO.

The ContiTech division of Continental was one of the leading suppliers of technical rubber products and a specialist for plastics technology. ContiTech developed and produced functional parts, components, and systems for machine and plant engineering, mining, automotive industry and other important industries. Industrial Fluid Systems and Mobile Fluid Systems are two business units in ContiTech that manufactured hoses, while the Power Transmission Group manufactured drive belts.

As shown in **Table 2**, in 2014 the ContiTech division had over 32,500 employees with product revenue of 3.9 billion Euros. FluidTech on the other hand contributed 38% of total revenue.<sup>9</sup> Its product revenue in 2013 and 2014 was 1,476 million Euro and 1,491 million Euro with 15,126 and 17,095 employees respectively working for the division.<sup>10</sup> Power Transmission Group, another division of Continental contributed 12% of total revenue. Its product revenue in 2013 and 2014 was 419 million Euro and 455 million Euro with a total of 2,744 and 3,006 employees respectively. The company had publicly discussed a global expansion strategy that included expansion plans in China, Germany and Serbia.<sup>11</sup>

**Table 2: Performance of ContiTech Over Years**

	(Euro Million)		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
<b>External Sales</b>	3,832	3,749	3,584
<b>Intercompany Sales</b>	99	129	128
<b>Total Sales</b>	3,931	3,878	3,712
<b>EBIT</b>	433	462	454
<b>Employee Number</b>	32,775	29,725	28,210

Source: 2012, 2013 and 2014 10-K of Continental

**Table 3: ContiTech Sales by Market**

	(Euro Billion)			
	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>Total Sales Revenue</b>	3.1	3.7	3.9	3.9
<b>Europe Excluding Germany</b>	34%	32%	31%	31%
<b>Germany</b>	38%	34%	33%	33%
<b>NAFTA</b>	7%	10%	12%	14%
<b>Asia</b>	14%	16%	10%	17%
<b>Others</b>	7%	8%	8%	5%

Source: 2011, 2012, 2013 and 2014 10-K of Continental

ContiTech had experienced a number of significant recent acquisitions and changes:

- i. A compounding center in China was opened in July, 2015<sup>12</sup>
- ii. The global economic downturn in mining sectors resulted in the scheduled closure of the Canada plant in Bowmanville, Ontario in mid-2016, impacting ~135 workers, and the announcement of plans to halt silicone rubber production at its Somersworth, NH plant<sup>13</sup>
- iii. Sites of the Belgian Mecaseat Group in Spain and Poland were acquired in November 2014<sup>14</sup>
- iv. Veyance Technologies was purchased from private equity firm Carlyle Group in early 2014<sup>15</sup>
- v. The business of the drive belt manufacturer Taizhou Fujou Rubber Belt Manufacture Co., Ltd was acquired in January, 2014<sup>16</sup>
- vi. The specialist Benchmark Drives was taken over by ContiTech, Hofheim in May, 2014<sup>17</sup>
- vii. Conveyor belt manufacturer, Legg Company Inc., was acquired in July 2013<sup>18</sup>

ContiTech had also launched a number of new products including:

- i. V-Ribbed Belt Conti Unipower Tough Grip<sup>19</sup>
- ii. Charge-air hoses and lines<sup>20</sup>
- iii. Double-sided timing belt<sup>21</sup>
- iv. Protective gaiter and torque clutch<sup>22</sup>
- v. Improved Hose product<sup>23</sup>
- vi. A new heavy-duty bushing for construction vehicles<sup>24</sup>
- vii. Fuel lines with electrically conductive liners<sup>25</sup>

## **Disruptive Innovation and Maintaining Relevance**

“Disruptive innovation” had become a widely-discussed phenomenon in business. Clay Christensen, acknowledged as the originator of the concept, defined disruption as a process in which a small company entered a market and successfully challenged industry giants. The process began with the entrant making a low-cost, low-quality product while industry leaders tended to chase more profitable markets (See **Exhibit 4**). While entrants started off serving low-end markets, as they improved their technology and quality to suit mainstream consumers the entrant became able to take more and more incumbent market share, forcing the incumbent to react.<sup>26</sup> In the case of Blockbuster and Netflix, the disruptor was eventually able to take over as the new industry giant.

Weber was particularly concerned about potential disruptors. Gates Corporation was the high-cost, high-quality manufacturer that served high-end markets. Their company was centered around rubber belts and hoses which outperformed and outlasted their competitors. Could maintaining focus on high-end markets leave room for disruptors to enter the industry? Would a preventative measure to begin serving the low-end market have negative consequences on the Gates brand? The company was conflicted and in disagreement about how to move forward.

Another challenge for the Gates Corporation was keeping up with industry trends. As the world transitioned to more sustainable technology, the future for traditional automotive parts was in doubt. By 2040, 35% of new cars sold were predicted to be electric vehicles (see Exhibit 3) and to cost less than \$22,000 USD.<sup>27</sup> In 2015 alone, electric vehicle sales had grown by 60 percent worldwide.<sup>28</sup> Drive belts, a core product of Gates Corporation, might not even have a place in an increasingly sustainable automotive industry. Studies showed that automotive engineers hoped to replace drive belts to increase fuel efficiency and Honda had already replaced starter generator belts in their electric and hybrid models.<sup>29</sup> As the automotive industry continued to transform, the future of rubber belts and hoses within the industry was unclear.

## **Exploring New Markets**

Some companies grow their markets by expanding who they serve, while others break into new markets through product diversification. Gates Corporation has dabbled in both of these ideas over the past 100+ years. In fact, at the end of the Great Depression the company was thriving with over 4,000 Gates products on the market.<sup>30</sup> The company also focused efforts on going global, building its first international location in Ontario, Canada in 1954. While Gates has a multi-national presence, their strongest regions are North America and Europe. Two huge markets in where the company had interest in expanding were China and India.

With 154 million cars owned in 2014, China’s rapid economic growth was an enticing market for companies like Gates Corporation. Furthermore, low-cost workers in China meant cost savings in manufacturing the goods. The same could be said for India, which recorded new vehicle sales of 2.7 million vehicles in the 2015-2016 fiscal year.<sup>31</sup> Another potentially attractive opportunity was electric bikes, which were becoming popular across the globe, but especially in European and Asian countries. Manufacturing rubber components for electric bikes provided a potential path for Gates to enter new global markets. In 2013, the company launched new bike systems at a major European conference—Eurobike.<sup>32</sup> The Gates Carbon Drive, which was meant to replace bike chains, was also demonstrated in 2015 in Taiwan but at a lower price point. 2.5 million electric bikes existed in just Beijing alone,<sup>33</sup> while two-wheelers made up 80% of all Indian transportation (See Appendix E).<sup>34</sup> While the sheer volume and

growth of these markets was appealing, there were also downsides. For one, other companies had taken advantage of Gates' strong brand image by selling low-quality, knock-off belts and hoses in Gates Corporation packaging. On Alibaba, the eBay of China, imitation "Gates" rubber belts were being sold for pennies on the dollar.<sup>35</sup> It was unclear whether officially entering this market with a high-quality, high cost product was viable—or whether entry in any form would increase opportunities for imitators and other potential disruptors.

### **Carol Weber's Challenge**

Although Weber's primary mandate was to foster the development of new, innovative products, she couldn't help but worry about broader potential competitive threats with the ability to challenge Gates' prominent global market position or perhaps even the company's survival. With so many possibilities it was hard to know where to focus. Although ContiTech represented the strongest current competitor of Gates Corporation, did ContiTech also pose the greatest future threat or was there another challenger lurking in the wings? What was the likelihood that one of the key industries served by Gates Corporation products would suffer a catastrophic downturn? Did the company's current sales process and reliance on distributors warrant reevaluation? How did Gates' patent portfolio and future pipeline compare to that of other firms currently in the market or with the potential to enter? Should Gates Corporation follow the example of Continental and focus on seeking more global expansion opportunities to maximize economies of scale and better serve specific global markets? These and many other questions needed to be answered as soon as possible in order to provide Gates with a plan for anticipating and responding to the competitive challenges and potential disruptive innovations.

**Your team's task is to review the facts of the case, identify the most pressing issues and threats, research and develop a set of alternative actions and then provide a recommended course of action to Carol Weber and Gates Corporation.**

## Appendix

### Exhibit 1: Timeline of Gates Corporation<sup>1</sup>

- 1911: Founded by Charles C. Gates as Colorado Tire and Leather Company
- 1917: John Gates invented rubber V-belt  
Charles Gates changed the name to the International Rubber Company
- 1919: Name changed to Gates Rubber Company
- 1946: Invention of the synchronous belt
- 1954: Built first international manufacturing facility in Brantford, Ontario, Canada
- 1958: Opened Gates Rubber de Mexico
- 1963: Built a belt and hose plant in Erembodegem, Belgium, the first of many European facilities
- 1986: Acquired Uniroyal Power Transmission to become world's largest synchronous/timing belt maker
- 1996: Charles Gates, Jr. sold privately held Gates Rubber Co. to Tomkins plc (\$1.16B) – end to 85 years of family ownership
- 2003: Name changed to The Gates Corporation
- 2010: Tomkins becomes part of Onex and Canada Pension Plan (\$4.5B)
- 2011: Gates celebrates 100th anniversary with events around the world and launched a new global brand initiative, adopting the new corporate tagline: "Powering Progress"
- 2013: Began demolition of final factory buildings
- 2014: Site purchased by Denver-based Frontier Renewal  
Acquired by Blackstone Company (\$5.4B) from Onex & CPP
- 2015: Released 850 New Automotive Aftermarket Parts  
Introduced New Serpentine Belt Inspection Tool, Innovative Solution Kit from Gates Corporation, New Belt Education Display  
Launched New Website for Automotive Educators  
New Century Series Micro-V Belt Line

## **Exhibit 2: Gates Locations in North America**

### **Gates Corporation World Headquarters**

1551 Wewatta Street, Denver, Colorado 80202

### **Gates Technical Center**

2975 Waterview Drive, Rochester Hills, Michigan 48309

### **Gates Customer Solution Center**

330 Inverness Drive South, Englewood, CO 80112

### **Gates Manufacturing and Distribution Facilities**

#### United States

Columbia, MO

Elizabethtown, KY

Siloam Springs, AR

Chambersburg, PA

Corpus Christi, TX

Davie, FL

Galesburg, IL

Hebron, KY

Iola, KS

Lithonia, GA

Poplar Bluff, MO

Red Bay, AL

Salem, NH

Versailles, MO

#### Canada

Brantford, Ontario, Canada

Downsview, Ontario, Canada

Windsor, Ontario, Canada

#### Mexico

Atacomulco, Mexico

Toluca, Mexico

Guadalajara, Mexico

Lerma, Mexico

Merida, Mexico

Mexicali, Mexico

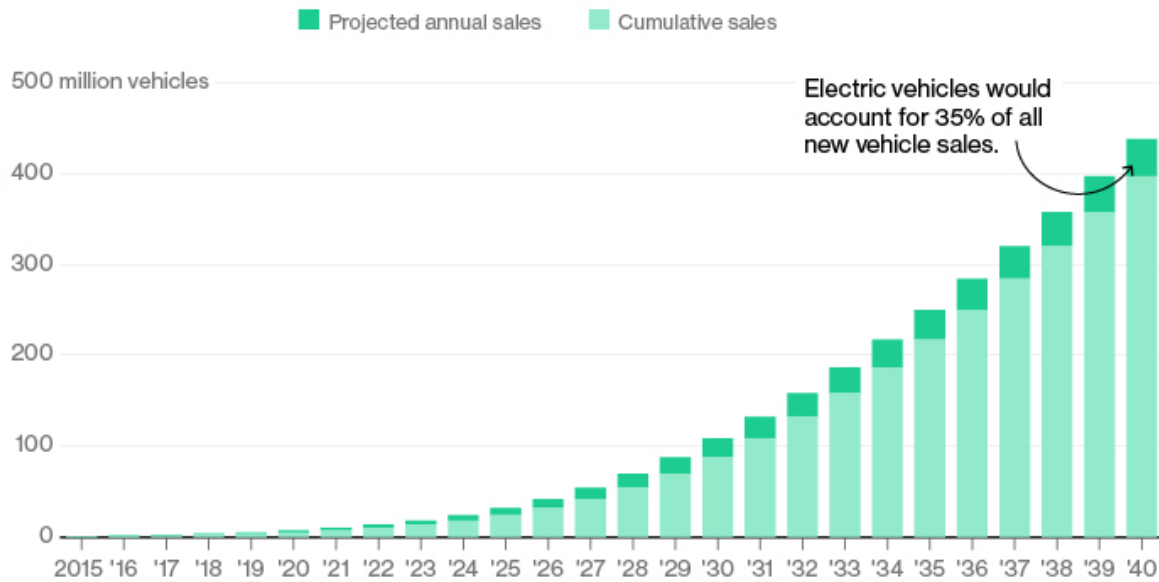
Monterey, Mexico



## Exhibit 3: Changing Industry Trends

### The Rise of Electric Cars

By 2022 electric vehicles will cost the same as their internal-combustion counterparts. That's the point of liftoff for sales.



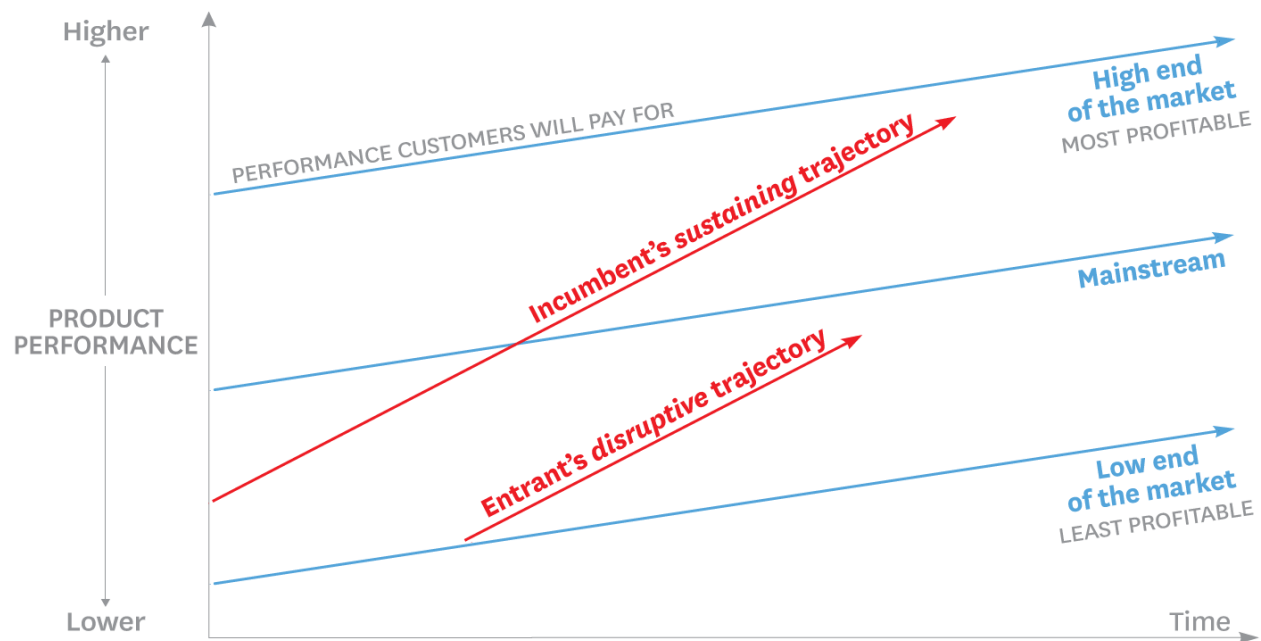
Sources: Data compiled by Bloomberg New Energy Finance, Marklines

**Bloomberg**

## Exhibit 4: Disruptive Innovation

### The Disruptive Innovation Model

This diagram contrasts *product performance trajectories* (the red lines showing how products or services improve over time) with *customer demand trajectories* (the blue lines showing customers' willingness to pay for performance). As incumbent companies introduce higher-quality products or services (upper red line) to satisfy the high end of the market (where profitability is highest), they overshoot the needs of low-end customers and many mainstream customers. This leaves an opening for entrants to find footholds in the less-profitable segments that incumbents are neglecting. Entrants on a disruptive trajectory (lower red line) improve the performance of their offerings and move upmarket (where profitability is highest for them, too) and challenge the dominance of the incumbents.

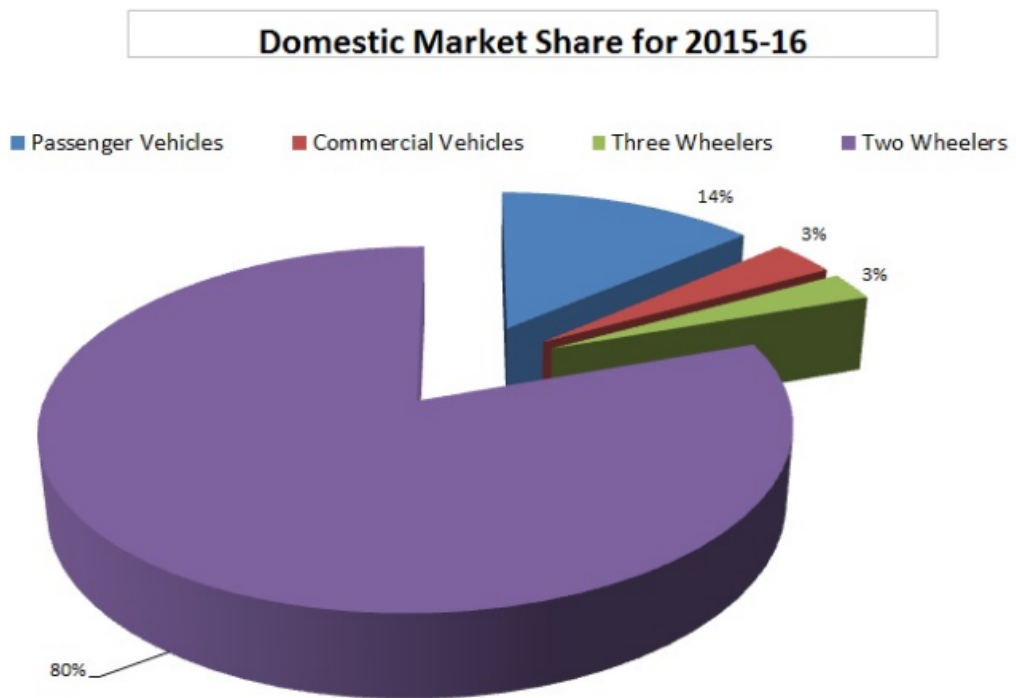


**SOURCE** CLAYTON M. CHRISTENSEN, MICHAEL RAYNOR, AND RORY MCDONALD  
**FROM** "WHAT IS DISRUPTIVE INNOVATION?" DECEMBER 2015

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## Exhibit 5: India Vehicle Breakdown

Domestic Market Share for 2015-16	
Passenger Vehicles	14
Commercial Vehicles	3
Three Wheelers	3
Two Wheelers	80
Grand Total	100



Source: Society of Indian Automobile Manufacturers

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### Notes

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