

Planning the Impossible with Lighting Solutions: A Strategy to Enter Brazil

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Abstract

Metalumen, a Guelph-based lighting solutions manufacturer, is considering the Brazilian market. For Canadian companies, the Brazilian market is not only difficult to enter, but it is also difficult to understand. In this paper, a strategy for Metalumen to enter the Brazilian market is explored. Based on a review of the literature, segmentation, mode of entry and distribution strategies are suggested. Data was also collected by a group who went to Sao Paulo to validate assumptions onsite. The paper suggests that Metalumen, will have the greatest success in entering the market using a Strategic International Alliance (SIA) strategy. Other dimensions of international marketing in Brazil are also presented.

Keywords: Brazil, strategic alliances, global segmentation, global distribution

1. Introduction

Metalumen, a Canadian-based company, which manufactures industrial lighting solutions, seeks the best expansion strategy to enter into the Brazilian market. Brazil is currently an attractive starting-point for Metalumen's international expansion due to the country's tremendous economic growth, resulting in ample opportunity for infrastructure development (Chung and Enderwick, 2001). The following paper depicts the optimal strategic plan for Metalumen to pursue in this endeavor. Data was further validated by a group who visited Brazil in 2012 to verify assumptions and consolidate strategic beliefs (Gall, 2012).

This includes: the ideal market segment to enter, the most efficient mode of entry, and the most cost-effective method of distribution. The market segment with the most opportunity for Metalumen's initial entry is the transportation and infrastructure sector (Dubowski, 2010). This is due to the many upgrades, renovations, and expansion projects being funded by the government and private investors. Metalumen will have the greatest success in entering the market using a Strategic International Alliance (SIA) strategy, as the company will be able to gain valuable insight pertaining to the Brazilian market from their partner firm's prior business experience and will gain a sustainable reputation in an otherwise unchartered region. The method of distribution that Metalumen should employ involves outsourced manufacturing in Brazil (Brida, Lionello et al. 2011). This will allow Metalumen to benefit from lowered costs of production while avoiding high exporting costs and elevated Brazilian protectionist import taxes and maintaining an ease of product access within the country (Kayo et al. 2010).

Further analysis contained within this paper include: prospective organizations with whom to form a strategic international alliance, potential target projects within Brazil, pricing strategies to employ, predicted return on investments, a detailed cost analysis, and an examination of future opportunities and risks (Higgs, 2011).

2. Literature Review

Dealing with emerging markets creates challenges (Oehler-Sincai, 2011). A country like Brazil has significant socio-economic and environmental challenges (Turcato et al. 2012). National competitiveness with emerging markets such as Brazil is a complex and dynamic concept that transcends macro- and micro-economic foundation of value creation and prosperity. Canada has been particularly challenged by trade disputes with Brazil which erupted in the aeronautics industry (Gouvea, 2004).

2.1 Brazil's Transportation and Infrastructure Sector

Brazil has seen significant growth over the past few years both economically and politically. The increased political stability of the past fifteen years has allowed for the economy to prosper, especially recently (Adroque and Cerisola, 2010). Public debt is a problem in Brazil; however the situation has greatly improved. Currently Brazil's economy is the sixth largest worldwide (Jackson, 2010).

The Brazilian government expects to spend billions in the upcoming years on infrastructure, of which \$US 541 billion will be associated with the 2014 FIFA World Cup and the 2016 Olympic Games (Trading Economics, 2012). \$US 16 billion of the budget will be for improvements to the urban transportation (Armijo and Burges, 2010). The government is also planning to implement the second phase of the Growth Acceleration Program (PAC), where \$US 104 billion of PAC will be invested into transportation improvement (Yearbook, 2012). As well, the public health and education systems currently in place are not up to the standards an aspiring country such as Brazil requires (Arruda de Almeida, 2003). Therefore, the government has allocated approximately \$US 85 billion to projects associated with increased healthcare and school infrastructures. These values show that the infrastructure industry in Brazil has extensive potential for Metalumen (Bland, 2012).

The construction and engineering segment was worth \$US 73.9 billion in 2012. The industry grew 10.4% and by 2014 the industry is forecasted to increase an additional 51.2% to reach a value of \$US 111.7 billion. Major Brazilian construction companies will be taking on much of the work accompanying the infrastructure improvements such as Odebrecht, Andrade Gutierrez S.A and Constructora Queiroz Galvao S.A.

To further determine the competitive intensity and attractiveness of the transportation and infrastructure sector (Jiang, Chu and Pan, 2011). Factors analyzed include the threat of substitute products, the threat of established rivals, the threat of new entrants, the bargaining power of suppliers, and the bargaining power of customers.

2.2 Metalumen: Company Analysis

Metalumen is a family-run business, which has led to the formation of a unique company culture that accepts a casual and flexible approach to business. A core competency of Metalumen's is their customer-centric approach. The company dedicates time and cares to ensure that their customers are satisfied and have received the appropriate lighting solutions for their specific needs. Metalumen strives to be dependable and consistent in providing high quality, customized products. With a reputation based very highly upon their capacity to deliver the best solution, it is vital that this competency is not obstructed while choosing the mode of entry into Brazil.

2.3 Market Segmentation Strategy

Due to the nature of Metalumen's product and the opportunities presented by the upcoming expansion of the Brazilian transportation and infrastructure sector, the company should aim to target segments in the construction industry (Canever, Van Trijp and Van der Lans, 2007). Within the construction industry, infrastructure segments include corporate properties, transportation, healthcare facilities, and residential and educational buildings that Metalumen could target (Papadopoulos, 2011).

Each segment offers potential for Metalumen; however the upcoming opportunities in the transportation segment are the most attractive. Potential projects in the transportation segment will be further discussed in subsequent sections of this study (Finchelstein, 2010).

2.4 Mode of Entry

The method of entry that Metalumen uses to expand its business into Brazil will be crucial to its level of success in the foreign market (Hague and Harrison 2011). Based on the premise that Metalumen is aiming to enter the Brazilian market in the transportation and infrastructure sector – by targeting the upcoming projects created to capitalize on the opportunity for infrastructure transformation in the wake of the country hosting the 2014 FIFA World Cup and the 2016 Olympic Games– we would recommend that Metalumen use a Strategic International Alliance (SIA) strategy (Moreira, Poole and Burini 1994).

2.4.1 Challenges

There are many challenges facing Metalumen in entering the Brazilian market. One of the most significant of these challenges is that many of Brazil's sectors are highly guarded with elevated protectionist import taxes, creating a very complex tax and labor regulatory environment within the country (Acquaah, 2009). Corruption and bribery are also very prominent issues in the Brazil business market and transparency of organizations in the country is lacking (Mehta, Rajiv et al. (2010). The fact that the official language of Brazil is Portuguese is another barrier in the process of entering the market (Van Raaijand Verhallen, 1994). Because of these challenges - as well as Metalumen's current corporate standing, being that they have limited financial resources

to invest and lack knowledge of the Brazilian market and of expanding internationally in general – the entry strategy that the company employs needs to consider certain variables and possess select key traits (Kim and Oh, 2002).

Metalumen needs a strategy that has a low to moderate cost, allows them to have a high level of internal operational control, safeguards their key resources from leakage (i.e. intellectual property theft), and mitigates the risk exposure inherent in first-time entry into a new market. Additionally, the strategy needs to ensure that Metalumen has control of key complementary resources, such as access to local distribution channels, since the organization has not had prior experience with the Brazilian market. Taking these variables into consideration, it is only by analyzing and evaluating each option that Metalumen will be able to make an informed decision concerning which mode of entry to choose. The concluding assessment of each strategy leads us to believe that choosing to pursue an SIA approach for entry into the Brazilian market is in Metalumen's best interests.

2.4.2 Strategic International Alliances

It is widely-known that Brazil is looking to construct new infrastructure and transportation systems to handle the visitors that the country will host at that time. Projects of a construction nature are typically managed through a tendering process (Brazil Canada Chamber of Commerce, 2012). Tenders are generally issued by the government, who engage the services of companies to facilitate the process or outsource the process to companies in the private sector. In either case, businesses are invited to make offers or proposals to supply the goods and services necessary to carry out the project. Since no one organization has all of the required skills and capabilities necessary to fulfill the demands of this type of project, multiple organizations enter into alliance arrangements that give them the highest likelihood of having a winning bid. In Metalumen's situation, choosing to build an SIA with a Brazilian firm would be Metalumen's best option (Baker and McKenzie, 2004). Entering into an SIA would allow Metalumen to gain valuable access to the market knowledge of the firm in question and piggyback on their reputation. This is an ideal situation for Metalumen since it is not an internationally known brand and does not have the necessary brand recognition needed to attract demand and win bids on its own. The ideal company for Metalumen to partner with would be either a construction, architectural, or engineering firm that is well established and has a high level of brand recognition in the transportation and infrastructure market.

2.4.3 Potential Alliance Firms

One of the key requirements of a successful SIA strategy is finding the right company to create an alliance with (Kumar and Bergstrom 2008). This involves extensive research and is dependent upon a wealth of criteria that can only truly be assessed upon face-to-face interaction between representatives of the two companies and a relationship that is built over time. With that being said, the following construction firms are examples of potential firms that Metalumen could create an alliance with, pending the requirements addressed above.

Queiroz Galvão– civil construction firm, member of the Bombardier-led Express MonotrilhoLeste Consortium (Eastern Express Monorail Consortium), which was awarded the The São Paulo Monorail system extension project

Construtora – civil construction firm, also a member of the above-mentioned consortium

Andrade Gutierrez – industrial construction conglomerate

Votorantim Group – industrial construction conglomerate

Odebrecht – industrial construction conglomerate

Camargo Corrêa– industrial construction conglomerate

CR Almeida – engineering and construction group

Toniolo Busnello – construction group

2.4.4 Competitors

Current competitors to Metalumen in the Brazilian market include independent lighting firms, lighting firms working in strategic alliances, as well as the contract firms that these competition are partnered with (De Mello, 2005). An international lighting industry exhibition in São Paulo called Expolux is offered to professionals in the industry to deliver information on new technologies and trends in the lighting industry (Expolux, 2012). An understanding of competitive offerings in the market will deliver a better understanding of demand in the foreign market, as well as more insight of product attributes and pricing (Kalette, 2007).

2.4.5 Costs

Since the transaction costs will be shared between Metalumen and the firm it chooses to build an alliance with, Metalumen will not have to absorb the brunt of all the investment costs involved. One of the most fundamental advantages of entering into an SIA is that virtually none of Metalumen's core competencies will be compromised (Simkin, 2008). Metalumen will be designing their products to meet the customer's requirements and will therefore have control over the products' specifications and will allow them to utilize the customization capabilities that they are renowned for. In this same sense, they will have full control of their own processes and will be able to ensure that the quality of their product and the customer service that goes along with it is up to their domestic standards (Lukacs et al. 2011).

2.4.6 Risk

As far as risks go, as with any entry into a new, unchartered market, Metalumen will be exposed to certain factors that may not be in their favour (Ramaswami, 1992). Collection of payment may be a risk, depending on the contractual relationship between the allied firms and the organization in charge of the construction project. Additionally, by allying themselves with a Brazilian corporation (Hiam and Schewe, 1993). Metalumen may be exposed to bribery and corruption. However, if the corporation in question is an international organization with a Brazilian business unit, there is a significantly lower amount of risk in this capacity. Further disadvantages include the fact that Metalumen's individual reputation and strengths are not taken into consideration – rather, the dependency of their success lies on the alliance's package. It could be argued, however, that this is a benefit, since Metalumen does not have brand recognition in Brazil and would not have a viable reputation in any case. As part of an SIA, Metalumen will be less exposed to individual risk than with exportation, contractual agreements and foreign direct investments (Reuer and Leiblein, 2000).

2.4.7 Future Opportunities

Moving forward, a SIA approach will allow Metalumen to build a sustainable relationship with a local Brazilian firm (DiPaolo, 2006). This will allow Metalumen to gain valuable insight into the inner workings of business in Brazil and will give them a better idea of the corporate culture there. It will also provide an excellent opportunity for other international alliance opportunities – such as International Joint Ventures and Consortia alliances, as well as Foreign Direct Investment opportunities – such as Sales Office Investments and Mergers & Acquisitions strategies (Katsikeas, Constantine et al. 2000).

Pending the success of the SIA strategy, we believe that an International Joint Venture (IJV) would be the best option for Metalumen to pursue in the future if they choose to continue expanding their business in Brazil. Metalumen should seek to form an IJV with a reputable Brazilian-based company once they establish themselves in the market (Haddad et al. 2011). Forming a joint venture with another company will further Metalumen's success in Brazil. Metalumen must carefully select the company they wish to co-operate with in the venture as it will reflect the values and objectives of their company. The objective of the joint venture for Metalumen would be to further expand in the Brazilian market, as well as access to distribution channels. The objective of the Brazilian company would mostly likely be to gain access to new knowledge and share technological resources. It is important for the company that Metalumen partners with to be similar in size and hold similar market share so the both partners can learn from each other while maintaining the proper proprietary skills. In order to choose the right company to form a joint venture with, it will be important for each partner to examine historical financial work sheets such as income statements to create a trusting alliance. Lastly, it is essential to determine the length of time the two companies will be bound to each other in the joint venture, as well as how dissolution will take place.

2.5 Potential Target Projects

A multitude of projects have been announced since the decision to have Brazil as the host country for the 2014 FIFA World Cup and 2016 Olympic Games. Many of these projects provide the opportunity for Metalumento break into the Brazilian market by supplying their lighting solutions.

3. Distribution Model

The final step to prepare Metalumen for establishment in the Brazilian market is to create a sound distribution channel to determine how and where their products will be manufactured, and how they will be moved from the manufacturer to the customer in the most logical and cost effective way (Thomas, 2005). Entering the Brazilian market will be a challenging task for Metalumen, as there are vast differences between Canada and Brazil pertaining to language, culture, social norms, and the typical management of business operations. With this being

said, Metalumen will experience a high success rate and elevated profits if they enter the market at the right time and in the right way using an appropriate distribution channel.

3.1 Financing

The financing of Brazil's transportation and infrastructure projects are being undertaken by a variety of sources including, but not limited to: international banks, the Brazilian government, other nations that want to partake in joint infrastructure projects, private equity infrastructure funds (FIP-IEs) and private investments (Ensign, 2006). One of the key players in upcoming infrastructure financing is the Inter-American Development Bank (IDB), who is the predominant source of multilateral financing in Latin America. This being said, it is widely known that there are significant gaps in infrastructure financing, and it is vital for the firms involved that costs be kept at a minimum (Esra, 2007). Naturally, this is also true for Metalumen, which acts as one of the many reasons that Metalumen should employ outsourced manufacturing in its distribution channel.

3.2 Outsourced Manufacturing

Since Metalumen is looking for a cost effective way to supply their products to their customers in Brazil, outsourced manufacturing is an ideal solution. Outsourcing manufacturing involves the transfer of manufacturing activities to a different region or country in order to reduce costs (Brooks, 2009). This will allow Metalumen to manufacture their products directly in Brazil, effectively avoiding high export fees and tariffs, and high distribution and inventory costs as the lighting fixtures and parts will be produced and installed in Brazil. It will also reduce fixed costs associated with manufacturing, as labour and parts costs are significantly cheaper, and will create jobs for the Brazilian market. This will allow for easier entry into the Brazilian market since the government will be more accepting of a firm that is increasing employment opportunities and therefore boosting the Brazilian economy (Jagdish, 2005). In addition, Metalumen would not have to purchase a manufacturing facility, new equipment, raw materials or hire and train employees (Leung and Kwong, 2003). This will further reduce the costs associated with manufacturing. In return, Metalumen would pay for the costs of producing the lighting fixtures, and pay a fee or commission on products that are manufactured in the facility. Research has proven that companies moving their operations to low-cost countries (also known as LCCs) save 20-60% on costs. For example, assuming that Metalumen's product cost is approximately \$5000 to produce a specific lighting fixture in Canada, that same product could be produced for anywhere between \$2000-4000 in Brazil.

The fee awarded for the manufacturer could be 10-20% of the cost – assuming the cost to manufacture is \$3000, the commission or fee paid would then be \$300-400. By providing a commission or fee for production, the outsourced manufacturer would have an attractive offer and would be willing to produce and assemble Metalumen's products in their facilities. An example of a lighting fixture manufacturer and distributor in Brazil is Taschibra-Brasilux Ind., which is a well-known company that was established in 1995 (Kirby and Kaiser 2003). It specializes in manufacturing, wholesale, and distribution of lighting fixtures and solutions. A possible course of action for Metalumen would be to contact Taschibra and request to manufacture their products in Taschibra's facilities. In turn, Metalumen would pay Taschibra a certain fee or commission depending on the amount of goods produced at their manufacturing facilities.

3.3 Free On Board Origin

In terms of the cost of shipping of Metalumen's products, it is recommended that Metalumen use geographic pricing to move their products from the manufacturer to the customer; more specifically, by using Free On Board Origin (also known as FOB origin) (Oehler-Sincai, 2011). This type of strategy implies terms of sale under which the title of goods passes to the buyer at the point of shipment. Under such conditions, the buyer (government or private owners) would own and/or have lawful claim to title of the product as soon as it is shipped from the manufacturer, and would cover the cost of transportation from the manufacturing facility to the construction site (Samiee, 1993). This strategy would work to Metalumen's advantage because it allows Metalumen to avoid paying for the transportation cost of their products from the manufacturer to the customer, and therefore, reduces costs associated with transportation of the finished products. In addition, the customer would have established relationships with distributors who could transport the products for a relatively low price, as these construction projects require receiving different types of equipment, products, and other items in order to complete the project. As a result, the contractor would be able to ask the distribution company to ship and receive the lighting fixtures from the manufacturer to the construction site (Sridhar, 2010).

3.4 Process Flow Chart

A detailed process flow chart (Figure 1) can be seen on the following page. This chart serves as an example of a distribution channel involving the use of outsourced manufacturing via a Strategic International Alliance between Metalumen and its partner firm.

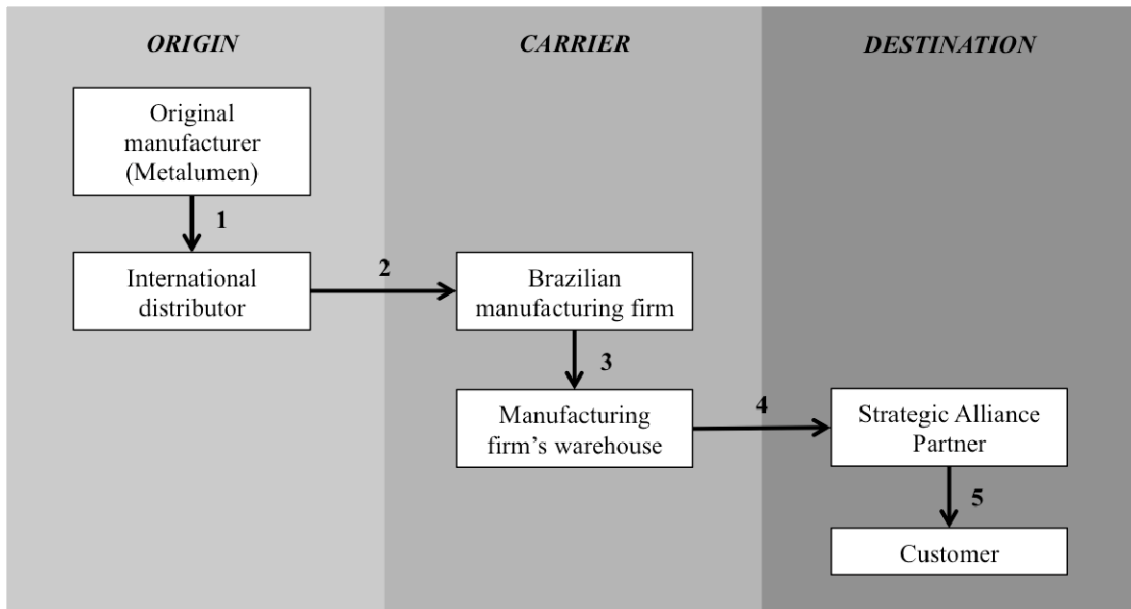


Figure 1. A detailed process flow chart

The “model” lighting fixtures are manufactured and assembled in Metalumen plant in Guelph, and are transported to the international distributor (A1 Global).

International distributor (A1 Global) receives the “model” lighting fixtures and ships it to the Brazilian manufacturing company (Taschibra) in Brazil.

Brazilian manufacturing company (Taschibra) receives the “model” lighting fixtures, and begin manufacturing the products at their facilities once orders are in (the “model” products are used because the manufacturer can perform ‘reverse engineering’ in order to find out how the product is manufactured, and they would have something to compare their products to once it is finished). Once manufacturing of products is completed, they are packaged and stored until they are ready to be transported.

The product is shipped using F.O.B. origin. The product arrives at the project site, where the strategic international partner in charge of the project will install it (Johnson and Tellis 2008). The final step in the distribution channel is the confirmation of product arrival by the customer, and ensuring all invoices and bills have been collected and paid.

3.5 Pricing Strategies

Metalumen could employ a variety of pricing strategies in the Brazilian market. These strategies could include bundled-pricing, cost-plus pricing, and price differentiation. The predominant pricing strategy that should be implemented by Metalumen is bundled-pricing. In the past, Metalumen has provided price discounts to customers that purchase a large quantity of products (Ellis, 2010). The bundle-pricing strategy tends to favour the seller; which in this case is Metalumen. The reason this pricing strategy will be effective is because Metalumen will be able to sell products that otherwise may have gone unsold, and secure large orders which will lead to more revenues earned (Meschi and Riccio2008). The benefit for the customer of bundled-pricing is the value of having the opportunity to buy a package of products at a discount, which they would perceive as a bargain. As for the exact pricing of their lighting fixtures, Metalumen should base their prices on the cost of an individual lighting fixture, and decide on a reasonable quantity of lighting fixtures that would qualify for a bundle discount. For example, assuming the order cost is \$500 per fixture, ordering more than 20 lighting

fixtures will reduce the order cost by 5%, making the total cost of a discounted order \$9 500, rather than the \$10 000 it would have originally been without the discount.

The second pricing strategy that should be implemented is cost-plus pricing (also known as mark-up pricing). This type of strategy could be used for small quantity orders, as it takes into account the variable costs associated with manufacturing the product, a portion of the fixed costs, as well as adding a certain percentage mark-up on the product. For example, assuming that the variable cost is \$700, a fixed cost allocation of \$300, and a desired mark-up of 50%, the price of the lighting fixture would be \$1,500. This pricing strategy is used to maximize revenues, and ensure that all aspects of the costs are covered in the sale price.

The third pricing strategy that should be implemented by Metalumen is price differentiation (also known as price discrimination) (Immelt, 2012). This strategy allows Metalumen to charge different prices to different customers depending on the project size, costs associated with the project, and the order size. The benefits of price differentiation to Metalumen include: covering the costs of production and manufacturing, increased profit margins, and increased order sizes as the organizations financing the project would seek price discounts. By using these pricing strategies at the right time and for the right orders, Metalumen would ensure that they earn maximum revenues and profits from each project (Shoham, Aviv., et al. 2008).

3.6 Return on Investment

The Return on Investment (ROI) for Metalumen will be based on the dollar value earned from the expansion into the Brazilian market, minus the costs associated with the expansion. In the past, Metalumen has earned an average of \$250 000-300 000 Canadian dollars from each project they completed in Canada and in the United States. Assuming that the costs of the project would be approximately 50-60% of the revenue, this would equate to \$125 000-180 000 of which 60% is labour cost. By manufacturing products in Brazil, costs can be cut by 20-60% as they are considered a low-cost country and labour is cheaper, meaning increased profit margins for the company. For example, if costs are reduced by 20% or 60%, revenue will increase by \$25,000 and \$75,000 respectively (calculation based on \$250,000 revenue, and cost at 50% of revenue). As a result, their ROI will increase since revenues and profit margins are higher (Industry Projects, 2012).

3.7 Risks

With any mode of entry strategy into Brazil there will be significant risk. A strategic international alliance provides two forms of risk: relational and performance. The first potential risk is Metalumen not finding an alliance partner, and if they do, relational risks may result. There is a possibility that the two companies turn out to be incompatible and have co-operation issues (Jabbour and Jabbour, 2009). This specific risk may be increased in Brazil due to extreme cultural differences. Canadians and Brazilians live very different lifestyles and have different work ethics. Lack of trust and control issues are also potential risks. Trust is extremely important due to the high rate of intellectual property theft in Brazil (Bamrud, 2011). As well, information sharing issues may arise. Performance risks can also occur. If the alliance partner does questionable work while Metalumen's name is attached, it can affect Metalumen's goodwill (Koch, 2001).

Metalumen would not want their name attached to any negative press. It is also possible that the alliance company cannot meet the expectations set out in the contracts.

All of these risks can be mitigated if precautionary measures are taken. The best to alleviate risk is by choosing the right partner (Shoulton, 2011). It is essential to conduct appropriate research on companies to align with. This will help with trust and control issues. Having proper contracts created and reviewed by a legitimate lawyer will reduce risk. It is also crucial that Metalumen and their partner company clearly define how they will split the profits and any losses. This should be outlined in the Memorandum of Understanding. It might also be beneficial to discuss leadership between the two companies. In some SIA cases, having a channel leader is a valuable resource.

The distribution channel also poses potential risks to Metalumen (Ueltschy, 2011). Using an outsourcing manufacturer increases the chance of having quality issues (Ribeiro et al. 2009). It is difficult to control the quality, especially when communication styles and product expectations vary (Bharadwaj, 2008). There is also the possibility of machine breakdowns, and unnecessary downtime at the manufacturing facility, which could reduce production capacity. This could delay order delivery, looking unprofessional on Metalumen (Lahiri, 2011).

Again, there are ways to mitigate these distribution risks. A good contract, with penalties for quality and delay issues is crucial. This makes the manufacturing company aware they are liable for any mistakes. Communication errors are difficult to mitigate, but with time and patience these issues can be lessened (Rosenbloom, 2003).

4. Conclusion

In conclusion, Metalumen should begin their expansion into Brazil by using a strategic international alliance. Metalumen's segmentation strategy, mode of entry, and distribution method has been created in order to establish an efficient and valuable way to penetrate the Brazilian market. It is vital to ensure that their expansion strategies are completed in a timely manner in order to capitalize on market opportunities that are emerging ahead of the 2014 FIFA World Cup and 2016 Olympic Games. Once they gain experience in the market and create relationships with contacts and businesses abroad they can establish an international joint venture with a reputable Brazilian company.

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