

BRAZILIAN COMPANIES INTERNATIONALIZATION

BRAZIL'S MULTINATIONAL CORPORATIONS' CASES AND CHALLENGES

São Paulo - SP, Brazil

July, 2007



Agenda

Globalization and international expansion process

Theoretic background

6 questions to develop an international strategy

Natura's business case



Globalization and international expansion process



Globalization is not a new phenomenon. What is new is the increasing presence of Emerging Markets' companies in this process

- Internationalization is becoming each day a more relevant option for companies in both developed and developing economies
- Fast-moving globalization forces are spurring this trend
 - Internet
 - World Trade organization
 - Low-cost communication technologies
- Emerging markets' (EM) companies are starting to move beyond their home markets in order to:
 - grow further
 - create value
 - sustain long term competitiveness

EM's companies are becoming global giants

- There has been a time in which EM companies were just marginal players in the global economy
- This reality is drastically changing as these companies starts to hold leadership positions

EM global companies are no longer restricted to low technology sectors

Examples of EM leading companies

- **Bharat Forge (India)** is the world's second largest forging company
- **BYD Company (China)** is the world's largest manufacturer of nickel-cadmium batteries
- **Cemex (Mexico)** has developed into one of the world's largest cement producers
- **Embraco (Brazil)** is the world leader in compressor, with a 25% share
- **Ramabxy Pharmaceuticals (India)** is among the top ten generic-pharmaceutical players in the world
- **Embraer (Brazil)** has surpassed Bombardier as the market leader in regional jets.
- **Galanz Group (China)** command a 45% share of the microwave market in Europe and 25%share in the USA
- **Techtronic Industries Company (China)** is now the number-one supplier of power tools to Home Depot in the United States
- **Johnson Electric (China)** is the world's leading manufacturer of small electric motors



EM companies find sources of competition at home...

- Rapidly growing markets (some of which very large) are sufficient to support large domestic companies
- Low-cost resources, specially in basic labor
- Difficult operating environments produce some highly capable companies
- Training ground for competing with global players, as EMs become markets for these companies



...and go out to grow further

- Although home markets are good experience acquisition platforms, they do not allow companies to attain global scale

- Companies seek opportunities overseas to:
 - create sustainable advantage
 - create shareholder value
 - access profit pools
 - secure long-term access to raw materials

How this trend affects Brazil

- FDI outflows brings up the discussion over its validity

Positive aspects

- Technological gain
- Increase in good will
- Managerial capacity enhancement
- Markets expansion
- Better qualification and remuneration jobs in the origin country
- Accordance to the new economic environment

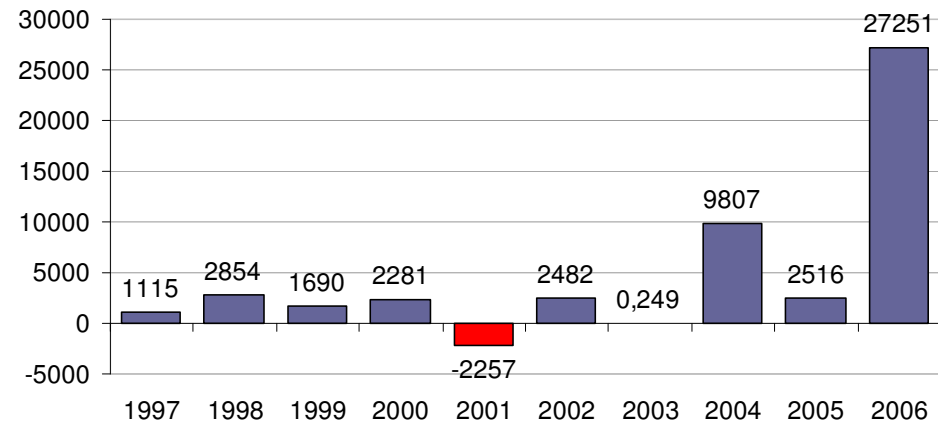
Negative aspects

- Total employment vs. Real economic aggregate
- Internal richness transference
- Increase in complexity and costs

For the first time Brazil presents significant positive FDI net flow

- Brazilian entrepreneurial landscape has a few companies seizing direct investments opportunities abroad
- However, the magnitude of the investments (mainly acquisitions) helped to increase dramatically the FDI net flow
- Brazilian companies are acquiring competitors in the developed countries.
- To this narrow group, exportations are giving place to the establishment of subsidiaries in foreign markets

Brazilian investments abroad - net flow (USD billion)



Internationalization is "essential to increase companies' international competitiveness, promoting development and making access to resources and markets easier" (ALEM and CAVALCANTI)

FDI "can create a group of indirect effects over productivity that are able to compensate partially or totally the negative effects over employment" (MOTTA VEIGA and IGLESIAS)

Brazilian Giants

- An analysis of the overall stage of internationalization of the most internationalized Brazilian companies suggests that
 - These companies' international activities are still broadly based on exports
 - Activities are led by fixed and human assets at headquarters in Brazil
 - The percentage of assets and employees abroad is low
 - Internationalization is becoming more relevant in companies' strategies

Source: FDC

Gerdau S.A



“To be a global steel company and one of the most profitable in the sector” (Company’s vision statement)

Industry: Steel and metal works

- The Gerdau Group is the largest producer of long steel in the Americas
- The company has mills in Brazil, Argentina, Canada, Chile, Colombia, the United States, Mexico, Peru, Uruguay
- The initial motivation was to avoid the Brazilian risk and access better financing conditions
- Internationalization mainly through **acquisitions**
- 57% of Gerdau’s production comes from outside Brazil

Internationalization strategic highlights

- Comparative advantage in steel production due to energy resources and lower labor cost.
- The company has consolidated its position in a chosen region, enhancing its regional influence
- Large export base and international subsidiaries enables strong foreign currency generation
- Proximity to consumer markets
- Gerdau S.A. shares are listed on the São Paulo, New York and Madrid Stock Exchanges

Construtora Norberto Odebrecht (CNO)

ODEBRECHT
Engenharia e Construção

Industry:
Engineering and
construction

“Being one of the top five non-financial private-sector business conglomerates in the Southern Hemisphere and the leader in its operating areas, with outstanding international operations” (Odebrecht Group’s objectives for 2010)

- CNO is the leading engineering and construction company in Latin America
- Present in South America, Central America and the Caribbean, North America, Africa, the Middle East and Europe
- The company was one of the pioneers in Brazilian Companies’ internationalization.
- The initial motivation for going international was the decrease in infra-structure investments in the late 70’s.
- The company had acquired expertise and machinery and needed to expand markets to maintain profitability

Internationalization strategic highlights

- Capacity to operate abroad due to decentralized structure
- Group structure enables to achieve economies of scale
- Tropical weather adaptation
- Government interest in projects enhances confidence
- Hydroelectric/Oil platforms construction expertise
- Operations can be implemented by transferring only essential resources
- Close monitoring inherent to engineering and construction is achieved by internalizing

Vale



VALE

Industry:
Mining

**“To be the most active Brazilian company worldwide that ranks among the three largest diversified mining companies in the world, and by 2010, achieve excellence in research, development, project implementation and business operations”
(Company’s vision statement)**

- CVRD is the Brazilian leading mining company
- The essentially exporting strategy carried out by CVRD is made evident by its low percentage of assets and employees abroad
- However, the company runs manganese production and R&D operations in France since 1999.
- Greenfield investments are common in mineral research and exploration
- CVRD can be found in 6 different world regions, through trade subsidiaries which support its exports.

Internationalization strategic highlights

- Access to one of the world’s largest mineral resources reserve
- Comparative advantages due to lower costs
- Integrate production and transportation enables quick exportation
- CVRD is listed in the Bovespa, NYSE and Madrid stock exchanges

Petrobrás



“ Petrobras will be an integrated energy company with a strong presence in the international market and as a leading force in Latin America” (Company’s vision statement)

- Petrobras is a pioneer in international expansion establishing its first international enterprise in Colombia in 1972
- The initial motivation for expansion was resource seeking
- For 2006-2010 the company aims to invest USD 7.1 billion in overseas operations
- Sales, marketing, procurement and manufacturing activities are also performed by Petrobras abroad
- R&D activities are concentrated at headquarters.

Internationalization strategic highlights

- Petrobras’ expertise in prospecting of remote oil is an unique and hard to imitate advantage
- Operational, management and technological excellence
- Fully integrated production chain
- Brazilian government interest in international expansion
- Political and national importance boosts internationalization process
- The company is listed in 4 stock exchanges (Bovespa, NYSE, Madrid and Buenos Aires)

Measuring a company/industry internalization degree

Internationalization index (SULLIVAN, 1994)

Markets

gross foreign revenue (exports revenue + revenue from foreign subsidiaries / total revenue)

Assets

Permanent assets abroad in the company's transformation chain / total value of company assets

Experience

number of years since the first subsidiary abroad was set up / number of years since the oldest subsidiary in the sample.

Human Resources

number of employees abroad / total number of employees

Value Chain

number of activities in the company's value chain executed by foreign subsidiaries / total number of activities in the company's value chain*

Governance

number of stock exchanges where the company is listed / maximum number of markets where sampled companies are listed

Geographic dispersion of markets

number of regions in the world where the company is present in other activities besides exports / total number of regions in the world**

* Ranked according to the following categories: sales and post-sales; marketing; manufacturing/operations; procurement; research and development.

** North America; South and Central America; European Union; East Europe; Middle East; Asia; Africa and Oceania.

Top 10 ranked Brazilian MNCs

Number	Company	M	A	HR	GD	VC	G	E	Degree of internationalization (from 0 to 7)
1	GERDAU	0,61	0,38	0,35	0,375	1	0,75	0,76	4,223
2	CONSTRUTORA ODEBRECHT	0,75	0,10	0,35	0,625	1	0,00	0,79	3,605
3	CVRD	0,77	0,02	0,04	0,75	1	0,75	0,18	3,512
4	PETROBRAS	0,10	0,07	0,11	0,625	0,8	0,75	1,00	3,454
5	MARCOPOLO	0,55	0,46	0,22	0,625	0,6	0,25	0,42	3,129
6	SABÓ	0,57	0,28	0,30	0,625	0,8	0,00	0,39	2,969
7	CONSTRUTORA ANDRADE GUTIERREZ	0,38	0,20	0,22	0,625	1	0,00	0,52	2,944
8	WEG	0,56	0,24	0,11	0,5	1	0,25	0,18	2,842
9	EMBRAER	0,92	0,01	0,14	0,375	0,8	0,50	0,09	2,838
10	TIGRE	0,18	0,13	0,15	0,125	0,8	0,00	0,88	2,263

M- Markets; A- Assets; HR- Human Resources; GD- Geographic Dispersion; G- Governance; E- Experience
 Source: Fundação Don Cabral



Theoretic background

What is known about internationalization?

- Most theories about entrepreneurial internationalization were oriented towards developed countries' enterprises.
 - Since the 50's, strategic changes faced by companies while internationalizing contributed to these studies.
- However, complexity and extremely different countries' structures and characteristics disable a general theory.
 - Theories based on both **behavioral** and **economic** motivations can be used together within adaptations for:
 - different economic, cultural, social and legal environments
 - industry global structure
 - company's path in internationalization

Some economic theories base international expansion motivations...

- **Rational decisions based on organization objectives and diverse environmental condition.**

Focus on costs and investment

Internalization theory

The company changes from exportation process to more complex ones in order to make resources and knowledge shared abroad exclusive property of the company (BUCKLEY & CASSON, 1976).

Cost of transaction theory

As the company incurs on costs to obtain information, it diminishes problems resulted from contracts and vice-versa. Therefore, costs related to hiring an agent or using own resources should be focused (WILLIAMSON, 1975).

Focus on comparative advantages

Industrial Organization

Operating abroad is more expensive than domestically, so, in order do succeed a company must explore comparative advantages based on market imperfections, instead of being dependent on picks and valleys of exportations (CAVES, 1971).

Product life cycle theory

Once the opportunities are tapped in the domestic market, the company starts to export to foreign countries its "old" operations and technologies to restart the profit cycle through a comparative advantage (VERNON, 1966).

...and some behavioral ones also

- The internationalization process may be a result of organizational behavior - **Theory of Firm**
- Internationalization is driven not by rational reasons, but by **knowledge acquirement experimental process**
- Penrose (1963) claims that the limit for the firm's growth is given by its resources valuation and knowledge available.
- Changes are ought to happen when existing markets are no longer enough attractive or when new attractive markets arise
- **Growth alternative is given by geographic expansion**
- Decisions concerning resources (financial, labor, management) transference are made in an increasing manner as consequence of the incremental learning

Uppsala theories

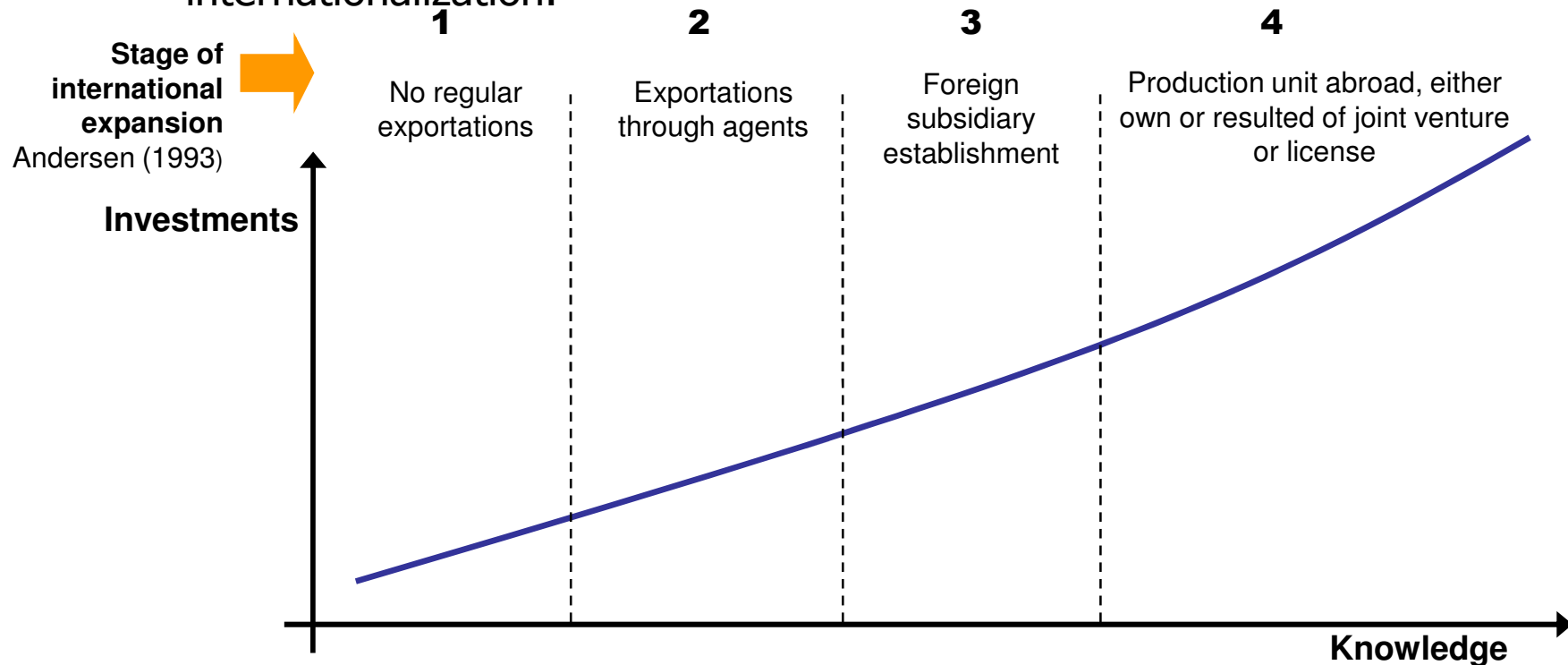
- Internationalization processes usually take time to become a relevant part of corporate strategy
- Theory of Firm - organizational behavior as decisive fact for market and entrance strategies

- **The Uppsala Model**

- Johanson and Wiedersheim (1975) found similar paths among Swedish MNCs during their international expansion
 - Establishment Chain
 - Psychic Distance

The Uppsala Model

- **Establishment chain:** resources are invested sequentially as the organization acquires knowledge of the market and internationalization.



- **Psychic distance:** is related to this behavior logic, as learning in the process is necessary to overpass differences in language, culture, managerial environment etc.

Uppsala theories

- Psychic distance is the sum of factors interfering the information flow between countries (VAHLNE & WIEDERSHEIM, 1973), such as:
 - language, development stage, culture, managerial practices, legal issues etc.
- As uncertainty and imperfections of new market's information diminishes commitment degree in decisions increases.
 - More distant markets would be chosen as experience and foreign markets actuation enlarges. (JOHANSON & VAHLNE, 1977)

Relevance of internationalization is enhanced as the company becomes more involved with international commerce, distribution and production. This involvement is based on the knowledge acquired after lower commitment experiences, such as exportations or licenses.

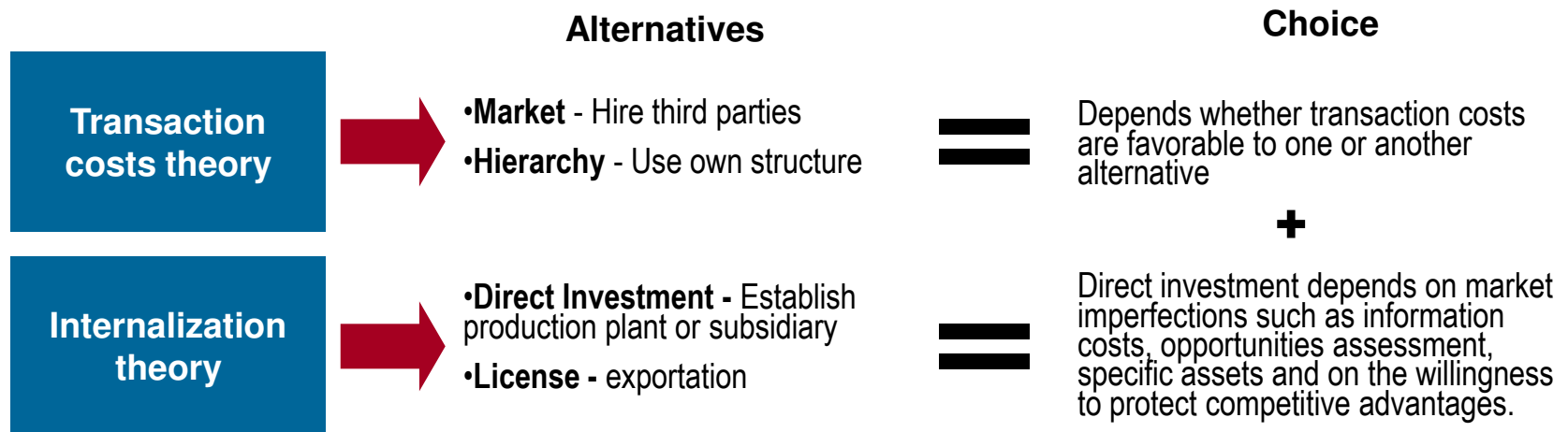
Motivations for foreign direct investments (FDI)

- Within combination of behavioral and economic aspects, Dunning (1994) identifies four kinds of motivation towards internationalization.

	Market seeking	Resource seeking	Efficiency seeking	Strategic asset seeking
Internationalization level	LOW HIGH			
	<ul style="list-style-type: none"> • Neighbor and regional markets exploration • Aims the broadening of the market size • Usually substitutes products formerly exported by the company • Commercial barriers, infra-structure can influence the decision 	<ul style="list-style-type: none"> • Oriented to the acquisition of specific resources. • Search for raw materials, labor and also know-how, technology, experience etc. 	<ul style="list-style-type: none"> • Investments driven for lower production costs. • Rationalize the structure in order to obtain full integrated efficiency from the assets worldwide. • Integrate subsidiaries to achieve economies of scale, scope advantages etc. 	<ul style="list-style-type: none"> • Acquisition of resources and capacities that help the company to enhance competitive advantages. • Distribution channel, knowledge, land are examples of strategic assets. • Acquisitions, merges and joint ventures are practices commonly used to seek these assets.

International production structure

- **Dunning (1988)** explains international production based on principles of transaction costs and internalization theories.



Sorts of internationalization advantages

Ownership specific advantages	Localization advantages	Internalization advantages
<p>What are my advantages in terms of efficiency? What differs me from my competitors?</p> <p>Structural advantages</p> <p>i.e.: knowledge about newer products; access to better raw materials; efficient techniques</p> <p>Transactional advantages</p> <p>i.e.:Quality standards; business knowledge; economies of scale</p>	<p>What advantage can I achieve by choosing here or there?</p> <p>Structural advantages</p> <p>i.e.: legal protection; high demand; high income; access to specific raw materials; technicians</p> <p>Transactional advantages</p> <p>i.e.:Financial arbitrage, FX rate risk administration; resources and knowledge exchange.</p>	<p>What would be the benefits of internalizing instead of exporting?</p> <p>Structural advantages</p> <p>i.e.: knowledge about newer products; access to better raw materials; efficient techniques</p> <p>Transactional advantages</p> <p>i.e.:Quality standards; business knowledge; economies of scale</p>

Implications

As companies hold many ownership advantages they enhance their competitive position in any market they may actuate.

Source: (DUNNING, 1988)

Location advantages shapes geographic disposition of a MNC, determining where to establish operations and why.

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The bigger the net benefits of these advantages the more inclined to be directly involved with production a company will be.



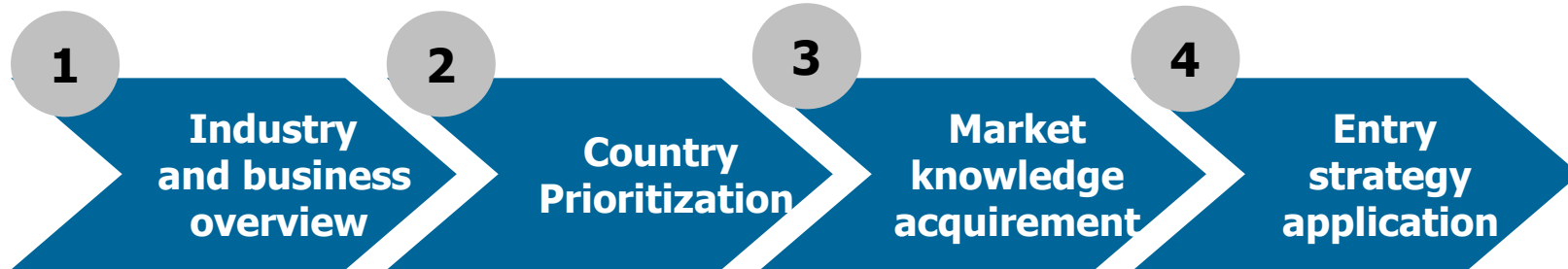
6 key questions to develop international strategies

6 key questions to construct internationalization strategies

- 1) What are the globalization trends in my sector / industry and how they affect my business?**
- 2) What are my core competencies / business model? Are they transferable abroad?**
- 3) Why "internationalization" should be a central point in my company's strategy?**
- 4) What countries should I consider? Exactly**
- 5) What are the characteristics of these markets?**
- 6) Which strategy should I deploy in these countries?**

Source: Factor de Solução / Kline Group

Business planning for international expansion



What?

- Understanding the relation among industry, business model and internationalization trends

- Analysis based in facts to identify the most attractive countries

- Single markets analysis before investing
- Revenues forecast and market plan development

- Evaluation of the entry modes
- How to apply this strategy

How?

- Identify industry's internationalization trends/pressure
- Approach business model and its transferability
- Align trends with corporate strategy

- Primary country selection
- Specify comparable and accessible criteria to evaluate countries
- Exploratory secondary search
- Identify the distance dimensions and institutional voids
- Ranking countries accordingly

- Secondary sources research and interviews
- How good is the company compared with local players?
- External environment analysis
- Development of a market plan through qualitative and quantitative information
- Revenues forecast based in market plan and external environment analysis inputs

- Criteria development according to key success factors
- Mapping of the possible ways of entry
- Identification of local partners

When?

- As the company start to suspect that internationalization is an option

- After a primary approach of localization opportunities that lead to several options

- When countries characteristics has to be focused to give inputs to investment decision

- When decision to enter market is made



What are the globalization trends in my sector and how they affect my business?

Analyzing opportunities of a Global Economy

- What are my industry/market's characteristics?
- How is my market growing? Where it grows more rapidly?
- How are regional markets performing?
- Where are my competitors?
- In which level does competition occur? Domestically or globally?
- Do my competitors have substantial advantages because they are global?
- What are these advantages? Can I also have them?
- Could I enhance my performance in the domestic market by internationalizing?
- How would it affect my business?

Internationalization pressure examples

R&D necessities

- adaptation to foreign demand specialties
- raising levels of technological integration and specialization
- the need to gain access to and exploit pockets of knowledge located in various countries
- the need to integrate “peripheral” forms of knowledge with core technologies.
- access to, and the use of, cheaper factors of production for the more time intensive phases of an R&D project.

Domestic low demand

- domestic demand is not enough to access adequate return
- necessity to amortize development costs
- grow further is only possible through expanding markets

Global brands competition

- some industries have the massive presence of global players
- pressure is to obtain competitive parity in terms of:
 - global Brand recognition; Worldwide Advertisement/Merchandising
 - experience
 - bargain empowerment

Scale and scope economies

- cost of production may require additional demand to be profitable
- different products adapted to different markets that can benefit from similar resources and capabilities can leverage company's ´profitability
- high fixed costs
- high technological

Internationalization pressure can differ among companies in the same industry

- Companies in the same industry can face different motivations for international expansion
- For some companies internationalization is the central part of corporate strategy, while for others its only peripheral or inexistent
 - Supermarket Chains (Wal-Mart vs. K-Mart)
 - Fast Food Chains (McDonald's vs. Wendy's)
- Internationalization trends can only be seized by transferring capabilities and resources efficiently
- Companies have to balance its capacity to transfer its business model efficiently and the benefits of internationalizing



What are my core competencies? Are they transferable abroad?

What are my core competencies? Are they transferable abroad?

- The identification of company competencies are vital to shape strategy while internationalizing.
- Companies must be able to transfer its core competencies to new markets
- The competencies are related to ownership specific advantages
- Tools usually used to identify competencies are:
 - RBV approach - VRIO Framework
 - S.W.O.T Analysis
 - Ownership specific advantages

RBV approach example - Natura

Resource or Capability	1) Is it Hard to Copy?	1a) Is it unique?	1b) Does a path dependency exist in the accumulation of the resource?	2) Durability: How quickly does the resource depreciate?	3) Who captures the value that the resource creates?	4) Is there reinvestment in this resource / capability?	5) Can resource be upgraded to translate into a new capability?	6) Is the resource being leveraged?	Could it be deployed abroad?
Capability of leveraging Brazilian Biodiversity into cosmetics	Yes	Yes	Yes	The products are easy to imitate, but capability to do them as broad, intensive and innovatively as Natura is hard to be acquired	Natura	Yes	Yes	Yes	Yes
Integrated Research, Production and Logistics center	Yes	No	Yes	Medium	Natura/ Suppliers	No	yes	Yes	Yes, but in neighbor countries only
System Infrastructure: Ordering	No	No	No	Rapidly	Sales representatives/ customers	Yes	No	Yes	Partially in neighbor countries
Innovation	Yes	No	Yes	Rapidly	Natura/ Sales representatives (direct sales business is driven by new products)	Yes	Yes	Yes	Yes
Brand equity (reputation / image)	Yes	No	Yes	Medium	Natura/ Sales representatives	Yes	Yes	Yes	Yes, but it would require massive advertising and communication investments
Relationship with suppliers	Yes	No	Yes	Slowly	Suppliers/ Natura	Yes	Yes	Yes	Yes, in neighbor countries mainly
Relationship w/ consultants	Yes	Yes	Yes	Slowly	Natura/ Sales representatives/ Customers	Yes	Yes	Yes	The process to build a relationship can be used, but it would require time and investments to be relevant

Competitive strengths and weaknesses of EC companies

Strengths

- **Low-cost access to key resources**
 - Labor; P&E (Property and Equipment); Raw Materials
- **Home markets environment**
 - often very large and among the fastest-growing
- **Strong operations platforms**
 - younger assets (ex.: China 7,2 years and USA 16,9 years)
 - more flexibility (use of labor instead of machinery)
- **Innovation**
 - Apparent weakness but is changing
 - Fast developing R&D talent; R&D resources are far less expensive

Weaknesses

- **Supply-chain management**
 - requires requires considerable skill, resources and organizational discipline
- **Going to market**
 - lots of hurdles such as becoming intimate with customers, their needs, design products and acquiring competitive distribution capabilities
- **International management talent**
 - Although quality management in EC global players is large, they still lacks in terms of internationalization skills
- **Rigorous Strategy**
 - Most EC players are in an incipient stage of internationalization and therefore lacks in coherent strategies towards globalization and development

Source: BCG

Ownership specific advantages

	Market Seeking	Resource Seeking	Efficiency Seeking
Ownership specific advantages	<p>Associated with management, commercialization and financing</p> <p>Domestic learnings that can be used in other economies</p> <p>Capacity to adapt to local characteristics</p> <p>Capacity to compete in open economies</p> <p>Rationalization of management</p> <p>Domain of production technologies</p>	<p>Management and commercialization capabilities</p> <p>Relationship with governments</p> <p>Technical competencies in off-shore exploration</p> <p>Logistics capability</p>	<p>Technological domain of process and product</p> <p>Management and commercialization capabilities</p> <p>Innovative competencies</p> <p>Adaptation to cultural, geographic, economic etc. backgrounds</p> <p>Large enterprises management competency</p> <p>Relationship with governments or support by authorities</p>



Why internationalization should be a central point in my company's strategy?

Why "internationalization" should be a central point in my company's strategy?

- Companies holds both economic and behavioral motivations to go international, amongst which:

- Costs reduction
- Increase markets
- Tax barriers transposition
- Broadening suppliers' chain
- Competitive parity
- Acquiring knowledge from market and researches
- Human resources seeking
- Industry pressure
- Lower cost of capital
- Demonstration effects
- Personal wishes

Motives must be followed by operational effectiveness

- Although having a reason to internationalize is essential, it is not enough to support a company's global engagement
- International expansion requires a deep understanding of its reflexes, viability, localization opportunities etc.
- Companies must be able to shape strategies that consider this facts, and organize its international production accordingly
- **The Eclectic Paradigm** (DUNNING, 1988) helps to shape a strategy based on **costs and advantages** inherent to an internationalization opportunity.

So, why "internationalization" should be a central point in my company's strategy?

- Some answers to this question are:
 - To increase your knowledge of foreign markets
 - Opportunities in domestic market are no longer enough to attend profitability goals
 - To sustain your internal advantages abroad
 - To explore comparative advantages in foreign markets
 - To seek for a specific resource
 - If the cost for exporting is bigger than of operating abroad
 - To extend the life-cycle of a certain product
 - If in your industry globalization is vital



What countries should I consider?

What countries should I consider?

- Internationalization opportunities can be seized by entering in specific countries
- Companies usually face multiple options to engage in foreign markets
- It is necessary that countries selected to integrate the company's market portfolio hold some advantages
- There are several ways of analyzing countries, both objectively and subjectively:
 - Composite Indices
 - Institutional Voids Spotting
 - CAGE Framework
 - Localization Advantages

The trouble of using composite indices

- Companies often base their internationalization strategies by using composite indices that ranks countries according to specific parameters
- These indices may lead to erroneous conclusions since it can classify extremely different countries as very similar
- Although China and India are closely ranked, there is no doubt that they differ widely in terms of cultural and administrative environments

	CHINA	INDIA
Growth Competitiveness Index ranking* (out of 104 countries; for 2005)	46	55
Business Competitiveness Index ranking* (out of 103 countries; for 2003)	47	30
Governance indicators (percentile rankings)** (out of 199 countries; for 2002)		
Voice and accountability	10.1	60.2
Political stability	51.4	22.2
Government effectiveness	63.4	54.1
Regulatory quality	40.2	43.8
Rule of law	51.5	57.2
Control of corruption	42.3	49.5
Corruption Perceptions Index ranking*** (out of 145 countries; for 2004)	71	90
Composite Country Risk Points**** (for January 2005; the larger the number, the less risky the country)	76	72
Weight in Emerging Markets Index***** (for February 2004, out of 26 emerging markets)	4.76%	5.02%

Sources

* World Economic Forum, "Global Competitiveness Report", 2004-2005

** World Bank Governance Research Indicator Country Snapshot, 2002

*** Transparency International, Corruption Perceptions Index, 2004

**** The PRS Group, International Country Risk Guide, January 2005

***** Barclays Global Investors, iSharaes "2004 Semi-Annual Report to Shareholders

Source: Harvard Business Review - June 2005 - Strategies that fit Emerging Markets

Identifying institutional voids to complete composite indices analysis

	INDIA	CHINA
POLITICAL AND SOCIAL SYSTEM	Political Structure	
	Democracy is vibrant. The government is highly bureaucratic. Corruption is rampant in state and local governments	The Communist Party maintains a monopoly on political power. Local governments make economic policy decisions. Officials may abuse power for personal gain
	Civil Society	
	A dynamic press and vigilant NGOs act as checks on politicians and companies	The media is muzzled by the government, and there are few independent NGOs. Companies don't have to worry about criticism, but they can't count on civil society to check abuses of power
OPENNESS	Modes of entry	
	Restrictions on greenfield investments and acquisitions in some sectors make joint ventures necessary. Red tape hinders companies in sectors where the government does allow foreign investment	The government permits greenfield investments as well as acquisitions. Acquired companies are likely to have been state-owned and may have hidden liabilities. Alliances let companies align interests within all levels of government

Source: Harvard Business Review - June 2005 - Strategies that fit Emerging Markets

Identifying institutional voids to complete composite indices analysis

	INDIA	CHINA
PRODUCT MARKETS	Product development and intellectual property rights (IPR)	
	Some local design capability is available. IPR problems with the United States exist in some industries. Regulatory bodies monitor product quality and fraud.	Imitation and piracy abound. Punishment for IPR theft varies across provinces and by level of corruption
	Suppliers base and logistics	
	Suppliers are available but their quality and dependability varies greatly. Roads are in poor condition. Ports and airports are underdeveloped	Several suppliers have strong manufacturing capabilities, but few vendors have advanced technical abilities. The road network is well developed. Port facilities are excellent
Brand perception and management		
Consumers buy both local and global brands. Global ad agencies are present, but they have been less successful than local ad agencies	Consumer prefer to buy products from American, European and Japanese companies. Multinational agencies dominate the business	

Source: Harvard Business Review - June 2005 - Strategies that fit Emerging Markets

Identifying institutional voids to complete composite indices analysis

	INDIA	CHINA
LABOR MARKETS	Market for managers	
	The country has a high quality pool of English-speaking management talent fueled by business and technical schools. Local hires are preferred over expatriates	There is relatively small and static market for managers, specially away from the eastern seaboard. Many senior and middle managers aren't fluent in English. A large number of managers are expatriates. Some members of the Chinese Diaspora have returned home to work
	Workers market	
	The trade union movement is active and volatile, although it is becoming less important. Trade unions have strong political connections	Workers can join the government-controlled All-china Federation of Trade Unions. Historically, there were no industrial actions, but there have been recent strikes at Hong Kong and Taiwan-owned manufacturing facilities

Source: Harvard Business Review - June 2005 - Strategies that fit Emerging Markets

Identifying institutional voids to complete composite indices analysis

		INDIA	CHINA
CAPITAL MARKETS	Debt and Equity		
		The local banking system is well developed. Multinational can rely on local banks for local needs. Equity is available to local and foreign entities	The local banking system and equity markets are underdeveloped. Foreign companies have to raise both debt and equity in home markets
	Venture Capital		
		VC is available in some cities and from de Indian Diaspora	VC availability is limited
	Accounting standards		
	Financial reporting which is based on a common-law system functions well	There is little corporate transparency. China's accounting standards are not strict, although the China Securities Regulatory Commission wants to tighten disclosure rules	
Financial distress			
	Bankruptcy processes exist but are inefficient. Promoters find it difficult to sell off or shut down "sick" enterprises	Companies can use bankruptcy processes in some cases. Write-offs are common	

Source: Harvard Business Review - June 2005 - Strategies that fit Emerging Markets

Distance still matters?

- In recent years much has been made of the death of distance
- People argue that information technologies and global communications are shrinking the world, turning it into a homogeneous place
- This assumption is incorrect and dangerous when it comes to business (GHEMAWAT, 2001)
- Traditional country portfolio analysis needs to be tempered by a clear evaluation of the four dimensions of distance
 - **C**ultural
 - **A**dministrative
 - **G**eographic
 - **E**conomic

Source: Distance Still Matters: the hard reality of global expansion. Pankaj Ghemawat. Harvard Business Review September 2001

The CAGE Distance framework

	CULTURAL DISTANCE	ADMINISTRATIVE DISTANCE	GEOGRAPHIC DISTANCE	ECONOMIC DISTANCE
attributes creating distance	<p>different languages</p> <p>different ethnicity; lack of connective ethnic or social networks</p> <p>different religions</p> <p>different social norms</p>	<p>absence of colonial ties</p> <p>absence of shared monetary or political association</p> <p>political hostility</p> <p>government policies</p> <p>institutional weakness</p>	<p>physical remoteness</p> <p>weak transportation/ communication links</p> <p>lack of sea or river access</p> <p>size of country</p> <p>lack of common border</p> <p>differences in climates</p>	<p>differences in consumers' income</p> <p>differences in cost and quality of:</p> <ul style="list-style-type: none"> - natural resources - financial resources - human resources - infrastructure - intermediate inputs - information knowledge
industries or products generally affected	<p>Products with high linguistic content (TV)</p> <p>Products that affect cultural or national identity (food)</p> <p>Product features vary in terms of size (cars); standards (electrical appliances); packaging</p> <p>Products that carry country-specific quality associations (wines)</p>	<p>Government involvement is high in industries that are:</p> <p>Producers of staple goods (electricity)</p> <p>Large employers (farming) and suppliers to government (mass transportation)</p> <p>Producers of other entitlements (drugs)</p> <p>Vital to national security</p> <p>Exploiters of natural resources</p> <p>Subject to high sunk costs</p>	<p>Products have a low value-to-weight or bulk ratio (cement)</p> <p>Products are fragile or perishable (glass, fruit)</p> <p>Communications and connectivity are important (financial services)</p> <p>Local supervision and operational requirements are high (many services)</p>	<p>Nature of demand varies with income level (cars)</p> <p>Economies of standardization or scale are important (mobile phones)</p> <p>Labor and other factors cost differences are salient (garments)</p> <p>Distribution or business systems are different (insurance)</p> <p>Companies need to be responsive and agile (home appliances)</p>

Source: Distance Still Matters: the hard reality of global expansion. Pankaj Ghemawat. Harvard Business Review September 2001

Adding distance as a attractiveness fact

- Distance can diminish or increase attractiveness
- Traditional country portfolio analysis do not consider these dimensions of distance
- Sometimes distance issues can overpass the economic attractiveness of a market
- Therefore, less attractive countries may become better options sometimes

Localization advantages

	Market Seeking	Resource Seeking	Efficiency Seeking
Localization advantages	<p>Market size</p> <p>Geographic and cultural distance</p> <p>Markets with insufficient offer</p> <p>Regional integration (Mercosul, NAFTA)</p> <p>Similarity in consumption patterns</p>	<p>Raw materials</p> <p>Geographic and cultural distance</p> <p>Technologies</p> <p>Human resources</p>	<p>Market size</p> <p>Access to other markets</p> <p>Innovative organizations</p> <p>Technological network</p>

- Localization advantages are narrowly related to internationalization objectives and host country's characteristics
- The country must give support to capabilities and resources transference



What are the characteristics of these markets?

Knowing the market

- The countries' institutional voids analysis gives a panorama of market conditions
- But to base international expansion investment decisions, one must be completely sure of the new market reality
- After screening countries and finding the top-rated ones, it is made necessary to determine the expected value the expansion might generate

Identifying markets' critical points

After the identification of one or more geographic markets it is made necessary to determine the expected value the expansion

Revenues Forecast

- Find the total customer base
- Identify competitors
- Determine the market size
- Segment market and identify target portion
- Estimate the penetration
- Determine price per unit

Costs and investments

- Determine how operations will be established
- Analyze locations and transaction costs
- Country's tax structure analysis
- Labor relations
- Income level
- Legislation analysis

Risk adjusted discount rate

- Country's risk profile
- Legal and regulatory environments analysis
- Success probability
- Impact on company's WACC

Main Tools

- Secondary and primary search
- Queries and interviews
- Focus Group
- Benchmarking
- Fundamental analysis

- Secondary and primary search
- Financial analysis
- Cost systems
- Tax planning

- Secondary and primary search
- Financial markets reports
- Financial analysis software



**What strategies
should I deploy in these countries?**

What strategy should I deploy?

- Before identifying what strategy to adopt in specific countries, one must have clear what is the main international strategy
- The main international strategy is responsible for bonding all internationalization moves a company makes
- This strategy will later be adapted for specific markets
- There is no unique approach over internationalization strategies
- Merges of several strategic approaches can be made

Six main strategies for globalization

Strategy 1

Taking EC Brands global

- transfer established home-market product lines and brands to global markets

Strategy 2

Turning EC engineering into global innovation

- marketing innovative technology-based solutions

Strategy 3

Assuming global Category Leadership

- establish as specialists and global leaders in one specific, relatively narrow product category

Strategy 4

Monetizing EC natural resources

- leverage home countries' natural-resource advantages

Strategy 5

Rolling out new business models to multiple markets

rolling out business primarily pioneered in the home market

Strategy 6

Acquiring natural resources

- acquire vital raw materials for their home market

Source: BCG

Five differently based strategies

Strategy complexity increases

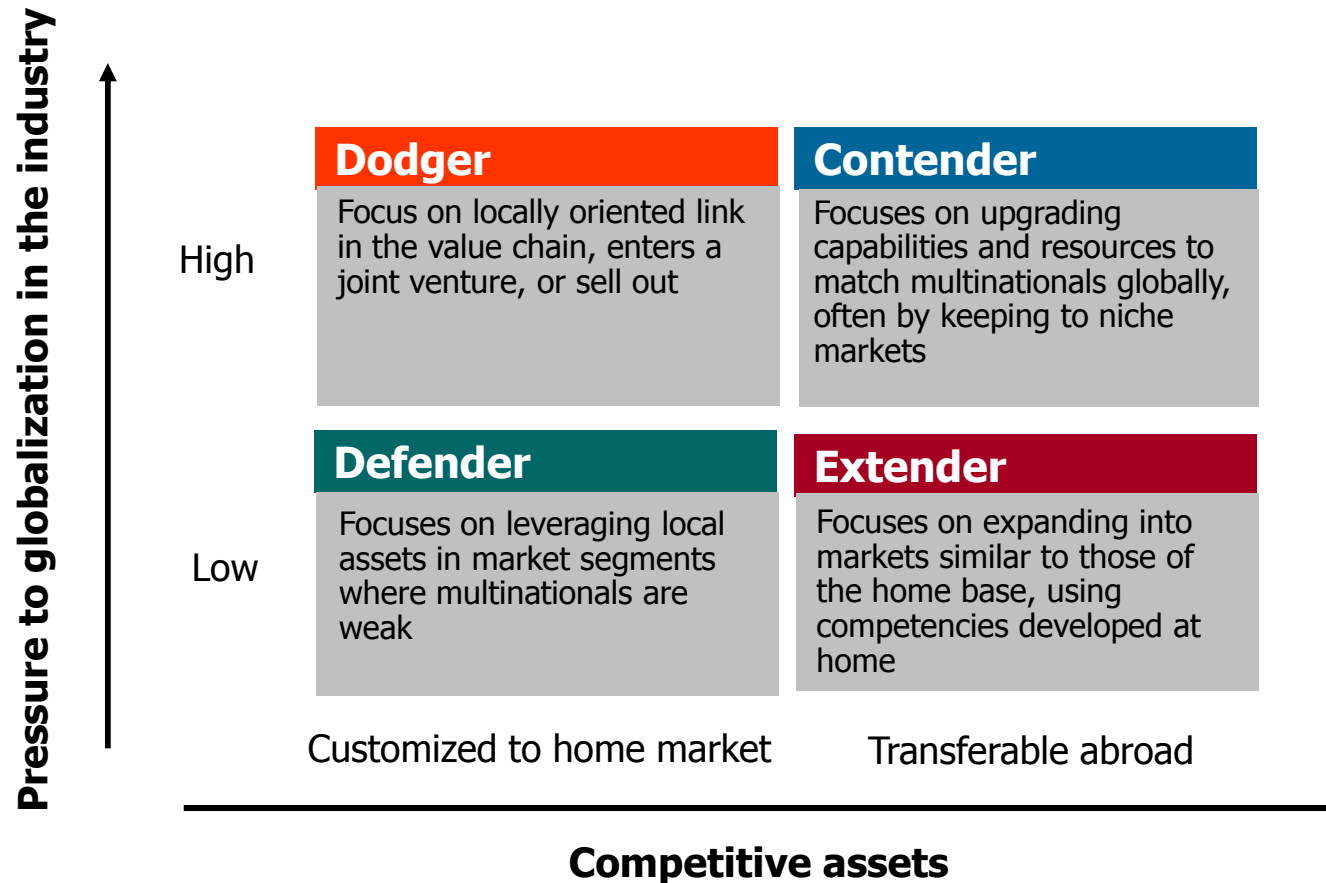
However, there is no need to a company to perform them sequentially

- **Origin basis strategy**
 - operations are centralized in the headquarters and internationalization is carried through exportations
- **Portfolio strategy**
 - establishment or acquisition of overseas operations but directly subordinated to the home country
- **Regional strategy**
 - conversion of an overseas operations into a autonomous subsidiary
 - multi-regional version of the origin basis strategy
 - distribute fixed costs over countries in a region
- **Platform strategy**
 - distribute fixed costs over regions
 - useful to achieve scale and scope economies
- **Mandate strategy**
 - Similar to platform strategy but approaching also specialization based on competencies owned by specific subsidiaries

Toyota's internationalization case is a miscellaneous of these kinds of strategy

Source: Harvard Business Review

Strategic focus to compete with giants



Source: Competing With Giants

Internationalization entry strategies

Globalization stage
(DAFT, 2006)



Domestic

Beginning of the international involvement

International

Exportations to achieve market expansion with low investments

Multinational

Increase in the international operations broadness, with transference of activities to foreign subsidiaries

Global

Property control and high management are spread worldwide, and national identity is not recognizable



Low



High

	Characteristics	Advantages	Disadvantages
Direct exportation	Company exports without needing to invest in production or set arrangements in the country	low risk, flexibility	marketing and logistics investments
Exportation through third parties	Company exports with the intermediation of distributors, representatives, agents etc.	quick absorption of commercial knowledge	low control over products and processes
Piggy-back exportation	Company without image or structure abroad exports through a national company that has them	low transaction costs	low market knowledge
License	Allows a foreign company to manufacture certain products abroad	low cost	low control, risk of losing the know-how
FDI - Joint ventures and partnerships	Deals with hostess country companies in order to develop activities such as distribution, production etc.	costs sharing, new competencies development	conflicts between parts and risk of know-how lost
FDI - Merges and Acquisitions	Company gets fully involved with the management of production assets	high control, high return potential	maximized risks, complex entrance

Internalization advantages

- The strategy of internalization is positive when internationalization plays a central role in the company's strategic statements
- Internalization often requires large amount of investments but also brings advantages

	Market Seeking	Resource Seeking	Efficiency Seeking
Internalization advantages	Market empowerment Difficulty to transfer tacit competitive advantages Distribution channel control Common governance advantages Regulatory requirements	Raw materials control Technology and human resources captation Strategic capitalization	Market empowerment Supply of complementary resources Geographic/productive especialization Access to tecchnologies



Strategies for EC companies to overpass entry difficulties

- Making acquisitions to gain market access and required commercial capabilities
- Building deep relationships with limited number of large retailers
- Targeting high-volume sales to relatively small number of large industrial and OEM clients
- Concentrating on developed markets that are lower priority for global players
- Serving other ECs that have similar characteristics to the home market before moving into high developed ones



Natura's business case

Company overview



Industry:
Cosmetics &
Toiletries

Natura's Vision

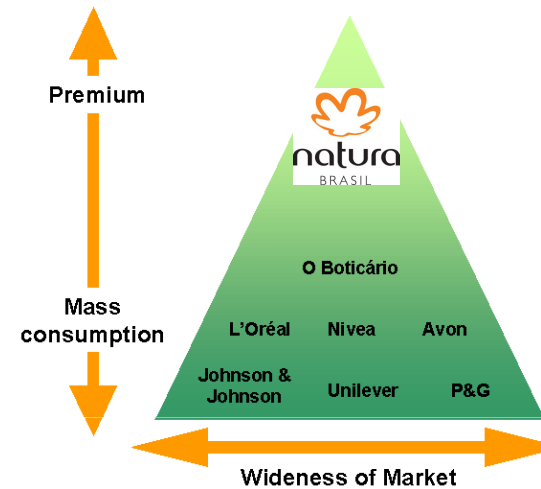
Because of its corporate behavior, the quality of the relationship it establishes and the quality of its products and services, Natura aims to be an **international brand**, which has as a target the ones who are committed to the construction of a better world, based on a better relationship with themselves, with others and with the (nature) environment.

- Natura is second overall in the Cosmetics and Toiletries marketer in Brazil, with total sales of BRL 3,890 million
- The brand is recognized for its different approach over beauty treatments and products

Revenues Breakdown 2006		
	Revenues (BRL)	Units sold (in millions)
Brazil	1,158.5 million	241.0
Latin America*	54.9 million	11.6
Other units**	5.1 million	0.58

* Argentina, Chile and Peru
** Mexico, Venezuela and France (under implementation)

Price Positioning



Brand Perception (as of 2006)		
	Natura	2nd in rank
Top of Mind	27%	25%
Preference	43%	19%
Innovation	68%	49%
Quality	70%	56%



Natura's internationalization key milestones

- 1982: Started activities in Chile (subsidiary)
- 1983: Bolivia: (through a local distribution)
- 1994: Argentina and Peru (local subsidiaries subordinated to Brazil)
- 2005: Opening of "Maison Natura" in Paris, France
- 2007: Start up in Venezuela and Colombia
- 2008: Russia and the U.S.

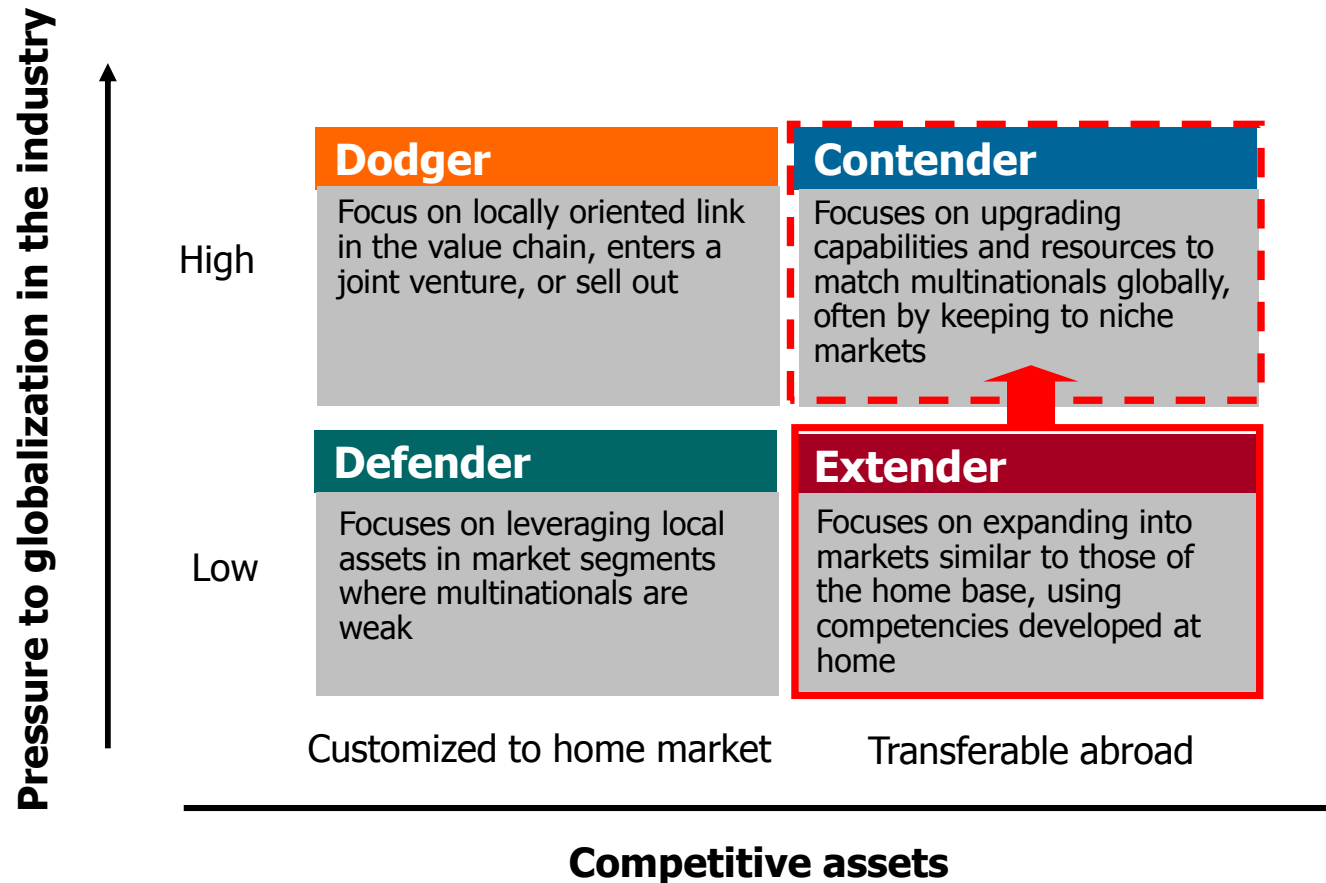
Natura has an “extender” approach in its 1st stage of internationalization...

	Natura	Avon / L’Oréal
International Expansion Model	<p>Neighbor and Regional Markets seeking</p> <p>Resources (knowledge) seeking</p>	<p>Global marketing and efficiency seeking</p>
Motivations	<ul style="list-style-type: none"> -Broad market size; -Customers’ proximity; -Advantages of integrated market (Mercosul); -Geographical, cultural and ethnic proximity -Become a regional strong player ; -Geographic dispersion in order to reduce risk; -Market access control <p>-Strengthen of its global/regional position</p> <p>-Knowledge access</p> <p>-Capabilities development</p>	<ul style="list-style-type: none"> -Become a global player in order to challenge competitors; -Ending or decreasing taxes of growth in the domestic/regional market. -Explore the knowledge acquired in other economies to succeed in new markets
Competitive advantages	<ul style="list-style-type: none"> -Capacity to adapt to the local market characteristics -Exploration of Integrated Center still possible -Brazilian Biodiversity as a differentiation factor. -Sales and order systems are more likely to work. -Empathy of the South American continent towards social sustainable development. <p>-Concept of well-being-well</p> <p>-Beauty image associated with Brazil</p> <p>-Tropical natural products is a differential</p>	<ul style="list-style-type: none"> -Domain of products and process technologies -Financial capacity -Large enterprises management skills. -The company has already been in process of adaptation to cultural, geographic , economic conditions in other countries. - Generally are supported by both local and domestic governments.

Natura has an “extender” approach in its 1st stage of internationalization...

	Natura	Avon / L’Oréal
Internalization advantages	<ul style="list-style-type: none"> -Increase market force -Distribution Channels control -Better market monitoring -Decrease geographic distance -More capacity to assimilate knowledge -Expansion possibility 	<ul style="list-style-type: none"> -Supply of complementary goods and services -Geographic specialization -Access to new technologies
Localization Advantages	<ul style="list-style-type: none"> -Market Size -Geographical and cultural proximity -Similarity in the concurrency and consumption patterns. -Being present in the world’s most sophisticated market. -Market importance and size -Existence of strategic assets (Knowledge) 	<ul style="list-style-type: none"> -Market Size -Access to third markets related to the ones explored - Market importance - Access to strategic asset
Investment Modalities	<ul style="list-style-type: none"> -Investment in subsidiaries with own capital or third parties’. -Investment in subsidiaries with own capital or third parties’. 	<ul style="list-style-type: none"> -Generally, purchase of existing firms; -Mergers (usually with company’s control) -Direct investments
Subsidiaries Characteristics	<ul style="list-style-type: none"> -Representatives of the holding company. -Replication of the business model -Related only with commercialization -Works as a knowledge laboratory -Is more focused in the brand image and reputation -Great role in distributing the products in more developed markets. 	<ul style="list-style-type: none"> -Integrated subsidiaries -Activities concerning production, marketing and commercialization -Strategic role -Knowledge constructors

... Trying to move to a kind of “Contender” positioning from now on (France; Russia; U.S.)



The Kline Group. O grupo Kline é uma organização de consultoria internacional com 45 anos de atuação, sediada nos EUA e com escritórios em todos os continentes. Atua na América Latina através de sua filiada Factor de Solução Consultoria, assistindo empresas Brasileiras e Sul Americanas no mapeamento e endereçamento de problemas práticos em estratégias de mercado e de posicionamento competitivo, programas de diversificação e de internacionalização, com foco nos segmentos químicos, ciências da vida, energia e cosméticos.

Se desejar maiores informações acerca do conteúdo deste documentos ou dos serviços que o Grupo Kline oferece, por favor entre em contato:

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