

# Growth and expansion of arcelik home appliances



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## **Introduction**

Arcelik Home Appliances is the leading manufacturer of home appliances in Turkey with a market share of 50% in the domestic market as at 2003 (Ghemawat, 2008). It supplies the market using two brands namely Arcelik and Beko. The company has adopted an international expansion strategy and has already been marketing its products to more than one hundred (100) countries mainly in Western Europe, Eastern Europe, Latin America, Asia, and North Africa (Ghemawat, 2008). Arcelik was originally founded to produce metallic office furniture in 1955 but diversified into production of household appliances shortly after. It has been hailed as the first company to introduce appliances such as washing machines and refrigerators to the Turkish households. Arcelik would face further challenges when it became apparent that the Turkish government would be participating in the European Community's tariff reduction which was meant to reduce to zero from 1992 to 1996 (Ghemawat, 2008). The challenge would be competition from other manufactures from the European Community who would be able to sell their products at more competitive process in the domestic market. Arcelik overcame this challenge by investing heavily in research and development thereby substantially improving the quality of their products. The company is currently the leading holder of patents in the Turkish market. This strategy cemented its market leadership in the domestic market as consumers preferred to spend a little more to obtain goods whose durability could be assured. This preference was also enhanced by Turkey's fluctuating market where inflationary forces were highly unpredictable with the greater odds being to the consumer's disadvantage. Arcelik would later

grow to establish its market dominance in Turkey for decades but would later face challenges that would trigger its focus on international expansion to ensure its survival and growth.

### **Arcelik's motives for international expansion**

The focus on international expansion by Arcelik was triggered by the economic crisis that hit Turkey in 2001. This crisis had led to soaring levels of unemployment and a significant reduction of market demand by an estimated figure of 35% (Ghemawat, 2008). This strategy mainly comprised increasing exports as well as engaging in international acquisitions. The economic crisis in Turkey must have proved to Arcelik the vulnerability of firms wholly dependent on domestic markets. Pressures from business cycles, inflation, interest rates, exchange rates and political forces are prevalent in domestic markets. On the other hand, international markets tend to be better insulated from such pressures since they will rarely apply across several countries. Economic crisis in one market would normally not be prevalent in the rest of the markets hence multinationals can ensure stability by marketing their products across many countries. Arcelik had to get a way to survive the economic crisis in 2001 and as well ensure that future company performance was stabilized by reducing its level of vulnerability to domestic market fluctuations. Arcelik also sought to focus on international expansion in order to increase its level of production and increase its economies of scale (Ghemawat, 2008). This means that with additional production, the cost of producing each unit product becomes significantly lower hence allowing a company to make higher margins per unit or allowing them to charge lower per unit without incurring any losses.

Economies of scale allow a company to remain competitive in the ever-evolving economies. To ensure that the economies of scale do not end up in accumulation of dead stock, or in the escalation of warehousing and storage costs, Arcelik would need to look to markets that would be able to support its intention of increasing the economies of scale through a larger demand. The national demand within Turkey would not be able to absorb these additional products hence the rationale behind Turkey looking to expand international trade. The level of demand for home appliances in Europe alone is about 25% of world demand (Ghemawat, 2008). Arcelic sought to tap into this huge demand to support its competitiveness and the large levels of production occasioned by their strategy of maximizing on the economies of scale. International expansion can also be explored where a company seeks to lower its production costs by having a significant proportion of their production done from regions where the cost is lower than in the domestic market. One of the major factors of production that normally influence the decision of overseas production is labour. When considering labour, it is imperative that a company weighs between the benefits of the savings from paying the lower labour cost, the differences in the productivity of the workers between the higher wage and lower wage areas, and the transport and storage cost implications. It is also worth noting that in many cases, where the labour costs are low, other factors of production such as land would also be relatively lower. The labour cost in Western Europe is estimated to be five times that in Turkey. Labor cost in Turkey is three times that in Eastern Europe (Ghemawat, 2008). In China, it is four times lower than in Turkey. Labor productivity also varies and must be taken into account. For instance, in China, labour productivity is just half of that in

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Turkey. Additional transportation costs are determined by both the distance between the production facilities and the legal environments of the countries through which the products must cross to get to its intended markets.

Access to international markets is crucial to any organization that seeks to expand itself. Domestic markets will often in many cases be found insufficient to support the growth targets that the companies set for themselves. They are also in many cases unable to enable an organization to recoup the investments they may make in research and development in time. The complexity and the level of innovations in the global market is advanced and often leads to production of new and better fulfilling products. This significantly reduces the product life cycles and the companies engaging in research and development need to gain assurance that their investments can be recouped before the products lose demand. This assurance can only be found by marketing extensively in the international markets where the demand is much larger and can ably support the level of sales needed. Arcelik was motivated to focus on international markets since it had opted to distinguish itself as a research and development specialist who focused on the production of quality and durable products. These features would mean that it would need to charge relatively higher prices for the products. On the other side, the products from other European countries were finding their way into Turkey due to the zero tariff arrangement with the European countries. The entry of other products in Turkey meant that Arcelik would either have to lower their prices in order to maintain its domestic share market, or expand its operations to European and other markets in order to maintain or increase its level of sales to clients that focus more on quality, suitability and durability of the products they purchase.

## **Arcelik's options for expansion**

In order to realize its goal of expansion into the international markets, Arcelik has adopted a number of options to help them realize this goal. The international market entry options adopted by Arcelik include use of exports, international acquisitions, use of private label contracting, and product diversification.

### **Organic domestic growth and use of exports**

Arcelik ensured growth domestically by ensuring reliable accessibility to the market using exclusive distributors and agencies who also served as centres for offering after sales services. This exclusive network also served as an entry barrier for any new market operators.

Exporting entails maintaining the company's operations in the home market and selling the products in overseas markets (Giroud, Sinkovics, and Yamin, 2011). It is hailed as the least costly mode of foreign market entry but at the same time the most vulnerable to various entry barriers as government regulations. The cost effectiveness of this entry method is enhanced by the fact that it requires no involvement with the foreign governments or the companies operating in the target market. It is often seen as the best mode of entry for an organization operating on a lower scale. With subsequent growth of exports, the company may open sales agencies in the foreign markets to be the link with the company's clients overseas. By 2003, Arcelik had grown to be the leading player in Estonia and Lithuania with a market share of 25% in these two markets. It also had a commanding presence in the rest of Eastern Europe. The presence of Arcelik's sales agencies helped grow significantly in Western Europe with a markets share of 15% in the <https://assignbuster.com/growth-and-expansion-of-arcelik-home-appliances/>

United Kingdom. Arcelik also conducted a successful export strategy gaining a 70% market share in Romania with its Beko brand. The net effect of these exporting strategies was a significant increase in Arcelik's production capacity from 440, 000 to 750, 000 in 2003 and 2004 respectively (Ghemawat, 2008).

## **International acquisitions**

This mode involves a company buying out another firm operating in the target market hence assuming full legal rights over it. This method is hailed as the best mode of expansion into other markets since it grants a company total control over the foreign subsidiary as well as full profits generated thereafter (Giroud, Sinkovics, and Yamin, 2011). The full control over the activities of a subsidiary is viewed as essential in ensuring they run in accordance with the philosophies of the parent company hence ensure the goals of the company are achieved as intended. The targets for acquisition would need to have the unquestionable ability to complement Arcelik's growth strategies. Arcelik would also evaluate the foreign firm's brands and take consideration on how these brands would help strengthen them as well as complement their capabilities. The target subsidiary's contribution to sustainable growth was also a key factor. Arcelik's acquisitions in 2002 include Bloomberg, Electra, and Flavel and Leisure in Germany, Austria and the UK for the two latter brands (Ghemawat, 2008). They also acquired Arctic in Romania. The acquisitions of brands in the target markets was likely informed by the fact that many consumers tend to prefer purchasing brands that they can identify with: the brands they consider national brands. These

acquisitions tremendously increased the product range offered by Arcelik and lead to its significant growth within the European markets.

### **Use of license contracting**

Licensing involves the company transferring certain rights to another firm to enable it manufacture products using its brand. In licensing, the consideration that the licensor gets is only the royalty or the license fee (Giroud, Sinkovics, and Yamin, 2011). It does not take part in profit sharing or any other marketing processes of the licensee. Licensing offers the advantage of enabling a firm to avoid government regulations and other restrictive policies such as tariffs and quotas. It also enables market penetration without involving extensive capital expenditures. However, this method is highly restrictive in the level of control the company can have over the activities of the licensee. There is also the risk of the licensee gaining the technical expertise and becoming a competitor in the production of close substitutes after the expiry of the mutual arrangement. Arcelik's production in 2004 comprised 40% from various licensing arrangements (Ghemawat, 2008). This complimentary effort helped ensure Arcelik's brand presence in the European's markets.

### **Diversification into other businesses within Turkey**

In order to enhance further growth in the domestic market, Arcelik sought to capitalize on its elaborate distribution network to provide consumers with additional products. By 2004, Arcelik was offered various types cellular phones and was already getting into arrangement with various Japanese firms to act as distributors of various electronic products. The diversification



proved to be a great success and further cemented Arcelik's leadership in the Turkish market.

## **Additional Options for Expansion**

Arcelik's ambitious goal of achieving revenues of three billion Euros in the next year may be difficult to realize unless additional methods were employed to ensure its continued growth in the international markets.

Domestically, Arcelik could opt to but out local competitors in a bid to solidify its hold on the local market. This solidification would help reduce the downward pressure on its product prices by reducing the significance of competition locally. In addition, the additional channels of distribution gained through any such acquisition would act as an entry barrier to any foreign firms hence ensuring steady domestic growth. Internationally, Arcelik could embrace a number of methods to ensure its continued growth. These methods include engaging in Joint ventures, franchising and use of strategic alliances.

## **Joint Ventures**

Joint ventures involve the formation of a partnership arrangement with a different company where the parent companies provide the resources to operate it, share responsibility on management, and share profits realized thereafter (Giroud, Sinkovics, and Yamin, 2011). This type of venture is especially popular where it comes to sharing the intelligence and technical knowhow required for research and development. With their determination to distinguish themselves as the masters of innovation and product development, this method can be used to ensure its rapid growth. Instead of engaging in competition with the already existing companies in the foreign

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market, Arcelik could identify a strategic partner who knows the market remarkably well. They could then research into the market needs in a bid to try and unveil any unsatisfied demands in the market. Having found the features lacking in the products found in the market, they could, through the joint venture develop new products that would suit this need and capture the unreached market. This method would be convenient to Arcelik since it would not involve many unnecessary government regulations that normally bar entry. In addition, such a venture, if well implemented would easily capture the market as it would be riding on the goodwill and distribution network of the strategic partner in the foreign market.

## **Franchising**

Arcelik needs to consider franchising in order to minimize the risks involved with the licensing as it currently practices. Here, Arcelik would transfer some rights to the franchisee to produce the products under its brand but will reserve the right to provide some aspects of technical support (Giroud, Sinkovics, and Yamin, 2011). This way, Arcelik will be able to be abreast with the activities of the franchisee. In addition, in Franchising, the royalty is based on the amount of sales hence Arcelik will be able to generate higher revenues in the event the franchisor is able to realize significantly higher sales. Franchising is easy to start since the franchisor incurs minimal capital cost hence Arcelik can expand into more foreign markets with relative ease. Moreover, the franchisee assumes all the risks and foots for all costs of labour and facility establishment. The company will also be able to avoid any political risks associated with foreigners operating in national markets. Arcelik can therefore easily expand its scale of production without worrying

about high capital expenditure hence edging closer to achieving the revenue targets

## **Strategic alliances**

A strategic alliance differs from joint ventures in that it does not necessarily involve formation of a legal entity. Strategic alliances are formed to enable companies use each others' distribution networks, technologies, production capacities, management experience and others (Giroud, Sinkovics, and Yamin, 2011). One very essential factor in ensuring product penetration in the market is the distribution network. This has been evident in the manner in which Arcelik has been able to capture the domestic market by using effective distribution networks in Turkey. Arcelik should also try to replicate this experience in the foreign markets. However, by virtue of the fact that it's a foreign market, they may not have the resources to establish an effective distribution network in those markets. It would therefore be relatively more convenient to identify foreign companies with a distribution network that serves their target customers effectively, and then enter into a strategic alliance with them. This may be companies offering similar products or those making completely different products. When the products are easily available to the consumers, they more likely to buy these products and this would lead to an increase in the amount of sales realized by Arcelik. The strategic alliance could also involve sharing of certain technologies between the companies in question. Arcelik could choose to leave the production of a certain product components to a company with a comparative advantage in its production in exchange for providing a component which it can produce more efficiently. This exchange could lead to lowering the production cost

which would be useful in helping the company become more price-competitive in the market.

## **Conclusion**

Arcelik's growth is mainly dependent on how the company can enter and prosper in the international markets. This is because it is already commanding the domestic market in Turkey and may have limited growth opportunities locally. Growth and diversification are often related as is evident from Arcelik's company history. Arcelik has grown in the past by steadily improving on the product range that it offers to the market and this diversification should be continued to ensure continued growth.