

Fandn food and beverage market expansion



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Introduction

The objective of this report is to assess the market attractiveness of South Korea for the purpose of Fraser and Neave, Limited (F&N) market expansion in the Food and Beverage (F&B) industry, particularly on the soft drinks and dairies segments. This report discusses the current strategies adopted by F&N in its F&B division in order for the expansion to be in line with the strategies. The report also addresses issues such as the strategy for international expansion, the best means to enter South Korea market and methods to organise the organisational structure. The report ends with recommendations on how F&N could move forward with the market expansion.

Methodology

Information pertaining to company's current strategies is obtained through F&N official website and its annual reports. Next, to facilitate the market assessment of South Korea, country risk analysis is performed at the macro level. Subsequently, market and industry opportunities assessments are conducted at the micro level. Generally, data for market assessment are exacted from sources such as government and trading websites. The limitation of this report is the lack of information sources for the beverage statistics in South Korea. Majority of information are targeted at food products whereas for drinks, there seems to be lack of information. Therefore, assumptions on the rules and regulations governing beverage industry are made based on the general rulings that apply to the food products.

Findings and Discussions

3. 1 F&N Food and Beverage (F&B) strategies

Company's strategies for F&B division growth are:

Focus on core businesses – soft drinks and dairies;

Invest in brands and product innovation;

Regional expansion into untapped markets.

F&N soft drinks and dairies brands include 100 PLUS, SEASONS, F&N Fun Flavours and Fruit tree. 100 PLUS is a success in Malaysian market.

Meanwhile, SEASONS is the number two player in the Asian drinks category.

(Fraser and Neave Holdings Bhd website 2009)

According to Fraser and Neave, Limited Annual Report (2009), revenue generated by the F&B segment was more than 50% of the Group's overall revenue. This signifies the need for F&N to continuously improve on its market leader position in the F&B segment in Asian region. The recent termination of bottling and distribution agreement by The Coca-Cola Company has placed intense pressure on F&N to seek alternatives to replace the portion of earnings that is bound to cease with the termination. For the purpose of F&N's long term growth and sustainability, it is necessary for company to re-focus on its own products and expand beyond its existing foreign markets. By reducing the dependency on the Coca-Cola distribution, it provides opportunity of growth for the homegrown brands. The expansion into South Korea market is therefore, in line with such aim. The expansion is to be undertaken by F&N's Malaysian subsidiary, F&N Holdings, Bhd (F&NHB)

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which specifies on the production and distribution of F&N soft drinks and dairies.

3. 2 South Korea Market Assessment

South Korea is Asia's fourth largest economy and one of the world's top 20 largest economies with Gross Domestic Product (GDP) of USD929 billion. The country's total population is 48 million with annual population growth rate of 0. 3%. (Trading Economics 2010) This creates the very fundamental attraction for market entry.

Country Risk Analysis

The macro-level risk assessment is conducted based on economic risks, political risks, operational risks and competitive risks.

Economic Risks:

The risks indicators include South Korea's economic growth, measured in GDP growth rate, interest rate, inflation rate, unemployment rate and purchasing power parity.

Table 1: Economic Risks Indicators of South Korea (2010)

Indicators

Percentage (%)

Growth Rate

0. 7

Interest Rate

2. 5

Inflation Rate

4. 1

Unemployment Rate

3. 7

Purchasing Power parity (2008)

USD 27658

The implementations of expansionary fiscal and monetary policy during the recent financial crisis, coupled with depreciation in Won currency, had boosted country's export and economic growth. (Coface 2010) Investment activities and private consumptions have increased. South Korea growth of 0. 7% is considered favourable, albeit minimal. Such growth is on par with some of the developed nations such as Japan (0. 9%), Germany (0. 7%) and the UK (0. 8%). (Trading Economics 2010)

The increase of interest rate to 2. 5% by Bank of Korea is a precautionary to curb future inflation. Inflation is recorded at 4. 1%, so there is a need for to increase interest rate. In the short run, running business might be costly due to higher bank loans but in the long run stable or low inflation rate is important for business growth.

Unemployment rate is considerably low at 3. 7%. Low unemployment rate signifies higher consumption and more disposable income. The purchasing

power parity has increased since year 1998 and ranked world's 13 highest. (Central Intelligence Agency 2010) This is an important indicator because the growth of Food and Beverage business depends mostly on consumers' purchasing power. Overall, the economic risks are low. (Refer to Appendix A for more statistical data.)

Political Risks:

Based on the risk assessment conducted by A. M. Best Company (2009), South Korea is categorised as country-risk tier 2 (CRT2) which means “ Predictable and transparent legal environment, legal system and business infrastructure; sufficient financial system regulation; mature insurance industry framework.” The government is stable and there is good infrastructure and widely use of information technology. However, the political tension between North and South Korea since May this year remains after the sinking of a South Korea navy ship allegedly caused by the North Korea submarine. Although there is risk of a possible war, the US government intervention has more or less hindered the outbreak. Therefore, the political risks are between low and medium.

Operational Risks:

According to ranking by Doing Business 2011 (2010), doing business in South Korea is considered favourable overall.

Table 2: South Korea ranking in doing business 2011

Doing Business 2011

Rank

Ease of Doing Business

16

Starting a Business

60

Dealing with Construction Permits

22

Registering Property

74

Getting Credit

15

Protecting Investors

74

Paying Taxes

49

Trading Across Borders

8

Enforcing Contracts

5

Closing a Business

13

The ranking tabulated above are based on 183 economies worldwide which include developed nations such as Japan, Singapore and Australia. The ease of doing business is ranked 16 which is a good indication. Getting credit is considered easy with a ranking of 15, so is trading across borders (8) and enforcement of contracts (5). Conversely, starting a business, protecting investors and paying taxes are ranked quite highly among all indicators. There is, however, a risk of local brand preference. Local producers 'buy local' campaigns have successfully created the nationalistic preference among the buyers. Hence, this is the risk that F&N should look out for.

Competitive Risks:

When establishing business in South Korea, the power of chaebols is not to be undermined. Chaebol is a group of mainly family-owned conglomerate. (Lee 2003) The influence of Chaebols in South Korea business environment is significant to the extent of causing financial crisis during 1997 due to the huge debts. There is normally close connection between the Korean government and the chaebols which allows some form of government protection. According to a research conducted by Lee (2003), chaebols have major advantages over foreign competitors due to the lenient credit terms given to them by the banks. Therefore, before market entrance, F&N should consider building connection with local chaebols.

Market and Industry Opportunities

The micro-level market and industry assessment is carried out based on resources, market and competition.

Resources:

South Korea is a knowledge-based economy, with mostly skilled labour. Due to the increase in education level, the unskilled labour market seems to face a shortage. Many graduates only seek for high-end job that requires professional skill; people are not willing to work in the manufacturing sectors, thus creating the need to hire foreign labour to fill in the gap. The labour market is flexible as a result of the increase of non-regular employment. (Cheon & Kim 2004)

Market:

Customers are brand-conscious and are willing to pay more for products of better quality. However, the nationalism is still strong and consumers would prefer local production. The target market for F&N products would be youngster. Good advertising and marketing is very important to create brand awareness. Going into the market as a complete foreign brand is not advisable because a new brand is difficult to penetrate the market.

Language is another issue. All products are to be labeled in Korean, although English is widely taught in schools, Korean is the only national language that remains dominant in the country. According to Kim (2006), consumers' monthly expenditure on food and beverage are 23% of the overall consumption, which is forecasted to increase over time. The importance that consumers place towards convenient food and drinks is creating opportunities for F&N products.

Competition:

Intensity of rivalry is strong especially with the presence of chaebols. The leading companies in the segment include Lotte Group, Nong Shin Co Ltd and The Coca-Cola Company. Lotte Group is one of the largest conglomerates in South Korea. Under Lotte Group, the company that manages the food and drinks segment is Lotte Chilsung. Bargaining power of suppliers is high because the chaebols have control over the distribution channel. The bargaining power of buyer is high because consumers could easily switch between brands.

3. 3 Strategy

Before the formulation of an appropriate strategy, company should identify two competitive pressures. Firstly, the pressures for cost reductions; secondly, the pressures for local responsiveness. (Ghoshal & Nohria 1993)

For soft drinks and dairy products in South Korea market, evidence gathered suggests that the pressures for cost reductions are not high because consumers are particular about the quality of food and beverage, they are willing to purchase drinks at a premium price. Also, the consumption of drinks products would only take up a small portion of consumers' overall consumption, therefore the cost reductions pressures could be considered low. On the other hand, pressures for local responsiveness are relatively high. Taking into consideration the differences in consumers' tastes, the products distribution channels in South Korea and the rules and regulations to be complied with as required by the local government, products customisation is essential to suit the differences. In light of the different

pressures, the most suitable strategy for F&N is localisation. Localisation strategy is relevant for business that faces low pressures for cost reductions and high pressures for local responsiveness.

3. 4 Market Entry

Considering the intense competitions, the more feasible option to enter the market is through joint-venture. F&N is new to the South Korea market, local consumers are sensitive to local branding and would purchase drinks from Korean production. By establishing joint-venture business deal with one of the companies, F&N would find itself to share competitive local information on the taste preference, the dos and don'ts when serving the local consumers. Also, since the chaebols influence is very significant, it is difficult to compete head on by setting up a subsidiary. Thus, by having joint-venture company is more likely to sustain long-term growth and profitability.

3. 5 Organisational structure

Figure 1 : F&N Corporate Structure

F&N current corporate structure is divided based on 3 business units. Food and Beverage (F&B) unit is subdivided into 3 categories according to companies that operate the different product range within the F&B division. As shown in figure 1, F&N soft drinks and dairy products are operated mainly through F&NHB, the Malaysian subsidiary. The management of South Korea Joint Venture Company should be placed under the responsibility of F&NHB, where the joint venture company in South Korea would report directly to the Malaysian branch, before it reaches the headquarter in Singapore. A worldwide area structure is in line with F&N current structure.

Conclusions

In shorts, the risks associated with establishing business presence in the South Korea market are between low and medium. In the macro level, the economic and operational risks are low, political risks are between low and medium, competitive risks are medium. In the micro level, the opportunities noted are the growing consumer demand for innovated products and the growing of market size. The main threat however, is the power of chaebols. The optimal strategy would be localisation and the best mode for entry is through joint-venture company with local chaebol. Finally, worldwide area structure is suitable for the organisational structure.

Recommendations

Branding and product innovations are more important than to keep price low because the youth population in South Korea are brand conscious, they are willing to pay more for a better products. Also, the youngsters are fond of western ‘hiphop’ culture. F&N’s Fun flavours drinks depict the exact image of ‘hip and trendy’. In addition, the right marketing strategy is essential to create brand awareness. Online advertising would be useful because the younger generations are very information technology literate. The competitions in the beverage segment are relatively high. By having a joint-venture connection with the local chaebol is not just beneficial for F&N, it is also a form of collaboration between a foreign firm (F&N) and a local conglomerate to compete with the rest of the local competitors, to help increase the market share, which in fact, is a win-win situation for both parties. F&N could cooperate with Lotte Group for its beverage division (Lotte Chilsung) to win over the market share enjoyed by other competitors

such as Nong Shi Co Ltd and The Coca-Cola Company. One method to build connection and to seek for potential partner is via the food and beverage exhibition in South Korea.

(Word count: 2151)