

Writing Sample

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Emerging market entry strategies

When they enter an emerging market, multinational corporations have to decide whether to compete or collaborate with local suppliers. To compete, the multinational must find a way to balance its strengths in technology, brands, quality, or scale with the need to have cheaper, “good enough” products, and it has to reach its target customers. To collaborate, the multinational will need to consider making a local acquisition or a joint venture with local partners in order to compete with the inherent advantages of local firms. Those local advantages include the ability to dream big, to be entrepreneurial and, especially, to live with the customer.

Competing with local firms

Shane Tedjarati, the president and CEO of Honeywell in China and India, believes that when it comes to competing with other multinational corporations, the foreign company is on familiar turf and happy to take on all-comers. However, Honeywell’s goal in India and China is to compete with local firms in these markets. That, he says, has meant a tremendous amount of cultural change—changes to how decisions are made, how capital is allocated and how new products are conceived. He says of Honeywell’s operation in China: “Our mantra is that we want to be considered the Chinese competitor on the ground, not just a Chinese competitor.”

Mr Tedjarati goes on to say that at Honeywell, they long ago gave up talking about the “localisation” of products. That simply implied taking an existing product that worked in a developed market and “adapting it, de-featuring, re-featuring, localising and so on”.

Instead, what was needed was a fundamental re-examination of what the company should be offering. Creating products for an emerging market should be as important as creating products for the established markets. Honeywell created a “Product Approval Committee”, which funds the local development of new products that can penetrate the middle-income market and make inroads at the lower end, too.

In China and India, this model has made for a strategy the company calls “East-to-East”, or for example, creating products in China for sale in China. The model also acts as a springboard into other emerging markets, such as those in Africa and the Middle East. And a bonus strategy is “East-to-West”—in which product features that have worked well in emerging markets are transferred by Honeywell’s Chinese and Indian partners back into the developed markets. This is known as reverse innovation. Mr Tedjarati notes that at Honeywell, they no longer refer to China and India as “emerging markets”; instead they are “high growth regions” that already contribute 27% of Honeywell’s growth.

Joining forces with a local firm

Joining forces with an established local firm is an obvious way for a foreign company to get a foothold. It can help a multinational firm launch a product in an emerging market much more quickly than going it alone. The benefits come from working with a partner who knows the terrain and has both reliable suppliers and the ear of local officials. It also combines the talents of both sides of the venture to create something bigger and better. But don’t forget to do your due diligence before committing to this model.

This following example shows how an American medical company worked with a Chinese one to develop cheaper medical devices. You should remember, though, that any partnership can be difficult to manage, and when you combine different cultures with different values, the difficulties may increase.

Jack Perkowski, CEO and Chairman of the Board of ASIMCO Technologies, a car parts company operating in China, advises multinational firms not to dismiss the strategies of local companies in emerging markets. In his experience, foreign companies are often arrogant. Many assume that their Chinese partner does not really understand what it takes to build an innovative firm. It's important for both sides to understand how the other thinks and to understand what it values most.

Case Study: Danone and Hangzhou Wahaha

Let's look in some detail at how one multinational firm, Danone, failed in a joint venture with China's largest drinks maker, Hangzhou Wahaha. This is a good example of how poor communications, differing expectations, and cultural, linguistic and legal barriers wrecked a joint venture.

In 1996, Groupe Danone, a Paris-based food and drinks multinational, entered into a joint venture with Hangzhou Wahaha Group, a Chinese beverages company founded by Zong Qinghou, China's richest man. With another partner, the Peregrine Group, it bought a 51% stake in Wahaha. Danone then bought out the Peregrine share, supplanting Wahaha as the majority partner in the joint venture, a move that was not well-received by Wahaha or the Chinese public.

At first the partnership thrived. It grew to 39 jointly owned companies. Danone made several attempts to buy out Wahaha, none of which were successful. Negotiations became hostile as both sides accused the other of breach of contract. Several legal battles ensued. Danone accused Wahaha of breaching an earlier contract by setting up mirror companies to sell drinks under the Wahaha brand outside the joint venture. Danone reckoned this was causing it losses of \$25 million per month.

In December 2006, the two parties reportedly reached an agreement to integrate the mirror companies into the joint venture, in return for a payment of 4 billion yuan, or \$566 million, by Danone. Mr Zong, however, allegedly reneged on this agreement, claiming that he had been "forced" to sign. According to Mr Zong, the assets of the mirror companies were worth 5.6 billion yuan, far more than Danone's offer, and the firms generated annual profits of just over 1 billion yuan. MR Zong further argued that the 1996 agreement giving Danone control of the Wahaha brand violated Chinese law and that rights to the trademark remained with his company. The Hangzhou Arbitration Commission found that ownership of the Wahaha trademark had never legally been transferred to the joint venture. This mattered because Wahaha had been considered a state-owned company and Danone and Wahaha had gone through considerable legal contortions to find a loophole allowing the two companies to form a joint venture. It was a huge loss for Danone.

The unhappy result was that these two supposed "partners" were involved in at least 25 lawsuits and arbitration proceedings in Sweden, the United States, France, China and Italy. Both the French and Chinese governments also intervened. Finally in 2009, Danone decided to sell its 51% share to Wahaha and end the joint venture. Perhaps Danone's biggest mistake was to assume that it could call the shots in the joint venture, rather than trying to work within the Chinese system. Danone also ended its joint venture arrangements with two other Chinese firms. Danone's problems were not limited to China. In 2008, it sold its equity stake in an Indian joint venture, Britannia Industries, to its local partners, the Wadia group, ending a relationship that had started in 1993. This time,

it was Danone that was accused by its partner of contravening the terms of the joint venture, by selling in Asia under the joint venture's most successful name, Tiger Brands.

This example shows how joint ventures can turn into ugly battles for control if both sides are not clear about their intentions from the start. The communications gap between Danone and Wahaha was huge, and there was no clear agreement on the use of trademarks or the use of the joint venture's resources by partners acting outside it.

For the Chinese government, it was of paramount importance that the judicial process be seen to be fair. After all, the dispute was being played out before the eyes of the international and domestic business communities, not to mention the people of China.

So what lessons should you draw from this? Above all, do your due diligence. If you are not an expert on Chinese law or Russian tax policy, seek the advice of someone who is. Understand the regulatory environment as it relates to joint ventures in general, and to your business in particular. Understand the role of the government, not just at the state level, where permission may be given for your venture, but also at the local level, where officials will interpret and oversee that permission. Structure the joint venture agreement so that all parties clearly understand their commitments, especially financial ones. Make sure you understand the other side's goals and expectations. Agree on a mechanism for resolving disputes before they occur. Arbitration is cheaper than litigation. Include an exit strategy for both parties and forestall trouble with strategic reviews and performance tracking. Ensure strong leadership at the board level and place top managers on the ground. Try to acquire a basic understanding of local cultural norms. Assume you will adapt to them, not the other way around.

As Danone found in China, the rules and regulations governing joint ventures can be ambiguous or even contradictory. Before 1992, foreign retailers in China were simply prohibited from setting up joint ventures. In that year, however, foreign investment was allowed on a trial basis in Beijing, Shanghai, Tianjin, Guangzhou, Dalian, Qingdao and five Special Economic Zones. By 1997, the central government had given permission for over 20 foreign stores to conduct business—and hundreds more were approved by provincial or local authorities. But many of the local approvals were subsequently revoked or restructured in favour of Chinese partners. A new, more liberal era has come with China's accession to the World Trade Organisation in 2001, although the retail sector is still hobbled by rules that lack clarity or transparency.

Joint ventures in emerging markets

Today, only 5% of China's retail enterprises are joint ventures with foreign partners, and there are a host of failed joint ventures. But what about India? In 2006, against the backdrop of a thriving Indian economy and an automotive market on overdrive, India's Hero Group announced a joint venture with Germany's Daimler Trucks. The idea was that Hero could use the joint venture to expand into commercial vehicles. In April 2008, however, Hero unexpectedly announced it was pulling out. Though the company blamed falling demand for commercial vehicles, it could well be that financial pressure forced Hero to re-focus on its core business of motorcycles.

Another big joint venture in the commercial-vehicle market, between Ashok Leyland and Nissan, is under review. Britannia-Fonterra, TVS Group-Wabco and UTI-Shinsei Bank are all either reviewing or have already abandoned their partnerships.

The underlying problem is that many joint ventures fail in India either because of mismatched business strategies or because the Indian partner cannot come up with its share of the money.

Buying a local firm

Another way for a multinational corporation to enter an emerging market is to buy a local company. Let's look at one company that has used an acquisition to enter the "good enough" market in China.

Danfoss, a Danish heating and air-conditioning company, knew it could succeed in China if it could enter the low-cost market, which was dominated by Chinese companies, rather than the premium market, which was dominated by other multinationals. In 2006, Jorgen Claussen, the CEO, said that Danfoss's global business strategy was to make China its "second home market" after Europe. After acquiring Holip, a Chinese manufacturer of low-frequency converters, Danfoss started making a profit. By keeping the Holip brand and using its existing Danfoss sales network, the company was able to break into the "good enough" segment where many of the key players were local Chinese companies. This is just one example of how a successful acquisition of a local company can help a multinational break into an emerging market.

In some cases, a firm may enter an emerging market by first signing a joint venture with a local company and then acquiring it. But as we saw earlier in the Danone example, this isn't always successful. One joint venture-turned-acquisition that did succeed was between Daiichi Sankyo, a Japanese drug firm, and Ranbaxy Laboratories, an Indian family-run business. Daiichi Sankyo first acquired a stake in Ranbaxy in 2008. Several months later, it bought a majority stake. The deal has made Daiichi Sankyo one of the largest drug firms in the world.

When companies such as IBM, Capgemini and Accenture were building up their presence in India, EDS decided that it too would also make a move. In 2006, EDS acquired a majority stake in MphasiS, an information technology company based in Bangalore. MphasiS remained a separate company but gave EDS an extra 11,000 staff in India. By acquiring MphasiS, while still keeping it as a separate company, EDS was able to compete in the market with its multinational rivals.

More recently, eBay announced it was buying a 20% stake in PeaceSoft, a Vietnamese version of the online auction house. eBay has collaborated with PeaceSoft since 2008, and the purchase of this stake will give eBay a representative on the PeaceSoft board and so help it direct its plans to expand. It also helps eBay overcome the challenge of a non-English-speaking market.