

## **Aernnova: Where in the world?**

**In 2007, Spain's leading maker of aircraft structures, Aernnova, planned to internationalize its operations. But should it go to China or Mexico?**

February 9, 2016

Does the future lie in China or Mexico? This was the question facing aerospace manufacturing company Aernnova in 2007.

At the time, the company was a new, and struggling, spinoff of the Spanish corporation Gamesa, and still very much based in Spain. To become competitive in the post-9/11 aircraft industry, the executive team was convinced that Aernnova should go global in its manufacturing, and open a plant abroad. The question was, where?

A [case study](#) by IESE Professor [Eduard Calvo](#) — with Professors Jesús Arturo Orozco and Miguel Estrada of IPADE Business School in Mexico — examines the dilemma that Aernnova managers faced, and the competing economic, cultural and practical forces that influenced their decision.

### **Onwards and upwards?**

Aircraft manufacturing was an unforgiving business in the early 21st century.

Back in the early 1990s, however, the Basque Country region of Spain had identified aerospace clusters as one of three key strategic areas to combat the decline of the once-robust steel industry. The company Gamesa was chosen to lead the region's aerospace project.

Gamesa was not solely dedicated to aircraft; in fact, it was a conglomerate of 20 different companies with fewer than 10 employees each, operating in a range of sectors. With the

Basque government backing aerospace, Gamesa Aeronáutica set out in search of global opportunities.

The doors that then opened to them were in the Americas. Embraer, a Brazilian company on the brink of bankruptcy, was betting everything on the success of a new jet model, the ERJ 145. The second and only other opportunity came from Sikorsky, a subsidiary of the U.S. giant Lockheed Martin, which was making a new helicopter. Sikorsky's project would be some years in preparation, and Embraer was by no means a safe bet.

Gamesa took on the risk, and the model proved to be highly successful. The ERJ 145 was a runaway hit, dubbed "the most successful wings in history," the case notes. While the breakeven point was reached with 200 units of the new regional jet, by 2007 over 1,000 units had been sold.

But the success this brought to Gamesa ironically led to some of the problems it would face down the road, problems that would lead to the fateful meeting to decide between China and Mexico.

## **Here, there and everywhere**

One challenge was the fractured nature of the company. Gamesa was already a conglomeration of companies in different sectors, but even within the aircraft sector the business was to become more disperse.

Bottlenecks in the original plant led management to set up a second plant just a few kilometers away. And when Gamesa was contracted by one of Embraer's competitors to manufacture parts, they decided it would be good policy to attend to these rival companies in different plants, too. Soon Gamesa Aeronáutica had no fewer than five plants in Spain, as well as one in Brazil to facilitate the relationship with its top client, Embraer.

An already complicated situation reached breaking points after the chaos caused by the 9/11 terrorist attacks on the United States, which led to investment freezes, skyrocketing oil prices and large-scale layoffs in the industry. Gamesa Aeronáutica became the underperformer of the Gamesa group, and in 2005 Gamesa announced plans to sell it for 140 million euros. It was finally purchased by former Gamesa CEO Iñaki López Gandásegui for a mere 45 million euros, and rebranded as Aernnova.

## Local interests or internationalization?

Aernnova's management team was largely made up of Basque executives who had been involved with Gamesa Aeronáutica for years and wished to keep production in the Basque Country as much as possible.

However, maintaining five plants in Spain was inefficient, with cost performance in the European nation falling far beneath what was being achieved in other countries. At this point, the aerospace sector was still in recovery mode and a strong dollar was squeezing margins as Gamesa had not yet dollarized its sourcing and manufacturing activities. In addition, the high-performing ERJ 145 design was aging, with orders declining. Overcapacity became an issue. With multiple plants running independently in different parts of the country, operations were vulnerable to volatility, sparked by the changing demands of Embraer and other customers.

It seemed inevitable that Aernnova would have to consolidate its plants in Spain, if nothing else, although managing each plant as a separate company had allowed the company to serve different customers and keep strong unions at bay.

While remaining in Spain was desirable to the management team, internationalization would allow Aernnova to be close to some of its key partners and clients. Meanwhile, lower labor costs in developing countries could increase competitiveness.

But where should they go? Starting with a list of 20 countries, Javier Pérez Alcaide, head of business development, led a benchmarking exercise spanning several months to winnow it down to just four: India, with the lowest labor costs and high potential in the aerospace market; Mexico, close to the U.S. market but lacking in industry development; China, whose labor costs were famously low — albeit less so in the coastal regions where needed infrastructure was already in place; and Morocco, which benefited from French government industry investments and was located close to Spain.

From there they ruled out India, for the decade-plus it might take for the Indian market to develop, and Morocco, for political uncertainty in France which could undermine financial support. That left just China and Mexico, and Javier Pérez Alcaide found himself locking horns with Aernnova president Iñaki López Gandásegui and most of the rest of the C-suite. The president favored China, the obvious choice for many in the industry, but Pérez Alcaide's research suggested they should go for Mexico for its simpler logistics and taxes, its proximity to Aernnova's main markets, and its cultural similarity to Spain.

The choice would have significant effects on Aernnova's success and development in the years to come. It also hinged on a deceptively simple question: should the decision be market driven, or cost driven?

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