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IN EMERGING MARKETS, SOMETIMES IT IS BETTER TO LET 'GRAY' POINT THE WAY

Edward Rubesch[1*] *and Ruth Banomyong*[2]

[1]College of Management
Mahidol University, Bangkok, Thailand

[2]Faculty of Commerce & Accountancy,
Thammasat University, Bangkok, Thailand.

ABSTRACT

Emerging markets are expected to provide much of the future growth for established multinational companies, yet strategies for entering these markets are often risky and uncertain. Transportation and distribution infrastructure in emerging markets may be limited due to a lack of reliable service providers and credible channel intermediaries. The combination of these factors may lead to a situation where companies find themselves competing with their own products that have entered the emerging market through parallel channels. However, while part of the literature suggests that informal parallel channels form because of impediments to free flowing distribution, the informal sector may also provide the solution to the challenges of entering emerging markets for multinational companies. This study describes the case of an informal network of border traders that has formed to supply consumer products to Vientiane the largest market in Lao PDR. It examines how this network effectively competes with authorized channels, and determines that the informal channel is also providing customer value, which would otherwise not be met. The paper concludes with suggested implications for developing distribution strategies in emerging markets.

INTRODUCTION

Emerging markets[*] are expected to provide much of the future growth of international business (Czinkota and Ronkainen, 1997). Growth rates in developing countries are attractive to multinational corporations, which struggle with high competition and slow growth in mature markets, and many emerging markets are characterized as having large pent-up consumer demand (Arnold and Quelch, 1998). Despite their increasing importance, there has been little research to understand entry strategies for emerging markets (Nakata and Sivakumar, 1997).

Despite the growing importance of emerging markets for firms engaging in international business, and the role of informal border trade as one way to participate in these markets, little academic research has been done in this area (Gillespie and McBride, 1996; Fadahunsi and Rosa, 2002; Nakata and Sivakumar, 1997). The research described in this paper seeks to help

[*]Corresponding author at erubesch@alum.mit.edu

[*] While there is no established definition of what constitutes an emerging market, usually it is one that is a developing country in terms of GDP, has a high rate of growth, and has embraced a free-market system (Arnold and Quelch, 1998). Emerging markets often share the characteristics of having a small urban elite with high incomes, among a larger low-income population, and a situation where demand for consumer products exceeds supply (Batra, 1997).

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fill the literature gap by trying to answer the question: how effective are informal channels at meeting consumer demand in emerging markets?

This is an important question because an effective and established informal channel represents both a formidable competitor to firms entering emerging markets (Arnold and Quelch, 1998), and a possible valuable complementary channel that helps firms meet demand (Prince and Davies, 2000).

BACKGROUND

There are three different ways consumers in emerging markets can acquire products. Firms may decide to supply a particular market, either on their own, or through an intermediary (Keegan, 2002), forming an authorized channel. Alternatively, if consumers' needs are not being met, shoppers may travel outside their regular local markets to seek greater product or service variety, or better prices (Samli et. al.,1983; Piron, 2002; Macklem 2003). This activity is known as out-shopping. Finally, products can enter emerging markets through informal distribution networks. These informal channels are usually made possible by a combination of a more liberalized trade environment, pent-up consumer demand in emerging markets, large numbers of border traders willing to engage in informal commerce, and customs organizations that can be easily circumvented (Gillespie and McBride, 1996).

This study explores an informal distribution network composed of border traders from Vientiane, the capital of Lao PDR, who travel to Nong Khai province in Thailand on a daily basis to purchase consumer goods and return to re-sell them to retail shops in and around Vientiane.

Lao PDR has an estimated GDP per capita of $330 in 2000 (Asian Development Bank, 2001). The UN Development Program ranks the country at 135 out of 177 in terms of human development. These measures indicate that Lao PDR is one of the poorest countries in Asia (UNDP, 2004).

Since adopting the New Economic Mechanism in 1986, the government has embraced more market-oriented reforms with a goal of spurring economic development, which led to average annual GDP growth of 6.5% during the period of 1989 to 1995 (UNDP, 1998). Vientiane is developing more rapidly than that rest of the country. The city is home to nearly 10% of the country's population, and has the highest population growth. The city also accounts for a quarter of the country's industrial establishments (Bourdet, 2000)). The city attracts a large number of foreign residents because of the embassies located in the city, as well as a large number of foreign aid agencies. There has also been a formal effort to attract former Laotian nationals who have sought refuge abroad to return to the country to invest and provide expertise. These factors have contributed to a relatively fast-growing market of sophisticated consumers, who are knowledgeable of, and desire international branded products.

Vientiane is located directly across the Mekong River from Thailand. Transportation links to Thailand include river ferry service, and the Thai-Lao Friendship Bridge providing a road connection to Nong Khai Province, and the rest of Thailand by a dual carriageway road network and rail. Nong Khai is home to a number of local retailers and wholesalers, as well as a large hypermart owned by a multinational. This means that a full range of branded consumer products are located just across the border from the Vientiane market.

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With this proximity, small-scale entrepreneurial border traders regularly cross to Thailand to buy products not available in ~~the~~ Lao PDR. Typically, the traders have established relationships with specific shops or small restaurants and contact them on a daily basis to take orders for products. After receiving orders, the traders travel to the bridge (and to a lesser extent the river ferry) in ~~the~~ small three-wheeled vehicles found in ~~the~~ Lao PDR and Thailand called *tuk-tuks.* At the bridge they pass through immigration with a border pass and cross the bridge on a shuttle bus. At the bus terminal on the Thai side, they hire another *tuk-tuk* and travel to retailers and wholesalers to make purchases. Once they have acquired the goods that the shops in Vientiane have ordered, they hire a Thai *tuk-tuk* to transport the goods back to the bus terminal, where they will be loaded onto the vehicle, and carried to the Laotian side for immigration and customs clearance. Finally, traders enlist a Lao *tuk-tuk* for the final leg of their journey, to send the goods to the shops in Vientiane.

METHODOLOGY

The study of informal channels, especially within the context of distribution, is not well researched with little empirical evidence. There was therefore a need to adopt a research method that could allow theory to be built inductively. The research tool that accomplishes this is the case study, with an emphasis on qualitative methods. Case studies are used in situations where current perspectives fail to adequately describe a phenomenon, or there is little empirical evidence (Eisenhardt, 1989). Qualitative methods are appropriate when it is necessary to understand a research problem in a relatively new context, and the richness of data derived from in-depth qualitative methods is desired (Belk *et. al.,* 1988).

In-depth structured interviews were performed with 24 border traders, who regularly travel to Thailand from Vientiane to purchase goods for re-sale. Semi-structured questions were developed in the following major topical areas:

- *Entrepreneurship*: How did the border trader start his/her operations? What was the original investment? Where did they learn about this occupation? How did they locate their first customers?
- *The current business situation*: How many customers does the border trader currently have? What products does he/she normally buy? How often does he/she come to Thailand? What is a typical day like?
- *Distribution network*: Which shops in Vientiane does the border trader buy for? Do those shops also buy from other traders? Why doesn't the shop get these goods (that the border trader is buying) from ~~the~~ authorized distributor? Who else does the border trader work with?
- *Product supply*: Who does the border trader buy from in Thailand? Do those suppliers do anything special to encourage the border trader to buy from them? How does the border trader learn about new products that become available in Thailand? How much does the border trader have to pay in customs duties?

RESULTS

All interviewed border traders were women. These women were all involved in the consumer goods trade. Almost every interviewee stated that the main reason for entering the trade was because they had "no other job opportunities," or "nothing else to do." Many began trading because they desired extra income to help raise families. Despite the fact these women worked as border traders because of few other employment opportunities, most expressed the

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fact that they liked the work because it gave them freedom and flexibility in their lives. Four of the border traders had originally begun working with their mothers when they were still in their teens, and eventually began working on their own as they got older.

It was discovered that the trader with the least experience has been trading for less than two years, starting with an initial investment of US$25. Currently this border trader is able to earn approximately US$400 per month. The more established traders have been working for around 12 years (in fact, even before the bridge had opened), and have developed extensive trading networks. Shops in Nong Khai, regularly called the more established border traders and gave them updates on prices and promotions. Some of them even developed a special business relationship with a trusted *tuk-tuk* driver on the Thai side. The existence of these informal networks means that some border traders are able to collect goods without having to physically travel to collect goods from their suppliers. This goods collection and transportation was outsourced to their trusted *tuk-tuk* driver. Every morning the more experienced border traders would work out of the bus station on the Thai side, making orders over the phone, and dispatching their *tuk-tuk* drivers to the various shops to pick up goods. As products were brought back, they removed the packaging, and re-packed the goods in bulk, not only to make it easier to cross the border but also to lower down import duties risk. A particular trader reported that she was earning the equivalent of US$5000 per month. Traders are required to pay import duties. However, interviewed border traders reported that the duties were arbitrarily determined, by assessing the size of the packages a trader was actually carrying. Re-packing is therefore a way to lower costs. High-volume items, such as cosmetics, were stripped of their boxes and packed in bulk. There were occasions however, when duties were assessed at a higher level than the price the trader had negotiated with the shop, and some trips ended in a loss.

Often border traders sold good in response to advertised promotions shown on Thai TV, which reaches Vientiane viewers. Consumers would see a new product (often a new size, flavor, or fragrance of an existing brand) and demand it at the local retailer. Those retailers would then place orders with the border traders who would supply the products within the same day (if the order was placed in the morning). This particular system is more responsive to customers need compared to the import of the same products through authorized channels.

Typically, traders had 3-5 shops that they worked with regularly. These shops also employed the services of other traders at the same time. Shops separated product or brand types, so that traders were not competing for the same products. Traders were also asked whether they thought further liberalizations of trade policies between Thailand and Lao PDR would drive them out of business. In response, border traders pointed it was freer travel to Thailand that originally provided them with the opportunity. Moreover, they were convinced that there would always be customer groups that the authorized distributors could not service effectively.

CONCLUSIONS

Exploratory research in the activities of border traders on the Thai-Lao border provided anecdotal evidence that informal channels can provide several value-creating services that cannot be met with authorized channel. The informal channel provides products that the authorized channel may be unable or unwilling to supply. It is possible that the informal channel may be the best way to meet the demands of a small number of consumers who desire a particular size, shape, fragrance or other type of product or brand, thus allowing authorized

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distributors to focus on higher-volume, more-profitable and less risky products. In this role, the informal channel creates customer value by helping to establish new products in the emerging market. As the market grows and demand increases, the authorized channel could then incorporate those products into it portfolio.

Similarly, the informal channel can often respond more quickly to changing customer demands. Widespread marketing communications spill over to this emerging market by informing consumers about new products available elsewhere, while a number of urban elite may have been introduced to new products while traveling outside the emerging market. Informal channels can respond quickly to changes in this demand, while increasing overall sales for the manufacturer. Authorized intermediaries are also protected from the risks of carrying and selling on new and untested products.

However, there is also the potential for informal channels to destroy value, by eroding brand equity or failing to maintain expected quality, service or maintenance that must be provided along with the product. Poor handling of product can result in damaged product or packaging entering a market, harming the image of the product and potentially also that of the producer.

These conclusions indicate there is an opportunity for firms to devise hybrid strategies that include informal channels, while ensuring overall quality, brand, and service goals are met. Firms might allow informal channels to import and supply goods to an emerging market, but provide formal support service within that market, ensuring customers' expectations and satisfaction are met. Packaging is an important part of the added value of a product, but there is a tendency by informal traders to dispose of it during shipment, manufacturers should consider distributing product to retailers near borders in bulk-packs, without external packaging. This would lower down traders' costs, facilitate shipment, and ensure proper protection of the product as it moves within the informal channel. Meanwhile, authorized distributors might have the task of providing external packaging to local retailers or alternatively, developing point-of-purchase displays to present the product to consumers in the way it was intended.

To make a formal-informal hybrid distribution strategy work successfully also requires new thinking about distributor relationships, and reward systems within multinationals. A distributor might be providing value by ensuring the product is clean, undamaged, and displayed correctly, without the opportunity to make a profit on the transaction. Similarly, managers tasked with opening emerging markets will likely generate sales in neighboring markets (to the possible benefit of different manager). Evaluation, compensation and bonuses must reflect the value that is being created by these parties, which may not fall within the geographical boundaries defined by nations, or by companies, when defining management responsibilities.

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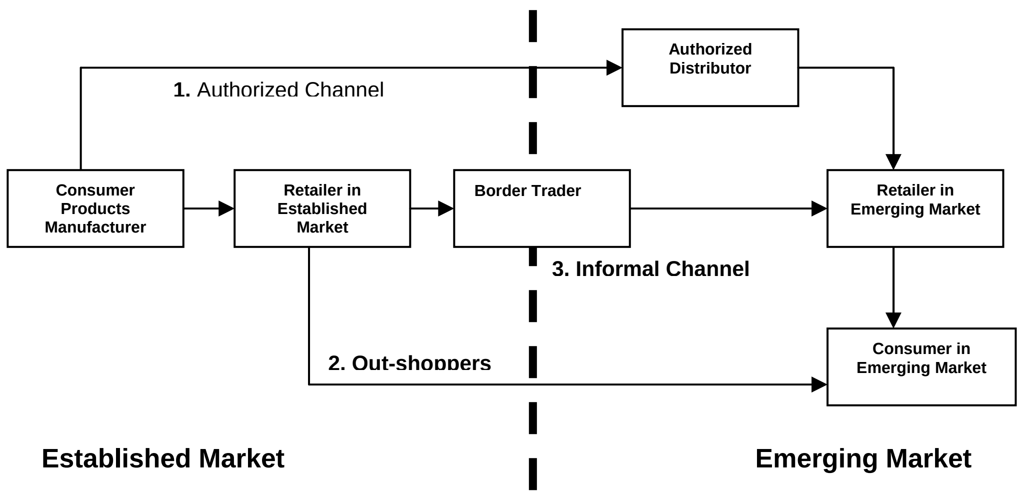

Figure 1: Product flows in an emerging market.

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