# 361°

## White Papers on Brand Diversification and Brand Licensing

**No. 4**

# BRAND LICENSING AS ENTRY OPTION IN INDIA

नमस्ते

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## INTRODUCTION

*India is home to 1.2 billion people, or 17% of the world's population. A fast growing country with key strategic importance, and a market to be for most multinational companies, all the more for branded consumer goods companies.*

*Countless Western companies entered India in the past 20 years by one way or another. Many of them did not achieve their objectives; quite a few failed and bowed out again. Still, it is a very strategic question to establish defendable competitive positions today in a market which is going to be huge in 20 years.*

*In the following white paper the authors analyse why it it is difficult to succeed in India, and why brand licensing can be a very attractive and scalable entry option.*

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## INDIA’S ATTRACTIVENESS

As a nation, India has the second largest population behind China. Its 1.2 billion citizens represent 17% of the world population. And – in contrast to China – India’s population is young, dynamic and growing. It is expected to surpass China by 2030.

Since the end of the licence raj in 1991 – when India was a Russian style, centrally planned economy with the government controlling and approving anything – the Indian economy showed an impressive growth. The retreat of government interventions, the new entrepreneurial ambitions and the desire of Indian people to progress were the basis for dynamism at all levels. As a result, India’s economy grew by a factor of 3 to 3.5 in the last 20 years, when developed economies only stagnated.

Growing individually is one of the most important things for Indians. Education, knowledge and literacy play a substantial role in Indian society. India has a well educated, highly skilled, intelligent workforce, plus a very high number of academics, scientists and engineers. 40% of Indians understand English which is an important plus in international business.

Further, India is an information society. Availability and usage of media of all kind is very high. Information, entertainment and advertising reach most of the population on a daily basis and at a high density. Proficiency in English also facilitates the distribution of foreign information and news. Indian entertainment and movie industry (Bollywood) is larger than Hollywood. Fast diffusion of information is a major reason for India’s dynamism.

Just to illustrate this with the example of mobile communications: the first Indian mobile phone service was introduced in Delhi in 1995. By 2001, India had no more than 5 million mobile phone subscribers.

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Within the next 10 years, this figure exploded to little less than 900 million today. But not only the sheer number is impressive; average prices per call, per subscription or per cell phone are among the most competitive worldwide. The engineering and investment capabilities behind that network are striking.

As a result of opening up, media diffusion and growing income, many Indian consumers—the so-called middle class— aspire to buy and own Western brands, thereby showing a modern lifestyle. Indians admire cars, machinery and appliances from Germany, precision mechanics from Switzerland, food from US and Italy, fashion and beauty products from Italy and France, consumer electronics from Japan and Korea, and generally the casual US lifestyle. Therefore, Western brands enjoy a good starting position against traditional Indian offerings.

One last aspect. India's culture – despite being so different - accommodates Westerners. Hinduism is open, tolerant and respectful to others. Doing business with Indians involves a lot of trust and sharing. Besides that, the British control over India for centuries also left its impact. And – the prototype of the multinational corporation emerged in India centuries ago – the British East India Company.

## WHY EARLY ENTRY IS SO IMPORTANT

A lot of companies hesitate. Why should they enter India now and not later? For some, the market seems to be so huge that it does not make a difference to enter now or later. This hesitation is however fatally wrong. First, the market might be huge in terms of demand, but the supply side is equally large. And second, the competitive positions amongst the suppliers and the loyalty with customers are taken when a market grows; it is nearly impossible to gain shares in mature markets. Therefore, moving into India early is as important as in any other market.

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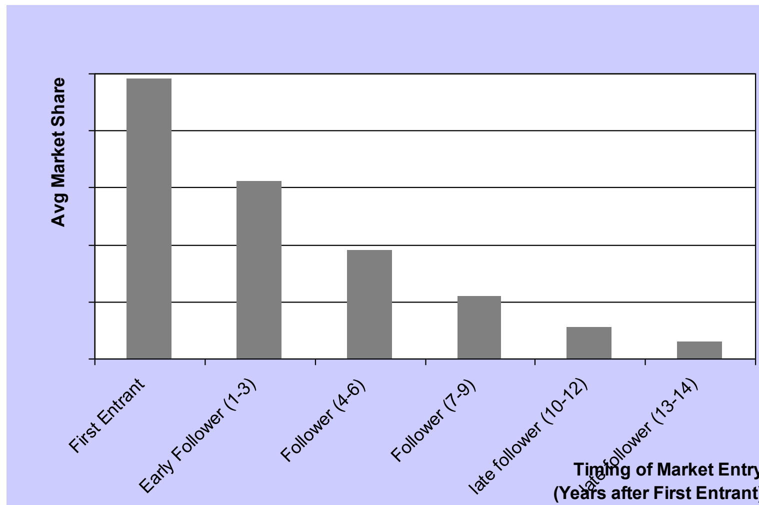
Late Entry Penalty China
-17% in market share per year of delay




The timing of entry was widely researched in China – a market that is similar to India in three major aspects: its opening to foreign companies in 1979, its change from a socialist to a free market economy, and its highly skilled and ambitious people, all of which resulted in a very dynamic economy. The results of such research show that there is a late entry penalty on all levels of measurement in all different industries. In terms of revenues or market share, each year of delayed entry is penalized by 17% less. In terms of profitability (RoE), the yearly penalty is even 24%. In other words: it Is the early entrant who catches the worm. There is nothing different about that wisdom in India. It is vital to build market positions now, and not in 5 or 10 years.

## TYPICAL PITFALLS

Unfortunately, it is not all roses in India. Four aspects illustrate the challenges in the Indian market and the requirements for the appropriate entry strategy.

- Purchase Power. The size of India's population is only of relative worth. Just to put it into a relation: India's GDP is similar to Germany's, but its population is 15 times higher (1.2 billion to 81 million). In other words: India's GDP per capita is 3.400 US$, compared to 42.000 US$ in Germany. And this is measured at purchase power parities, not at current exchange rates.

  According to Maslow's hierarchy of needs, many Indians spend most of their small income for basic needs like food, habitation

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and education. The number of Indians that can afford Western "nice to have" lifestyle products is still very small, and generally overestimated. Many sources refer to India's growing middle class of 300—400 million people; but nobody quantifies their disposable income. In reality however, not more than 3 mn Indian households are "income millionaires" in Rupees which corresponds to 22.000 US$. This is just about the size of Switzerland. It must be very clear that India's potential does not consist of the luxury segment; it is the medium and mass market which requires large quantities of very affordable and basic products.

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- Diversity. India is one nation, but it is not that simple. India consists of 7 union territories and 28 federal states, all with regional governments and different laws and regulations. Even more diverse is India's landscape of languages and scripts. There are two official national languages – Hindi (42% proficiency) and English (~15% speaking and 40% listening proficiency) – plus 18 official federal, plus several hundreds of local languages. Similarly, there are approximately 10 different scripts plus their variations; i.e. Hindi and Marathi are written in Devanagari script. With respect to religion, India accommodates Hindus (80%), Muslims (14%), Christians (2%) and Sikhs (2%) plus some smaller communities. All in all, India is a country of excessive diversity, and anything else than a homogeneous single market. It is even more diverse than Europe with its 27 member states. Why would foreign companies succeed in this market if it is a major challenge even for Indian companies to cover the whole of the country through a national distribution and service network?

- Distribution System. Retailing in India still means outdoor markets, bazaars and small sized mom-and-pop stores. Overall, far less than 10% of retail is part of the organized sector, i.e. of larg-

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er stores and professional retailers operating store chains. As a result, India has millions of small points of sale. L'Oréal, the French personal care and beauty company, reaches Indian consumers through 400.000 points of sale for annual sales of 150 mn €. It is obvious that such distribution systems require several different levels and stages of regional and local distributors, wholesalers and resellers. Depending on the category, there are no or very few key accounts. Point of sale (or push) marketing is in a very early stage, and it is impossible to establish controlled or selective distribution unless one operates own stores only. Not to mention the distribution of perishable products with an expiry date. Finding access to that complex distribution system requires networks and time.

- Staffing. Establishing a business from zero in a market like India is close to impossible for foreigners. Key members of the executive team need to be native Indians or expatriates who are used to culture, language and business conduct. However, finding and hiring them is easier said than done. The best talents prefer to work for famous or well-established employers, compared to risky newcomers.

## EXPORTING TO INDIA

Entering India by simply exporting products is eventually the easiest and most obvious market entry option. This approach however has some basic disadvantages, no matter if such exports go through an independent Indian importer or through an own sales subsidiary in India.

- One issue is cost or price. Imported products bear the cost of a Western high-cost value chain, plus the cost of Western product features. Cost of transportation and logistics must be added on top. Thus it must be very clear that for its prices imported prod-

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ucts address  only the 2-3% of high-income Indians

- Another issue is product design and features. While Indian consumers generally aspire after Western products and styles, most of these products are simply not designed for India. Again, such products address only a very small segment of Indian consumers.

- India still protects its national industry by imposing substantial tariffs and duties on imported products. Even if such import duties have been reduced steadily in the past, they still amount to an average 20% on consumer products. I.e. the current import tariff on pasta, bicycles or cutlery is 35%, Depending on the strategic importance of the product category for the country, import duties range from 0% up to 50%, thus making many imported products even more expensive for Indian consumers.

- India's foreign trade balance is negative. As a result, political initiatives facilitate exports from India rather than imports into India.

- The development of the Indian Rupee against Western currencies increases the prices of imported products even further. A European product that was exported for 50€ cif to India was 2.000 Rps in 2002 and is now 3.400 Rps.

- Exporting to India is an idea that many Western companies started to pursue during the last 5 years. As a result, the Indian import market is already crowded with Western exporters. Many Western brands are already present and court the few Indian high income consumers.

To sum up, one could say that exporting into India is only attractive if

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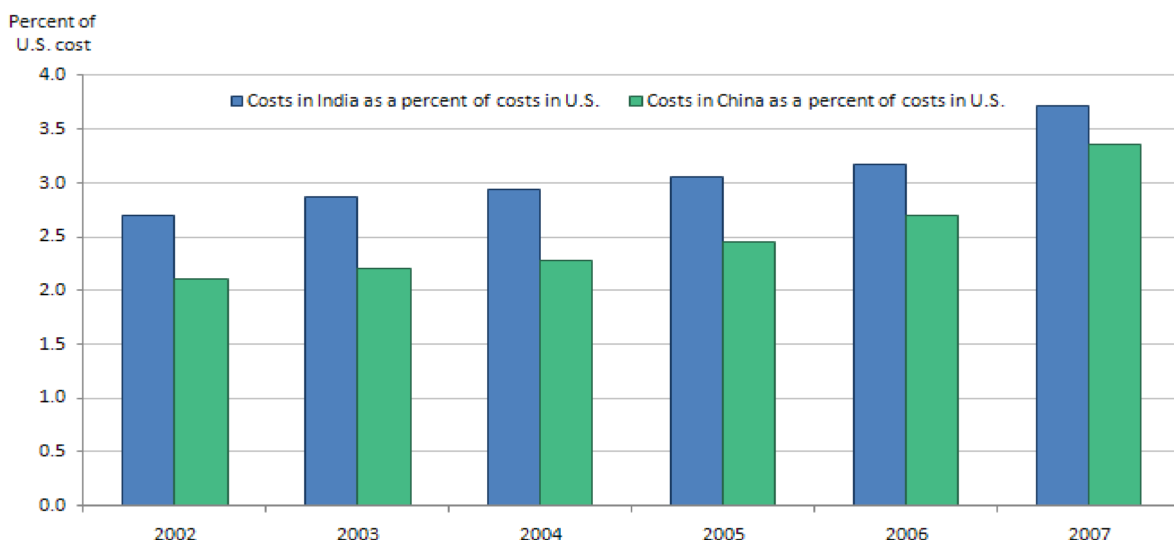
the products a) are manufactured in low-cost countries (China), b) are not penalized by Indian import duties, and c) do not bear European or US overheads. If not, they simply become too expensive for the Indian consumers, or the business will stay very small and below expectations.

So, if export is not the right option, manufacturing within India would be an alternative, either by setting up an own factory or by acquiring an existing Indian company.

## OWN FACTORY IN INDIA

Own manufacturing operations in India would circumvent all the disadvantages of an export strategy with regard to pricing. India is a low cost country. Even if labour cost in India is increasing, it is still at only 4% of Western countries and comparable to China (cheaper than urban China, slightly higher than rural China).

**Chart 4. Mean hourly compensation costs in the manufacturing sectors of India and China as a percent of corresponding costs in the United States, 2002-2007**




SOURCE: U.S. Bureau of Labor Statistics, Division of International Labor Comparisons

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Further, the 15%-45% price disadvantage resulting from import tariffs and freight would be avoided.

From a strategic point of view it can be wise In a fast growing economy to build additional manufacturing capacities in order to prevent competitors from doing so—provided there is no long-term overcapacity for that product. However, building new factories requires substantial investment and involves a lot of risks to get operations started and profitable.

A location needs to be found, the permissions granted, the plant and equipment built, the workforce hired and trained, the product technology transferred, the administrative functions and business processes established. And this is only the first part of it. The second part is to set up outbound logistics and distribution and to acquire clients. And the third part is to keep these clients satisfied through an aftersales service network. All these challenges in a huge, diverse and complex country require financial strength, profound understanding of country and culture, endurance and ambition.

## ACQUISITION OF AN INDIAN COMPANY

Another entry option is to acquire an established Indian company. This option is characterized by three major restrictions:

- The availability of targets is limited. Typical Indian companies are either widely diversified conglomerates, or very focused product specialist. The product category approach as established in Western economies is still underdeveloped, and Western acquirers have difficulties to find corresponding targets. Further, targets with national distribution network in consumer goods are still rare.
- Indian companies are priced at relatively high multiples, due to their growth rates and profitability. Thus, the acquisition price

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for a certain business volume is high, and the synergies or restructuring gains are low. These circumstances often make Western acquirers hesitate.

- A major success factor of Indian companies is the person of the founder of the company (or a descendant). This person does not only act as the driving entrepreneur in the technical and strategic sense, but also the charismatic leader who gives the employees of the company a home and identity. Often the success of Indian companies starts to diminish when the founder sells his shares and is replaced by Western managers.

While the inbound cross-border M&A market in India shows impressive growth rates, it is still at a relatively low level due to a limited number of targets, high valuation and price premiums, and hesitation on the side of the foreign investors. Asian corporations are the largest group of foreign investors, followed closely by US corporations, and still Europe far behind. The number of acquisitions in consumer goods is not (yet) impressive. The current focus of investors is in infrastructure, base materials, IT, telecom, banking, automotive and electricals. Therefore, M&A is a viable entry option only for few Western companies.

## BRAND LICENSING

Above we discussed exports, own factory and M&A. All three approaches have their pros and cons. If none of them is suitable, brand licensing can be an attractive option.

Through brand licensing, an established Western brand grants the rights to use that brand in India to a local Indian company according to the terms fixed in the licensing agreement. In return, the brand owner gets a royalty fee. Let us first discuss the disadvantages and risks of that approach.

- The profit of the brand owner is limited to the royalty fee he gets

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from the Indian licensee. This is typically somewhere between 3% and 8% of net sales. The key question is: would the alternative thereto — exports, own factory or M&A — be more profitable, and would it generate higher sales and market share. Answering that question is pure theory. Exports could generate a higher profit contribution, but certainly less sales. An own factory would need years to turn profitable, at considerable risk. With M&A, profitability and future growth is to be paid for in the purchase price.

- The brand licensing option depends on the selection of the right license partner. If the partner fails or looses interest, the business will suffer or cease. True. But the selection process is manageable, and the downside risk can be covered and taken care of in the licensing agreement, i.e. through minimum guarantees.
- The brand owner might loose control over the activities of the licensee under his brand, and as a result the brand might be perceived in the Indian market in a different (inappropriate) way. This can happen only if the license agreement does not allow appropriate quality control measures and approval procedures, or if the brand owner does not care enough.

On the other side, there are numerous advantages of brand licensing.

- The products are produced within the country, at local cost and with local style and design features. They perfectly match the need of the average Indian consumer and allow access to a huge population, not only to the small top of the pyramid (the rich Indians).
- The approach is fast, because the Indian licensee has already an established business system in place (products, manufacturing, distribution, service) that is able to take on within a short

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period. Having the resources in place means not only being fast to market, but also slashing the risk of failure.

- The financial involvement of the brand owner is very low if not close to zero.

As a matter of fact, brand licensing plays an increasingly important role in the market entry strategies of Western companies in India. Basically, there are three major reasons that brand licensing is growing fast:

- Many Western companies realise that the other entry options—exports, own factory and M&A—are not viable.
- Indian government has recently facilitated the administrative framework for cross-border intellectual property licensing in general, and in particular for trademark licensing.
- There is a self-accelerating demand for brand licenses from established Indian suppliers who realize that a partnership with a Western brand can help them to defend and even improve their market position against competitors.

| **Licensor / Brand** | **Licensee** | **Licensed Products** | **Year** |
|---|---|---|---|
| Morphy Richards | Bajaj Electricals | Small household appliances | 2002 |
| Eureka | Forbes Gokak | Water purifiers, vacuums | 2004 |
| Hewlett Packard | Moser Baer | Optical storage media | 2004 |
| Electrolux, Kelvinator | Videocon | Large household appliances | 2005 |
| Haier | Olive Telecom | Mobile handsets | 2006 |
| Philips | Videocon | TV sets | 2010 |
| Old Spice | Menezes Cosmetics | Cosmetics | 1993 |
| Del Monte | Field Fresh Foods | Processed food and beverages | 2010 |
| Fila | Cravatex | Footwear, apparel | 2000 |
| Wrangler | Arvind Fashion | Fashion, apparel | 2000 |
| Esprit | Madura Garments | Fashion, apparel | 2005 |
| s.Oliver | Orient Craft | Fashion, apparel | 2007 |
| Daniel Hechter | Indus League Clothing | Fashion, apparel | 2008 |

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Many existing brand license partnerships serve as prototypes and role models, thereby increasing the interest of other Indian companies in following similar patterns. Selected examples include:

Most promising areas for Western brands in India are in consumer electronics, household appliances, telecommunications, computers and IT, food and beverages, housewares and kitchen aids, car accessories, and bikes. Sports, fashion and lifestyle brands aim more at joint venture partnership models.

Indian managers are skilful negotiators. The fight hard for the terms and the royalty rights of a brand license agreement. On average, royalty rates tend to be lower than what brand owners are used to in Western countries. On the other hand, many brands are only little known in India; the licensee has to lay all the groundwork to launch and establish the brand in India. Therefore, lower royalty rates can be justified.

In addition to the brand license, technology from the brand licensor can be a valuable extra for the Indian licensee. Design rights, design support, patents, manufacturing technology, recipes or access to sourcing channels and components granted to the Indian licensee may help to make the license rights in the trademark more attractive and sustainable. Licensed products that do not only display a Western brand but also have a Western look and feel have better chances of success.

Similar to joint-ventures, many brand licensing partnerships terminate sooner or later. For that reason, many companies hesitate to consider brand licensing as a viable option. However, there are several viable perspectives thereafter. One major question in the context of brand licensing is its long-term perspective.

Above all, what remains at least from brand licensing is that the brand has established a presence in the market, and that it has become part of the mindset of retailers, consumers and the public. One may call

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that a brand position, or even a competitive position. Anything that comes thereafter would not start from zero but build upon exactly that position.

If a brand license works well and successfully, the brand owner may at some point want to get a higher share of the profit or exert more control over the business. In that case, he could

- establish a joint venture with the licensee (what Calvin Klein did in 2011 when it converted its license with Brand Marketing India Ltd. into a joint venture)
- acquire the licensed business from the licensee outright (what VF Corp. did when it acquired its licensed business for Wrangler and Lee brands from licensee Arvind in two steps in 2006 and 2011, or what Unilever did when it acquired the Brylcreem license from Godrej in 2012).
- take the license back inhouse and establish own operations without paying a purchase price for the business (what Puma did in 2006 when it established its own subsidiary Puma Sport India Ltd. after a period of licensing.

The brand owner should also be prepared that its successful licensee wants to increase his own security in the license by extending the contract term, by acquiring shares in a JV or even by acquiring the trademark rights for India.

If none of these options applies, the brand owner can still renew the license. Some licenses live 20 years and longer (i.e. the brand license between Arrow/Phillips-Van-Heusen and Indian Arvind).

If the brand license does not satisfy the expectations originally associated with it, the brand owner can just terminate or refuse to renew the license agreement, and resign from India. In that case, he does not

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face closing or exit costs.

## CONCLUSION

The market entry in a foreign country like India is no easy step for Western companies. There are many pitfalls related to typical entry strategies like exports, own factory or M&A. Some of the most common pitfalls include import tariffs, unit cost and pricing, product features, cultural differences, start-up costs and time, taxation, and investment risk.

Brand licensing is an entry option that helps to minimize all these pitfalls. It is an attractive, low-risk and fast solution leading to market success that is in any case superior to imports or the building up of own operations in the country. Through the right Indian partner and the right contractual framework, brand licensing is flexible enough to be converted into more binding and definite solutions.

The timing is right for brand licensing. The demand from Indian companies for established Western brands under license is increasing fast. The prestige segments of the Indian market are already crowded with high-price imported products and leave only little room for further market entrants. And only few large MNCs can afford the investment required for M&A or FDI in the country.

However, Adequate diligence should be taken to find and select the right license partner in India, to draft a well-balanced licensing agreement and to make sure that the launch of the branded products is well carefully prepared and well thought-out.

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