BUSINESS OPPORTUNITIES AND CHALLENGES IN LESSER DEVELOPED MEMBER COUNTRIES OF ASEAN: A CASE STUDY FROM THE SEAFOOD PROCESSING INDUSTRY IN THAILAND

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CASE DESCRIPTION

The primary subject matter of this case concerns international business management. Secondary issues examined include exporting, regional agreement and doing business in developing countries. The case has a difficulty level of first year graduate level. The case is designed to be taught in 90 minutes and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

Lucky Union Food (LUF), Co. Ltd. has been a Thai processor and exporter of ground fish (surimi) products for more than twenty years. Vantanee Seang-U-Tai, Managing Director, is revising LUF's 2016 business strategy for venturing into the Lao PDR. Its first outlet operation in the Laos market in 2014 is running into obstacles because the Lao government ordered the land right owner to develop the property where LUF's outlet is located into a distribution center. Its joint venture partner is facing financial hardship causing it to be unable to assist LUF any longer. Moreover, the market is underdeveloped and somewhat different from LUF's domestic one.

Expanding into Laos' traditional segment is running into the conflict with wholesalers at the border who are keeping an eye on LUF's movements in the Laotian market. These wholesalers have to date been LUF's product distributors for the Laotian market. In addition to these complexities, the promise of a freer market from the ASEAN regional agreement has not fully materialized. Being unable to use similar exporting methods as these wholesalers, LUF's prices are higher in this market relative to those of the wholesalers. Given these obstacles, Vantanee now wonders if LUF has entered into this market too soon or employed a too risky method.

CASE BODY

The month of December would ordinarily be a season of festive holidays. However, for Vantanee Seang-U-Tai, Managing Director of Lucky Union Food (LUF), Co. Ltd., December 2015 was proving to be a time of great anxiety and worry. LUF, in joint venture with International Seafood Quality (ISQ), had opened the now closed Laos outlet in October 2014 as a distribution center for surimi and frozen seafood exports from its factory in Thailand. She had recently learned, in October, that the government of Laos[1] had not approved the company's request to operate at its existing minimart outlet, a refusal that had forced LUF, a processor and exporter of ground fish (surimi) products to close this outlet. Its joint venture partner, ISQ, faced too severe financial hardship to assist LUF to deal with this situation. To further complicate decision making concerning what LUF should do at this point, the company had also run into a conflict with wholesalers at the Thai-Laos border whom LUF had traditionally relied on to distribute products in Laos. They were threatening to drop the company's products altogether if LUF pursued its plan to aggressively venture into the Laos via the establishment of company-owned outlets.

LUCKY UNION FOOD ("LUF")

Established in 1991 in Samut Sakhon Industrial Estate, Thailand, LUF's processing plant for surimi-based products was a joint venture between Thai and Korean partners. LUF's surimi-based products appeared in many forms, such as crab sticks, imitation shrimp and fish tofu (view the company's website at http://surimiproducts.com/site/company/). Its raw material was sourced from its business partner in Vietnam. Because its main export markets were the EU and the USA, LUF's production system was strictly operated under various international standards, such as Good Manufacturing Practice (GMP) and Hazard Analysis Critical Control Points (HACCP). In 2010, in consequence of a disagreement among LUF's joint venture partners, a major realignment of management responsibilities occurred. Vantanee struck a deal with the Korean partners that granted LUF the responsibility for managing the operation in Thailand and allowed Koreans to control the Polish plant.

LUF'S DOMESTIC EXPERIENCE

Prior to LUF's commitment to the domestic market, its products had been sold under the "Kani" brand, which was licensed to Venturetec Marketing Co. Ltd., which was granted an exclusive right to sell to modern trade channels in Thailand. Because of this pre-existing arrangement, LUF now had to venture into different outlets, i.e., traditional trade and small businesses. Focusing on these markets proved challenging because LUF had long been more familiar with and accustomed to, supplying high quality surimi to large supermarket chains in Europe. However, buyers in Thailand were much smaller and had diverse needs. The challenge in adjusting LUF's operation to the local situation was seen in the company's dealings with the largest users of surimi products--- street-vendors selling deep-fried snacks on sticks. Its superior quality of crab stick turned out to be its weaknesses. For instance, because there was no preservative added, LUF surimi products turned slimy when street vendors did not refrigerate them properly. In the endeavor to convince wholesalers to promote its products, LUF offered an exclusive right to wholesales in major markets and a deep discount when buying in a large volume. Alas, this tactic brought forward other challenges. That is, the quantity discounts only tempted wholesalers to aggressively negotiate for larger discounts for larger orders, with the wholesaler selling the surplus in other markets. Consequently, LUF faced difficulty in recruiting new wholesalers and had to strive constantly to avoid any conflict with these powerful wholesalers. Despite these obstacles, LUF's persistence brought some success. It captured sixty-three percent of market share in the lower end of crab stick sales.

THE SURIMI INDUSTRY

Even though there were several surimi suppliers competing in the domestic market, only the companies listed and discussed below were major players in the same market segment as LUF (Exhibit 1).

Thaveevong Industry

As part of the TVI Group, Thaveevong Industry (TVI) was able to use this extensive local network in the fishing industry to lower costs and therefore prices. With its in-depth understanding of domestic market needs, TVI could spot market trends and launch new products continuously, allowing it to offer a broader product assortment than other competitors. TVI did not grant exclusive rights to any wholesalers, utilized a "one price" policy and all transactions were done in cash. Even though wholesalers were dissatisfied with these policies, they continued to purchase from TVI because of its "low-price provider" position among producers. Recently, however, its cost leadership was threatened, as the EU began cracking down on illegal, unreported and unregulated (IUU) fishing in Thailand causing the depletion of raw materials for the surimi industry (Surimi Processor Hit by Soaring Raw Material Costs, 2016)

Pacific Fish Processing

Pacific Fish Processing Co. Ltd., (PFP) was a local, fully-integrated food business specializing in frozen, processed value-added products. Use of mass media had made the PFP brand well-known in Thailand. However, because of its well-known brand, the company became a target for copying, price undercutting and brand counterfeiting. Intense competition and higher raw material costs eventually forced the company to expand into more profitable businesses such as ready-to-eat meals, the catering business and kiosk stands in supermarkets.

Smile Heart Foods

Smile Heart Foods was locally owned, with the registered capital of 25 million baht. Smile Heart Foods positioned its products at the lower end of the market and thus sold at a cheaper price than LUF. However, because it bought surimi blocks from outside sources, the shortage of raw material in 2015 had hit the company hard, causing its prices to soar.

Exhibit 1
ANNUAL REVENUE OF SURIMI COMPANIES IN THAILAND Million baht (a)

	2010	2011	2012	2013	2014
LUF	217	382	382	445	576
Venturetec (b)	242	275	291	335	332
TVI	727	937	1,114	1,841	1,793
PFP	963	976	1,140	1,345	1,387
Smile Hart	82	101	123	165	210
Other	260	337	341	372	438

Notes: (a) US$ 1=35 baht
(b) LUF produced for Venturetec
Source: LUF’s estimation

THE ASEAN ECONOMIC COMMUNITY

The ASEAN Economic Community (AEC) was part of the agreement of the Association of Southeast Asian Nations (ASEAN). With more than 600 million people, ASEAN had ten member countries: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar (Burma), the Philippines, Singapore, Thailand, and Vietnam. AEC’s primary initiative was to promote a single market among member countries based on freer flows of goods, services, investment, skilled labour, and capital. While the tariff reduction among more developed country members was implemented, Cambodia, Laos, Myanmar and Vietnam (i.e., the “CLMV” countries) were allowed to gradually implement tariff reductions (Sachdev & Christensen, 2015). The CLMV countries had high growth potential due to their youthful demographics**,** low-cost labour and abundant natural resources. They were located at a connecting point for China and India. Despite the economic opportunity, conducting business in the CLMV countries faced several political and economic challenges. Overlapping and contradictory regulations, ubiquitous corruption and insufficient financial services were commonly found.

GENESIS OF LUF'S VENTURE INTO THE LAO PRD

The Initiating Proposal

LUF had been receptive to an early-2012 proposal from International Seafood Quality Co., Ltd (ISQ), a Nong Khai-based Thai exporter of seafood to China, to form a Vientiane-based joint venture to distribute seafood and surimi products throughout the Lao market. ISQ stressed their excellent connections with Laotian politicians, connections-- they averred–that afforded the company some privileges in doing business in the country. It also had good relationship with hotels and other catering operators–an especially useful resource, given that Laotians were generally unfamiliar with seafood (because of their landlocked geographically) and therefore were more likely to consume seafood at hotels and restaurants and through catering, as opposed to trying to prepare the dishes at home. Therefore, the first phase of ISQ's plan had been to target these institutional customers and to build refrigerated storage in Vientiane, the capital city, to supply products to them.

LUF's initial investigation of the proposed business opportunity in Laos had been promising. Even before ISQ's proposal, LUF's products were already being exported to Laos, albeit through wholesalers located in various locales at the Thai-Lao border. Generally, products and brands from Thailand were regarded as better quality but higher priced than those from China and Vietnam.

The Entry – and the Learning Therefrom

In any event, as requested by ISQ, LUF had proceeded to send product samples to be tested in February 2013**.** Contrary to what ISQ had assumed would be the chefs' preference, it turned out that they wanted lower quality products with lower prices, not premium quality with higher price as had been expected. Alarmed by this early setback, in March 2013, Vantanee sent a task team to investigate. They returned with a number of findings and insights that would have a direct bearing on the viability of the initial market entry strategy.

Nature of the Laos Market

LUF's task team had reported that Laos market was very much at a crossroad between the traditional consumption pattern and the modern one. The majority of Laos still preferred to eat breakfast and dinner at home and tended to pack food from home for lunch. Eating out in a restaurant was rare because of the high prices in restaurants relative to their income. However, teenage consumers, particularly in Vientiane, had begun to depart from this traditional consumption pattern. They increasingly preferred to eat out during lunch and dinner. Imported ready-to-eat meals had also become more popular among these consumers.

The retail system was also changing rapidly. There were few mega shopping malls or hypermarkets, but there were numerous projects underway in Vientiane. However, traditional markets were more prevalent and served specific shopping needs. Products from Thailand were popular because Laos understood the Thai language and had an access to various mass media from Thailand.

Cross Border Trade with Laos

Even though there were several border check points, Nong Khai province was the major distribution network in sending surimi products to Vientiane by truck. The distance between the two cities was approximately 15 miles. Only five wholesalers in Nong Khai province exported surimi to Laos. The largest one was "NM" Shop which shipped approximately 8.2 tons per week. A typical method of sending surimi products from wholesalers to buyers in Laos started with a buyer sending a purchase order to a wholesaler. The wholesaler quoted an FOB price and then sent products to a shipping company which handled both transportation and export documentation. The custom rate varied at 5 baht per kilogram for frozen food, 3 baht per kilogram for room temperature, 200 baht lump sum per bag (approximately 100 kg per bag). Some wholesalers were able to avoid paying tariffs by using various unlawful methods. However, a major difficulty in doing business in Laos involved payment collection. The manager of a major shipping company provided insight into the difficulty:

If buyers fail to make any payment, [there] is almost no way to get your money back. Also, being a brand leader in Thailand will not guarantee the brand's success in [the] Lao market. For example, the leader in fish source products, "Tiparos", was not the most popular brand. The brand "Squid," using squid as its logo, is the leader because Lao consumers believed that this sauce fish is made from squid, a preferred ingredient in local cooking. [But] as you know, all fish sources are made mainly from small fish and salt.

Overall, the market had seemed to be attractive. Hence, LUF had ultimately decided to form a joint venture with ISQ in November, 2013.

IN SEARCH OF A WAY FORWARD IN 2016

To be sure, entering into Laos had been harder than initially anticipated for LUF. The promising joint venture with ISQ had faltered after ISQ ran into financial hardship in November 2015. A month earlier, their first jointly owned minimart that had opened in Houey Hong Village on the outskirt of Vientiane, in October 2014, was unexpectedly terminated in October 2015. The land right owner who operated this property was ordered in June 15, 2015 by the Laos government to modernize and turn the property into a distribution centre for seafood and agricultural product[2]. The Laos government rejected LUF's request to locate its store at the current location. Fortunately for LUF, the land right owner still honored the lease contract with LUF by letting LUF to operate in his building for another twenty seven months. During this transition, coordinating with faltering ISQ proved difficult, all the operational tasks became the responsibility of LUF. It was not long, however, before Vantanee saw a potential risk in this arrangement,

"*We heard a rumour about a foreign company who set up an operation with a full control of ownership by using a local nominee as a silent partner. Since this was viewed as an illegal arrangement, a troop of Lao soldiers showed up to close down the operation. The owner had to get in touch with a high ranked politician for help."*

Given that LUF already had a "toe hold" in Laos, Vantanee was convinced that the country represented high market potential, especially in the modern trade sector and particularly now that the Laos government had started enforcing the GMP standards, which required that surimi products be stored at the appropriately controlled temperature. LUF was the only supplier, who could meet this requirement because other suppliers from Thailand still relied on selling through border wholesalers, while products from other countries were of inferior quality. Vantanee rationalized that

"*We have moved to a nearby building and set up to be our wholesale operation. We have already tested a delivery system in which we can fulfil an order from a modern trade within one day by sending surimi products from Thailand to Vientiane.*"

As for dealing with the traditional segment, LUF anticipated conflict with wholesalers at the border who were keeping an eye on LUF's activities in the Laotian market. If their sales volume remained fairly constant, LUF anticipated that they would not react. LUF's retail price in the traditional market was not competitive as compared to these wholesalers. The AEC agreement on zero tariffs had not implemented at the local level forcing LUF to pay more import duty than those operating in the underground economy ("The Underground Economy," 2012). Because LUF used a formal custom procedure, its retail price was higher than that of the wholesalers.

Another opportunity was emerging in the form of the possibility of setting up an operation in one of the special economic zones (SEZs) in Laos (the map of SEZs at http://www.investlaos.gov.la/index.php/special-economic-zone-sez). Vantanee believed that one of SEZs in Laos could be used as a packing site for re-export. Nevertheless the packing site prospect was not without some potential issues, as Vantanee explained.

The idea in locating our packing factory in one of these SEZs is interesting since they offer business opportunities beyond the Laotian market. Laos is located near Cambodia and South China. Moreover, it has a GSP privilege[2] *allowing our products to export to Japan, the US and other developed countries with a very low tariff rate. We might be able to sell our output in Laos from any SEZs but this is not Laos' main intention to have this SEZ scheme. If we want to do this, a high tax rate will be added. From what we know, this rate will be higher than the tariff rate at the border.*

DECISION TIME IS NIGH

When the holidays were over, Vantanee had to present her plan for the Lao market to the company's board of directors. She was starting to wonder whether LUF had perhaps entered into this market too soon, or perhaps had chosen too risky a venue. Further, perhaps LUF should have waited until the zero duty was implemented before aggressively expanding into Laos? Going forward, should LUF terminate the joint venture agreement with ISQ and search for a new partner? Would it be safer to export to the Lao market by relying on the existing wholesale system at the border? Or, if possible, should it simultaneously rely on various trading methods to hedge against these risks?

The opportunity window as a "first mover" was closing, as other Thai companies were planning to step up their activities in these markets. If LUF was to remain a viable contender in the coming race to capture and retain an attractive market share, first, in this market, there was no time to waste in deciding and implementing its next strategic move.

ENDNOTE

[1] As a communist regime, all properties belonged to the government**.**

[2] The information on the Generalized System of Preferences (GSP) is available at www.wto.org. Thailand was losing this privilege because it became an upper middle income country which did not qualify for the GSP.

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