BHP BILLITON AND RIO TINTO: SEIZING OPPORTUNITIES IN CHINA’S DRAGON ECONOMY

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Introduction

BHP Billiton and Rio Tinto are two of the biggest names in Australian commodities. The greatest demand for iron ore is in the developed world and in countries undergoing rapid development such as China. These firms seized opportunities offered by dramatic transformation of China’s dragon economy. In 2008, China’s GDP was estimated to be US$3.860.039 million. In terms of world trade, it was ranked second for exports and third for imports.1 Demand for iron ore resulted in unprecedented price levels and profits for the Australian mining giants. In 2008, BHP reported a profit of $18 billion.2 Australian companies and the Australian government have worked hard to become the supplier of choice for raw materials.

Developments in the domestic market

Consolidation is a key trend in mining. A joint venture agreement between BHP Billiton and Rio Tinto was proposed in 2009, creating an effective iron ore duopoly. BHP Billiton’s chairman, Mr Don Argos, cited synergies as the motivating factor. For instance, the joint venture would make it easier for them to share rail transport and technology used to extract, move and blend iron ore. The joint venture agreement allows for the royalty-free sharing of proprietary technology. For example, Rio Tinto remotely operates train lines and rock crushers in its Pilbara mine from its offices in Perth and has plans for driverless trains and trucks.3

The BHP–Rio Tinto merger has international ramifications. Although it won the approval of the Australian Competition and Consumer Council (ACCC), it attracted the attention of the EC (European Commission) regulator, Chinese steelmakers, Japan’s Fair Trade Commission and the US Federal Trade Commission. There are concerns that the merger, which would create an entity producing over a third of the world’s iron ore, would reduce competition in the market.4

In the domestic market, the challenges facing miners revolve around skill shortages, greater labour flexibility and environmental issues. Foreign Direct Investment (FDI) remains a controversial issue. China is interested in taking more control over the supply chain. However, foreign investment in Australian companies is subject to government approval and assessment by the Foreign Investment Review Board (FIRB). Criteria include:

• whether the investment would impact on national security or Australian government revenue
• whether it would lead to undue control or concentration in an industry or industry sector


• whether the investor was independent from its government
• whether it adhered to the law.\textsuperscript{vii}

While some politicians have reservations over Chinese investment in the resource sector others see it as normal market behaviour. According to Marius Kloppers, the Chief Executive of BHP Billiton, Australia needs to be open to this type of investment. Investment in new resource projects is typically measured in billions of dollars, takes many years to complete and many decades before returns on investments are realised. He warns that capital sources are limited and highly mobile and Australia risks losing dollars to another country.\textsuperscript{v}

The reaction of China to developments in the Australian competitive environment

Australia and China are determined to build close commercial relationships given the interdependency of their economies. Economically, China is one of the strongest performing nations in the world. The economic reforms made by Deng Xiaoping in 1979 and China’s accession to the World Trade Organization in 2001 enabled the totalitarian state to move towards a modern, market-driven economy. A Chinese economy with over 1.3 billion people needs access to affordable energy and raw materials. China is heavily dependent on exports and imports and needs resources for production from all over the world. It is understood by the Australian government that any decline in demand for commodities would be damaging to their economy.

The upward mobility of Chinese into the middle class is driving demand for all kinds of goods. As the country urbanises, there is heavy investment in infrastructure, such as railways, expressways, airports and seaports, along with the property market – commercial, residential, retail and industrial. The McKinsey Global Institute predicts that by 2025, China will have 221 cities with more than 1 million residents. It is estimated that China will consume as much steel in the next 10 years as the US did in the entire 20th century.\textsuperscript{vii}

The failure of the planned alliance between Rio Tinto and Chinalco, together with opposition from some Australian politicians towards Chinese investment in the Australian resource sector, was met with resentment in China. China’s state-owned Xinhua news agency, referred to the ‘short-sightedness and prejudice’ of decision makers which could only ‘stall the pace of economic co-operation between China and Australia and also hurt the interests of the Australian enterprises themselves’.\textsuperscript{viii} The subsequent arrest of an employee of Rio Tinto on charges of bribery did not help relations between the two countries.

The arrest and conviction of an Australian citizen and employee of Rio Tinto

Differences in cultural value systems lead to differences in attitudes towards ‘payments under the table’. What is illegal in one country, such as Australia, may be customary or acceptable in another. Transparency International is an international not-for-profit organisation devoted

\textsuperscript{v} ‘China’s Stake in Rio Wins Swan’s Approval’, The Australian, 23 August 2008.
\textsuperscript{vi} Marius Kloppers, ‘There’s More to Success than Luck and Geography’, The Australian., 19 November 2009.
to curbing corruption worldwide. It publishes the Corruption Perception Index (CPI) on its website (www.transparency.org), which ranks countries by their perceived levels of corruption as determined by expert assessments and opinion surveys. In 2009, China scored 3.6 out of 10, suggesting that corruption is expected in Chinese society even though it is illegal.

In August 2009, Stern Hu, Rio Tinto’s head of iron ore operations in China, was charged with using bribery to acquire commercial secrets. A year later he pleaded guilty to taking bribes, was fined and sentenced to 10 years in jail. In the mining sector, negotiations over price are often bitter and protracted since they involve multi-billion dollar contracts, creating an environment that is conducive to corruption. According to state media, Hu and his colleagues bribed the employees of private steel companies to obtain confidential information on the state-owned steel companies, their negotiating strategy and attitudes towards iron ore prices. In return, the private steel companies got access to iron ore at better prices. They also understood that, only by giving benefits to Hu, would a long-term, stable relationship with Rio Tinto be possible. It was reported that Hu had caused huge losses to China’s economic interests. In a Confucian culture that values collectiveness, family, respect, glory, face and avoidance of shame, the conviction against the Chinese-born Hu was very serious.

The arrest of Hu was a cautionary tale for foreigners doing business in China. Although China had a well-developed legal system, enforcement is very different from Australia’s common-law system. The original charge of espionage was downgraded to bribery and this was seen as an attempt by the Chinese to defuse a diplomatic row. The Chinese government considers information about steel production, sales and iron ore costs to be a state secret. Unlike Australia, China does not make a distinction between commercial secrets and state secrets. In politically sensitive industries such as resources, the business of collecting commercial intelligence is an area where foreign executives risk crossing an invisible line.

Response of Rio Tinto to conviction

Shareholders of Rio Tinto started wondering if Hu’s superiors knew that something was amiss since the information obtained by Hu was sent up the corporate chain. After the convictions, the chief executive of Rio Tinto moved quickly to distance the company from the scandal; he condemned bribery and emphasised Rio Tinto’s announcement that the company planned to conduct an independent review of its procedures and controls to ensure that such management failures would not happen again.

Conclusion

There is no doubt that Australia needs China and China needs Australia. While business between Australia and China continues as normal, there are political tensions and cultural challenges to be overcome in the international business arena. Company executives have to balance the desire for profits in the short term with the need to build trusting relationships in the long term.

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QUESTIONS

1. Explain why the Chinese economy has achieved such rapid growth in the last 30 years.
2. How does the economic and financial environment affect the success of BHP Billiton and Rio Tinto?
3. What aspects of the political–legal and cultural environment pose problems for Australian miners?
4. What responsibility did the CEO of Rio Tinto have in relation to protecting the interests of their then employee, Mr Stern Hu?

ENDNOTES

9. East and West Germany (1948) are combined in 2008. 1948 USSR becomes 2008 Russian Federation, though the territory is smaller.
20. At times, especially during the world wars, Australia has been an important partner for New Zealand, as it is today.
26. Which is a major reason why New Zealand’s share of world exports has decreased so much.
Entering the beautiful island

Giordano was established in Hong Kong in 1981 as a manufacturer and wholesaler of high-priced causal wear. In 1983, Jimmy Lai, its founding chairman, decided to enter the Taiwanese market and establish Giordano’s wholesale business there. The reason for picking Taiwan as the first destination for international expansion was more than geographical proximity. Since 1979, the Taiwanese government had been emphasising the development of its microelectronics industry and investment in R&D. The resultant technological transfer had benefited the textile industry by enabling hi-tech, low-cost domestic garment production. Due to its supply of quality raw materials, Taiwan had been able to provide an abundant supply of artificial fabrics to the clothing industry, making it a favourable expansion target. Although both Hong Kong and Taiwan were Chinese communities, there were substantial differences in their political, economical, and social environments. Giordano decided to enter the Taiwanese market by forming a joint venture with a local Taiwanese company.

Three years later, Giordano made a dramatic change in its business strategy by scaling back its wholesale operations in Hong Kong and Taiwan and concentrating on retailing. Instead of using high-price positioning in its wholesaling era, Giordano positioned itself as a value-for-money casual-wear retailer. It pledged four corporate values – value, quality, service, and speed – to its customers, ushering in a new direction. While the Taiwanese apparel market was still in its infancy in the mid-1980s, Giordano’s experience as a wholesaler in the region provided it with a first-mover advantage. In 1988, Giordano took over the joint venture; by then, it had become one of the most well-known apparel brands in Taiwan.

According to data from Global Monitor, a majority of Taiwanese (69 per cent) either ‘like’ or ‘love’ shopping for clothes. The Taiwanese market continues to be strongly influenced by Japan and Hong Kong, although there are customisations to fit local tastes. In general, unconventional designs are not popular. A study conducted by Survey Research Taiwan suggests that the majority of consumers in Taiwan are students, young office workers or young couples. They are relatively wealthy, tend to be fashion sensitive, and are more receptive to new brands and products. Most wear causal clothes such as t-shirts, jeans, and shorts after work. They also prefer simple designs.

* This case study is a major revision of the Giordano in Taiwan case study, which was developed by Dr Alex S.L. Tsang and Professor Wai Sum Siu in 2004 as a basis for class discussion rather than to criticise any particular company’s managing effectiveness. It is based on information and quotes from a wide variety of published sources. The authors would like to thank Ms Canice Kwan for her assistance in revising this case.
Continuous brand portfolio enhancement

Giordano was listed on the Hong Kong stock exchange in 1991. Although Giordano had scaled back its wholesale operations, it still owned four manufacturing plants in China in the 1990s. These plants implemented a ‘just in time’ logistics system to streamline operating costs. Subsequently, Giordano expanded into other Asia Pacific countries including Singapore, the Philippines, Thailand, Malaysia, Mainland China, South Korea, and later the Middle East.

The Asian markets were dominated by a group of large casual apparel companies in the mid-1990s. International renowned brands such as Benetton, Esprit, and Gap, were more upmarket than Giordano; they offered trendy and stylish casual apparel. Theme specialised in upmarket women’s business wear and smart fashions. Baleno, Bossini, and Hang Ten provided low-priced alternatives.

The 1997 Asian financial crisis hampered the economic environment in many Asian countries. Purchasing power dwindled due to the depreciation of domestic currencies (with the exception of the Hong Kong dollar). The lacklustre retail market was also affected by consumer sentiment during the economic downturn.

Facing keen competition and an adverse economic environment, Giordano repositioned its image in 1998 and introduced a multibrand strategy that emphasised high quality and trendy styles. Although Giordano found itself in an austere situation, it was able to take advantage of diminished competition and the lower cost environment to upgrade its brand image, enhance its product quality, and restructure its product lines. Its Core Line was positioned to target the more upmarket segment; Giordano Junior was aligned closely with Core Line, targeting the children’s and teenage markets. Bluestar Exchange was later launched to compete in the low-price casual apparel market. Giordano also saw a rising percentage of working women in the region; this signified an increase in women’s purchasing power. To take advantage of this promising market and to compete against Theme, Giordano launched Giordano Ladies in 2000, which has since been expanded to 11 retail outlets in Taiwan. Giordano Ladies entered the market without any major setbacks and has performed satisfactorily whereas its main competitor, Theme, has experienced a decline in sales and market share. In 2001, the New Taiwanese dollar devalued by 5.7 per cent which brought about a decrease in sales revenue. However, this did not negatively impact Giordano’s overall performance in Taiwan, and the company still had a profitable year.

Giordano has become a dominant player in the South-East Asian apparel market. In 2001, Giordano entered the Japanese and German markets, and at the same time changed its corporate values to quality, knowledge, innovation, simplicity, and service in an attempt to strengthen its brand image. However, Giordano exited the German market a year later. This did not upset Giordano. In order to stay up to date in the ever-changing market environment of the apparel retail industry, Giordano has continuously rejuvenated its image and its brands. It observed a growing number of consumers who became more mature and sophisticated; consumers who were more concerned with their personal tastes and lifestyle choices, and preferred clothing that reflected their own identities and styles. Thus, Giordano upgraded its Core Line so that it complemented Bluestar Exchange in serving both the price-conscious and the middle-market segments.

In recent years, Giordano has been strategically disengaging from manufacturing to focus on retailing. Hong Kong remains a platform for sourcing suppliers from Mainland China, South Korea, and Singapore. It has concentrated its strengths to enrich its brand portfolio. Its existing brands have been repositioned complementing its Core line more effectively and expanding and updating its coverage of all middle markets. Giordano Concepts was introduced in 2006 to fulfil the needs of more sophisticated consumers who were pursuing aesthetics.

Despite its encouraging performance during introduction, Bluestar Exchange, under fierce competition and lacking a distinctive brand image, was unable to sustain satisfactory growth.
In light of this, in 2007, Giordano rebranded Bluestar Exchange as ‘BSX’ playing down its low-cost image and repositioning it as a youth-oriented urban brand. This turnaround strategy led to preliminary success. The brand’s fun and youthful image has been gaining consumer acceptance, enabling it to narrow its operating loss by approximately 45 per cent even as turnover dropped by 31.5 per cent in the first half of 2009.

Challenges amid the financial tsunami

In the second half of 2008, the financial tsunami swept the globe, creating unprecedented uncertainty in all segments of the economy. Facing the challenges ahead, Giordano employed all possible means to narrow its loss. It restructured its operations and streamlined its network of stores by slashing the number of outlets as well as trading up available and affordable stores into better locations. Along with more rigorous cash and inventory management, it hoped that its operational efficiency could be significantly enhanced. However, with a loss in the first half of 2009, it will take more time to determine whether the upgraded brand portfolio and restructuring strategy will allow Giordano to survive under market fluctuations.

QUESTIONS

1. If Giordano had not repositioned itself as a value for money casual wear retailer from a high-price wholesaler, do you think it would have been able to achieve such success?
2. Discuss the competitive advantage Giordano had over its competitors.
3. How do consumer attitudes and environmental factors affect Giordano’s global marketing strategy?

Sources:

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<th>TABLE 2.14</th>
<th>Timeline</th>
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<tr>
<td>1981</td>
<td>Established Giordano in Hong Kong</td>
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<td>1983</td>
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<td>1996</td>
<td>Launched Giordano Ladies and Giordano Junior</td>
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<td>Remarked Giordano brand image</td>
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<td>Launched Bluestar Exchange</td>
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<td>Launched Giordano Concepts</td>
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<td>2007</td>
<td>Rebranded Bluestar Exchange to BSX</td>
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NEW ZEALAND BUTTER BATTLES EUROPEAN BUREAUCRACY

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International agricultural trade ranks among the most regulated global commodity markets. Food safety, stability in storage, and protectionism of local farming restrict international trade potential for meat, dairy, wheat, fruit, wine, and most other agricultural products. One of the world’s most regulated and protected food markets is the European Union (EU). The EU offers local farmers several support mechanisms including tariffs and tariff-rate quotas on imports, export subsidies, and intervention buying of surpluses. Agricultural subsidies amounted to over 50 billion Euros in 2009, representing about 40 per cent of the EU’s overall annual budget. One result of these protective policies is that certain foodstuffs cost European consumers up to 80 per cent more than their world price.¹

Foreign producers attempting to compete with pricey but subsidised European farm goods face difficult barriers in gaining access and establishing themselves in the EU market, despite being vastly superior in terms of production efficiency and/or labour costs. In addition, EU phytosanitary, sanitary, and technical regulations require that imported products undergo lengthy administrative procedures to meet EU standards.

Fonterra, a New Zealand-based cooperative owned by dairy farmers, controls 40 per cent of all international dairy trade and accounts for roughly one-quarter of all New Zealand exports. With over 95 per cent of its production being exported, the company faces trade barriers every day, with occasional major upheavals including one in July 2006, when its long-standing EU preferential butter market access fell apart.

Fonterra joins together more than 10,500 New Zealand dairy farmers as shareholders and suppliers, processes 14.8 billion litres of milk annually, employs around 15,600 people worldwide and caters for consumers in 140 countries.\(^1\) Fonterra was created in the merger of the two largest New Zealand dairy cooperatives and the New Zealand Dairy Board in October 2001. Its brands, such as Anchor (milk), Anlene (bone nutrition dairy products for adults), Mainland (cheese products), Tip Top (ice cream), and Fresh and Fruity (yoghurt), are well known locally and internationally. Fonterra builds on the long-established international quality image of New Zealand farming, which can trace its origins to the mid 19th century when settlers from the British Isles began exporting surplus produce back to their erstwhile homeland. The first ship full of New Zealand cheese sailed from Banks Peninsula (Christchurch) for Sydney as early as 1846, while a ship named Dunedin delivered one of the world’s first cargoes of refrigerated meat and butter to London in 1882. Heritage linkages made the United Kingdom New Zealand’s dominant trade partner for nearly the next hundred years.

In the 1970s, when Great Britain joined the European Economic Community, which then transformed into the European Union, historical and trade ties helped New Zealand gain preferential access to the common European market. Specified amounts of butter, cheese, meat, and other produce could be exported each year from New Zealand to Europe at tariffs lower than those applicable to other non-EEC/EU members. The exporters pocketed extra profit from the resulting quota rents (the difference between the world price at which the produce left New Zealand and the price at which it could then be sold in the EU). In the early 2000s, New Zealand could market as much as 77 thousand tonnes of butter annually at the lower import tariff of 86.88 Euros/100 kg instead of the regular rate of 189.6 Euros/100 kg.\(^4\) Fonterra was the sole importer of New Zealand butter worth 128 million Euros to the European Union, with quota rents contributing as much as 35 million Euros a year to the company’s profits. It was believed that the rules governing New Zealand butter imports would remain about the same until 2015, with an interim review in 2008.

However, in mid-July 2006, the European Court of Justice ruled that the regulations for importing New Zealand butter were illegal and discriminated against firms outside of Britain, because all imports were handled by Fonterra’s British subsidiary. Complaints from Germany and Poland, originating principally from Egenberger, a German company that wanted to obtain licences and import some New Zealand butter in 2003, succeeded in court. The timing for this ruling couldn’t have been worse, coinciding with the British dairy group Dairy Crest’s launch of a campaign to promote its Country Life butter brand. Comparative advertisements showed Anchor butter imported to Britain on a rusty ship travelling 11,000 ‘food miles’ from New Zealand, while the locally produced butter avoided these negative environmental effects. Fonterra’s Anchor brand sold about 64 million butter packs in Great Britain annually through its licensee Arla Foods UK, a branch of a Danish–Swedish company.

The European Commission reacted promptly and suspended all New Zealand butter imports before it decided how to proceed further. However, the butter supply chain could not be halted quite that quickly; substantial amounts were already en route on ships or stored in warehouses awaiting formal entry to the European market. Fonterra issued a press release where it described the commission’s decision as extraordinary and ridiculous.\(^4\) New Zealand Trade Minister Phil Goff made bold media statements and immediately started to negotiate amendments with


Mariann Fischer Boel, the European Agriculture Commissioner. A few days later, EU officials lifted the ban and allowed 14 thousand tons of butter, which was already in Europe or on the way, to be sold. It was becoming clear that Fonterra would not be able to retain its exclusive market position. A provisional import regime was negotiated, with a final decision pending.

In September 2006, the European Commission agreed on a new system of butter imports from New Zealand. The EU requested at least six companies to be awarded tenders held in October or early November to import the remaining 14 thousand tons of butter quota. Fonterra lost its monopoly, although two Fonterra European subsidiaries applied for the tenders and together imported about 30 per cent of the outstanding 2006 quota. Since 2007, a new system has been set up under which traditional importers such as Fonterra can retain as much as 50 per cent market share. In addition, the new system has reduced the tariff for New Zealand butter imported under the quota to 70 Euros/100 kg instead of the previous 86.88 Euros/100 kg, providing potentially higher profits to importers and granting Fonterra a partial offset for its loss of market share.

For the financial year ended in July 2009, Fonterra announced a strong profit of more than NZ$603 million (compared with NZ$ 364 million for the year before). However, global economic conditions had shifted into recession mode late in 2008 and were again threatening Fonterra’s European operations. European milk producers enjoyed many profitable years with guaranteed high dairy prices and increasing demand until the end of 2008, when global economic contraction sent dairy demand down sharply and milk prices within the European Union fell by more than 30 per cent. European dairy farmers in several countries, including Germany and France (the world’s largest milk producing countries), marched in protest, blocking traffic and pouring excess milk on fields and in city centres repeatedly throughout 2009.

Assisting farmers during this unanticipated period of market turmoil, the European Union revived its export subsidies for butter, cheese and skimmed milk powder in January 2009, effectively threatening all dairy imports to the EU and reducing import butter prices by as much

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as 10 Euros/100 kg. The European Commission decided to buy from local farmers 30,000 tons of butter at a guaranteed price of 230 Euros/100 kg and 109,000 tons of skimmed-milk powder at 170 Euro/100 kg. According to EU officials, the subsidies were to remain until 2013 at least. The US followed a similar path and retaliated to the EU policy with the Dairy Export Incentive Program in May 2009, intended to subsidise US dairy exporters (including to the EU), in direct competition with Fonterra – whereas the New Zealand government persisted in its policy of providing zero subsidies to agriculture, particularly in terms of export price assistance.

QUESTIONS

1. How can agreements between governments create a business opportunity? How could Fonterra originally benefit from the preferential access to the common European market?

2. Why did Fonterra lose a significant part of the butter quota? Was the problem a political or a legal issue? Provide some examples of other political or legal factors affecting the conduct of international business.

3. What impact did the interim European Commission decision to award six tenders have on Fonterra? What is the long-term impact of the new system on Fonterra?

4. Discuss the consequences of the new trading system between the EU and New Zealand introduced in 2007 and the recessionary measures employed by the EU in 2009 on Fonterra’s European operations.

**RECOMMENDED READING**

Who could have imagined that a young boy, born in Hamamatsu, Shizuoka, Japan, son of a modest blacksmith, would later become the founder of one of the most innovative global automobile companies of the 20th century, Honda. Soichiro Honda’s spirit of adventure and determination led him from his earlier interest in making toys to becoming a leader in the automobile industry. Today, Honda employs 181,876 people globally. In 2009 alone, despite the automobile industry being hit by the global financial crisis the company earned 102,905.50 million yen in revenue.

One country which stands strong on Honda’s balance sheets and vision now is India, benefiting from its export ambitions along with rewarding research and development programs. Honda has an opportunity to be a major player in one of the world’s most promising markets.

The Indian market with its growth over the last few decades is an obvious choice of location for many companies and is especially attractive to automobile companies. A developing country, it still has a relatively low vehicle-penetration rate of only three cars and 50 two-wheelers per 1000 individuals compared to Australia’s 540 cars per 1000 individuals. This low penetration rate, coupled with growing GDP, indicates significant market potential, indeed it is expected that vehicle production will increase by 9 per cent annually to 2011. However, entering a foreign market is not just about estimating market potential; there are many hurdles which must be overcome before that potential can be realised, not the least of which is the political and legal situation.

The story of Honda’s growth in the Indian market is one of successfully entering a new market where many before had failed. In order to understand the company’s success in this market we have to go back to the 1980s and the initial decision to enter this market which clearly was far-sighted.

Given the political and legal environment in India at that time, Honda’s first hurdle was to choose a business partner. India’s Foreign Direct Investment (FDI) policies have been reviewed several times in the past two decades. However, until 1996 any foreign company was required to partner with an Indian company to be able to operate in India; the rules also stipulated that the partnership had to be 51 per cent Indian owned.

Honda chose Hero to form Hero Honda. Hero was a family-owned bicycle firm which had built a network of independent bicycle dealers and had established one of India’s leading bicycle brands. Honda had been waiting for years to sell motorcycles in India because the country’s motorcycle business is extremely profitable. Honda realised this potential by finding synergies between the two firms. They shared a similar operating discipline (i.e. ‘just in time’ (JIT) inventory practices) and Honda saw the potential of converting Hero’s large network of bicycle dealers to motorcycle dealers. Today, Hero Honda is the largest two-wheeler motor
vehicle manufacturer in the world and in India its annual sales volume is over three million motorcycles.

While Honda’s initial foray was aimed at the two-wheeler market, it was able to utilise the experience and market knowledge gained there to expand its operations in India. After tasting the success of Hero Honda in the motorcycle industry, Honda formed an alliance with Siel Limited, establishing another Honda giant, Honda Siel Cars India Ltd (HSCL) in 1995. In 2003, Honda also formed Honda R&D (India) (HRID) Pty Ltd in order to have R&D that works jointly with the people of India to produce motorcycles for the enrichment of the lifestyle of their Indian users. In 2006, they also commenced operations as Honda Motors India (HMI). HMI is a wholly owned subsidiary of Honda Motors Co Ltd and is part of an overall strategy to strengthen and integrate the operations of Honda companies in India with respect to service parts.

Honda’s expansion and success in India is testament to the fact that the company found its way through a maze of political and legal difficulties with clever partnerships and careful planning. By looking at the history of Honda in India, we see that despite ownership hurdles in the early years it successfully charted a path through the ever-changing world of foreign ownership laws.

We could conclude that Honda’s innovation is not just limited to its products, but also to its management practices. Honda’s smart ways to understand, partner, learn, adopt and spread, diversify, invest and grow reflect its true ability to succeed as a leader in any given political, legal and business environment.

QUESTIONS

1. How can companies learn from Honda’s investment in the Indian market?
2. Honda and Hero – what made them such a great partnership?
3. Imagine yourself as CEO of Honda in the Asia Pacific region. Would you choose India or China to establish a new manufacturing plant for producing cars and two-wheelers?

Sources:

RECOMMENDED READING

**QUESTIONS FOR DISCUSSION**

1. Comment on the assumption, ‘If people are serious about doing business with you, they will speak English’.

2. You are on your first business visit to one of the South-East Asian countries. You feel confident about your ability to speak the language (you studied the language in school and have taken a refresher course), and you decide to use it. During introductions, you want to break the ice by insisting that everyone call you by the first name. Speculate as to the reaction.

3. What can a company do to culture-sensitise its staff?

4. What can be learned about a culture from reading and attending to factual materials? Given the tremendous increase in international marketing activities, where will companies in a relatively early stage of the internationalisation process find the personnel to handle the new challenges?

5. Management in an Australian company trying to market tomato paste in the Middle East did not know that, translated into Arabic, tomato paste is ‘tomato glue’. How could they have known in time to avoid problems?

**CRITICAL ANALYSIS QUESTIONS**

1. Many companies such as Transperfect and Brookfield Global Relocation services are available to assist companies with the cultural challenge of internationalisation. Using their websites assess the role these companies play in helping the international marketer (www.transperfect.com and www.brookfieldgrs.com).

2. Compare and contrast the home pages of an international marketer for presentation and content. For example, go to the homepage of Coca-Cola and use the change country option in the top right corner to see homepages for other countries (www.coca-cola.com).

**LONELY PLANET GUIDES GLOBAL EXPLORERS**

Lonely Planet has been global since before it was even a company – in its audience, its scope, and its foundation. The now ubiquitous guidebook brand got its start in 1973 when Englishman Tony Wheeler and his Northern Irish wife, Maureen, holed up in Australia to write a pamphlet on their experiences of travelling in Asia. The couple had met in Britain, found that they shared a love of adventure, and married shortly after. For their honeymoon they chose to make a trip that no one at the time believed was possible – a journey from Britain across Europe and Asia via land all the way to Australia. They made it, but were stuck in Australia with 27 cents to their name. Tony made the best of the situation by writing the 94-page Across Asia on the Cheap, which sold 8500 copies. From this suitably adventurous
start, Lonely Planet ballooned into one of the powerhouses of the growing guidebook and phrasebook industry, with around 500 titles on 118 countries. Lonely Planet now represents one quarter of all English-language guidebooks sold in the world and has annual revenues in excess of US$75 million.

The company has offices in London and Oakland, with its headquarters in Melbourne. It employs 500 office staff and around 300 on-the-road contributors. Thanks to these contributors from dozens of different countries, the company has a global scope and a global perspective, which helps the company successfully market worldwide. The huge diversity of languages, cultures, and interests across their consumer base makes it difficult to market and develop a coherent brand image. To cope with these hurdles, Lonely Planet works on maintaining a balance between consistency in branding and customising marketing to suit specific target markets.

In 2007, the Wheelers finally relinquished control of the company when they sold it to BBC Worldwide, which is the commercial branch of the British Broadcasting Company. The addition of the BBC’s extensive network of distribution channels has helped Lonely Planet to market itself more successfully and to branch into complementary business areas such as Lonely Planet Images, Lonely Planet Television, Lonely Planet Foreign Rights Team, Lonely Planet Business Solutions unit, and Lonely Planet Foundation (which contributes 5 per cent of all profits to international charities and has established a carbon offset program for printing and the travels of all employees). From the start, one of the fundamental tenets of the Lonely Planet brand has been that travel can truly change the world and make it a better place. Through the Lonely Planet Foundation, the Wheelers have tried to make profound differences in the places they visit. Their far-reaching message is being heard loud and clear as evidenced by the 4.3 million unique visitors clicking on lonelyplanet.com each month.

This marketing strategy of selective customisation combined with relentless fact checking and updating, and a focus on hiring the best and most knowledgeable travel writers, has earned Lonely Planet a reputation for quality. Lonely Planet books are not only popular; they are considered by many to be the definitive guidebooks. In fact, Jay Garner, the first American administrator in Iraq, considers Lonely Planet such an authority on global travel that he used the book *Lonely Planet Iraq* to develop a list of historical sites worth saving. Another nod to the success of the brand is the fact that in Asia, imitation Lonely Planet guidebooks are now sold alongside imitation Gucci and Chanel handbags and Rolex watches.

No matter what criticisms people may have of Lonely Planet, this guidebook brand has been singularly responsible for the soaring popularity of adventure tourism worldwide. Because of Lonely Planet, there are surf camps in El Salvador, foreign-owned luxury resorts in Nicaragua, and remote villages in the heights of the Himalayas. Economies based on tourism are monuments to the success of Lonely Planet’s marketing strategy.

Lonely Planet continues its trek toward boundless success, due largely to the organisation’s clear vision of its target market. The Lonely Planet traveller is willing to embrace foreign food and culture, but still wants to do it comfortably and cheaply, if possible. The company reaches its customers through smart marketing strategies that balance a recognisable brand with customisation to accommodate local tastes. Lonely Planet has never forgotten that there really is no such thing as global – that the world consists of thousands of different local populations. And Lonely Planet, by knowing clearly who comprises its market and by using smart marketing strategies, has grown from a pamphlet written in a cheap hostel to a huge global brand loved by millions of travellers the world over.
CHAPTER 5 THE CULTURAL ENVIRONMENT

QUESTIONS

1 Why is Lonely Planet a global success?
2 How has Lonely Planet been able to provide and market guidebooks that are useful across languages and cultures?
3 How could Lonely Planet guidebooks help marketers to develop effective marketing strategies in targeted foreign markets?

Sources:

RECOMMENDED READING


ENDNOTES

IKEA, the world’s largest home furnishings retail chain, was founded in Sweden in 1943 as a mail-order company and opened its first showroom 10 years later. From its headquarters in Almhult, IKEA has since expanded to worldwide sales of US$27 billion from 253 outlets in 37 countries (see Table 6.3). In fact, the second store that IKEA built was in Oslo, Norway. Today, IKEA operates large warehouse showrooms in Sweden, Norway, Denmark, Holland, France, Belgium, Germany, Switzerland, Austria, Canada, the US, Saudi Arabia, and the United Kingdom. It has smaller stores in Kuwait, Australia, Hong Kong, Singapore, the Canary Islands, and Iceland. A store near Budapest, Hungary, opened in 1990, followed by outlets in Poland, the Czech Republic, and the United Arab Emirates in 1991 and Slovakia in 1992, followed by Taiwan in 1994, Finland and Malaysia in 1996, and mainland China in 1998. IKEA first appeared on the Internet in 1997 with the World Wide Living Room website. The first store in Russia opened in March of 2000 and in Greece and Israel in 2001. Turkey was added in 2005. Five stores have been opened in Japan after 2006. The IKEA Group’s new organisation has three regions: Europe, North America, and Asia and Australia.

The international expansion of IKEA has progressed in three phases, all of them continuing at the present time: Scandinavian expansion, begun in 1963; West European expansion, begun in 1973; and North American expansion, begun in 1976. Of the individual markets, Germany is the largest, accounting for 15 per cent, followed by the US at 10 per cent of company sales.

**Table 6.3** IKEA’s international expansion

<table>
<thead>
<tr>
<th>Catalogue Year</th>
<th>Outlets</th>
<th>Countries</th>
<th>Co-workers</th>
<th>Circulation</th>
<th>Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>1954</td>
<td>1</td>
<td>1</td>
<td>15</td>
<td>285000</td>
<td>3000000c</td>
</tr>
<tr>
<td>1964</td>
<td>2</td>
<td>2</td>
<td>250</td>
<td>1200000</td>
<td>7900000c</td>
</tr>
<tr>
<td>1974</td>
<td>10</td>
<td>5</td>
<td>1500</td>
<td>13000000</td>
<td>616000000c</td>
</tr>
<tr>
<td>1984</td>
<td>66</td>
<td>17</td>
<td>8300</td>
<td>45000000</td>
<td>6770000000c</td>
</tr>
<tr>
<td>1990</td>
<td>95</td>
<td>23</td>
<td>16850</td>
<td>n.a.</td>
<td>19400000000c</td>
</tr>
<tr>
<td>1995</td>
<td>131</td>
<td>27</td>
<td>30500</td>
<td>n.a.</td>
<td>40000000000c</td>
</tr>
<tr>
<td>2002</td>
<td>175</td>
<td>32</td>
<td>65000</td>
<td>1100000000b</td>
<td>11000000000d</td>
</tr>
<tr>
<td>2005</td>
<td>226</td>
<td>33</td>
<td>90000</td>
<td>1600000000b</td>
<td>15212000000d</td>
</tr>
<tr>
<td>2008</td>
<td>253</td>
<td>37</td>
<td>127800</td>
<td>2000000000b</td>
<td>21200000000d</td>
</tr>
</tbody>
</table>

*a Stores/countries being opened by 2008.
*b Estimate.
*c In Swedish crowns.
*d In Euro.

Source: IKEA U.S., Inc.
The phases of expansion are detectable in the worldwide sales shares depicted in Figure 6.3. ‘We want to bring the IKEA concept to as many people as possible’, IKEA officials have said. The company estimates that over 1.25 million people visit its showrooms daily. Similarly, IKEA websites attract 450 million visitors per year.

The IKEA concept

Ingvar Kamprad, the founder, formulated IKEA’s mission to ‘offer a wide variety of home furnishings of good design and function at prices so low that the majority of people can afford to buy them’. The principal target market of IKEA, which is similar across countries and regions in which IKEA has a presence, is composed of people who are young, highly educated, liberal in their cultural values, white-collar workers, and not especially concerned with status symbols.

IKEA follows a standardised product strategy with a universally accepted assortment around the world. Today, IKEA carries an assortment of thousands of different home furnishings that range from plants to pots, sofas to soup spoons, and wine glasses to wallpaper. The smaller items are carried to complement the bigger ones. IKEA has limited manufacturing of its own but designs all of its furniture. The network of subcontracted manufacturers numbers nearly 1300 in over 53 countries. The top five purchasing countries are China (21 per cent), Poland (17 per cent), Italy (8 per cent), Sweden (6 per cent), and Germany (6 per cent).

IKEA’s strategy is based on cost leadership secured by contract manufacturers, many of whom are in low labour-cost countries and close to raw materials, yet accessible to logistics links. Extreme care is taken to match manufacturers with products. Ski makers – experts in bent wood – have been contracted to make armchairs, and producers of supermarket carts have been contracted for durable sofas. High-volume production of standardised items allows for significant economies of scale. In exchange for long-term contracts, leased equipment, and technical support from IKEA, the suppliers manufacture exclusively at low prices for IKEA. IKEA’s designers work with the suppliers to build savings-generating features into the production and products from the outset. If sales continue at the forecasted rate, by 2010 IKEA will need to source twice as much material as today. Since Russia is a
major source of timber, IKEA aims to turn it into a major supplier of finished products in the future.

IKEA has acquired some of its own production capacity in the last few years, constituting 10 per cent of its total sales. While new facilities were opened in 2000 in Latvia, Poland, and Romania to bring the total number to 30, IKEA plans to have its own production not exceed 10 per cent, mainly to secure flexibility.

Manufacturers are responsible for shipping the components to large distribution centres, for example, to the central one in Almhult. These 12 distribution centres then supply the various stores, which are in effect mini-warehouses.

IKEA consumers have to become ‘prosumers’ – half-producers, half-consumers – because most products have to be assembled. The final distribution is the customer’s responsibility as well. Although IKEA expects its customers to be active participants in the buy–sell process, it is not rigid about it. There is a ‘moving boundary’ between what consumers do for themselves and what IKEA employees will do for them. Consumers save the most by driving to the warehouses themselves, putting the boxes on the trolley, loading them into their cars, driving home, and assembling the furniture. Yet IKEA can arrange to provide these services at an extra charge. For example, IKEA cooperates with car rental companies to offer vans and small trucks at reasonable rates for customers needing delivery service. Additional economies are reaped from the size of the IKEA outlets; the blue-and-yellow buildings average 300,000 square feet (28,000 square metres) in size. IKEA stores include baby-sitting areas and cafeterias and are therefore intended to provide the value-seeking, car-borne consumer with a complete shopping destination. IKEA managers state that their competitors are not other furniture outlets but all attractions vying for the consumers’ free time. By not selling through dealers, the company hears directly from its customers.

Management believes that its designer-to-user relationship affords an unusual degree of adaptive fit. IKEA has ‘forced both customers and suppliers to think about value in a new way in which customers are also suppliers (of time, labour information, and transportation), suppliers are also customers (of IKEA’s business and technical services), and IKEA itself is not so much a retailer as the central star in a constellation of services’. Figure 6.4 provides a presentation of IKEA’s value chain.

Although IKEA has concentrated on company-owned, larger-scale outlets, franchising has been used in areas in which the market is relatively small or where uncertainty may exist as

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**FIGURE 6.4** IKEA’s value chain

![Diagram of IKEA's value chain]

to the response to the IKEA concept. These markets include Hong Kong and the United Arab Emirates. IKEA uses mail order in Europe and Canada but has resisted expansion into the US, mainly because of capacity constraints.

IKEA offers prices that are 30 to 50 per cent lower than fully assembled competing products. This is a result of large-quantity purchasing, low-cost logistics, store location in suburban areas, and the do-it-yourself approach to marketing. IKEA’s prices do vary from market to market, largely because of fluctuations in exchange rates and differences in taxation regimes, but price positioning is kept as standardised as possible. IKEA’s operating margins of approximately 10 per cent are among the best in home furnishings (as compared to 5 per cent at US competitor Pier 1 Imports and 7.7 per cent at Target). This profit level has been maintained while the company has cut prices steadily. For example, the Klippan sofa’s price has decreased by 40 per cent since 1999.

IKEA’s promotion is centred on the catalogue. The IKEA catalogue is printed in 52 editions in 27 languages and has a worldwide circulation of 200 million copies. The catalogues are uniform in layout except for minor regional differences. The company’s advertising goal is to generate word-of-mouth publicity through innovative approaches. The IKEA concept is summarised in Table 6.4.

**IKEA in the competitive environment**

IKEA’s strategic positioning is unique. As Figure 6.5 illustrates, few furniture retailers anywhere have engaged in long-term planning or achieved scale economies in production. European furniture retailers, especially those in Sweden, Switzerland, Germany, and Austria, are much smaller than IKEA. Even when companies have joined forces as buying groups, their heterogeneous operations have made it difficult for them to achieve the same degree of coordination and concentration as IKEA. Because customers are usually content to wait for the delivery of furniture, retailers have not been forced to take purchasing risks.

<table>
<thead>
<tr>
<th>TABLE 6.4</th>
<th>The IKEA concept</th>
</tr>
</thead>
<tbody>
<tr>
<td>Target market:</td>
<td>‘Young people of all ages’</td>
</tr>
<tr>
<td>Product:</td>
<td>IKEA offers the same products, which are distinctively Swedish/Scandinavian in design, worldwide. The number of active articles is 9500. Each store carries a selection of these 9500, depending on outlet size. The core range is the same worldwide. Most items have to be assembled by the customer. The furniture design is modern and light.</td>
</tr>
<tr>
<td>Distribution:</td>
<td>IKEA has built its own distribution network. Outlets are outside the city limits of major metropolitan areas. Products are not delivered, but IKEA cooperates with car rental companies that offer small trucks. IKEA offers mail order in Europe and Canada.</td>
</tr>
<tr>
<td>Pricing:</td>
<td>The IKEA concept is based on low price. The firm tries to keep its price-image constant.</td>
</tr>
<tr>
<td>Promotion:</td>
<td>IKEA’s promotional efforts are mainly through its catalogues. IKEA has developed a prototype communications model that must be followed by all stores. Its advertising is attention-getting and provocative. Media choices vary by market.</td>
</tr>
</tbody>
</table>
The value-added dimension differentiates IKEA from its competition. IKEA offers limited customer assistance but creates opportunities for consumers to choose (e.g., through informational signage), transport, and assemble units of furniture. The best summary of the competitive situation was provided by a manager at another firm: ‘We can’t do what IKEA does, and IKEA doesn’t want to do what we do’.

**IKEA in the US**

After careful study and assessment of its Canadian experience, IKEA decided to enter the US market in 1985 by establishing outlets on the East Coast and, in 1990, one in Burbank, California. In 2008, a total of 37 stores (12 in the Northeast, eight in California, and others in Arizona, Florida, Georgia, Illinois, Michigan, Minnesota, Ohio, Oregon, Texas, Utah, and Washington State) generated sales of over US$4 billion. The stores employ 13,000 workers. The overwhelming level of success in 1987 led the company to invest in a warehousing facility near Philadelphia that receives goods from Sweden as well as directly from suppliers around the world. Plans call for five to six additional stores annually over the next 25 years, concentrating on the northeastern US and California. The goal is 50 US outlets by 2010. IKEA’s first US manufacturing operation opened in 2008 in Virginia.

Success today has not come without compromises. ‘If you are going to be the world’s best furnishing company, you have to show you can succeed in America, because there is so much to learn here’, said Goran Carstedt, head of North American operations. Whereas IKEA’s universal approach had worked well in Europe, the US market proved to be different. In some cases, European products conflicted with American tastes and preferences. For example,
IKEA did not sell matching bedroom suites that consumers wanted. Kitchen cupboards were too narrow for the large dinner plates needed for pizza. Some Americans were buying IKEA’s flower vases for glasses.

Adaptations were made. IKEA managers adjusted chest drawers to be an inch or two deeper because consumers wanted to store sweaters in them. Sales of chests increased immediately by 40 per cent. In all, IKEA has redesigned approximately a fifth of its product range in North America. Today, 45 per cent of the furniture in the stores in North America is produced locally, up from 15 per cent in the early 1990s. In addition to not having to pay expensive freight costs from Europe, this has also helped to cut down on running out of stock. And because Americans hate queuing, store layouts have been changed to accommodate new cash registers. IKEA offers a more generous return policy in North America than in Europe, as well as next-day delivery service.

In hindsight, IKEA executives are saying they ‘behaved like exporters, which meant not really being in the country . . . It took us time to learn this’. IKEA’s adaptation has not meant destroying its original formula. Their approach is still to market the streamlined and contemporary Scandinavian style to North America by carrying a universally accepted product range, but with a mind on product lines and features that appeal to local preferences. The North American experience has caused the company to start remixing its formula elsewhere as well. Indeed, now that Europeans are adopting some American furnishing concepts (such as sleeper sofas), IKEA is transferring some American concepts to other markets such as Europe.

QUESTIONS
1 What has allowed IKEA to be successful with a relatively standardised product and product line in a business with strong cultural influence? Did adaptations to this strategy in the North American market constitute a defeat to its approach?
2 Which features of the ‘young people of all ages’ are universal and can be exploited by a global/regional strategy?
3 Is IKEA destined to succeed everywhere it cares to establish itself?

Sources:
QUESTIONS FOR DISCUSSION

1 Discuss the difference between a proactive and a reactive firm, focusing your discussion on the international market.
2 Explain the benefits that international sales can have for domestic market activities.
3 Discuss the benefits and drawbacks of treating international market activities as a safety valve activity.
4 Comment on this statement: ‘Licensing is not really a form of international involvement because it requires no substantial additional effort on the part of the licensor’.
5 As a government official in the Asia Pacific region, looking to attract FDI would your preference be for the FDI of a resource seeker, efficiency seeker or market seeker?

CRITICAL ANALYSIS QUESTIONS

1 A small Australian company has developed some valuable new medical products using its unique biotechnology know-how and is now trying to decide how to best serve the Japanese market. Its choices are
   (i) Manufacture the product at home and let foreign distributors handle sales and marketing.
   (ii) Manufacture the products at home but set up a wholly owned subsidiary in Japan to handle sales and marketing.
   (iii) Enter a joint venture arrangement with a large Japanese pharmaceutical firm. The product would be manufactured in Europe by the 50/50 joint venture and marketed by the Japanese firm. The cost of investment in the overseas manufacturing facilities will be major for the Australian firm, but not totally outside its reach. If these are the firm’s only options, which one would you advise it to choose and why? Can you recommend any other course of action that it might follow?
2 What services does the Export Finance and Insurance Corporation (www.efic.gov.au) offer to benefit businesses trying to export? What benefits can be derived from these services?

SHOW ME THE MONEY: THE BIRTH OF SINGAPORE’S GAMING INDUSTRY

Dr John Fong, Macquarie University, Faculty of Business and Economics, Sydney, Australia

This case study looks at Foreign Market Entry and uses the hospitality and tourism sector as a backdrop by focusing on two casinos: Las Vegas Sands Inc. and Genting International, both of which have made huge investments in Singapore to the tune of more than SGD$5 billion each. The case study explores the motivations behind the investments and seeks to understand the various advantages and disadvantages of a greenfield investment.

Most companies undertake foreign market entry or greenfield investments in the hopes of reaping the benefits. The stakes are high, risk is definite and the returns never guaranteed. Hence, when two of the world’s largest gaming companies decided to operate casinos in
Singapore at a staggering investment amount of SGD$5 billion* each, this gamble certainly raised a few eyebrows.

In an attempt to ditch Singapore’s sterile and sanitised image, the 40-year-old country has reinvented itself by adding a bit of sizzle. It announced in 2005 that it will reverse its four-decade ban on casinos and have not one but two casinos. This is an about-turn from its long and utter anathema towards gaming. Through a lengthy process of planning, consultation and public debates on the pros and cons of legalising gambling and casinos, it emerged that these ‘Integrated Resorts’ or ‘IRs’ as they are more commonly known, will be an integral part of the city-state’s long-term strategy to grow the tourism and hospitality sectors by doubling visitor arrivals to 17 million and tripling annual tourism revenue to SGD$30 billion over the next 10 years.

Las Vegas Sands Inc. is an American company that was awarded Singapore’s first casino license in 2006 to build Marina Bay Sands (MBS). The corporation committed to invest SGD$3.85 billion into the project, not including the fixed SGD$1.2 billion cost of the 560,000 square metres (about 52 soccer fields) site (refer to www.marinabaysands.com). MBS will feature 110,000 square metres of convention and expo meeting space capable of accommodating over 45,000 people, a three-tower hotel with 2600 rooms, a 19,000 square metres arts and sciences museum, luxury retail space, two 2000-seat theatres, an extraordinary sky park, a ‘floating’ crystal pavilion and, of course, the jewel in the crown, a state-of-the-art, world-class casino. The overall cost of the MBS project will potentially make it the most expensive casino in the world.

*Note: SGD$5 billion was approximately US$3.5 billion at time of writing.
The second IR is located on the island of Sentosa, off the southern coast of Singapore. Resorts World at Sentosa (RWS) occupies 49 of the 463 hectares of Sentosa and it is built by Genting International, a Malaysian-based company. RWS has committed to invest more than SGD$5 billion into the project and it will own and operate all key attractions at the resort, which houses 1830 rooms in six hotels, a casino, Universal Studios Singapore®, The Marine Life Park (which will be the world’s largest marine park), a Maritime Experiential Museum and the Equarius Water Park (refer to www.rwsentosa.com). In comparison to MBS, which focused on developing a convention and expo business, RWS was designed with the family in mind thus the two casinos will hopefully work in tandem and attract different clienteles in the long run.

The bidding process that these two corporations went through before emerging as the winners was extremely competitive with numerous corporations and consortiums around the world placing their formal bids. An overall proposal detailing the concept and rationale had to be submitted to the tender evaluation committee that was chaired by the Deputy Prime Minister of Singapore. Proposals were evaluated based on tourism appeal, design, level of investment and strength of the bidding consortium and partners. The projection of revenue, job-creation estimates and even a plan to combat gambling addiction had to be included as no detail was considered too minor to leave out.

MBS was chosen over several others as the winner because its proposal included not just a casino but other facets of entertainment which will suit the profile and expectations of a potential business visitor to Singapore. The revenue estimates were bullish, forecasting revenues of about SGD$1 billion a year. Job creation estimates of 11000 with 75 per cent of them reserved for Singaporeans were a good selling point too. In his announcement of the result, Deputy Prime Minister, Professor S. Jayakumar, said: ‘(Las Vegas) Sands has submitted the best overall proposal that meets our economic tourism objective. In particular, the proposal will significantly strengthen Singapore’s position as a leading MICE (Meetings, Incentives, Conventions and Exhibitions) destination and the proposal also possesses unique design elements that will provide a memorable image for Marina Bay’.

RWS on the other hand edged out other rivals by maintaining consistency with the theme of a ‘family resort’, downplaying the casino and working with Universal Studios® to offer 18 attractions specifically created and redesigned for Singapore. The theme park occupies half of the site as the main attraction, with the casino being less visible. Genting International provided ‘the most compelling proposal overall that best meets our economic and tourism objectives’, said Professor Jayakumar. ‘In particular, the proposal reflects our vision for the Sentosa integrated resort as a large-scale family resort with its host of world-class family leisure activities and other strong offerings.’

The winning of the bids by Las Vegas Sands Inc. and Genting International only marks a beginning. Both corporations will now have to deliver what they have promised. As with any large-scale project, there have been instances in which these companies have faced problems: falling behind in building schedules, a shortage of labour and raw materials and rumours of financial insolvency, just to name a few. Both casinos are eager to open their doors in 2010. With the Singaporean government firmly behind these two projects, coupled with the country’s long-established reputation of efficiency, political stability and a population with a ‘can-do’ attitude, these projects certainly have the goodwill of the entire nation. The lower gaming tax rate of 15 per cent in comparison to neighbours Malaysia (28 per cent) and Macau (39 per cent) will prove to be advantageous but when the 10-year moratorium on further casino licenses lapses, both corporations may find more competitors entering the already crowded gaming industry in Singapore. Therefore it is imperative that
these companies focus on getting their returns soon or risk losing their bets on a SGD$5 billion investment.

**QUESTIONS**

1. What are the key motivations for international corporations such as Las Vegas Sands and Genting International to pursue foreign-market entry?
2. Discuss the major determinants that influenced Las Vegas Sands’ decision on whether or not to make the SGD$5 billion investment in Singapore.
3. The case indicated that Genting International will own and operate all the key attractions at Resort World at Sentosa. Identify the pros and cons associated with this form of foreign business ownership?

**RECOMMENDED READING**


**ENDNOTES**


CHAPTER 8 CHANNELS OF DISTRIBUTION AND LOGISTICS

QUESTIONS FOR DISCUSSION

1. If a small exporter lacks the resources for an on-site inspection, what measures would you propose for screening potential distributors?

2. One method of screening candidates is to ask distributors for a simple marketing plan. What items would you want included in this plan?

3. Is grey marketing a trademark issue, a pricing issue or a distribution issue? As an exporter to India how would you tackle the booming grey market in that country?

4. Contrast the use of ocean shipping to airfreight in an Australian or New Zealand context.

5. How can an international firm reduce its order cycle time?

6. How can an improved logistics infrastructure contribute to the economic development of China?

CRITICAL ANALYSIS QUESTIONS

1. What type of transportation information is available to exporters? Do an Internet search to find available and reliable information. Identify three sites which you think would provide the most information and explain why these sites are best.

2. Identify three companies (anywhere in the world) who have not employed the same distribution channel as their competitors. Why do you think these companies choose alternative means of reaching their customers and do you think their approach has been successful? Is it always best to go with normal practice in your industry?

3. Is grey marketing a trademark issue, a pricing issue or a distribution issue? As an exporter to India how would you tackle the booming grey market in that country?

4. Contrast the use of ocean shipping to airfreight in an Australian or New Zealand context.

5. How can an international firm reduce its order cycle time?

6. How can an improved logistics infrastructure contribute to the economic development of China?

LI & FUNG

Background

Southeast Asian firms are well known for the ability of their manufacturing divisions to compete in the US and Europe. Less famous in many cases are the region’s service providers, also looking to success in international markets. But Li & Fung, operating out of Hong Kong, is now ‘the world’s largest trade sourcing company’ (Chen 2009) and on track to achieve revenues of US$20 billion and profits of US$1 billion in 2010. Although a firm with a long history, started in 1906, Li & Fung is an interesting blend of modern technology and traditional relationships.

Li & Fung started as an old-line trading firm, making money as the intermediary between English-speaking buyers and Chinese-speaking sellers. Now, Li & Fung is a company with 65 offices in 38 countries and over 5000 employees. The firm can schedule production at over
7000 factories. The interesting part, however, is that the firm’s export sourcing group doesn’t own a single factory, machine, or piece of inventory. Li & Fung still specialises in establishing and managing relationships.

The basic business model is for Li & Fung to contract with a retailer (major clients include Walmart, Kohl’s, Abercrombie & Fitch, Talbot’s, American Eagle Outfitters, Marks & Spencer, and The Body Shop), fashion house (Liz Claiborne and Levi’s), or some other firm with a need for clothing or similar items (Disney, Coca Cola, Reebok, and Avon) to supply it with product (for example, 50000 sweatshirts). Li & Fung will then use its network of factories to optimise the sourcing of the order. One often-used example is of Li & Fung filling a garment order by purchasing yarn from Korea, having the yarn woven and dyed in Taiwan, purchasing zippers from a Japanese firm manufacturing in China, and actually making the piece in Thailand. Victor Fung characterises the firm’s employees as having a laptop in one hand and a machete in the other as they look deep into Asia to find the right locations for all these activities. Product quality, costs, available capacity, textile quota issues, other trade constraints, and numerous other variables can affect the choice of where to best conduct an operation. The value added by Li & Fung is found in its existing relationships and knowledge of where to do what and with whom. The firm’s employees have the deep knowledge necessary to optimise these complex supply chains for clients.

Strengths and weaknesses

Li & Fung’s chief core competency is in managing what it calls a dispersed production model. Its services not only allow a client to outsource a supply chain but to burst it apart into dispersed pieces. Each supplier, each activity necessary to construct the final product is optimised by country and firm. Li & Fung is the ‘orchestrator’ of the chain, another highly descriptive term that has been used to characterise the firm and what it does. This approach is hard to duplicate, as we’ll see, and has several concrete advantages.

Initially, there are cost savings. If a typical item costs $10 to source, $3 of that might be the production cost, the rest comes from getting it to the client. Li & Fung’s approach saves money at both ends. The firm can identify the factory or factories that can produce at lowest cost while still providing the necessary quality and reliability. It can also cut costs off the logistics end, sourcing from locations that minimise transfers, transportation, trade-related red tape, etc. Most importantly, it can balance the two, accepting a higher transportation cost, for example, if that solution results in a lower production or tariff cost. Savings of 20 to 30 per cent in overall sourcing costs are common.

Secondly, Li & Fung’s approach adds speed. Because the dispersed production model has flexibility, orders can be filled very quickly. The arrangement is particularly useful when Li & Fung knows something is coming, just not what. If a client wants 25000 garments but is unsure of what style will be ‘hot’ when it receives them, Li & Fung is able to reserve space at raw material and component suppliers and at final producers. Order specification can change up until the point each player actually starts work, allowing more responsiveness. And in a retail industry where four orders per year with eight- or nine-month lead times have been typical, rapid response and five-week lead times are becoming necessary for retailers to compete.

Li & Fung is also able to customise its services for individual clients. Indeed, in part, the firm is organised into divisions around its major clients, including extranets allowing immediate and deep information sharing. Consequently, personalised solutions are possible using all of Li & Fung’s network of sources. The company can also manage trade complications such as
quotas, shipping documents, tariffs, etc. To duplicate the expertise and connections, individual firms would have to spend exorbitant amounts of money on their supply chains, and still probably wouldn’t have as good a solution. The organisation also has controls in place. With most of its sourcing partners, Li & Fung looks to provide 30–70 per cent of the business. The firm’s management believes that this range makes suppliers responsive to its needs while still retaining enough flexibility and independence to react quickly to orders, when necessary. It also keeps its own people on the ground at supplier plants, relying on them to verify order progress rather than the word of the partner. In short, Li & Fung has built up expertise, relationships, and even the embedded IT/communications structure over decades, allowing it to offer a one-stop service that is extremely hard to duplicate.

In terms of the 7000 manufacturers for whom Li & Fung acts as a distribution partner, there are obvious attractions. These many small operations could probably never participate in transactions involving major corporations such as Wal-Mart and Disney or brands such as Juicy Couture, Hannah Montana, or Vera Wang. Having Li & Fung handle their relationships allows them to compete for such business and be tapped for contributions that put them in the best position to succeed, as they are typically chosen for reasons that have to do with their foremost competencies.

But there are a few holes in the armour. Sixty-two per cent of Li & Fung’s revenues come from the US (though down from 70 per cent just a few years ago). Management admits that the company is weaker than it could be in supplying Europe and Japan. Perhaps even more of a concern is the process of consolidation occurring in the US retail sector. The downturn of 2008–09 cost Li & Fung a number of clients, including Mervyns and KB Toys. And while Li & Fung has started selling to Wal-Mart and Target, the discounters taking ever bigger shares of the US market, the firm would like a bigger role. Both firms feature both national brands and store brands, but prefer to control the sourcing of the latter themselves, rather than outsourcing that responsibility. Indeed, Li & Fung has been characterised as the Wal-Mart of Asia in that it optimises and controls supply chains for others in much the way that Wal-Mart does for itself. If the consolidation trend continues and Li & Fung does not gain a bigger role with these retailers, it could lose market share as the giant discounters continue to put its existing clients out of business.

**QUESTIONS**

1. Consider Li & Fung’s weakness in the European market. In doing so, you might want to take a closer look at Spain’s Inditex, owner of retailer Zara. Inditex is well-known as a rapid-response retailer, changing over its fashion items very quickly, with very short lead times. But it does so by owning much of and keeping tight control over its supply chain, choosing to supply its stores from its own production facilities close to its headquarters in Spain. This ownership and tight control approach is, of course, directly opposed to Li & Fung’s non-ownership and loose control approach.

   a. Might differences in the business environment in Asia and Europe have something to do with these differences between Li & Fung and Inditex? What differences do you think might be important?
   
   b. What would you recommend for Li & Fung in terms of increasing its competitiveness in Europe?

2. Li & Fung has recently moved in a couple of new strategic directions by working for more licensed or sub-brands (LL Cool J at Sears, Metro7 at Wal-Mart), by working directly with
more brand owners rather than retailers (Liz Claiborne’s Lucky Jeans and Juicy Couture, Levi’s Signature and Red Tab), and by creating its own brands, often through acquisition.

**a** Given what you know of Li & Fung, is this a good move for the company? What is required of a firm as it alters a distribution channel or its place in a distribution channel? What is required of a firm in managing a consumer brand? Does Li & Fung have the necessary skills to succeed in these areas?

**b** What other actions might Li & Fung take in order to ensure it stays strong in the US market?

**3** In recent years, we have seen a global recession that severely lowered consumer spending in many of the markets served by Li & Fung. What are the implications of such changes in the economic environment of overseas markets?

**Sources:**

**RECOMMENDED READING**

**ENDNOTES**
DOC MARTENS MAKES STRIDES AROUND THE WORLD

Got a pair of Doc Martens in your closet? Maybe you’re wearing them now. Perhaps you’re wearing a pair of classic 1460 boots or a twin-strap sandal. Maybe your best friend is wearing a pair of guys’ Grip Trax boots or even some wingtips. You’re probably familiar with the distinctive yellow stitching, heel loop, and two-tone soles of Docs. The colour names are pretty amazing, too – Bark Grizzly, Tan Analine, Aztec Crazy, Black Greasy. Even if you can’t tell what colours these really are, you get curious. You scroll through the offerings online; you try on a pair in a shoe store. They look pretty clunky, but the Docs fit. When you walk around in them, your feet are really comfortable.

Doc Martens, or Docs or DMs, as they are often known, are officially named Dr. Martens, after their German inventor Dr Klaus Maertens. Maertens, a physician in the German army during the Second World War, injured his ankle on a ski trip to the Bavarian Alps in 1945. He’d been skiing in his uncomfortable army boots and as he was recovering from his ankle injury he spent a lot of time thinking about how to improve the boots. He came up with a design for a boot made of soft leather with air-padded soles.

Half a century later, consumers everywhere swear by their Docs. Now available in more than 250 styles of boots, sandals, and shoes, Doc Martens are worn by men, women, and children around the world. Madonna wears them and so did Pope John Paul II, who had his own exclusive line in pure white. Police officers and postal carriers, construction and factory workers, students and supermodels all wear them. Docs are sold in 78 countries, with two-thirds of them bought by American consumers. Madonna wears them and so did Pope John Paul II, who had his own exclusive line in pure white. Police officers and postal carriers, construction and factory workers, students and supermodels all wear them. Docs are sold in 78 countries, with two-thirds of them bought by American consumers. The firm has offices in such diverse places as Australia, Poland, the Philippines, Singapore, Turkey, the US, and the Ukraine. Even the United Arab Emirates boasts an office for Docs. People can buy them at retail stores or online from just about anywhere in the world. Unless you are stationed in Antarctica or climbing Mt Everest, you can probably get a pair of Docs.

Since 1960, Doc Martens have been manufactured by R. Griggs, one of the two largest shoemakers in the UK (the other one is C&J Clark, maker of the Clarks brand). Despite its size, however, Griggs faces serious competition from other designer shoe manufacturers, as well as sports shoemakers such as Nike and Reebok. Because of fierce competition and uncertain economic conditions that have affected sales in the shoe industry in general, Griggs made the painful decision to move all of its manufacturing to China several years ago. Many companies in Europe have experienced similar pressures. Chinese manufacturers can produce goods cheaper than European facilities. Since China is now considered a global trade power, having surpassed Taiwan and South Korea as the largest exporter of sport shoes to the US, footwear companies everywhere are feeling the pinch. But Griggs marketers believe that the move was critical to the survival of its Dr. Martens brand.

In addition, the marketers behind the Doc Martens brand have changed their entire global strategy, rescinding foreign licenses and focusing more on marketing the brand than on manufacturing the boots. Now, all marketing and sales efforts are overseen from the firm’s UK headquarters. When Docs were allowed to return to South Africa, for example, it was under a stricter agreement than the one that was previously in force. 'We are importing the Doc Martens – we don’t manufacture them,' explains Stewart Franks, international brand director for South Africa’s Jordan Footwear. ‘That will ensure that there is standard uniformity in the quality of the shoes themselves.'
Perhaps the most innovative effort by Docs’ marketers is the firm’s current website. The site not only provides all the usual information and access to styles, but it also introduces ‘VEER: A Series of Documentaries’, a program in conjunction with *Sports Illustrated* that is currently touring college campuses. Described as ‘six films about people taking a different direction’, the project focuses on six individuals who form the cutting edge of art, music, and other fields. Visitors to the site can click on each one of the films, download it, and watch it. They can follow Janette as she struggles to make it as a DJ or John, Adam, Mark, Whylee, or Ndidi as they make their way in various pursuits. The films have an edgy quality, as does the site itself, which features black-and-white photography. After 50 years, Doc Martens are cool again, on the feet of a new generation. You could say they are walking tall, around the world and back again.

**QUESTIONS**

1. Dr. Martens are now manufactured in China. Should the company also market its shoes directly to Chinese shoppers?
2. Marketers for Doc Martens are using Internet technology to reach consumers via the documentaries presented on the company’s website. Describe other creative ways they could use Internet technology to attract consumers.
3. Does the move to China affect Dr. Martens’ image and risk exposure?
4. Do you think it was a good idea for Dr. Martens to rescind foreign licences for its products at this time?

**Sources:**


**References**


**RECOMMENDED READING**


CHAPTER 10 PRODUCT AND BRAND MANAGEMENT IN INTERNATIONAL MARKETS

QUESTIONS FOR DISCUSSION

1. How can a company’s product line in Asia reflect the maxim ‘think globally, act locally’?
2. Will a globally oriented company have an advantage over a multi-domestic, or even a domestic, company in the next generation of new product ideas?
3. What factors should be considered by companies in the Asia Pacific region when deciding on the location of research and development facilities?
4. What factors make product testing more complicated in the international marketplace?
5. What are the benefits of a coordinated global product launch? What factors will have to be taken into consideration before the actual launch?
6. Sales of private brands are growing worldwide, but consumers’ perceptions still vary considerably about these brands. Why are we seeing such a growth in these brands worldwide? Take a trip to your local supermarket, identify some of the private brands on offer. How do you think they may appeal to consumers worldwide?

CRITICAL ANALYSIS QUESTIONS

1. Sales of private brands are growing worldwide, but consumers’ perceptions still vary considerably about these brands. Why are we seeing such a growth in these brands worldwide? Take a trip to your local supermarket, identify some of the private brands on offer. How do you think they may appeal to consumers worldwide?
2. How is Gillette using its website (www.gillette.com) to attract younger consumers to its product portfolio?

GUANGZHOU KINETEK JINGHE MACHINE COMPANY LIMITED*

Nicholas Grigoriou, Monash College

Introduction

Kinetek Jinghe (KJH) Machine Company was founded in 1988 and is located in Guangzhou, in south China’s Pearl River Delta region. In 2008, KJH recorded a sales turnover of US$15 million.¹ In the same year, KJH became a member of the Kinetek Group, a US company focusing on the design and manufacturing of drive and transmission technology.

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* The author would like to thank Mr Henry Ho and Mr Sunny Long from the Guangzhou Kinetek JingHe Machine Company Limited and Ms Jeannette Liu for their co-operation in the preparation of this case study.

¹ This amount has been disguised to protect the company’s confidentiality, and is used here for illustrative purposes only.
KJH manufactures high-quality machine parts, specifically high precision metal parts including shafts and gear boxes that are widely used in power tools, automotive and power transmissions.

Company ownership, vision and structure

KJH has over 600 employees across its manufacturing facilities in China. KJH operates in China under a joint venture agreement with the Kinetek Group (USA). The Kinetek Group offers a comprehensive solution in the field of transmissions and motion, including elevator, floor care and materials handling. Kinetek has a truly global presence with 28 facilities worldwide including 13 design centres. Kinetek has a manufacturing and/or design presence in the US, China, Mexico, Italy, Germany, and France.

Three of the Kinetek facilities are located in China. They are located in Wuxi in Jiangsu Province (operated by ZYK, see company listing below), Shunde in Guangdong Province (operated by KDS) and Guangzhou also in Guangdong Province (operated by KJH). The Wuxi and Shunde facilities are also design centres.

The Kinetek Group’s operating companies include:

• Advanced Motors and Drives
• Imperial Electric
• Scott DC Power Products
• Merkle-Korff Industries
• TEA International
• Motion Control Engineering
• KDS
• Euclid Universal
• Selin Sistemi
• ZKH
• Valmark Industries
• Kinetek Control
• Kinetek Jinhe Machinery Company.

He Mintao, President of KJH, has the following vision for the company: ‘To be the “hidden champion” in precision manufacturing in the entire world’. He offers the following explanation of ‘hidden champion’. He would like KJH to be internationally recognised as a small player in the field of manufacturing precision instruments that satisfies customer needs with every order, but not necessarily an internationally recognised company.

Business overview

The Kinetek Group competes in a number of diversified industrial markets. These are depicted in Figure 10.5 as a percentage of turnover. (Please note: not all markets are identified here.) KJH has a presence in each of these markets.
Product range and design

KJH manufactures a range of precision instruments for industrial application. The instruments may be used in power tools, grinding machines, washing machines, golf buggies, air compressors, lamps, air conditioners, and worm milling machines. Essentially, KJH assists its customers to design special machines or devices that improve productivity, reduce cost or increase quality.

KJH manufactures instruments to order. It receives the design from the customer and then manufactures the instruments to the customer’s specifications. In some cases, KJH is involved in the design of the instruments it manufactures, however, the design ownership remains with the customer.

KHS has ISO 9001 certification.

KJH does not own any products. It makes products for others to use in their own machines. KJH designs the process of manufacturing; that is, how to make the component part or instrument. The customer defines the materials and specifications, while KJH sources the material and builds to specification. Most of the raw materials used to build the component parts are sourced within mainland China.

From the receipt of an order (with design specifications) to completed manufacture, lead times can vary depending on:

- the order size
- the customer’s location
- the type of product
- previous experience in manufacturing the same or similar product.
Generally, for existing customers for whom a component part or instrument has been previously manufactured, the lead times are approximately one month. For designs which have not been previously made (either for an existing or new customer), customers can expect lead times exceeding one month. Approximate lead times are given to the customer prior to the acceptance of any order. Figures 10.6 and 10.7 depict typical component parts manufactured by KJH.

**Exporting, export markets and customer profile**

**Promotional activities**

Most of KJH’s customers are attracted through a presence at the annual Hannover Fair. The Hannover Fair is the world’s leading showcase for industrial technology. It is held in April of each year. The Hannover Fair now ranks as the leading international showplace for industrial technologies, materials and product ideas (www.hannovermesse.de/hmprofile). The Fair attracts approximately 6000 exhibitors and 200,000 visitors annually.

In addition to the Hannover Fair, KJH has a presence in several domestic trade fairs. These include China International Textile Printing Industrial Technology Expo, China International Industry Fair, and China International Fair of Catalysis Technology and Application. The domestic trade shows, exhibitions and fairs, the Hannover Fair, and existing clients make up the vast majority of KJH’s sales turnover. In addition, 50 per cent of sales turnover comes from exporting, the balance from domestic sales.

KJH’s export sales can be divided into direct and indirect exporting. Some of the products KJH makes are sold to overseas companies, mainly multinationals based in China who then take the responsibility of exporting the component part to their own home country or another of their own overseas markets. The rest of the export products are sold (exported) direct to a client overseas.
Customer profile

Since 2003, KJH has been a procurement target and business partner for many multinational industrial companies such as Schneider (France), Imperial (US), Valeo (Korea) and Siemens (Germany). However, the majority of KJH’s sales come from its four main multinational clients in the power tools industry. These are (in order of sales volume):

- Bosch (Germany)
- Makita (Japan)
- Hitachi (Japan)
- Black and Decker

So important are the top four clients to KJH that the company has established dedicated manufacturing lines (and processes) specifically for these clients. Hence, there is a dedicated Bosch manufacturing line, a Makita manufacturing line and so on.

Understanding the buying behaviour of their clients is crucial to KJH, given the specific needs the clients have, and KJH’s ability to manufacture products to individual customer specifications. For KJH to better understand clients’ needs, it must work closely with them to see how the products that KJH makes for clients work in the machines these products go into. In other words, KJH doesn’t just want to know about the spindles it produces for Bosch, it also wants to know more about the final product that Bosch produces of which the spindle is one component part. To that end, KJH doesn’t just accept product specifications from potential and actual clients then simply manufacture the product. It often is involved in the design process of a client’s product needs.

QUESTIONS

1. Given that KJH does not take ownership of the products it manufactures and exports, what effect does this have on the company’s ability to brand itself as a leading manufacturer of precision instruments and component parts?
2. Why do the products that KJH manufactures for clients lend themselves to exporting as a foreign-market entry strategy?
3. Explain how KJH can use product adaptation as their position strategy in the China market for industrial goods manufacturing.
4. Critically appraise KJH’s approach to securing new clients, clearly stating the advantages and disadvantages of the company’s current strategy.

RECOMMENDED READING

SOUND LOUNGE LOOKS TO THE FUTURE

Minas Poulos, Sydney Institute of TAFE – Ultimo

Sound Lounge is a branded chain of recorded-music stores. They provide a café environment and facilities for downloading music, as well as selling CDs. They sell ‘pop music’ aimed at young adults and teenagers. Their image is designed to appeal to this age segment. Sound Lounge management is aware of rapidly changing technology and faster adoption of new products, even by traditionally less innovative consumers. This means a potentially larger market as downloading music becomes more popular. Management has decided to try to expand their appeal to those interested in classical music. In other words, a potentially older age group. Such a segment is likely to expand in the long run. It’s thought that established players such as Sound Lounge are in a good position to take advantage of this.

‘Let’s get in early before the others’, said Bill Smith, the CEO.

‘Yes, however, let’s be careful not to risk losing the market we have. We could lose customers by changing our image too quickly’, replied Jane from marketing.

‘I hope its not going to cost too much’, added the company accountant.

Sound Lounge grew from a specialist CD store located in inner Sydney owned and run by the present CEO, Bill Smith. He began the new enterprise with two stores in Sydney, and one each in Melbourne and Adelaide. They now have stores in all of Australia’s capital cities and are continuing to experience growing popularity. It is envisaged that they will expand to New Zealand and several regional centres.

Although New Zealand is a small market by world standards, its population of 4.3 million puts it just behind Queensland, and ahead of smaller Australian stages. Its size – not too big and not too small – made it a good starting point for internationalising Sound Lounge. New Zealand is geographically close; the flying time to Auckland from Sydney is less than the flying time to Perth. More importantly, New Zealand was considered culturally close with a similar exposure to popular music as other English-speaking countries. Economies would be gained by applying an undifferentiated product and communications strategy. The population of New Zealand is relatively young. Around half of the population is under 35 with 87 per cent of the population residing in urban areas (CIA, 2008). This would suit Sound Lounge’s target market as well as corresponding to the characteristics of lead users. The generation corresponding to Australia’s baby boomers would most likely have had a similar experience to Australians and exposure to similar music, movies and so on.

Obviously, Sound Lounge would need permission from copyright holders, as would the final consumer. However, some files may be legitimate free downloads. Minor problems exist though regarding New Zealand copyright legislation. For example, laws regarding the making of ‘back up’ copies are ill-defined under the ‘fair use’ doctrine. However, the Copyright Act 1994 was amended in 2008 and allows for ‘format shifting’ – copying a file that is legitimately owned onto another media. For example, copying a CD to your portable music player. A further complication arises in cases of material sourced from overseas where both NZ and international
Copyright laws apply, as well as the World Trade Organization’s policy relating to intellectual property.

Smith was aware of the high level of cooperation in trade between the two countries. Australia is New Zealand’s top trade partner (Statistics New Zealand, 2009). Historical links between Australia and New Zealand stretch back to Gallipoli as reflected in the acronym ANZAC. These links include a series of preferred trade agreements culminating in the CER (Closer Economic Relations) or ANZCER, which came into force in 1983. The CER was based on a series of earlier arrangements, such as the 1966 New Zealand Australia Free Trade Agreement, resulting in the removal of tariffs on around 80 per cent of trade across the Tasman (T. Fischer & L. Smith, 1997). The CER resulted in the free trade of goods with careful attention to country of origin. Agreement on services was formalised in 1988, and is less clear cut due to considerations of regulations governing services in each country. Intellectual property rights were not covered formally by the CER, both countries relying on more general global arrangements through the World Trade Organization (T. Fischer & L. Smith, 1997).

Smith also was aware of the more recent agreement between Australia, New Zealand and the Association of Southeast Asian Nations (ASEAN), paving the way for further expansion into the emerging economies of South-East Asia. This agreement came into effect in January 2010, and is referred to as the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA). The region covered by this agreement has a population of 600 million with a gross GDP greater than $3 trillion. Austrade advises that these markets are far from saturated, making it attractive for further expansion (Austrade, 2010; Investor updates, 2009). This provides an opportunity for further expansion if investment into New Zealand is successful. Success at this level would open the door for even further enlargement, and may lead to ‘Sound Lounge’ becoming a global player.

QUESTIONS

1 Outline the steps that you would take as an entry strategy into the New Zealand market and further expansion into the Asia-Pacific region.

2 Direct investment or franchising would give a higher degree of control, although may be more expensive. Why would a high degree of control be important? Answer this question with reference to the extra three Ps associated with the service marketing mix: people, physical evidence and process.

3 Music downloading is now commonplace and can be delivered at ‘arms length’. This service can be categorised as ‘intangible actions’ and ‘mental stimulus processing’ (Lovelock, 2005). What is meant by this? How can you justify the establishment of a physical outlet in New Zealand? (Hint: consider ‘product augmentation’ and ‘non-core benefits’).

4 Review the following areas related to international trade problems discussed in Chapter 11. Discuss the marketing implications of these areas in relation to the advantages or disadvantages of exporting the service product to New Zealand:
   a regulation of services trade and barriers to entry
   b data collection
   c difficulties associated with market communications in service marketing compared to the marketing of goods.

Sources:

RECOMMENDED READING


Department of Foreign Affairs and Trade, India’s Services Sector – Unlocking Opportunity, Canberra: DFAT, 2007.

Department of Foreign Affairs and Trade, Trade in Services Australia, Canberra: DFAT, 2005–06.


ENDNOTES


2 Simon Crean, 2009.


5 Introduction to GATS, World Trade Organization, 29 March 2006.


QUESTIONS FOR DISCUSSION

1. What are the implications of price escalation for Australian and New Zealand exporters?
2. Argue for the use of more inclusive shipping terms from the marketing point of view.
3. Suggest different importer reactions to a price offer and how you, as an exporter, could respond to them.
4. The standard worldwide base price is most likely looked on by management as full-cost pricing, including an allowance for manufacturing overhead, general overhead and selling expenses. What factors are overlooked?
5. Which elements of pricing can be standardised?

CRITICAL ANALYSIS QUESTIONS

1. International countertrade can be used to evade international obligations and domestic laws and regulations. What are the characteristics of countertrade which enable it to be used in that way?
2. Iron ore and concentrates rank as Australia’s second highest exports, totalling A$29.9 billion in 2009. Using ABS trade data available from www.dfat.gov.au chart the trends in exports of this commodity over the last 10 years. Compare the trend with prices for iron ore in that time period and fluctuations in the Australian dollar. Are there other factors which account for the trend? What do you feel has had the greatest impact on exports of iron ore in the last 10 years?

DAMAR INTERNATIONAL

This case was prepared by Michael R. Czinkota and Laura M. Gould.

Damar International, a fledgling firm importing handicrafts of chiefly Indonesian origin, was established in Burke, Virginia, a suburb of Washington, DC. Organised as a general partnership, the firm is owned entirely by Dewi Soemantroro, its president, and Ronald I. Asche, its vice-president. Their part-time, unsalaried efforts and those of Soemantroro’s relatives in Indonesia constitute the entire labour base of the firm. Outside financing has been limited to borrowing from friends and relatives of the partners in Indonesia and the US.

Damar International estimates that its current annual sales revenues are between US$20,000 and US$30,000. Although the firm has yet to reach the break-even point, its sales revenues and customer base have expanded more rapidly than anticipated in Damar’s original business plan. The partners are generally satisfied with results to date and plan to continue to broaden their operations.

Damar International was established to capitalise on Soemantroro’s international experience and contacts. As the daughter of an Indonesian Foreign Service officer, Soemantroro spent most
of her youth and early adulthood in Western Europe and has for the past 18 years resided in the
US. Her immediate family, including her mother, now resides in Indonesia. In addition to English
and Malay, Soemantoro speaks French, German, and Italian. Although she has spent the past four
years working in information management in the Washington area, first for MCI and currently
for Records Management Inc., her interest in importing derives from the six years she spent as
a management consultant. In this capacity, she was frequently called on to advise clients about
importing clothing, furniture, and decorative items from Indonesia. At the urging of family and
friends, she decided to start her own business. While Soemantoro handles the purchasing and
administrative aspects of the business, Asche is responsible for marketing and sales.

Damar International currently imports clothing, high-quality brassware, batik accessories,
wood carvings, and furnishings from Indonesia. All of these items are handcrafted by village
artisans working in a cottage industry. Damar International estimates that 30 per cent of its
revenues from the sale of Indonesian imports are derived from clothing, 30 per cent from batik
accessories, and 30 per cent from wood carvings, with the remainder divided equally between
brassware and furnishings. In addition, Damar markets in the eastern US sell comparable
Thai and Philippine handcrafted items imported by a small California firm. This firm, in turn,
markets some of Damar’s Indonesian imports on the West Coast.

Most of Damar’s buyers are small shops and boutiques. Damar does not supply large
department stores or retail chain outlets. By participating in gift shows, trade fairs, and
handicraft exhibitions, the firm has expanded its customer base from the Washington area to
many locations in the eastern US.

In supplying small retail outlets with handcrafted Indonesian artefacts, Damar is pursuing
a niche strategy. Although numerous importers market similar mass-produced, manufactured
Indonesian items chiefly to department stores and chain retailers, Damar knows of no
competitors that supply handcrafted artefacts to boutiques. Small retailers find it difficult to
purchase in sufficient volume to order directly from large-scale importers of mass-produced
items. More importantly, it is difficult to organise Indonesian artisans to produce handcrafted
goods in sufficient quantity to supply the needs of large retailers.

Damar’s policy is to carry little if any inventory. Orders from buyers are transmitted by
Soemantoro to her family in Indonesia, who contract production to artisans in the rural villages
of Java and Bali. Within broad parameters, buyers can specify modifications of traditional
Indonesian wares. Frequently, Soemantoro cooperates with her mother in creating designs that
adapt traditional products to American tastes and to the specifications of US buyers. Soemantoro
is in contact with her family in Indonesia at least once a week by telex or phone to report new
orders and check on the progress of previous orders. In addition, Soemantoro makes an annual
visit to Indonesia to coordinate policy with her family and maintain contacts with artisans.

Damar also fills orders placed by Soemantoro’s family in Indonesia. The firm, in essence, acts
as both an importer and an exporter despite its extremely limited personnel base. In this, as well
as with its source of financing, Damar is highly atypical. The firm’s great strength, which allows
it to fill a virtually vacant market niche with extremely limited capital and labour resources, is
clearly the Soemantoro family’s nexus of personal connections. Without the use of middlemen,
this single bicultural family is capable of linking US retailers and Indonesian village artisans and
supplying products that, while unique, are specifically oriented to the US market.

Damar’s principal weakness is its financing structure. There are limits to the amount of
money that can be borrowed from family and friends for such an enterprise. Working capital is
necessary because the Indonesian artisans must be paid before full payment is received from
US buyers. Although a 10 per cent deposit is required from buyers when an order is placed, the
remaining 90 per cent is not due until 30 days from the date of shipment FOB Washington, DC.
Yet, the simplicity of Damar’s financing structure has advantages – to date, it has been able to
operate without letters of credit and their concomitant cost and paperwork burdens.

One major importing problem has been the paperwork and red tape involved in US customs
and quota regulations. Satisfying these regulations has occasionally delayed fulfilment of
orders. Furthermore, because the Indonesian trade office in the US is located in New York rather
than Washington, assistance from the Indonesian government in expediting such problems has
at times been difficult to obtain with Damar’s limited personnel. For example, an order was
once delayed in US customs because of confusion between the US Department of Commerce
and Indonesian export authorities concerning import stamping and labelling. Several weeks
were required to resolve the problem.

Although Damar received regulatory information directly from the US Department
of Commerce when it began importing, its routine contact with the government is minimal
because regulatory paperwork is contracted to customs brokers.

One of the most important lessons that the firm has learned is the critical role of participating
in gift shows, trade fairs, and craft exhibitions. Soemantoro believes that the firm’s greatest
mistake was not attending a trade show in New York. By connecting with potential buyers,
both through trade shows and ‘walk-in scouting’ of boutiques, Damar has benefited greatly
from helpful references from existing customers. Buyers have been particularly helpful in
identifying trade fairs that would be useful for Damar to attend. Here too, the importance of
Damar’s cultivation of personal contacts is apparent.

Similarly, personal contacts offer Damar the possibility of diversifying into new import lines.
Through a contact established by a friend in France, Soemantoro is currently planning to import
handmade French porcelain and silk blouses.

Damar is worried about sustained expansion of its Indonesian handicraft import business
because the firm does not currently have the resources to organise large-scale cottage-
industry production in Indonesia. Other major concerns are potential shipping delays and
exchange-rate fluctuations.

QUESTIONS
1 Evaluate alternative expansion strategies for Damar International in the US.
2 Discuss Damar’s expansion alternatives in Indonesia and France and their implications for
the US market.
3 How can Damar protect itself against exchange-rate fluctuations?
4 What are the likely effects of shipment delays on Damar? How can these effects be
overcome?

RECOMMENDED READING
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Practices in Australia’, Industrial Marketing
Alexandra Woznick & Edward G. Hinkelman, A Basic
Edward G. Hinkelman & Molly Thurmond, A Short
Course in International Payments, New York: World
John H. Jackson & Edwin A. Vermulst (eds),
Antidumping Law and Practice, Ann Arbor:
Jose Manuel Carrero Caldreon, Advance Pricing
Agreements: A Global Analysis, Cambridge, MA:
BlackBerry is a line of wireless devices developed by Canadian company Research in Motion (RIM), whose global headquarters are in Waterloo, Canada. The first BlackBerry device, introduced in 1999, was a two-way pager. In 2002, the more commonly known ‘smart phone’ BlackBerry was released, which supports email, mobile telephone, text messaging, web browsing, Internet faxing and other wireless information services. Globally, BlackBerry now holds a 20.8 per cent share of smart phone sales, just slightly behind its main competitor, Nokia Symbian.

In December 2004, RIM and Indosat, one of the largest Indonesian-based telecommunications companies, commercially launched BlackBerry in Indonesia. Since then, BlackBerry has achieved unprecedented growth in Indonesia. With a population of almost 250 million, Indonesia is a very lucrative market for mobile phones. Research suggests that in 2010, nearly half of the people in Indonesia will have mobile phones. In 2008, BlackBerry sales rose 550 per cent year-on-year, with 350,000 users, compared to 15,000 iPhone users across the region, and the number of BlackBerry users is predicted to continue growing. From January 2009 to June 2009, mobile ad requests on BlackBerry phones increased significantly (by 842 per cent, compared to an increase of 205 per cent on iPhone – see Figure 13.12). One of the reasons why BlackBerry has outsold iPhone is price competitiveness, with a BlackBerry priced at around US$500 compared to US$900 for an iPhone. Furthermore, as Indonesians are typically heavy users of text messaging, the keypad model in BlackBerry seems more popular than the touch screen of the iPhone.

Another factor that has contributed to the growth of BlackBerry’s sales is the lack of good Internet infrastructure in Indonesia, as Internet access is still expensive and unreliable. By using a BlackBerry, a consumer can surf the Internet for around $16 a month, compared to $100 a month for a regular home broadband connection. The rise of social networking sites (e.g., Facebook, Twitter) also plays a significant part in this growth. Finally, the prevalence of a word-of-mouth culture in Indonesia is another contributing factor in BlackBerry’s success – once your mate has it, you need to have it too. It puts pressure on people to own a BlackBerry.

Despite its remarkable growth in Indonesia, BlackBerry faced several barriers. First, in June 2009, the government froze the sale of new BlackBerry phones until the company established a service centre in Indonesia. Consumers were complaining that there was no local service centre available and phones had to be sent overseas for repairs. BlackBerry needed to react immediately and within two months it was able to open the first service centre in Indonesia. This should have been a blessing in disguise for BlackBerry in confronting the gray market. As with any expensive products in developing countries, gray markets are unstoppable. To avoid import duty, the BlackBerrys are smuggled in then sold to unauthorised dealers and resold to users at lower prices. It is estimated that 80 per cent of the phones sold in Indonesia are traded through the gray market. The price of a device sold in the gray market
is sometimes 50 per cent cheaper than the same model sold through a licensed operator. This situation would soon hamper BlackBerry sales in Indonesia. An expert suggests that unless BlackBerry comes out with new affordable products, the gray market distributors will continue to dominate the market. Currently, consumers can buy a BlackBerry handset through more than 50 distributors across the nation, but only four operators are licensed to provide BlackBerry services. These authorised providers are only servicing phones that are bought from an official distributor. The company hoped that this condition would drive consumers away from the gray market. However, this doesn’t seem to have had the intended effect on consumers. The gray market is still thriving in Indonesia and provides an ongoing challenge for BlackBerry.

The second barrier BlackBerry faces is stiff competition to its ability to provide users with unique access to the Internet. Local providers are now offering a service that gives any mobile phone users (other than BlackBerry and iPhone) unlimited Internet access to Facebook, Twitter and Yahoo mail with lower fees. This could drive consumers away from BlackBerry.

Finally, many BlackBerry users in Indonesia are often unaware of the wide array of the phone’s capabilities such as PIN and IMEI. BlackBerry devices are assigned a unique eight-digit number called a personal identification number (PIN), which BlackBerry uses to indentify the unique device on their network. The IMEI is the number that all GSM phones have to identify the device as a unique phone. These barriers may lead consumers to switch to another brand as they realise that BlackBerry is no different from other brands.
QUESTIONS

1. What are some of the local market characteristics that could affect the advertising and promotion of BlackBerry?
2. How should BlackBerry communicate the benefits of purchasing a phone through an authorised provider?
3. What is the best marketing communication strategy BlackBerry could use to maintain its lead in the smart phone markets?
4. What should BlackBerry do to educate consumers about the phone's unique capabilities?

Sources:

RECOMMENDED READINGS


ENDNOTES

CASE STUDY

COSTCO DOWN UNDER

Constanza Bianchi, Queensland University of Technology, Stella Minahan, Deakin University, Patricia Huddleston, Michigan State University

Should retailers standardise or adapt when entering a new country?

When a retailer enters a foreign market using a standardisation (global) strategy, they make few, if any, changes to their product assortment, service offering, store design and promotional effort. An adaptation (multinational) strategy uses the opposite approach. The retailer modifies their merchandise mix, services, store environment and promotions to fit the local culture. The standardised strategy assumes that consumers in other countries have similar tastes and preferences to the home country and will respond in a comparable way to promotional strategies. Advantages to this strategy include presentation of a clear and consistent brand image and utilisation of economies of scale, which increase profitability. An adaptation strategy creates advantages too. This strategy takes into consideration local tastes and preferences, which makes it more likely that the firm will capture market share. Typically, smaller format retailers (e.g., The Gap, Zara) use a standardised (global) strategy when entering foreign markets.¹

Costco operations

Costco is a membership warehouse club that opened in 1983. It is the fourth largest retailer in the US and eighth largest in the world with 527 outlets in seven countries. With 2008 sales revenues of US$70.9 billion and a profit margin of 1.8 per cent, its business proposition is to offer a limited assortment of about 4000 SKUs (stock keeping units) of national and private brand merchandise at lower prices than their competitors. By contrast, their competitors typically carry 45000–140000 SKUs. Of the 4000 SKUs, 1000 are changing constantly which creates a ‘treasure hunt’ mentality. In other words, customers shop at Costco expecting to find something new and exciting each time they shop, but the ‘treasures’ are different every time. Costco’s product assortment includes sundries, such as candy, alcoholic beverages (23 per cent), and food (21 per cent), hardlines such as major appliances (19 per cent), softlines such as apparel, jewellery (12 per cent), fresh food (12 per cent) and ancillary and other such as petrol stations, pharmacy (15 per cent).

Their warehouses are typically about 140000 square feet in size, with a ‘bare bones’ atmosphere. Costco’s floor plans are designed to efficiently use selling space, handle merchandise and control inventory. Merchandise is displayed on pallets and is sold in bulk form, rather than by single item. Entrances and exits are tightly controlled to reduce shrinkage (theft), and they are very successful at this, with only a 0.2 per cent shrinkage rate. To control

expenses, advertising and promotional activities are limited to promoting new warehouse openings, direct mail to prospective members and regular direct marketing programs to existing members.

To shop at Costco, you must be a member and pay an annual fee. There are three levels of membership in the US: Executive Members pay a $100 fee, receive a 2 per cent cash back on purchases (up to a total of $500), Business Members pay a $50 fee and receive up to six additional cards, and Goldstar Members pay $50 and receive one additional card per household. With 56 million members, Costco is extremely successful at membership retention; renewal rates are approximately 87 per cent. The membership fee allows Costco to charge lower prices; revenues from membership fees account for about 75 per cent of net profit.

Jim Sinegal, Costco’s President and CEO says: ‘Costco is able to offer lower prices and better values by eliminating virtually all the frills and costs historically associated with conventional wholesalers and retailers, including salespeople, fancy buildings, delivery, billing and accounts receivable. We run an extremely tight operation with extremely low overhead which enables us to pass along dramatic savings to our members’ (www.costco.com). Despite the bare-bones, no frills shopping environment, Costco has a reputation of attracting a high-end clientele who love to find the treasures on offer.

Costco’s entry into Australia

Costco has demonstrated a commitment to international expansion, and has operations in five countries outside the US: Canada, UK, Japan, Korea and Taiwan. International operations account for approximately 25 per cent of revenues and there is a plan in place to double the revenues generated from these operations in the next 10 to 15 years.

On 17 August 2009, with great fanfare, Costco opened its first store in Melbourne, Australia in the Docklands precinct. Since that time advertising and promotion has been very limited. Over the holiday season Costco has sponsored a number of charitable organisations by providing hampers as prizes and gifts.

The location

The Docklands is described as a ‘$12 billion dollar premium waterfront development’ and is located on Victoria Harbour. Docklands is accessible by car, train, ferry and tram and is very close to the central business district of Melbourne. There are 6500 residents and 19 000 workers in the Docklands’ precinct, with over 10 million visitors in 2009. The Docklands precinct is part of a massive waterfront regeneration project that is not finalised and is expected to attract a huge number of visitors in the next decade. The location is adjacent to the industrial west of Melbourne where there are many businesses that can visit Costco readily. For the individual customer, Costco is very much a destination store. Melbourne is a large (three million people), and at times congested, city with the majority of the population living in the east and southeastern suburbs. These residents do not regularly travel to the western suburbs. So, for them, visiting Costco is a special activity rather than a regular event.

According to Patrick Noone, Managing Director for Costco Australia, Costco chose to enter the Australian market because consumers here are similar demographically to US consumers. However, despite this similarity, some retail analysts think that Costco may have barriers to overcome in the Australian market. In addition to the location issues identified in the previous
section, there are several other concerns. Specifically, a membership fee structure is a new concept to the Australian market and it is uncertain how readily consumers will be prepared to 'pay to shop'. Further, Australian shopping habits may be different from the US. Rather than one weekly shopping trip, most Australians shop several times a week. It is also not clear whether buying in bulk will be embraced by consumers there. According to one retail analyst, 'Costco is going to have to change a shopping culture, not a shopping habit. Around 17 per cent of people now go to the supermarket once a week to do their shopping. So, that means about 83 per cent of Australians are driven by convenience'.

Costco’s entry and standardisation vs adaptation

The membership fee for Costco Australia is $55 for Business Members and $60 for Goldstar members, which is slightly higher than in the US. The product mix for the Australian stores is nearly identical to the US stores. Most brands featured will be similar to those offered in the US. Eventually, Costco may feature Australian products produced locally. One difference is that there won’t be any petrol stations because of the land required to install them.

QUESTIONS

1. Do you think that Costco has chosen the right market-entry strategy for Australia? Explain your answer.
2. What problems, if any, do you think Costco will face in their entry into the Australian market?
3. For problems identified in the previous question, how would you advise Costco management to solve them?

RECOMMENDED READING

include services. Then have a look at the statistics on ageing, and predictions. Here are a couple of sites to get you going:


Finally, bring the two sets of information together. Consider your country’s top five export markets and analyse what effect their ageing will have on your exports to them; again, don’t forget services.

3 Ageing is not the only aspect of demographic change which is important to international marketing. Consider, for instance, urbanisation. What is the effect of urbanisation on markets? What products does it promote growth for? How does it change people’s consumption patterns?

Let’s repeat question 2, but this time looking at urbanisation. List what you consider the most important products sensitive to urbanisation, not forgetting to include services. Then have a look at the statistics on urbanisation, and predictions. A useful website to get you started is:


Finally, bring the two sets of information together. Consider your country’s top five export markets and analyse what effect their urbanisation will have on your exports to them; again, don’t forget services.

**CASE STUDY**

**WOULD JOOJOO WANT AN IPAD?**

Mr Lee Wee Leong, Republic Polytechnic, Singapore & Dr John Fong, Macquarie University.

The unmitigated success of the Apple iPad, announced to much fanfare on 27 January 2010, presented a stark contrast to another product that was similarly heralded when first announced in July 2008 – the ‘JooJoo’ (or initially known as ‘CrunchPad’) by Fusion Garage, a Singaporean start-up. JooJoo is a Linux-based tablet computer designed for web surfing and the original price point was positioned at US$200.

While the iPad launch attracted worldwide media coverage, the JooJoo was similarly much anticipated, with Popular Mechanics magazine recognising it as one of ‘the top 10 most brilliant gadgets, tools and toys that you can buy in 2009’. That said, it was struggling from the outset with one snafu after another: a very public spat with key marketing partner TechCrunch, repeated delays in shipping dates and the ever increasing price point from US$200 to US$300.

and subsequently US$400; all contributed to a product that seemed doomed to failure against
the Cupertino marketing behemoth.

The result? A grand total of 90 (no typo here – NINETY) units of the JooJoo were pre-ordered
since orders started to be taken in March, as against a reported six-figure number for the iPad.

This episode was just the latest display of market domination by Apple Inc., sometimes
against strong incumbents. Examples abound: the iPod craze that swept the market in 2001 (as
of September 2009, Apple still enjoys almost three-quarters of the MP3 player market),
the iTunes store, iPhone craze, and now the iPad.

So what exactly is the secret sauce behind Apple's Midas touch in almost every one of its
product offering? Superior products? Not really – its latest offering, the iPad, was panned for
not being Flash-enabled, something a low-level netbook could manage. Could it be superior
distribution networks then? Try telling that to US iPhone fans restricted to the AT&T network
since the iPhone debuted in 2007. What about simply great pricing? Try this for size – figures
released in September 2009 revealed that Apple dominated with almost 90 per cent of US
retail sales of PCs above US$1000, and Steve Jobs has repeatedly junked the notion that Apple
needed to enter the red-hot sub-US$500 netbook market. It seems he knows which side the
bread is buttered for Apple Inc. Until, that is, he introduced the iPad as 'a magical device, at a
breakthrough price' (the iPad comes in very netbook-like dimensions, at a very netbook-like
starting price of US$499). And the rest, as they say, is history.

In a nutshell, Apple is clued into what consumers want, which is not difficult in itself. What
is truly amazing is how it is clued into what international consumers want. Its major products
(iPod, iPhone, iPad, iTunes store) have been well received internationally, with seemingly
homogenous offerings that are mass produced, and little customisation in terms of the hardware
out of the box. This flies in the face of conventional marketing wisdom, to offer customised
offerings of your product when targeting diverse markets – market leader Nokia had almost
20 smart phone models in 2009, versus two (only incrementally different models) from Apple.
Despite having more 'customised' models, Nokia's global market share actually declined vis-
à-vis Apple's, which gained significant ground despite its 'lean' product offerings.

With an almost primal reaction from consumers the world over whenever something new
ships out of Cupertino, it seems somebody at Apple Inc. has tapped the primordial soup of
consumer needs and wants, and attained the nirvana of international marketing. Sometimes it
pays to really understand what your customer wants, wherever he or she may be from.

QUESTIONS

1. Identify the controllable and uncontrollable elements that Apple has encountered when
entering international markets?
2. What are the major sources of risk facing Apple in the future?
3. What are the critical success factors of Apple's overall corporate strategy?

v www.businessweek.com/magazine/content/09_47/b415600345421.htm.
PART 1 THE INTERNATIONAL ENVIRONMENT

PART CASE STUDY

CAR FINANCING IN CHINA

This case was compiled by Ilkka A. Ronkainen using publicly available materials.

In China, car financing is a lot like the unification of North and South Korea. Just about everyone wants it to happen. But before that can happen, you first need to sweep away the landmines.

Mike Dunne, Automotive News

China and the WTO

After 15 years of negotiations, China formally became a member of the World Trade Organization (WTO) on 11 December 2001. During this time China had been gradually liberalising most of its trade and investment policies, making the official admission largely symbolic. More than anything, WTO membership signals China’s commitment to establish clear and enforceable non-discriminatory rules to conduct business in and without the country. For example, China’s trademark and copyright laws were brought in line with international standards in October 2001. In a similar fashion, many companies established their strategies in the 1990s based on the assumption that China would gain entry into the WTO and are now ready to execute those plans.

Given China’s unwillingness to show progress on political reform, the commitment to structural economic reforms has been particularly noteworthy. A constitutional amendment in 1999 legitimised private capital and granted private firms the same legal rights as state-owned enterprises, which laid a foundation for sustained, market-based growth. The private sector has grown to 40 per cent of GDP with over 30 per cent of the workforce. New jobs created in the private sector account for 38 per cent of all new formal employment, rising to 56 per cent in urban areas. The significance of this is more pronounced given layoffs in the state-owned enterprise sector.

China has been the fastest growing economy in the last 10 years, with annual real GDP growth averaging 10.8 per cent. While average national GDP per capita is US$2500, urban populations (such as those in Shanghai and Guangzhou) enjoy incomes of over US$9000 (a point at which consumption increases dramatically). This has meant that urban households can afford colour TVs (96 per cent have them), phones (76 per cent), and mobile phones (28 per cent). Similar wealth is gradually (albeit slowly) spreading to rural areas as well. Furthermore, purchasing on credit is gaining acceptance among young urban consumers.

China’s integration into the world economy has resulted in spectacular numbers both in trade and in investment. China’s foreign trade volume is expected to reach US$2.5 trillion in 2010, making it the second largest trade country in the world. In 2008, Sino-US trade volume reached US$302 billion.

While the lowering of trade barriers may permit more sales of foreign goods in China in the future, the rush by many companies from the Americas and Europe to manufacture in China for export may maintain China’s trade imbalance with these trading partners. With Asian
countries, however, China has been running a trade deficit since 2000 and will continue to be a source of demand as markets liberalise.

China received more foreign direct investment (FDI) in the 1990s than any country in the world except for the US. The inflows have amounted to over US$60 billion per year in the last five years, as shown in Figure 5.4. In 2007, inflows totalled US$74.8 billion. One of the most popular sectors of this investment has been automobile production (Table 5.5). Planned capacity had already exceeded 2.75 million units in 1999, when actual auto sales reached 565,000 units. However, China’s FDI has not only come at the expense of the rest of Asia. FDI inflows go to areas (within a region and a country) with comparative advantages – some to areas with abundant labour, some to areas with technological skills. With China leading in terms of inward investment flows, it may emerge as a hub for interregional demand for goods and services. Countries such as Japan will have to reorient themselves to focus on research and development, design, software, and high-precision manufactured goods.

Of economic significance is China’s effort to stabilise its currency in the last five years. While officially described as a managed float, the currency (yuan renminbi) is effectively pegged to a basket of currencies. This has resulted in China being immune to currency fluctuations that have wreaked havoc among emerging markets such as Mexico, Indonesia, Russia, Brazil, and Argentina. However, due to China’s increasing foreign exchange reserves, strong capital inflows, and current account surplus, as well as pressure from Asian countries (especially Japan), the currency has come under appreciation pressure. However, with trade liberalisation due to WTO membership, the higher value of the renminbi would aggravate the shock on domestic companies that compete with imports as well as on exporters who must compete in the global market (often on the basis of price). Chinese authorities have acknowledged the need for financial and currency liberalisation, but the damaging impact of rising currency in the short term will most likely keep the currency regime of pegging unchanged. This will naturally result in low currency risk for investors.

It has been widely assumed that large corporations in particular from around the world would benefit from the liberalisation measures undertaken and committed to by China (Table 5.6). For example, the Motion Picture Association estimated that lifting the barriers to film distribution would result in US$80 million in revenues, in addition to another US$120 million...
from sales and rentals of videos (which would no longer be plagued by rampant piracy). Some sectors, such as banking and insurance, are expected to make especially strong moves as markets open up. Foreign insurers can now operate beyond the two cities they were originally limited to and were allowed nationwide access in 2005. Similar liberalisation occurred in the retail sector, allowing companies such as Wal-Mart and Carrefour to develop their chains throughout the country. Majority ownership in Chinese companies is now possible, as is the choice of joint venture partners.

Because many imports now face no tariff barriers (and the remaining ones are to be eliminated by 2010) or non-tariff barriers (many quotas were eliminated on accession and the rest by 2005), and because trading and distribution rights are now provided, business questions focus on the timetable for change. Most business leaders have been quite realistic in not expecting substantive changes immediately, but have committed to long-term planning. In some sectors, competition has already heated up given consumer expectations of more and less expensive choices.

### TABLE 5.5 Top 20 foreign-invested enterprises in China by sales

<table>
<thead>
<tr>
<th>Rank</th>
<th>Foreign-Invested Enterprise</th>
<th>Sales Value (RMB billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Shanghai Volkswagen Co. Ltd.</td>
<td>56.7</td>
</tr>
<tr>
<td>2</td>
<td>Hongfujin Precision Industries (Shenzhen) Co. Ltd.</td>
<td>54.8</td>
</tr>
<tr>
<td>3</td>
<td>FAW-Volkswagen Automotive Co., Ltd.</td>
<td>49.0</td>
</tr>
<tr>
<td>4</td>
<td>Dafeng Computer (Shanghai) Co. Ltd.</td>
<td>47.8</td>
</tr>
<tr>
<td>5</td>
<td>Motorola (China) Electronics Co. Ltd.</td>
<td>38.6</td>
</tr>
<tr>
<td>6</td>
<td>Shanghai General Motors Co. Ltd.</td>
<td>34.7</td>
</tr>
<tr>
<td>7</td>
<td>Great Wall International Information Products (Shenzhen) Co., Ltd.</td>
<td>29.1</td>
</tr>
<tr>
<td>8</td>
<td>Shanghai Hewlett-Packard Co. Ltd.</td>
<td>28.7</td>
</tr>
<tr>
<td>9</td>
<td>CNOOC China Co. Ltd.</td>
<td>27.0</td>
</tr>
<tr>
<td>10</td>
<td>Dell (China) Co. Ltd.</td>
<td>25.2</td>
</tr>
<tr>
<td>11</td>
<td>EMB International Trading (Shanghai) Co., Ltd.</td>
<td>24.3</td>
</tr>
<tr>
<td>12</td>
<td>Huaneng Power International, Inc.</td>
<td>23.5</td>
</tr>
<tr>
<td>13</td>
<td>Guangzhou Honda Automobile Co., Ltd.</td>
<td>22.3</td>
</tr>
<tr>
<td>14</td>
<td>Lenovo (Beijing) Co., Ltd.</td>
<td>17.4</td>
</tr>
<tr>
<td>15</td>
<td>West Pacific Petrochemical Co., Ltd., Dalian</td>
<td>15.8</td>
</tr>
<tr>
<td>16</td>
<td>Maanshan Iron &amp; Steel Co., Ltd.</td>
<td>15.7</td>
</tr>
<tr>
<td>17</td>
<td>Ocean Crown Logistics (Shanghai) Co. Ltd.</td>
<td>15.1</td>
</tr>
<tr>
<td>18</td>
<td>Dong Feng Motor Co., Ltd.</td>
<td>13.3</td>
</tr>
<tr>
<td>19</td>
<td>Nokia (China) Investment Co. Ltd.</td>
<td>12.8</td>
</tr>
<tr>
<td>20</td>
<td>Seagate Technology</td>
<td></td>
</tr>
</tbody>
</table>

China’s transformation must be seen in the context of political change that is slow in countries such as China. Adverse effects of WTO membership are expected in terms of output and employment in sectors such as agriculture, financial services, and in general ‘less-competitive industries’ which are typically dominated by state-owned enterprises. For example, agricultural employment is forecast to fall by 11 million, while a substantial share of the 1.7 million workers in the four largest state-owned banks is in jeopardy. These factors have contributed to the government wanting to move with caution in allowing for change in the post-WTO environment. Furthermore, any dramatic change will probably face opposition from regional or local government officials who may see themselves as protectors of local interests.

There are already examples of the challenges to be faced as the WTO agreement is implemented at industrial and regional levels. Companies wanting to exploit the world’s largest mobile telecommunications market were promised a 49 per cent stake in domestic operators. But to obtain this, companies have found that waiting periods for official approval are between 270 to 310 days and that any local partner must put up 75 per cent of 1 billion renminbi before permission is granted. This will mean that the number of joint-venture partners is considerably smaller than expected and is possibly limited to state-owned entities. In a similar fashion, banks have found their aspirations dampened. Under the WTO agreement, foreign banks were able to offer renminbi banking services to Chinese corporate clients in 2004 and Chinese consumers starting in 2007. New regulations stipulate that foreign banks can only open one branch per year which, given that many are starting from scratch (only 158 branches of foreign banks existed in 2001) and given the tens of thousands of branches currently held by local entities (e.g., the Bank of China has 15,200), creates a daunting task. Foreign branches are required to have 1 billion renminbi in operating capital to conduct a full range of services, an amount considered discriminatory by those hoping to develop the sector. Exporters have found delays in certifications for their products to enter the China market, especially in areas that are sensitive, such as agriculture.

The expectation is that disputes and problems will emerge but will be solved over time. A parallel can be drawn between the US and its trading partners (such as the European Union and Canada), which continue to have disagreements within the WTO framework. The extent of the challenges will depend on China’s economic health and its ability to absorb the competitive shocks of WTO membership. Of concern for politicians will be the growing gap between the haves and the have-nots (especially the urban and the rural), and the costs of reforming the state sector causing social unrest and challenging the legitimacy of the political structures.

**TABLE 5.6**

<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>After membership, China opened new cities to foreign banks for local currency business.</td>
</tr>
<tr>
<td>2002</td>
<td>China eliminated restrictions on where foreign law firms may operate and the number of offices that can be opened.</td>
</tr>
<tr>
<td>2004</td>
<td>Foreign companies permitted to provide health and group insurance to Chinese.</td>
</tr>
<tr>
<td>2005</td>
<td>US eliminated Chinese textile quotas but adopted measures to prevent import surges.</td>
</tr>
<tr>
<td>2006</td>
<td>China reduced auto tariff’s to 25 per cent from current 80 per cent to 100 per cent.</td>
</tr>
<tr>
<td>2007</td>
<td>Foreign companies can hold 49 per cent in telecom services (voice) joint ventures.</td>
</tr>
</tbody>
</table>

The Western world has had a commercial fascination with China for the last 2000 years. The latest wave of interest started in 1979 with the official ‘opening’ of China, culminating in the official acceptance of China as the 143rd member of the WTO. Companies will continue to speculate on what sales might be achieved if only a fraction of the Chinese population would buy their products or services.

China’s economic stature will undoubtedly continue to grow. Increased investment will make China a production base for the world as global companies put their best practices to work in the largest emerging market in the world. For the US, this may mean losses of more than 600,000 jobs and a widening trade deficit with China which, in turn, may result in growing tensions between two world superpowers. At the corporate level, the huge investments have meant that while efforts in China may be profitable, they are not earning their cost of capital (which many multinationals calculate at 15 per cent).

Those companies interested in entering China primarily to exploit its domestic market may have more freedom to do so (such as having control of their own distribution or the ability to provide financing) but will continue to face the same challenges as before the WTO agreement. It is no longer enough to extend products and services (however famous their brand names may be) without adjusting to local market conditions. While foreign players are dominant in sectors such as beverages, film, and personal care, local companies still dominate in televisions, refrigerators, and washing machines despite the presence of multinational companies. Multinationals may bring their best practices to China, but local firms are quick to copy those practices and with their inherent advantages are able to compete effectively. While some doubt these Chinese companies will be competitive in global markets due to the lack of success factors such as global brands, some companies are already dominant in commodity-based sectors. Qingdao-based appliance maker Haier already has a 40 per cent market share in small refrigerators and is planning to expand its base in the US to, among other things, learn to be more effective at home. Car imports from China totalled US$8.5 billion in 2007.

Changes in the Chinese car market

A full-scale price war between car makers in China broke out in the first months of 2002. The phenomenon was a result of Chinese consumers’ delays in buying cars throughout 2001 as well as increased imports following China’s tariff cuts as part of the WTO agreement. The slashing of tariffs in the car sector was the biggest in any sector (from 80 per cent to 50 per cent and down to 25 per cent in 2006).

Consumers had been waiting for cheaper cars for years and this dream became a reality through the effects of the WTO agreement. For example, the Buick Sail’s pre-WTO price was US$13,855 but dropped to US$12,040, with further decreases possible as domestic makers lower their prices to maintain competitive advantage. The price war was ignited when Tianjin Automotive Industry Group slashed prices of all of its Xiali compact cars by 9000 yuan to 23,000 yuan (US$3367). More than 3600 are reported to have been sold during the first four days after the price cut. Chang’an Suzuki, a joint venture between Chongqing-based Chang’an Motor and Japan’s Suzuki Motors, cut its prices by 20 per cent. Analysts estimated that domestic car makers of vehicles priced at less than 150,000 yuan (US$21,963) would have to reduce prices, although car makers such as Shanghai General Motors and Shanghai Volkswagen would try to hold on and let dealers engage in price promotions. Even with the price decreases, comparable cars cost far less in Europe, a fact not lost on the Chinese consumer.
Car makers already producing in China are bracing for intense competition. As the Chinese government phases out regulations as to what models to produce, General Motors (GM), Volkswagen (VW), Ford, Honda, and Toyota all plan to launch models aimed at quality- and cost-conscious consumers. With the new market freedoms, car makers will have to focus on customer desires more than ever before.

Eventually, lower prices and wider choice should create a thriving auto industry. Car sales increased from 900,000 units in 2002 and hit the six-million unit mark by 2006 making China the second largest auto market after the US. Car sales have been slowing, however, due in part to the central government’s crackdown on easy auto credit to help cool an overheating Chinese economy.

Market structure for car financing in China

In 2005, most Chinese consumers paid cash for cars, with only 20 per cent financing their purchases. More than 20 per cent were financing their purchases before new government restrictions. In contrast, US auto purchasers finance between 65 to 93 per cent of all units purchased, depending on the make.

China is still a very small market for auto financing and for consumer credit in general. There are a number of reasons behind the small market size. Auto financing was not permitted by the government before 1998. From 1998 to 2004, only four state-owned and two private banks were authorised by the Chinese government to provide loans, with interest rates regulated by the government. These include Bank of China, China’s oldest bank, as well as China Construction Bank. These institutions had onerous requirements to gain approval for a loan, including: (1) collateral other than the car (home, deposits at the bank) valued at 100 to 120 per cent of the amount of the loan, (2) a guarantor, (3) proof of income and tax payments (not onerous in and of itself, but many Chinese underreport income and taxes to an extent that verifiable income is insufficient for loan repayment), (4) a marriage certificate, (5) an official estimate of the value of the vehicle, and (6) mandated vehicle purchase through an ‘approved’ retailer. This meant that nearly one-third of car buyers opted to quit the process rather than complete it. Even with the onerous requirements, results have not been promising – since 1998, default rates have ranged from 10 to 30 per cent. Reasons include bad credit checks and disgruntled buyers who refuse to pay off loans after declines in prices for models they had purchased.

In late 2003, the Chinese government granted permission to non-financial and foreign firms to start providing auto-financing operations. The central government saw personal credit as a way to stimulate consumer spending and take some of the burden off the government’s traditional means of stimulating the economy through expensive infrastructure projects. By the end of 2005, China had six auto financing firms, some of which are wholly owned (e.g., Ford, Toyota, and Volkswagen), some joint ventures (e.g., GM with Shanghai Automotive Industry Group, and PSA with the Bank of China). DaimlerChrysler announced its financing operations in late 2005 to boost sales of its Mercedes E-class and Chrysler 300C produced in China.

The infrastructure is not yet fully developed for car financing. Most vehicle regulatory agencies do not allow liens or security interests in autos that are registered for personal use. Laws and regulations are not consistently in place to protect insurance companies when investing in loans or underwriting loan risks. Repossession procedures are not generally codified.
rules exist, the Public Security Bureau must effect repossession and will decide resale value on repossessed vehicles.

Regional differences are significant. While the industry is still in its infancy, Shanghai is the most advanced both in terms of amounts of consumer credit and the systems in place. For example, GM’s venture limited its operations initially to Shanghai, where a credit bureau keeps computer records that shortened credit checks to a few hours. The urban populations of the east will play a major role in the change process because of their increasing wealth and non-traditional attitudes toward buying on credit. Foreign interest in the market for car financing is predicated on the long-term potential of the market, influenced by China’s membership in the WTO. While government rules made market entry possible in theory already prior to January 2002, setting up operations is still challenging.

Auto financing companies are only allowed to have one office, which may present logistics challenges. Government rules mandate loans denominated in renminbi (the local currency, ‘people’s money’). Furthermore, foreign entities can count on local competition from existing and new government-owned institutions as well as private entities. China’s banks have more than 10 trillion yuan (US$1.2 trillion) in deposits and are eager to put it into use. Yafei Auto Chain General Store – with default rates at less than 2 per cent and 90 per cent regional market share – is a chain of auto dealerships that gets preferential treatment from the Beijing government and enjoys exclusive underwriting support from the China People’s Life Insurance Company.

The WTO agreement caused a drop in the tariffs of imported cars from a range of 70 to 80 per cent of the list price to 50 to 60 per cent. By 2006, duties sank another 25 per cent – enough to put cars within the reach of China’s upper middle class.

Expected market changes in car financing in China

All indications are that auto financing in China in the 21st century will be a lucrative business both at the macro level and the micro level. Only a very small share of China’s total consumption is made through consumer credit. In an effort to fuel economic growth, Chinese officials have stated that they are working toward percentages of consumption from credit more in line with the Western world. Most of the Western economies average between 20 and 25 per cent of consumption through consumer credit.

Urban incomes increased 75 per cent between 1997 and 2008, to an annual level of US$5000. GDP per capita in Beijing, Guangzhou, and Shanghai exceeds US$9000. Rural incomes, which are a third of the urban incomes, in comparison, increased only modestly in the same time frame. Most experts agree that automotive purchases generally and automotive finance specifically expand rapidly after crossing the US$3000 per capita GDP threshold.

Consensus estimates for the car financing market – both for personal and business use – are 20 per cent of the expected unit sales. This number is expected to increase by 40 to 60 per cent over a five-year period, resulting in a US$3.25 billion market.

All indications are that Chinese consumers’ aversion to debt is waning – at least in the cities of the south and east. Estimates for consumer lending in general can be extrapolated from analogous evidence. In 1995, 15,000 individuals in Shanghai borrowed 570 million yuan worth of mortgages. By 2004, 76 per cent of new bank loans went to property, of which 72.8 billion yuan was for personal housing mortgages.
The industry is dependent on accurate and timely information as well as a transparent system of operation. Shanghai Credit Information Services has emerged as a reliable source of credit information for more than five million Chinese. Rules for recording liens and repossession and remarketing of vehicles are now in place in Shanghai and Beijing (albeit in their infancy and open to local interpretation).

**Options for market entry and development**

There are four ways that auto finance companies can set up in China:

1. Automakers can launch an auto-financing services subsidiary.
2. Banks (Chinese) can set up special auto financing institutions.
3. Non-banking financial institutions owned by enterprise groups can form an auto financing company.
4. Existing lending consortia can provide financing services for auto companies’ sales divisions.

**GMAC’s competitive position**

GMAC and the other financing arms of car makers were at an obvious disadvantage in relation to home-country institutions because the market was reserved for Chinese institutions until January 2002. GMAC previously acted in an advisory capacity to GM’s Shanghai JV manufacturing facility, which, in turn, has set up relationships with official government lending institutions (such as China Construction Bank and the Bank of Shanghai).

GMAC’s competitive position vis-à-vis the other foreign companies appears to be solid for a number of reasons:

- GM is one of the largest corporate FDI contributors to China in the world and has a substantial partnership with the government.
- GMAC has numerous manufacturing partners to leverage – SGM, Jinbei GM (which produces the Chevrolet S-10 pickup and Blazer SUV), and Wuling (GM has an equity stake in the largest producer of mini-cars for the Chinese market). These partners deliver the second highest number of FDI autos in the market – just behind VW and far ahead of Ford Motor Credit and Peugeot.
- GMAC has numerous GM-network partners to leverage (Isuzu, Suzuki, Fiat, Fuji Heavy Industries).

GMAC’s expertise in auto lending generally and in the following ancillary areas critical to doing business in China should allow for the business to get up and running. It has extensive experience in auto lending in developing markets without efficient infrastructure; for example, it has experience in India, which has no credit bureaus and state involvement in repossession and remarketing. Partnering with other private and quasi state-run institutions such as Fannie Mae, GMAC subsidiaries (GMAC Mortgage, GMAC Commercial Mortgage and Residential Funding Corporation) have developed expertise in profitable loan securitisation, profitable (mortgage) loan servicing, and profitable receivables (purchase and sale), giving them the necessary skills to work together with third parties and governmental units. Finally, market presence in many other countries in the Asia Pacific region gives GMAC the human resources
necessary for China expansion. These offices are staffed with a broad array of third-country expatriates from China and other cultures who have better insight into the Chinese market than do GMAC’s US-based staff.

Despite the overwhelming external and internal opportunities, challenges exist as well. Ford’s and GM’s credit ratings were downgraded by Moody’s and Standard & Poor’s in 2001, forcing the automakers out of commercial paper and into other, more expensive forms of funding. Their no- or low-interest loans and cheap leases intended to pump up sales since then have threatened the financial health of the carmakers’ credit arms. For example, GMAC North America’s huge success with 0 per cent financing during 2001 Q4’s ‘Keep America Rolling’ and the 2005 ‘Employee Discount for Everyone’ campaigns ate up significant resources. Effectively, GMAC may be out of cash for big market-entry investments and equity investment from the parent company, when GM as a whole faces an unfunded pension liability and reduced cash flow that is critical for reinvestment into future product programs. Ford Motor Credit is facing even bigger problems given its more aggressive lending practices in the recent past.

Implications for Global Operations

A carmaker’s captive financing arm exists for two reasons: to assist in delivering additional cars and trucks to consumers, and to provide a superior return on investment and cash flow to its sole stockholder. While still extremely risky and lacking in short-term profit, the China market is still valued by carmakers because of its market potential for sales and because of the potential it displays for their financing arms in terms of auto finance and mortgages. The question is how to deliver on the promise and the mandate. No company can adopt a wait-and-see attitude any longer.

QUESTIONS

1. Suggest reasons for a company to enter the Chinese market for auto financing.
2. What is the most prudent mode of entry and market development for a car-financing arm of an auto maker?
3. Where should a company make its moves and with what type of products?
4. What should a company do to influence the positive change in China in its favour?

Sources:
HONEYLAND MANUKA FROM NEW ZEALAND: AN INTERNATIONAL NEW VENTURE

Sabina Jaeger, AUT University

New Zealand’s economic environment

New Zealand is a small island nation in the South Pacific, southeast of Australia. Its landmass of 268 million square kilometres compares with the size of Oregon. With a slightly higher population than Oregon – just over four million (4.15 million in 2006) – New Zealand’s domestic market is small. GDP per capita is about US$26 400 per year (2007), slightly more than half of that of the US with an annual economic growth rate of 3 per cent in 2007. Virtually free access of overseas competitors to New Zealand’s home market forces its numerous small and medium enterprises (SMEs) to seek and develop international markets. Australia is its most important trading partner, accounting for 22 per cent of New Zealand’s exports, followed by the US (11.5 per cent) and Japan (9.2 per cent). New Zealand relies for its economic viability mainly on the success of its SMEs, since these constitute up to 90.7 per cent of all firms and provide about 50 per cent of New Zealanders with work and income (Ministry of Economic Development, 2004). A 2002 report initiated by the New Zealand Treasury identified the two major constraints for economic growth in New Zealand: the distant geographic location from international markets and the difficulty of raising sufficient capital.

The making of Honeyland and its products

Honeyland is an export business specialising in native New Zealand honeys. It was established in Palmerston North, a small town in the Manawatu region in July 1986. The business started exporting right from its beginnings and has, in effect, never operated in the domestic New Zealand market, focusing on one international market only. The company exclusively supplies the lucrative Japanese market. Even by New Zealand’s standards the company is very small. It is literally a one-(wo)man enterprise. That does not limit its success, though. From modest beginnings the enterprise has grown into a reasonable business that turns over more than NZ$500 000 annually (about US$275 000) operating from a small office in the family home.

New Zealand honey is positioned as a health promoting product, using New Zealand’s clean and green image. The company strategically targets quality conscious customers, especially those who have been to New Zealand for a holiday and know its spectacular landscape. New Zealand has a reputation for its beautiful and rather unspoilt natural environment, including its exotic plants. The majority of New Zealand’s plants are indigenous, found growing naturally only in that part of the world. In particular, New Zealand has many flowering trees, such as the Pohutukawa, Kamahi, Manuka, Tawari, and Rewarewa. Native bush and forest honey, which is produced in this environment, has a reputation for being healthy and beneficial to human well-being. The honey that bees collect from the flowers of the New Zealand tea or Manuka tree is said to have a great taste and very beneficial healing properties.
The owner of Honeyland, Sue, a trained school teacher, became aware of the good reputation and health benefits of New Zealand honey early on. In the 1970s, she raised a young family while keeping bees in a few beehives in the back of her garden around the family home. Sue has always kept a friendly open home and entertained the many international friends of her teenage children and business partners of her husband. ‘When I look back, our home was always an open home, long before other people actually were in the international world’, she said. Many of these visitors were Japanese because Palmerston North has strong links to Japan through its International Pacific College and Massey University. Many young Japanese complete their high school and university education there. Attracted to the cultivated and polite Japanese, Sue chose her preferred market destination long before she started the company. Her interest in Japan and Japanese culture grew during visits when she accompanied her husband, a successful wool merchant, on his business trips. Soon Sue started looking for a business idea that would enable her to visit Japan on a regular basis without having to depend on her husband. The hobby of producing honey grew into a business idea.

Export market Japan
The contacts with Japanese friends exposed her to their culture, way of life, and work. While on her trips in Japan she gradually built up an extensive network of friends and business partners. ‘We had a real network of friends and acquaintances in Japan. I think that probably has been one of the great advantages, because some of them are students, some of them are old, they range from 15-years-old to 90-years-old. They are all around Japan and they enjoy different sorts of lifestyles. So that is a wonderful way of getting a feel for what a country is like’, she said. Additionally, Sue undertook further preparation before starting up the enterprise. She began to learn the Japanese language because she understood the importance of language skills when doing business in Japan. It did not take long before she became convinced that New Zealand speciality honeys would be a suitable export product. Sue applied great care to understand the specifics of the Japanese market. One major hurdle she had to overcome was gaining access to Japanese distributors and retail businesses. She said that in the 1980s this was not easy for a businesswoman. Speaking the language, and with some support from her friends, she eventually overcame this difficulty. Sue modifies and markets her products to special Japanese requirements.

Marketing strategy
Honeyland’s market can be broken up into three different segments. One-third of the business comes from sales through a supermarket chain that operates a ‘fixed price’ strategy. Quality branded products are sold at a discount: ‘It is a discount-type store. Unbelievable, their whole layout is similar to the one of the ‘two dollar’ shop. It is primarily liquor … So they use good brands to bring people in and sell them cheaply’. Another third of her business involves supplying a Japanese honey company with New Zealand comb honey. This company brands the product under its own name. The third and most important segment of Honeyland’s business derives from sales to a firm that is associated with Japan Travel Business (JTB).

It targets the top range of the gift product industry with high returns selling gifts to returning travellers, various honeys in small gift packaging. ‘The third part of my market is very much a niche market, a very top-shelf specialty honey … The niche market is going through my representative
in Japan. Japanese tourists spend their short holidays in New Zealand’s surroundings. They experience the great outdoors, enjoying the scenery doing bush walks and encounter many exotic plants among New Zealand’s wild flora. It is part of Japanese culture that travellers take home a small gift to friends and family. Others like to have a piece of New Zealand as a memory for themselves. Honeyland provides a solution for those tourists who do not want to worry about purchasing presents when holidaying. Honeyland products are available in Japanese airport stores for tourists to pick up upon arrival back in Japan. Packaged in small, beautifully labelled containers, the distinctive New Zealand honeys have become a much appreciated gift in Japan.

Export barriers
One of the biggest obstacles to Honeyland’s growth is sourcing and securing the supply of quality honey. Thus the New Zealand supply determines the extent of the company’s involvement in the international market and limits business expansion. Annual variations in quality and quantity are natural occurrences of the product. Sue solved the supply difficulties by developing and maintaining a very good relationship with her domestic supplier. Their loyal commitment guarantees preferential supply even when overall stocks are low and they cannot deliver to other clients. Another problem is the management of organic export products. New Zealand has entered into an international treaty to protect plants and natural vegetation that requires strict export controls. New Zealand’s Ministry of Agriculture and Fisheries (MAF) is the official body that looks after the treaty’s enforcement. Export operations are difficult because MAF requires strict compliance with their phytosanitary and bio-security regulations, including the inspection of all exported organic products and detailed documentation. Careful planning and organisation on the part of Honeyland is necessary to be able to meet export deadlines. These problems have been solved through close attention to MAF regulations at the planning and strategy stages. Thus Honeyland now organises international trade around these requirements and uses these MAF certificates for quality differentiation.

Logistics
Access to reliable and cost-effective transportation is another issue with which Honeyland has to deal. New Zealand is far off the main shipping routes and transport costs are high compared to countries that are in the centre of the world trade network. The large geographical distance between New Zealand and Japan is a big obstacle in itself. The normal shipping time to Japan is 10 days on average. However, in reality it takes much longer for a shipment to arrive safely to the customer. Why is this? Honeyland usually ships out of Napier, a small rural town with international harbour facilities. Napier has turned out to be a convenient location since most of the honey is sourced and packaged regionally. The supplier loads the honey into sea containers onsite so transport costs and time inside New Zealand are minimised. However, using a small regional port also has disadvantages. Most of the drawbacks are related to capacity and frequency of transportation services, particularly during times when the general harvest season is underway. Around harvest time a variety of produce exporters usually compete for limited container space and shipping facilities.

There are other problems concerning logistics. The size of Honeyland’s export unit is on average just one container load. To date (2008) the shipping of a 20-foot standard container
to Japan costs about NZ$4000 (US$2200). This price includes the basic paperwork such as customs declaration. There may be times when customers require a more frequent delivery mode and then the size of the shipment can be less than one container. If containers are shared, the projected arrival time is less predictable than normal because a suitable load going to the same destination to fill up the remainder of the container has to be found. When shipping smaller quantities of high-priced niche products, Honeyland employs the services of a reliable international freight forwarder. Although utilising the services of freight forwarders is more costly than organising the shipping with the shipping company directly, it has the advantage that professional logistics services take care of all formalities, including the customs’ declaration and documentation of the bio-security requirement. They also ensure the necessary import licence that is only valid for one year and has to be renewed in a timely fashion. If need be, they organise the swift clearing of customs at port in Japan, which reduces the order cycle time considerably.

Export pricing

For the setting of export prices it is important to remember that Honeyland has no domestic sales and that only one export market is involved. Therefore, the price decision is straightforward since the export prices are based on the costs of sourcing the honeys as well as logistics. The prices for the Japanese customers are quoted and paid for in NZ dollars. Sue acknowledges that sufficiently large profit margins are critical to manage foreign-exchange risk. Frequent currency fluctuations of the NZ dollar affect profits and in the long term the business itself.

Risk management

Sue believes in the benefits of maintaining long-term relationships with her clients. One factor that will most certainly upset Japanese clients is the renegotiating of prices. Sue is aware of this sensitivity. Therefore, she attempts to keep her prices fairly constant in spite of the New Zealand currency volatility. She does so even if that means that sometimes losses occur. Another important aspect of good business relationships is that it minimises general risks, lowers transaction costs, and helps to avoid lengthy negotiations. For example, Honeyland experiences reliable payments on time and payment to the full amount. The company’s excellent networks and culturally appropriate business practices practically guarantee that default situations rarely arise.

For Honeyland, the existing three Japanese business segments are a sufficiently large market because they account for Honeyland’s entire export volume. A prerequisite for sustained good

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<th>Approximate exchange rates for the New Zealand dollar</th>
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Source: New Zealand Reserve Bank.
business relations with Japanese companies is that size and quality of the export ventures have to match expectations in order to create a good business fit and sustainability.

Just from the beginning I realised three main factors in dealing with Japan: one is quality and guaranty of quality; two is supply ability – you must be able to guarantee supply and that was very important with maintaining this relationship with this catalogue company ... And the third one was stability in price – so you have to take losses sometimes.

**International communications**

Over the years, Honeyland has maintained mutually beneficial and trusting relationships with the same networks. Information technology, Internet access, and email have allowed Sue to keep in regular contact with her network partners in between her regular visits to Japan. Often she is also busy with answering customers’ queries and requests directly. ‘There are daily emails from business partners; they have a habit of sending vast numbers of emails with queries, such as potential benefits of treating race horses with NZ Manuka honey to prevent stomach ulcers.’ These kinds of queries have given Sue food for thought if she ever wanted to expand her business and develop other products. It is no surprise that Honeyland has its own website for general information and marketing.

**Conclusion**

Sue says that she is very content with her business. She operates a lean and efficient enterprise with minimal expenses and overheads. She does so single-handedly (no employees) from a small office room in her own home and she has no immediate plans to change. Honeyland is now one of the long-time successful international new venture businesses in New Zealand.

**Additional resources for research**

For further information please see the following websites:
- General information about New Zealand, including socioeconomic details, supplied by the New Zealand Trade & Enterprise website which is government sponsored: www.marketnewzealand.com/MNZ/aboutNZ/sectors/14436.aspx?Buyer=true.
- Information about New Zealand’s quality assurance program for bee products, including its certification: www.asurequality.com/auditing_and_inspection/apiary.cfm.
- Information about the port facilities of Napier and useful details concerning transport and shipping vessels: www.portofnapier.co.nz/.

QUESTIONS

1. Imagine that you are in charge of logistics for a small exporting business such as Honeyland. What are the difficulties you need to think about?
2. What are the specific contextual requirements when exporting from New Zealand?
3. Considering that Sue is under a significant time constraint, do you think that outsourcing the entire logistics would be a good move for Honeyland?
4. What would have been an alternative entry strategy for the Japanese market?
5. Do you think the company should expand or diversify?
IIINET EXPANDS GLOBALLY WHILE STAYING HOME

Steve Klomp, Murdoch University

Introduction

The rags-to-riches story of iiNet is well known in Australia, particularly in Western Australia where the company started.

Beginning as a backyard garage operation in 1993, the company has risen to be the number three Internet service provider in Australia today. iiNet is a highly successful public company with Australia-wide operations and around 650,000 subscribers.

Michael Malone started his company in his parent’s garage in Padbury, a northern suburb of Perth, Western Australia. In the beginning it was all pretty primitive for Michael and his partner Michael O’Reilly. The Internet was in its absolute infancy. In fact, there was virtually no commercial demand for Internet connection among consumers or businesses. Michael admits he started iiNet because he had just left university and was concerned about losing his network access to his university buddies! In those days the Internet was really only for military and academic applications.

iiNet owes its success to three important factors. Technological advances like the development of web browsers (such as Netscape and Explorer) is factor number one. This development saw Internet use really come of age in the 1990s – and this helped propel the tiny company servicing a small base of dedicated, technology-focused customers into the marketing phenomenon it has become. Opportunity met preparedness.

Success factor number two was the company’s early decision to focus on service. Gemma Pollard, Communications Manager for iiNet, argues that service is the most important issue for clients. They want to be helped, quickly and efficiently, and they don’t want to hear excuses. Providing a high level of service is expensive of course, but pays off in the long run.

Linda French, Head of Australian Marketing for iiNet, put it like this in 2007: ‘We always knew that customer service was important. It is the number one priority throughout the company. And it is also a numbers game. The more clients the company could attract the better we could utilise our capital investment and the more overall profit we could make’.

Service is also the reason the company has the structure it does. Michael Malone set up iiNet with a very flat structure. It is a low power distance-type company.

The third factor is capability.

In the early days of the commercial Internet, ISPs (Internet Service Providers) sprang up everywhere. Many would-be entrepreneurs attempted to cash in on the low set-up costs and the potentially lucrative profits the Internet seemed to be offering. Unfortunately these ISPs
often didn’t have strong business plans or financial backing and were also held to ransom over the reliability of the networks they were forced to use.

An ISP is at the mercy of the network on which data is transmitted. If this network is slow or unreliable customers blame the ISP, not the network. iiNet recognised early that it should only expand in a financially appropriate way and always to areas with reliable communications technology. In this way it could always provide a high level of service to its business and residential clients.

The company uses DSLAMs (Digital Subscriber Line Access Modules) to expand its own network. These interface with existing telephone exchanges to service customers in the local area. The company chooses its expansion target areas carefully, installs infrastructure then employs integrated marketing communications principles in order to maximise its success in gaining customers in that location.

iiNet currently has DSLAMs in about 320 exchanges across Australia.

**Expansion**

iiNet expanded very rapidly in Australia in the 1990s. In these early times the company often grew by purchasing other Internet service provider companies such as Ozemail. These buyouts were generally self-funded as the publicly listed company was in a strong financial position in the late 1990s. Later, expansion focused on growing the company’s existing network.

Yet despite rapid expansion, the level of competition and the relatively small market in Australia (in world terms) iiNet had no plans to expand internationally. It just wasn’t on the horizon. Even today the company believes that while international expansion is a valid growth option, there is still plenty of market left in core services in Australia – quite apart from other profit avenues such as content provision, allied services and hardware installation. Gemma Pollard argues that the company has about 9.5 per cent of the market in Australia, up from 6 or 7 per cent in just the last year – despite the saturation marketing of the two dominant players. These numbers mean there is a lot of scope for market penetration here at home!

In addition, the Australian industry has high levels of government regulation (similar to the situation in many other countries). Government regulation continues to have distinct advantages for iiNet. For example, a recent ruling forced Telstra (the owner of most of the network cabling in Australia) to lower the wholesale rent charged to providers such as iiNet.

This ruling allowed ‘Bob’, iiNet’s DSL (Digital Subscriber Line) product, to be commercially viable.

**New Zealand and iHug**

In the 1990s the Internet was expanding exponentially all over the world. Just as iiNet was powering through the Australian market things were also starting to happen in New Zealand.

New Zealand is situated to the east of Australia. This small country of two main islands is home to just a few million people – close to half of whom live in the one city of Auckland(!) on the North Island – but it is a major world player in many industries including meat and livestock exporting.

There are cultural differences between Australia and New Zealand, of course, but the countries are also very similar in many ways. They are also close geographically and are frequently the first choice of international market for companies in each country.
Clearly proximity and cultural similarities are not sufficient reasons in themselves to choose an international market destination, but it is common for exporters to be psychologically swayed by these two facts.

By 1994, a company known as ‘iHug’ – an acronym for Internet Home Users Group – had relocated to Auckland from its start in Dunedin on New Zealand’s South Island. It was dominating the Internet market and at one stage enjoyed a 92 per cent unprompted recognition level among New Zealanders. It completely eclipsed ‘Clear’ – the New Zealand ISP entry from Australia’s Telstra.

However, New Zealand was never going to be a big enough market for iHug. The population was just too small and the infrastructure too primitive to allow for the sort of service provision and content iHug knew its customers would eventually want. The firm moved into the Sydney (Australian) market in 1998–99 and soon had 50,000 customers there.

**ISP expansion options**

The Internet makes for an interesting industry. For a start there are virtually no barriers to entry. With no government restrictions, open access to existing telecommunications infrastructure (the telecommunications of virtually every country in the world was developed by government and in most countries the government still owns all the infrastructure and makes it available to ISPs for a regulated price) and cheap technology virtually anyone can start an ISP.

In fact, many entrepreneurs do! Unfortunately they often start with no real strategic plan or financial analysis. The industry, particularly in the early years, was dotted with ISPs that had good ideas and a reasonably sized client base, but were never going to be commercially viable in the long term. For companies such as iiNet this represents a big expansion advantage, of course, because it means by buying these struggling businesses the company can build its client base very cost effectively.

Ultimately though, an ISP is just a carrier of data. The success of any ISP company will ultimately depend on content provision. This is a consumer-led demand. Consumers are wooed by service initially and the bundling of services into one cheap ‘package’ is viewed favourably by many customers, and certainly the ever increasing download speeds of broadband are attractive, but in the end the Internet must provide the market with useful, interesting and cost-effective content or access to services.

Content that readily attracts consumers are offerings like VOIP (Voice over Internet Protocol) and Video on Demand, but there are many others on the horizon. iNet is already developing content applications. Its ‘Freezone’ is an example of its plans in the content area. Freezone is unmetered content. Clients are not charged to download this content, although the third-party provider may charge for the content itself. Currently Freezone provides sports, itunes, and TiVo where movies are downloaded with no effect on the client’s download allowance.

**iHug’s international move founders**

iHug’s entry into the Australian market was not without drama. It decided to move in as an initial start-up rather than taking over a recognised local company. Its reasoning was that it would at least capture the bulk of expatriate New Zealanders living in Sydney then it could build business from there without having to fund the cost of a local buyout. However, things didn’t go according to plan. For a start, the company decided to incorporate in order to attract capital.
This meant it needed public share finance. This should have been a done deal for iHug given its profit and growth record, but just as the IPO (Initial Public Offering) was being organised the dot.com crash happened. Overnight things became difficult indeed for the company. Funding could not be secured for the IPO.

On top of this problem the company may have been expanding too fast. In order to evolve as a combined ISP and content provider it had purchased 50 per cent of Blockbuster (a video and DVD rental company), was moving into online shopping and was trying to grab a stake in digital TV.

The company started to look very attractive to iiNet as an acquisition target. iiNet was really only interested in iHug's Australian arm but got the entire New Zealand operations in the final deal, struck on 16 September 2003.

**iiNet an international player**

‘Over time we shifted operations between the two countries to achieve synergy and economies of scale’, says boss Michael Malone. ‘We distributed call-centre functions across Australia and New Zealand, taking advantage of the five-hour time difference between Perth and Auckland.’ The network operations and head-office functions for both countries are still predominantly from Perth, which remains home to more than half the company’s staff.

As an international market entry strategy for the Internet industry the move into New Zealand could not have been better for iiNet. The company had instant and dominant recognition of its acquired brand in the new market, with little local resentment to the takeover. It also gained a large number of new subscribers in perhaps the most cost-effective manner possible. These customers were immediate sources of ongoing revenue.

New Zealand’s telecommunications infrastructure was also not as advanced as that in Australia. This was another, albeit longer term, advantage to the company as there is profit in migrating existing customers to broadband once the technology allows for this change. Additionally, the introduction of faster technology has always been a major drawcard for new customers to enter the industry – another opportunity for strong growth.

By November 2006, however, iiNet had sold iHug to Vodafone. The company retained iHug’s Australian customers and kept its Auckland-based call centre. The Auckland operation services iiNet’s Australian market by using the advantage of the five-hour time difference between the two countries. The foot is still firmly in the door.

**iiNet in South Africa**

So what is iiNet doing in Capetown? ‘We moved to Capetown so that we could focus even more on our Australian clients’, says Pollard.

‘Our focus is always on service and having a call centre there means we can use local Capetowners to service our Australian customers. Capetown is six hours behind Perth and, if you combine that with the fact that New Zealand is five hours ahead, and factor in our Australian call centres, we are able to cost effectively have real people servicing our clients, 24 hours a day.

‘It’s called the “follow-the-sun” methodology. There is always someone working during daylight hours to talk to our customers. This supports our market strategy of customer service. Michael Malone always intended that our service would put us ahead of other providers and this is the latest way of keeping this edge. You can spend millions getting customers through
the door, but without the right provisioning service and the right sales people and customer service people those marketing dollars are wasted.’

The company is so keen on customer service that it uses the NPS system (Net Promoter Score) to evaluate its service performance and monitor and update the results automatically and immediately. The NPS graph is displayed in the company’s Network Operations Centre for all to see.

NPS is a system that uses client feedback to determine service quality levels. Clients get sent a survey asking how a service call went for them. A score of 9–10 makes the client a promoter, 0–6 makes the client a detractor, a score in between is a neutral result.

NPS = promoters – detractors. iiNet’s percentage score is currently in the high 40s, which is a significant improvement since NPS was introduced.

On a global scale the company scores very highly in its category. NPS is used by many companies but some get negative results. NPS is a part of the KPIs for every employee at iiNet.

The question though, is why iiNet chose to set up an operation in Capetown, rather than converting the Australian operation to run 24 hours a day.

The answer lies in two considerations. First, the need for an expanded call centre was identified at the height of the economic boom in Western Australia. It was very difficult to get staff for the Australian operation and even more difficult to retain them. Wages were also at historically high levels. Then there was the question of rostering staff for night shifts. Night work was not popular and the company was not convinced a person working these hours gave as good a level of service.

Capetown offered daylight hours, a lower wages bill and easier staff retention. The decision to move this part of the operation offshore was in fact an easy one.

Again, Capetown was identified in part because of its familiarity to at least one senior staff member – Marina Pienaar, the General Manager of Corporate Services. Overseas destination targets are often chosen because of senior management familiarity with the target.

iiNet’s presence in Capetown is limited to a call centre only. ISP services are not offered to the local population. This is a surprising situation, particularly as the local population are relatively affluent by African standards. However, the answer lies in the telecommunications infrastructure standards of the country. South Africa does not have a high-standard network, which in turn means that iiNet could not offer a high-quality service there.

Is it a beach-head designed to allow for future client-base expansion? ‘Not really’, says Gemma Pollard, ‘although if the country’s network improves in time it might be an expansion option for us. No, for iiNet, Capetown was an attractive proposition simply because it offered an economic solution to our call-centre staffing needs. And it had the right longitude to be useful for time-zone purposes – for servicing our clients in Australia’.

iiNet worked for months with a local South African company, Merchants, to select and train local staff, thus ensuring high service standards would be maintained for Australian customers. Merchants is known in the region for its capability in providing customer-contact solutions.

‘In an ideal world the company could have chosen an offshore destination with low costs and high levels of telecommunications infrastructure. Unfortunately these two factors rarely go hand in hand’, explains Pollard.

Future international expansion

There are many reasons why a company will consider venturing internationally. An obvious one is that the domestic market is too small. There may also be too much local competition. Again, companies may thwart domestic competition by going on the offensive and targeting the home country of an overseas competitor.
It may also be that local market regulations make competing difficult. This is especially a problem for smaller, less-experienced companies where the existing market is dominated by large, established competitors. This type of situation makes an international foray a much more attractive proposition.

Frequently, international markets are considered because of incentives offered by foreign governments. In iiNet's case internationalisation became important because of low cost conditions overseas. So, what would the company look for in the international market?

‘Number one, we would probably only expand internationally by using local acquisition as our market entry strategy’, said Michael Malone. ‘We would look to 100 per cent ownership of the acquisition of the local target. It would preferably be a company that was underperforming financially, but one that had a loyal customer base. A company would be particularly attractive if it gave us the opportunity to effect cost savings using our economies of scale, management expertise and synergy with our existing operations,’ he added. ‘These are probably criteria that would be used by most companies entering a new international marketplace.’

For the Internet industry itself there are further considerations. First, it would be best if the takeover target was in an area that had reliable infrastructure but at a more ‘primitive’ level of technology than that existing in the home country (Australia). For that reason, most attractive areas would have clients predominantly connected via dial-up modems.

Second, it would be best if the clients were as technologically ‘savvy’ as possible. It would also be great if the market was underserviced by existing competitors.

The government or other infrastructure owner must allow for universal access to the network, thus negating the need for iiNet to provide its own telecommunications ‘backbone’ – an enormous capital cost that would probably render most market entries unfeasible.

Finally – and perhaps more importantly than anything else – iiNet would look to the political and economic stability of the target country or market.

This is particularly important because of the nature of the market offering: iiNet’s and indeed all ISPs’ primary product offering is communications and this is not a product that is allowed to
be freely distributed in some areas of the world. It is also not a product that can be afforded by all consumers in all geographic locations.

So what is an ‘ideal’ international market expansion target for iiNet today?

‘Because of our expansion criteria, the ideal locations for us would probably be all in Europe in the short to medium term’, said Michael Malone. ‘I prefer Ireland – and not just because my family was originally from Ireland! One reason is that its population is approximately the same size as that of New Zealand …’

On the minus side, however, international expansion brings the probability of powerful competitors entering the already fiercely competitive Australian market. Still, international expansion is probably inevitable in the long term.

**Other attractions of the international scene**

The international marketplace is not just for selling or cost cutting. It is also a source of market and product research. For example, iiNet looks overseas to identify development trends for its own industry.

The executive team tours overseas in order to find new technologies and new service offerings. Each tour results in ideas that then must be evaluated back in Australia.

The company knows, for example, that Korea holds the trophy as the country with the fastest (average) broadband speed in the world (even though Singapore is busy developing in this area in order to be the financial and information-flow centre of the region).

The Australian rival to the Korean speed mantle will be NBN. The National Broadband Network will be owned (perhaps dominant ownership) by the Australian Government and project managed by ‘NBN Co’. It will likely deliver fibre optic to every home (a multi billion dollar plan) for 95 per cent of Australians, meaning fast broadband and an equal playing field for all ISPs.

NBN also means prices will be fixed – and therefore no longer the differentiator between providers. The differentiator will be service, brand image and content – a fact already clearly understood by the international yet stay-at-home Internet Service Provider iiNet.

**QUESTIONS**

1. Is international expansion a necessity for a company’s long-term survival in the ISP business? Why or why not?
2. Consider the case of an Australian ISP wishing to expand internationally. Develop criteria for market selection and determine a list of five countries that fit that criteria. Then determine the order in which those countries should be entered.
3. What is the most appropriate international market-entry strategy for an ISP or telecommunications provider? Why?
4. How significant is culture and government regulations to the success of ISP businesses expanding internationally?
DENIM: FROM DYE TO DERRIERE

Ifran Weldon, Donelda S. McKechnie, Jim Grant, Sahar Husain and Ossama Faour, American University of Sharjah

Introduction

To know X-Pertex Denim Mills is to ‘Discover the name behind brand names’. The company, founded in 1987, makes denim fabric for export to garment manufacturers throughout the world. The main product is indigo-dyed cloth, which is better recognised as material for blue jeans. X-Pertex is located in the south Asian city of Karachi, Pakistan. The company was one of the first denim textile manufacturers to be established in the region. This pioneering spirit has carried forward to the company positioning itself as trendsetters in the world of denim. Current production capacity is 1.2 million metres/month.

When X-Pertex entered the market, according to company Chairman, Ibrahim Weldon, marketing was not a big issue: ‘Back then, we enjoyed the monopolistic rule over the market and devoted all our efforts towards production with no one in the local market to compete against’. The industry, he explained, is changing rapidly with the entry of new competitors, the removal of quotas that restrict export quantities and globalisation. ‘Marketing now’, said Mr Weldon, ‘must go hand-in-hand with quality management because no denim manufacturer is guaranteed survival.’

X-Pertex recognises that consumer demand throughout the world drives the need for denim fabric. To compete internationally, X-Pertex must satisfy garment manufacturers’ unique requirements for colour shade variations, yarn weave patterns and textile finishes. The garment manufacturers have customers of their own and they rely on X-Pertex to deliver quality product and to meet shipping deadlines at minimum cost. X-Pertex commits to customer satisfaction with the statement: ‘We take pride in getting the perfect after-wash shade at minimum time and expense’.

Currently, X-Pertex sells to several different jeans manufacturers around the globe. The main markets include Turkey and Bangladesh although the company reach extends to some customers in the US. X-Pertex recently entered the Italian market. Success is attributed to garment manufacturers’ cost considerations – Italian buyers are turning to the subcontinent for product because locally made Italian garments are very expensive. X-Pertex intends to develop this market further. Other X-Pertex customer locations include North, Central and South America, Eastern Europe, North Africa (including Tunisia and Egypt), countries bordering the Persian Gulf (including United Arab Emirates and Iran), as well as Asian countries Nepal and Vietnam. The Australian market is yet to be explored by X-Pertex along with Brazil and Mexico.

Manufacturing process for denim fabric

The first step in the process to manufacture denim fabric is the careful selection of white cotton yarn. Then, the white cotton is rolled into six-feet length beams (rolls). The number of beams is determined by the customers’ fabric order quantity. Recently, buyers have been asking for
the more expensive ‘organic cotton’ which is grown on farms that are insecticide and pesticide free. X-Pertex must charge a premium for the orders that ask for organic denim fabric, but buyers are willing to pay.

Next is the dyeing stage where some of the white cotton will become the colour of blue jeans using indigo blue dyes that are environmentally safe and skin-friendly. The blue yarn is then woven with white yarn into fabric that has the patterns and the textures that meet the customer’s specifications. The last stages before quality control are where the fabric is de-sized and pre-shrunk. At the QC inspection station, the fabric is checked for any errors in dyeing or weaving. Once quality control approves, the fabric beams are shrink-wrapped, bar coded, and loaded on to big containers for shipment to the buyer firm.

X-Pertex management says that the weaving looms and the indigo dying machines should never stop. A breakdown means production time is lost. Worse, however, is that machine stoppages and re-starts can cause colour shade and weave variations in the fabric. When this occurs, the finished denim may have to be scrapped because it no longer meets the customer’s specifications. X-Pertex plans regular preventative machine maintenance which is important for continuous production.

**Indigo dye**

A key element of the denim manufacturing process is the indigo blue dye that gives the fabric the distinctive blue jeans colour. X-Pertex buys the chemical through the Karachi regional office of Clariant, a Switzerland-based company. ‘Exactly your chemistry’ is the Clariant slogan. This reinforces their positioning as a quality supplier of precise chemical formulae that meets each customer’s individual requirements.

For custom denim orders, X-Pertex will involve Clariant in the early stages of the colour analysis process. Usually a customer sends a small cloth sample to X-Pertex and asks for the particular indigo shade to be developed. Mr Weldon, a qualified and experienced dyeing agent, would typically meet with the Clariant representative. However, this responsibility is increasingly shifting to the new production manager who continues the strategy of ‘empathetic dialogue’ when discussing the likely dyes and pigments that combine to obtain the desired colours. Using high-tech machines, Clariant conducts further analysis to identify the precise shade and to determine the mixture of dye pigments, other chemicals and water that will bring out the required colour. Clariant provides X-Pertex with sufficient dye for a small production run to test that the output fabric shade matches the shade of the original sample. When X-Pertex is satisfied, the test sample, coloured by the newly developed dye, is sent to the customer for approval. If the garment manufacturer is not satisfied, Clariant representatives work onsite at X-Pertex until the right shade is achieved.

Clariant has shade-matching software that is able to detect subtle fabric differences not visible to the naked eye. The expense has stopped X-Pertex from making the technology investment. Instead, X-Pertex continues to outsource the shade-matching, closely watched by the skilled and knowledgeable senior management. X-Pertex considers it is a much better financial decision to ‘pay-as-you-go’ for the service than pump huge amounts of capital investment into the business to buy the software.

Despite other nearby companies able to supply indigo dyes, X-Pertex continues to rely on Clariant’s regional Karachi office saying that Clariant understands the challenges facing businesses in a developing nation such as Pakistan. X-Pertex says they have been spoiled by
Clariant’s pre-sales and after-sales service and the consistently high-quality standards. In return, X-Pertex has set a prompt and efficient payment schedule for any Clariant invoices. The challenge to this relationship is price pressure within the denim industry – X-Pertex has found it necessary to consider alternate dyes from China.

Denim becomes jeans

Senior X-Pertex management prefers to handle the accounts of customers who order regularly rather than assign the care to the sales staff. X-Pertex says that the personalised attention makes the customer feel important and keeps management involved in the customers’ decision making. An important customer for X-Pertex is the family owned and operated Apparel Manufacturing Company (AMCO) which is located in the United Arab Emirates. AMCO targets quality conscious retailers and wholesalers. It maintains high production standards and were the first ISO 9001:2000 certified apparel manufacturer and supplier in the UAE.

Name-brand customers of AMCO have included JC Penney, Wal-Mart and Sahara Sportswear. Four years ago, AMCO ventured into the denim market with its own label. It has since left its brand development and now primarily supplies denim to other brands. This has relieved it of the necessary hardcore B2C marketing and branding that is required when promoting and selling a distinctive label. X-Pertex recognises the potential of AMCO to be a substantial buyer and is intent on maintaining strong ties. Fashion for denim comes and goes approximately every two years. There are times when AMCO does not require denim because of the denim industry’s cyclical nature. At other times, when demand is high X-Pertex wants to be AMCO’s preferred supplier.

AMCO considers X-Pertex to be an efficient OEM (original equipment manufacturer) because it provides on-time delivery, relaxed payment schedules, and prompt after-sales service. Another positive point for AMCO and other garment manufacturer customers is that even though X-Pertex is a ‘made-to-order’ supplier, it will sometimes offer ready-made fabric at lower prices. Such stock is typically inventory leftover when other customers could not pay for their orders or a cheaper supplier was found and the order with X-Pertex was cancelled before shipment.

Price negotiations are a critical part of business operations for X-Pertex. For example, when a customer’s purchasing department asks for a quote, X-Pertex responds with the list price. In the case of AMCO the information is relayed to the AMCO Chairman who contacts the X-Pertex Chairman to begin discussions. Typically, AMCO may argue that the same fabric is available from an X-Pertex competitor at a lower price. X-Pertex will recheck market prices to verify if this is true. If so, then X-Pertex will match the competition’s prices. AMCO may ask for a greater price reduction. X-Pertex will argue that the same fabric has been sold to another garment manufacturer, possibly an AMCO competitor, at a higher price. To prove this, X-Pertex will show AMCO the purchase invoice. By this time, both firms want to find the common ground that will complete the transaction. If X-Pertex agrees to prices lower than their competition, then AMCO is asked to increase the order quantity, for example, from 20000 metres to 50000 metres. Thus, X-Pertex increases its profitability through volume of sales turnover rather than selling at high margins/low quantities. If the inquiry placed by AMCO is large in quantity, for example, 500000 metres, X-Pertex tries to settle price and terms of payment issues within a single day rather than risk the order being lost to competitors. When AMCO has confirmed the order, then the X-Pertex production department takes over.
X-Pertex production

Once the customer accepts the dye shade and confirms the details with X-Pertex, then the order becomes a priority for production. The production manager checks with the purchasing department to confirm if X-Pertex has sufficient raw material, cotton, in inventory. Typically, purchasing will buy cotton in bulk using forward buying strategies to obtain the best discounts. If the stock indigo dyes need to be replenished, the purchasing department will place an order with Clariant. Delivery is expected within one week. Timing is crucial; any delay in raw material availability may impact on whether the X-Pertex customer order is shipped on time. If the customer is long-standing, like AMCO, then receiving the dye order on time is very important to X-Pertex. When re-ordering dyes, X-Pertex senior management does not step forward unless a major customer is involved. This is because, compared to cotton, dye prices are quite stable and negotiation takes place less often. However, when X-Pertex needs a new dye for a custom order, the Clariant country manager for Pakistan will visit X-Pertex to negotiate prices and quantities.

Once the denim fabric order is complete, the beams are loaded into containers and sent to the Karachi sea-port on a CNF (i.e., cost and freight) basis. In the case of AMCO, this means that X-Pertex is responsible for the shipment costs and freight until it reaches Dubai sea-port. At Dubai, an import agent takes over to secure the customs release and complete the delivery. When the containers arrive at the AMCO receiving dock, the fabric quality is checked. If the order is accepted then 60 days later AMCO releases payment to X-Pertex. This occurs by bank transfer that complies with the letter of credit terms and conditions originally agreed when the order was placed.

On occasion, a customer may submit a claim to X-Pertex about a fault with the received fabric. Then, a quality inspector may be sent to the customer’s factory to check the fabric. If there is a problem, it usually can be traced to the textile weave, shade variations from the dyeing process, or fading too fast after every wash. X-Pertex policy for a genuine claim is ‘refund or remake’. Occasionally, X-Pertex finds that the customer’s customer has cancelled an order: making a claim that the denim fabric was poorly manufactured is a way for the X-Pertex customer to avoid taking the garments back into inventory and incurring a loss. AMCO has never filed a claim. The fabric shipped to its plant is always to its quality specifications.

X-Pertex has developed a catalogue of various shades and fabric types. Customers can feel the denim swatches for texture and see the colour shades. Information about fabric weight, name reference and identification digit code makes ordering easier. Updates follow the fashion season cycle and take place about every three months. X-Pertex is intent on adding more products to the fabric portfolio and has been actively investing in R&D initiatives. This is a risky venture considering the economic volatility of the marketplace, but one that is proving to have positive impact. An electronic version of the catalogue is also available and can be accessed from the company website.

X-Pertex, growth through customer development

Finding new customers while retaining established accounts is very important to the ongoing success of X-Pertex Denim Mills. Currently, to reach the global market, the company relies on foreign agents, advertising, trade shows, Internet and personal visits (see Figure 15.11).
The recent introduction of online Customer Relationship Management software is intended to keep customers updated with the progress of their orders while helping X-Pertex to organise information and cut costs. The data typically collected and stored includes customer purchase history, meetings at trade shows, samples received and quotations returned, feedback about fabrics and/or business relations improvements and after-sales service involvement.

Twenty per cent of the X-Pertex customer base has been sourced through the well-dispersed network of foreign agents who work from regional offices in many countries. The agents are paid base salary plus commission. Additionally, 25 per cent of companies have been found through trade show attendance. One of the most important exhibitions for denim fabric and garment manufacturers is Tex-World, which is held semi-annually in Paris. Mr Weldon actively participates in many such events. His presence means that established and potential customers can meet him personally. His visibility often helps X-Pertex close manufacturing orders with interested buyers.

Thirty per cent of the customer base has been developed through personal visits by sales staff and senior management to foreign and local buyers. X-Pertex finds fabric quality and payment terms are more easily discussed via face-to-face contact. Ten per cent of customers are the result of advertising. X-Pertex has contracted for space in the top left corner of every Thursday edition of an internationally distributed local newspaper. The intent is to create awareness about the denim mills and to attract potential buyers. Additionally, to reach the global marketplace, X-Pertex publishes advertisements in foreign business magazines.

Finally, 15 per cent of companies have been sourced through the Internet. X-Pertex sales staff search for potential buyers and then make contact via email or telephone. Over the last eight years, increasing customer numbers by using this method has grown at a faster rate than all other methods. International buyers are finding X-Pertex using search engines such as Google to identify denim companies in Pakistan. X-Pertex has noticed an increase in inquiries coming through the website ‘contact us’ portal. An early website addition was the facility to place orders online and to check for new product information. Now, as information requests increase, X-Pertex is concerned that the website has not kept pace with changing business practices and that opportunities to capitalise on the online marketing opportunities are being lost. The need for an online marketing plan is being discussed among senior management.
Facing international and domestic challenges

Doing business in the international arena has many challenges including customers’ perception of Pakistan’s political unrest and economic instability. The risk to companies who do business in the international marketplace is that negative news reports from media potentially influence foreign buyers. However, X-Pertex is finding that international customers view the political instability as leverage when placing orders and they are pressuring for low prices. Fear of political unrest does not appear to be pushing them away. Instead, concerns about costs of denim fabric as a raw material for garments is attracting clothing manufacturers to the Karachi-based company.

However, X-Pertex is not immune to the adverse effects of political unrest. For example, X-Pertex is noticing that foreign buyers do not visit the Karachi operations as often as they once did. To counter this, more investment has been directed to marketing initiatives. Specifically, personal visits and attendance at trade shows, to meet customers face-to-face, have been increased. The premise is ‘if customers can’t come to us, we will go to them’. This decision is helping X-Pertex maintain strong customer relations. Rivals who have cut marketing expenditures to save money are paying a heavy price in the form of less buyer interest in their products.

A concern for the industry is that recent political unrest and economic instability is causing Pakistan’s cotton suppliers to seek new markets in other countries, particularly India. Pakistan has an abundance of cotton and much is now exported rather than sold locally. Greater demand is pushing prices up and the export markets are paying. The textile association, of which X-Pertex is an active and vocal member, has been lobbying the government to give priority to local businesses rather than permitting the export of resources, such as cotton, to other countries at a premium. The association’s argument is that export is taking a significant competitive advantage from Pakistan’s textile industry. Price negotiations are a key element of the business-to-business relationship that X-Pertex has with garment manufacturers because prices are affected by the fluctuating costs of cotton.

To counter inevitable price pressures, X-Pertex invested in infrastructure upgrades to improve productivity and to buffer cost margins. For example, large generators were purchased and installed to provide continuous electricity. X-Pertex no longer relies on the public utility network that continues to be burdened with unexpected blackouts and brownouts. Despite these production initiatives, the effects of political unrest still reach X-Pertex in the form of high prices for the fuels that power the electric generators.

Pakistan’s economic instability is arguably not as contentious as the situation in other countries for two reasons. First, taking financial leverage from banks and other financial institutions is culturally frowned upon and second, banks in the country have limited resources which prevent them from being able to help numerous cash-strapped large companies. Nevertheless, many companies are struggling to survive against the current financial challenges; major denim manufacturing plants have closed within the past two years because they were not able to repay the banks for loans.

X-Pertex has taken the position that the global economic downturn is an opportunity. The company is financially solid with no outstanding loans or major interest expenses on asset investments. As a result, the cost of doing business is somewhat lower than other companies
who are carrying heavy debt burdens. X-Pertex is able to quote competitive prices to foreign buyers, particularly those in developed nations who are desperate for lower-cost fabrics.

X-Pertex’s future strategies include family succession decisions. At the recommendation of son Ifran, Mr Ibrahim Weldon has taken the position of company Chairman and is shifting his focus towards the strategic side of the business. Another son, Imran, has taken the seat of Managing Director. He has long worked with his father and understands day-to-day business requirements. Imran’s management style includes more autonomy for his staff. He has recently hired a Production Manager who now deals with selecting dyes and making production decisions. Ifran continues to act as a consultant to the business on marketing strategy issues.

Conclusion

X-Pertex management has established the company as a formidable player in the denim manufacturing sector of the textile industry. The company has grown from a local textile operation in Karachi to a successful business with global reach. Management has successfully removed country and continent boundaries to compete internationally.

The future looks good for X-Pertex if consumer demand for denim is any indication. However, market attractiveness means that X-Pertex will continue to face increased competition. Management has the tough decision whether to rely on proven business practices that have successfully built the company or to introduce some degree of change. Either action must contribute to competitive advantage and keep X-Pertex in its current position of strength in the industry. Three years ago, X-Pertex identified five possible options that have the potential to improve productivity as well as enhance the business relationship with customers and suppliers. These included: (1) focusing on safeguarding relationships with customers and suppliers; (2) empowering employees with greater decision making; (3) introducing extranet facilities whereby buyers can check order production and delivery; (4) buying the Clariant shade-matching software and (5) setting up a research and development department for identifying new textiles, shades and trends. Since then, steps have been taken to implement actions that address the five concerns. Now, however, X-Pertex is confronted with external issues that cannot be controlled, but that must be anticipated in any decision. Not the least of which is pressures on market prices, both for cotton raw materials and denim finished goods, as companies struggle to survive in volatile conditions. Additionally, X-Pertex is undertaking internal changes to shift management decisions from father to son.

QUESTION

1 Put yourself in Ifran Weldon’s shoes. What would you recommend to your father and brother if they asked for your input and expertise?

Sources: