



International Marketing

Case Study Sample 205.02

A Disjointed Venture

You are marketing executives for JACKSON MOTORS, the largest manufacturer of high-quality electric motors in the United States. For the past 6 years, sales have been slowing at a steady pace. Profits have been declining at a rate equal to sales. The cause of the sales slide is a shift in the demand for electric motors manufactured in countries outside the U.S.

The prognosis for growth for the general-purpose motor market in the United States is very limited. All market research says that the market demand for motors is growing rapidly in China. Your research further states that there is a particularly strong demand for high-quality motors. As more companies move to China, they expect to use the same high-quality motors they have been accustomed to in their home countries. But making an efficient motor takes special technologies that have not been available in China. Your research points to a growing market niche for high-quality motors made in China.

JACKSON MOTORS has evaluated the various ways to service the China market. If JACKSON exported motors made in the United States to China, they would be prohibitively expensive. The company concluded that the best approach would be to set up a joint venture with an existing motor manufacturer already located in China. So a new company was established in Shanghai called INNOVATIVE MOTORS, formed by JACKSON and TIGER MOTOR COMPANY of Shanghai. JACKSON was very careful to control the availability of its technology to its partner. If the joint venture would someday dissolve, it would take TIGER MOTORS an estimated seven years before they were able to supply similar motors to another world market. Jackson believes that within those seven years technological improvements would override the technology contributions of JACKSON.

INNOVATIVE MOTORS was created to manufacture motors to export from China to other worldwide customers, as well as to serve the growing China domestic market demand for high-quality motors. The concept of the INNOVATIVE joint venture optimized a mix of precision automation and low-cost labor. JACKSON provided designs and technology, while the Chinese partner provided knowledge of complex Chinese business systems. INNOVATIVE's products were well received by China's domestic market, and the company was in a position to begin exporting to other countries. The quality of the motors was excellent and the price was very competitive.

TIGER MOTORS was not a large company, but JACKSON executives felt they had the drive and willingness to grow the China market. Because they were not large or sophisticated, TIGER did not have a strong relationship with a high-quality steel manufacturer and, accordingly, paid higher costs. The bulk of a motor's material costs are for steel, while another large expenditure is labor. JACKSON MOTORS was able to solve the materials issue by leveraging their relationship with their steel supplier in the U.S.

LYNCH METALS is JACKSON's captive steel supplier in the United States. LYNCH and JACKSON have had a business relationship for over 40 years. LYNCH METALS also saw an opportunity to extract profits from the China market in a manner similar to JACKSON's, and they also started a joint venture. Since high-quality steel is essential for efficient motor operation, LYNCH teamed up with CHINA IRON & STEEL (CIS), the best-quality, largest supplier of cold-rolled sheet steel in China. This joint venture was a partnership set up to leverage CIS's low costs and provide LYNCH METALS' customers access to Chinese low steel costs. LYNCH was going to be the U.S. sales agent for CIS's products shipped to the United States from China. Since JACKSON MOTORS was an excellent customer of LYNCH METALS, the U.S. steel company was able to convince CIS to give their best possible pricing to INNOVATIVE MOTORS. The volume generated by sales to INNOVATIVE did not warrant that pricing structure, but, as a measure of good faith, CIS agreed to supply high quality steel to INNOVATIVE at their best pricing.

For the first 20 months everything was going according to plan, but that was about to change when a duty was applied to steel products imported into the United States from specified countries. China was on that list. The import duty effectively raised prices of steel so they were comparable to U.S.-manufactured steel. There was no longer an advantage to importing steel—in fact, it was a disadvantage due to the long supply chain.

The relationship between LYNCH and CIS turned sour after six months without shipments from China to the United States. CIS felt that LYNCH was not trying hard enough and was preferring to sell their own steel rather than steel made by CIS.

The joint venture that LYNCH has formed with CIS has begun to break down, and the companies have planned to dissolve their joint venture. This has put INNOVATIVE MOTORS in a position where they need to buy steel directly from CIS. INNOVATIVE had a contract with the steel company joint venture, but the steel company joint venture contract did not consider what would happen to customers in case of a breakup. This means there is no longer any special pricing for INNOVATIVE MOTORS. CIS is taking action to change their pricing to INNOVATIVE since the steel supply contracts were voided when the joint venture dissolved.

CIS has announced a new pricing schedule. They are raising their prices and limiting availability of steel by changing INNOVATIVE's priority. JACKSON MOTORS has investigated sending LYNCH-manufactured steel from the United States to China, but that is not an option because of freight and a 17 percent duty levied by China on steel imports from the United States. INNOVATIVE has been forced to pay higher prices to CIS and other steel suppliers.

The effect of the steel price increase is that motors manufactured by INNOVATIVE are no longer competitive with other high-quality motors coming out of China. Previously, INNOVATIVE was able to be profitable with a 10 percent lower selling price. Now they can barely break even. Sales of motors are still good, but the joint venture is not making any money.

JACKSON MOTORS does not have the luxury of simply walking away from their joint venture as LYNCH METALS was able to do. JACKSON has \$20 million invested in the joint venture, and there is a penalty clause for breaking the contract. The partner wishing to dissolve the joint venture must sell its portion to the other partner at a price that would represent a loss.

YOUR CHALLENGE

You must develop a potential solution to enable INNOVATIVE MOTORS to compete successfully with other Chinese manufacturers and return to profitability. You will submit your proposal to JACKSON MOTORS' executive committee.