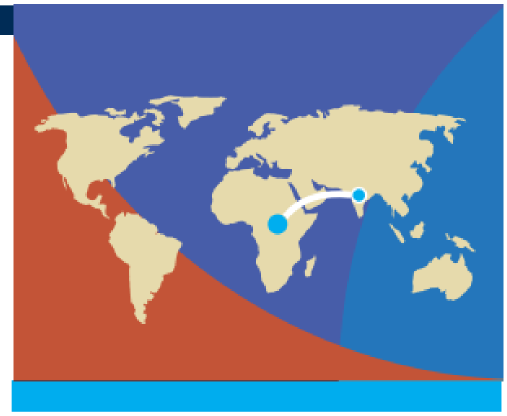
Expanding the business into Africa through “Subsidiary” route



There are situations when it is a better option for a firm to expand its business to Africa by setting up own operations in the form of a wholly or partly owned subsidiary or acquiring a new firm. This route to expand to a new country would require a considerable amount of capital investment and a medium to long term lag period when the business starts getting returns from Africa operations.

While taking the business to Africa, there are multiple customizations that the enterprise has to make with respect to the product/service, service delivery, operating model and distribution channel to adapt it to the local cultures and market characteristics. In such scenarios, the firm needs to have high degree of control on its operations and service delivery and setting up its own operations in the destination country comes out as a better option.

This document provides an initial checklist of assessing if an enterprise is ready to set up a subsidiary and things to consider while opting for “subsidiary”.

UNDERSTANDING “SUBSIDIARY”

Company can opt for subsidiary either by owning 100% stake or by owning a partial stake in existing local firms.

A company whose common stock is 100% owned by another company is called the “Wholly owned subsidiary”. A company can become a wholly owned subsidiary through acquisition by the parent company or as a spin off from the parent company itself. In contrast, a regular subsidiary is 51 to 99% owned by the parent company. While partly owned subsidiary is a company that is partly owned by another company, and also has other owners.

One situation in which a parent company might find it helpful to establish a subsidiary company is, if it wants to build a strong hold and brand presence in the new country. This arrangement is common among high technology driven companies or service driven models who want to retain complete control and ownership of their technology or service delivery. The enterprises that follow this route are mostly the ones which have good financial strength and have tested their model in the home country well enough. A wholly owned subsidiary is always a longer term plan to align with the future goals and objectives of the enterprise.

WHAT CAN A SUBSIDIARY BRING TO THE TABLE?

Wholly Owned Subsidiary

- *Full Control - A Wholly owned subsidiary allows the parent company to exercise full control on the business strategy and operations and hence, provides the enterprise freedom on the manner it plans to operate*
- *Stepping stone towards market development- Setting up operations in a new country can be a medium for the enterprise towards capturing a wider customer base. This investment would help the organization to learn the local trade practices, business laws, market practices, competition. They can plan their further move accordingly*
- *Customization- A subsidiary can help the organization to understand the needs and requirements of the local consumers in a much deeper manner and thus, the organization can bring its offering in a more customized manner*

Novartis Arogya Parivar: Setting Up Wholly Owned Subsidiary in Africa

Established in 1996, after the merger of Swiss companies Ciba- Geigy and Sandoz, Novartis is a world leader in providing healthcare solutions. It has set up a for- profit rural healthcare initiative, Arogya Parivar (Healthy Family) in India in 2007. Arogya Parivar aims to improve healthcare access and reach to remote rural communities

Arogya Parivar preferred setting up its own operations as it would allow complete control over the quality of service offerings and operational costs. It also helped Novartis in aligning brand values and mission across geographies.

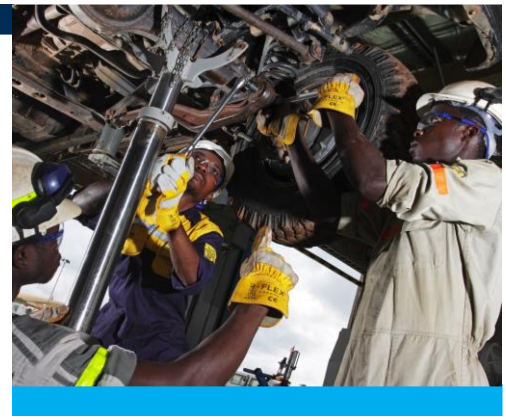
Partially Owned Subsidiary

- *Offers considerable tax advantages as a fully owned entity by foreign national do not qualify for numerous tax benefits. It reduces the potential legal risks associated with new ventures when compared with fully owned subsidiary. It offers more flexibility in offsetting profits and losses of different parts of the business. Entering into an unknown geography with as a partly owned subsidiary actually reduces the risk the firm takes up in establishing the operations. Apart from these benefits, a partly owned subsidiary with a local firm having stake, makes the subsidiary appear local and many legal frictions are automatically taken care of. Firms like Manasa Agro adopted this strategy to expand to Malawi*

Manasa Agro Pvt. Ltd. - Setting up party owned subsidiary in Malawi

Manasa Agro engages in captive cultivation of lemon grass, through contract farming and on self- owned land; processes the same to lemon grass oil and markets it in India and abroad

Manasa decided to own majority stake (60%) in Agritech through which they could acquire land for cultivation. Choice of a partly owned subsidiary to facilitate replication was necessitated owing to the regulatory environment that does not allow foreign ownership of land. Manasa entered into a partnership with a local farmer to set up Agritech Pvt. Ltd in order to acquire land on lease. This association helped in connecting with local government investment agencies, and thus, helped it acquire land quickly and access tax benifits through VAT. Agritech was locally registered with a Malawi citizen on board. This helped Manasa to gain trust of government officials and local communities as well.



WHEN IS SETTING UP A "SUBSIDIARY" BEST MODE OF BUSINESS REPLICATION IN AFRICA?

The decision whether to go for setting up a wholly owned or partly owned subsidiary for expanding to an African country will depend upon many factors related with organization, business model, product/services offered and macro environment which make it imperative for a business to start their own operations in order to succeed in African market. Some of these factors have been explained below:

Organizational Factors that can Lead to a Wholly or Partly Owned Subsidiary

- *When management needs to have full control of business: When management is unwilling to share the control of business with any local or strategic partner, it is advisable to take the subsidiary route and set up own operations*
- *When the organization has proven its model in home country and reached scale: When the organization has good hold of the business model, products or services that it is offering in the home country, it has the scale and financial capacity to take the operations to Africa and set up a new venture. It also involves the senior management to have a good level of experience in the business with respect to the total value that they bring to the business. This will also increase the risk appetite of the organization*

Business Model Related Dependencies

- *Type of product or services being offered: In cases when the product/service being offered is driven by high end customizable technology or service delivery model or protected by any IP, organization can go for a wholly owned subsidiary. Enterprise possessing tacit assets that cannot be easily transmitted to an external partner also makes a case for wholly owned subsidiary*
- *When the business model is dependent on customized service delivery: Services are often customized to serve the local requirements; business models which are high on customized services have the requirement to set up their own operations.*
- *When the business has high dependence on expertise: Businesses which are run on human capital and are driven by the experts in their field. It is advisable to set up their own operations in the new country, taking help of the home country experts.*
- *When the business model requires high monitoring and evaluation: When there is high emphasis on quality of service delivery and thus requires intensive monitoring and evaluation, setting up a subsidiary would be a better replication format to go for in Africa*

Macro Environment Related Factors

- *When a wholly owned or partly owned subsidiary is the only legal way to enter market of destination country in Africa: The laws and regulations in different African countries differ. It's necessary to investigate what are the different legal ways to set up operations in the destination country. It is also required for the enterprise to see what legal structure – private limited, limited liability partners or a not for profit structure goes well with the organizational goals*

WHEN IS SETTING UP A "SUBSIDIARY" BEST MODE OF BUSINESS REPLICATION IN AFRICA?

- *Huge Investment at stake: There is a huge financial investment that the enterprise makes in the beginning for setting up its own operations, if the business model does not work as expected in Africa; there are chances of losses for the enterprise.*
- *Non alignment of Business dependencies in the destination country: There are possibilities that the destination country in Africa does not have availability of the critical business dependencies like human resource talent, necessary infrastructure. It is imperative to do detailed research on the country's existing infrastructure and its alignment with the business needs before embarking on the expansion. Understanding the critical business requirements is more crucial with respect to the enterprises taking up the subsidiary format as they are mostly service oriented and have a lot of investment in stake*