

Trends In Cross-Border Operating Company Expansion: When Does Direct Investment Make Sense, and When Is It Better To Expand By Contract?

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Corporate Development, Abbott Laboratories
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ACG Chicago

Trends in Cross-Border Operating Company Expansion: When Does Direct Investment Make Sense?

Al Reid

Abbott

ACG Chicago International Conference
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Several Market Entry Options Exists

Acquisition

**Direct
Investment**

Joint Venture

**TPM/Contract
Manufacturing**

Greenfield

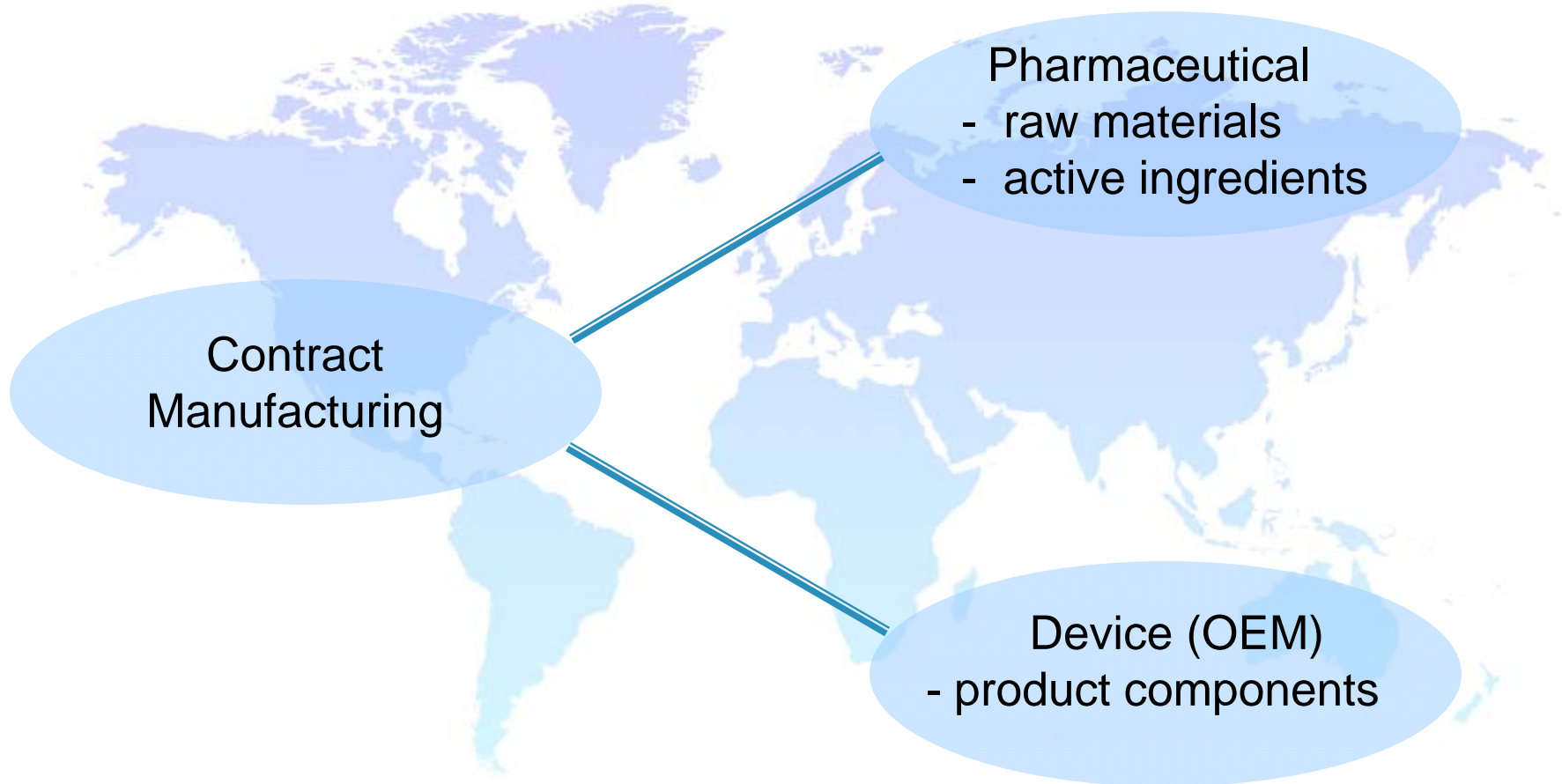


Contract Manufacturing vs. Direct Investment

- The decision to use a contract manufacturer is influenced by a companies ability to:
 - Obtain access to technology / products not available within company
 - Support product development needs
 - Address future market demand capacity
 - Enhance competitiveness in target market
 - Gain entry to new local / regional markets
 - Reduce product cost
 - Avoid capital costs for new technologies / products



Contract Manufacturing - Sources of Use





Contract Manufacturing - Selection Criteria

- Assurance of product quality and consistency
- Adherence to U.S. and local country regulations

Capacity & Capability

A Venn diagram consisting of three overlapping light blue ovals. The top-left oval is labeled 'Capacity & Capability', the top-right oval is labeled 'Total Cost', and the bottom oval is labeled 'Business Alignment'. The ovals overlap in the center, and each overlaps with the other two.

Total Cost

Business Alignment



Direct Investment - Objectives

- Reduce dependency on TPM's
- Address product capacity shortfalls
- Drive product cost favorability and raw material availability
- Reduce in-country / regional duties and distribution cost
- Address in-country / regional market demand
 - Favorable demographics (market dynamics, patient population, reimbursement, segment growth, competitive structure)
 - Business justification
 - Enhance infrastructure / manufacturing capabilities
 - Improve cost position
 - Meet in-country regulatory requirements
 - Achieve ROI



Advantages of Business Approach

Contract Manufacturing

- Avoid direct investment cost
- Provide adequate supply of key products
- Shorten lead time for regulatory compliance
- Improve speed to market

Direct Investment

- Develop local manufacturing capabilities & infrastructure
- Achieve product savings and eliminate use of TPM suppliers
- Generate incremental sales
- Generate duty savings for sourcing to other regional markets
- Establish in-country/region manufacturing footprint
- Mitigation of regulatory risk related to disruption in supply chain



Summary

- Utilize Contract Manufacturers
 - Market protection
 - Quality assurance
 - Management of competition
- Expand/acquire another company facility
 - Cost to retrofit
 - Fail to provide regional diversification
- Make direct investment
 - Wholly own subsidiary
 - Local country tax and land incentives
 - Freight and duty savings

ACG International Growth Conference

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Baird Private Equity

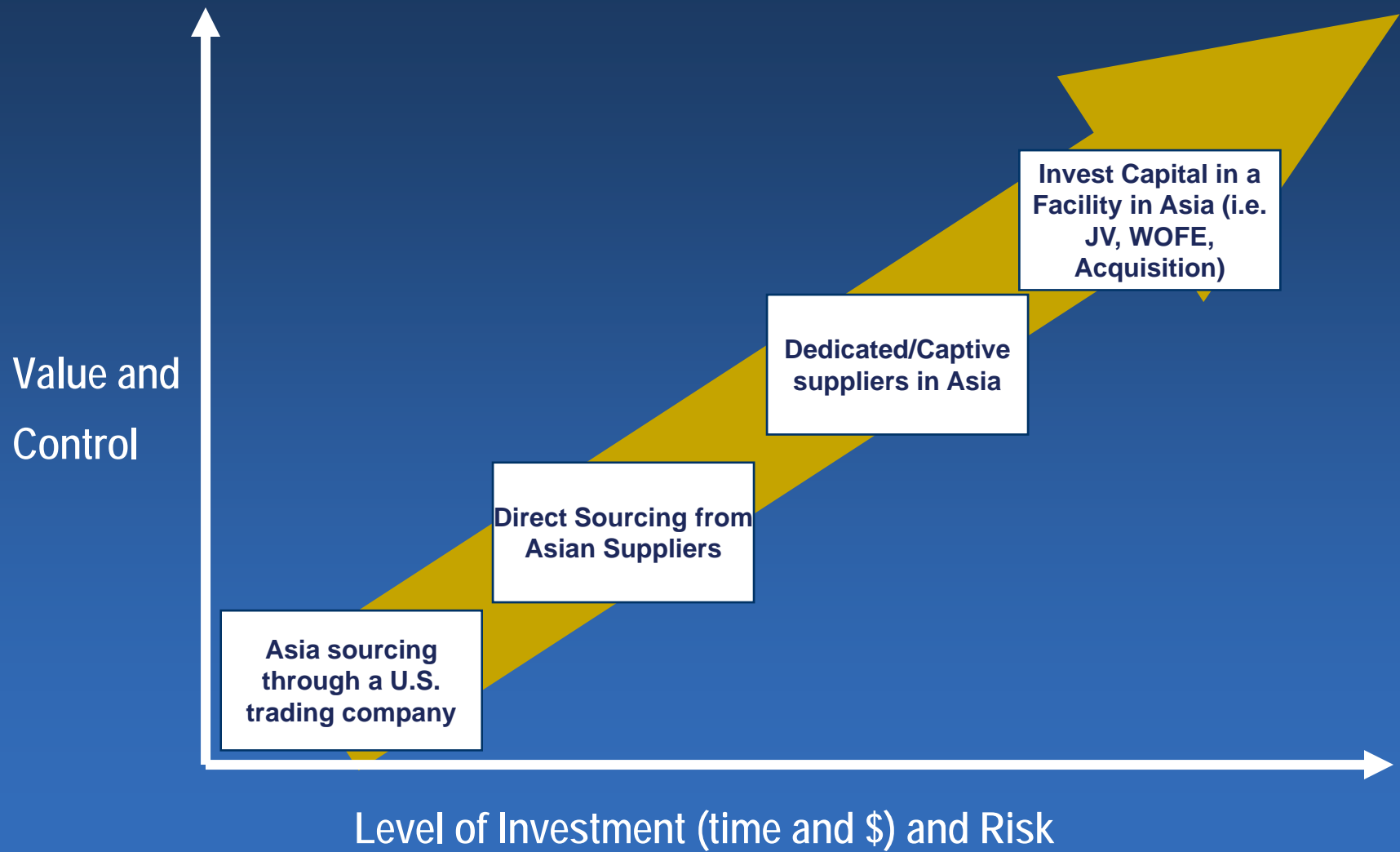
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Baird Private Equity

- ▶ Baird Private Equity
 - Over \$2.2 billion raised and managed since 1989
 - Direct investment vehicle affiliated with Robert W. Baird & Co
- ▶ Baird Capital Partners, BPE's US buyout fund, is investing out of a recently raised \$300 million fund targeting companies with TEV between \$25 to \$125 million in the manufacturing and business services sectors
- ▶ Global team of 40 investment professionals complemented by 35 operating professionals and senior advisors
- ▶ China operations team with decades of "on the ground" experience
- ▶ Recently established Baird Capital Partners Asia, a Shanghai-based investment team focused on providing growth equity to companies with operations and growth opportunities in Greater China

Commitment Migration to Asia



Common Questions and Misperceptions About US Companies Investing in China

Not just for manufacturing anymore...Invest to sell in the local market

- ▶ 63% of U.S. companies say they have a presence in China to sell into the China market ⁽¹⁾

US Companies are finally making money in China

- ▶ 72% of US companies operating in China said their China operations are profitable ⁽²⁾
- ▶ U.S. Bureau of Economic Analysis reported that in 2006, U.S. affiliates in China repatriated \$4.5 billion of profits back to the US

While there are exceptions, JVs did not work....US companies are going alone

- ▶ In 2005, 73% of the foreign investments in China were 100% foreign owned, as opposed to joint ventures with Chinese partners ⁽³⁾
- ▶ ...vs. 10 years ago, when only 30% were 100% foreign owned ⁽⁴⁾

⁽¹⁾ 2007 AmCham China – AmCham Shanghai White Paper – 88 companies responded
⁽²⁾ 2007 AmCham China – AmCham Shanghai White Paper – 150 companies responded

⁽³⁾ PRC Ministry of Commerce and September - October China Business Review.
⁽⁴⁾ Mode of Entry and the Regional Distribution of FDI into China. Shapiro, Tang and MA, March 2006.

Baird Private Equity Portfolio Companies In Asia

- ▶ Baird Capital Partners has worked with 12 portfolio companies in Asia
- ▶ These strategies have included sales and distribution networks, sourcing and setting up manufacturing

4 Challenges Faced By Baird Portfolio Companies

- ▶ **Project Heavy Duty** – Significant multinational customers encouraged us to establish a presence in China to support their local growth while at the same time move global production from England to China
- ▶ **Project Brake** – 2 months into the investment, one of the largest customers “encouraged” us to follow them to China and be operational within 12 months
- ▶ **Project Wood** – Consumer products company was sourcing a large percentage of their COGS from suppliers across China that it was not able to manage directly/efficiently and paying 10% to a trading company
- ▶ **Project Furniture** – High defect rate on product landing in the US during a new product launch

Lessons Learned

- ▶ Following a customer to China is a good way to “finance” both a market entry and a low-cost manufacturing base
- ▶ Try to get minimum volume commitments when following a customer
- ▶ Hiring and training your own direct employees (especially in quality control) and establishing an the ground presence is critical and not very expensive
- ▶ Regardless of whether you are selling or sourcing, going direct takes time and effort but pays dividends in the long run

*3rd Annual International Growth Conference
Middle Market Growth in Uncertain World Markets: Risk and Opportunity*

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**Pradeep Nedungadi
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Visthar LLC – An International Business Development Company with a strong focus, since 2005, on US-India opportunities

Helping US companies access and enter international markets:

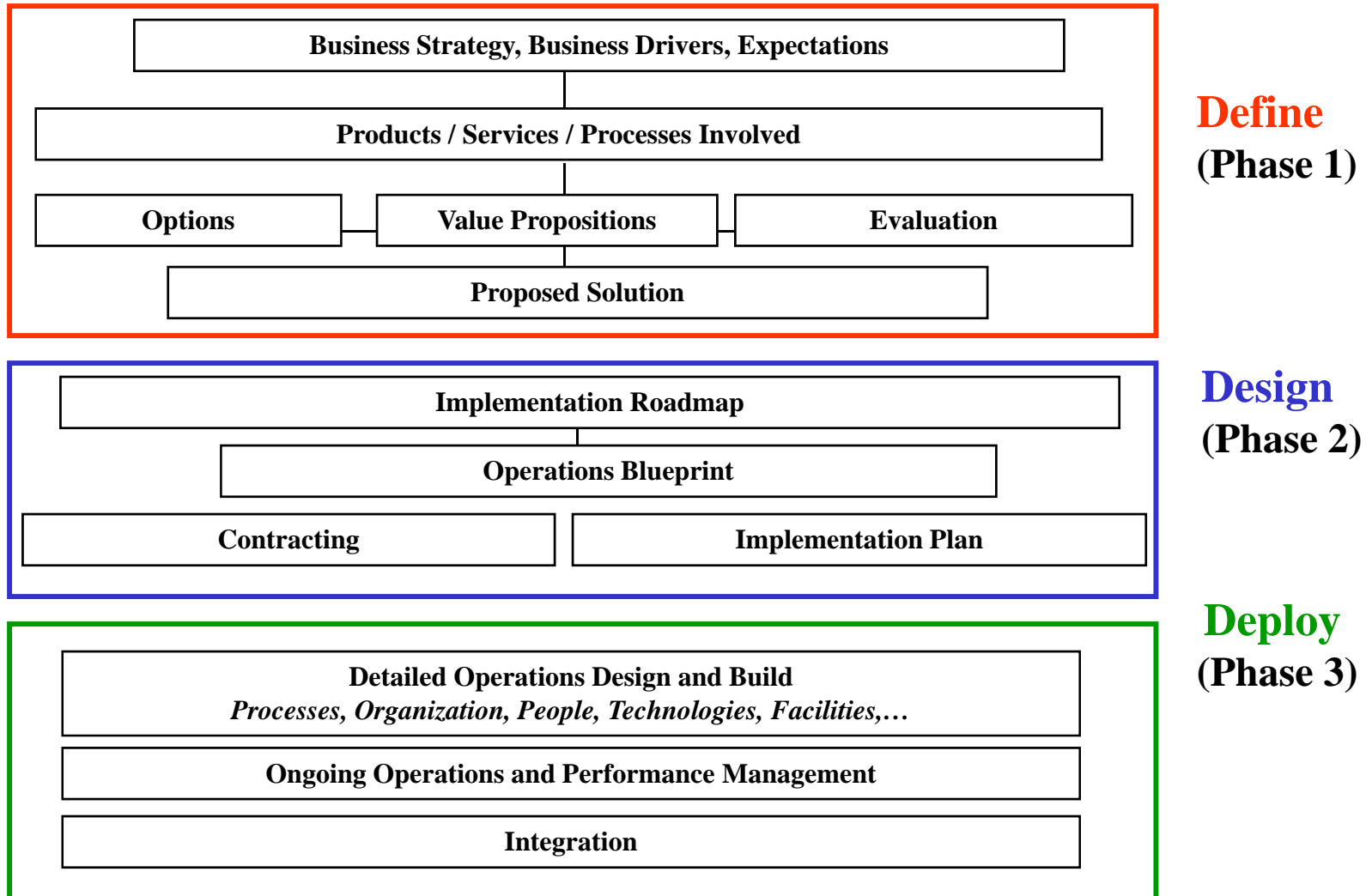
- B2B market research and development of country-specific market strategies
- Identification and selection of potential suppliers/ partners/ distributors/ licensees
- Negotiation and structuring of business relationships
- Post-integration strategy and business process and organizational alignment

Partnering with Investment Banks and US Private Equity firms on cross-border sourcing and M&A projects and post acquisition business integration and process alignment

Representing four Indian companies in the US:

- Kaynes Technology – Industrial Electronics
- Essae Digitronics – Precision Machining and Finishing
- CIGFIL Limited – Packaging Materials Technology and Manufacturing
- Feedback Consulting – B2B Industry/Market Research

Framework for Expansion



Factors to Consider when Entering a Foreign Market

Entry Options

- Greenfield Operations
- Acquisition or Joint Venture
- Outsourcing
- BOT

Capitalizing on Strengths; Addressing the weaknesses

- Are you bringing your product superiority or marketing savvy to the market?
- Is the focus on research, design and/or manufacturing capabilities?
- What is your knowledge and experience in localized distribution and sales?
- Can you easily establish an effective supply chain?
- Are you concerned about protecting IP? Introducing latest technologies?
- Labor/personnel requirements? Experience in international HR practices?

Expectations / Risks

- ROI
- Clear competitive advantage
- Effective and efficient processes
- Minimize risk:
 - Financial, Business, Supply Chain, Liability, Geo/political, IP

A Couple of Case Studies:

A Print Technology Company:

- Current State: Exporting is not competitive and restricts ability to cover multiple segments; also, current customers may vertically integrate and soon compete
- Opportunity: Significant growth in certain Asian markets; can capture leadership position in technology and market share
- Decision: Multi-pronged approach – begin with contract manufacturing while pursuing options including acquisition OR joint venture OR BOT

A Bulk Material Loading Technology Company

- Situation: Had tried through individual reps in India for 6+ years and not a single sale due to complexities of market and regulatory environment
- Opportunity: India deregulating the mining industry and private companies moving aggressively to bring modernization and process efficiencies to handling and moving bulk materials
- Decision: Established a blended model of licensing proprietary technology to the India partner while capitalizing on their strengths in manufacturing, sales, service/support and procurement. Met demands of local customer base while introducing new technology from US and protecting IP