South African
International Expansion Feasibility Study

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Executive Summary

In the near future, Katambas Co. will continue to manufacture domestically and will begin marketing in South Africa. The inventory will be sent to a warehouse in Cape Town or Johannesburg, due to the fact that these two markets have the most to offer as far as customers and distribution channels. This will increase profitability, as revenues and cost of goods sold would both increase. We came to a consensus of strictly marketing in South Africa because, as a new entrant in the market, we want to test the waters and find success before we manufacture and move our entire operations into said country. Manufacturing for a new entrant would call for finding suppliers, purchasing new equipment and other business-related factors that we feel would have the most risk for our standing as a business. Manufacturing in the United States would be best because we have well-established relationships with suppliers and our supply chain is running smoothly, shown by our 15% domestic market share.

South Africa meets the criteria in our decision matrix as having a well-developed infrastructure due to a recent investment of billions of Rands into roads, buildings and highways. South Africa also has plenty of warehouse space and a summer climate year-round so that will not be a problem. But we will have to ensure a strong line of international communication, as our headquarters are thousands of miles away. South Africa's developing market recently experienced an economic revival following the World Cup 7 years ago. Poverty levels in South Africa have been exhibiting a steady decline in recent years, suggesting that the country is economically sustainable. Our main opportunities to obtain distribution channels will be through supermarkets and hypermarkets or individual retail stores. This strategy will be simple since the market is not overly-saturated with competitors. After an analysis of the products currently accepted by the South African culture, Katambas Co. is sure our high-end towels and other linens will be well-received in this new location. In the future, we may consider partnering with a foreign towel manufacturer to lower international costs.

Introduction

The purpose of this report is to support corporate level strategies for expansion with the goal of increasing profits. We would like to make recommendations for establishing a foreign presence in South Africa and for gaining a competitive advantage. We are looking to expand into South Africa with our business activities such as manufacturing and marketing activities in South Africa for export to neighboring countries.

Our NAICS code is 314120, which consists of Curtain and Linen Mill products. Our supply chain starts with obtaining raw materials such as cotton, polyester, and yarn, from textile and linen suppliers. For now, we are only manufacturing our products domestically and have received information that South Africa could potentially be a major source of raw materials. We distribute via tractor trailers and third party distributors like Fedex and UPS for our direct to consumer orders. Our customers include retail chains such as Target and Kohl's. The population of end consumers consists of mid- to upper-class families who want towels that last long. Our supply chain is well depicted in Exhibit 1.

Our corporate-level strategies consist of both domestic and international expansion and related diversification through marketing other linen products. This will lead to horizontal integration as we are expanding into other markets. Our business-level strategies include a broad target market at higher costs, which leads to differentiation.

There are criteria we will have to consider before making the decision to expand into South Africa. As far as marketing, we will seek a developing market, a stable and sustainable economy, easily implemented distribution channels, and cultural acceptance. For manufacturing, we aim to move into a market with a well-developed infrastructure, warehouses available for rent, strong international communication, and a warmer climate suitable for our products. Transitioning our operations to foreign markets will help our company gain market share.

Analysis (Max 7 pages)

U.S. Business Activities

Katambas Co. is a company based in Fort Lauderdale, Florida that is looking to expand internationally. We manufacture high quality towels made from Egyptian cotton and other luxurious materials. Our role in the supply chain is domestic manufacturing and early stages of distribution. We receive raw materials from suppliers, then our completed products to distributors for delivery to retailers. We manufacture towels on a Make-To-Order (MTO) basis. The process that is used to manufacture towels includes purchasing spools of cotton or polyester, having the cotton massaged, fluffed and combed. The thread from the cotton is then woven and dyed to customer specifications.

Our company requires training for workers to gain expertise in using traditional looms and handling of materials. Additionally, we need marketing expertise to help our brand become more recognizable to consumers. The spools of cotton-polyester blend yarn are purchased in huge quantities. Katambas Co. currently sells to domestic retail stores, hotel chains, and water parks in warmer states. We currently utilize delivery services to distribute orders to our online customers. A problem that has hurt our business recently is the natural disaster of Hurricane Irma in September. Our facilities were damaged slightly from the storm, slowing production for a couple of weeks. Katambas Co.'s competitors include IKEA, L.L. Bean, and Turkish Bath Towels. These three companies alone account for approximately 40 percent of the market share.

External Environment

South Africa encourages investment because it has a mostly free-market economy. The foreign direct investment (FDI) in 2016 was $2,270 million USD for 3.9% of gross fixed capital formation. FDI Stock was $136,837 million USD for 46.5% of GDP. Greenfield investments totaled $139 million USD. The Clothing and Textiles Competitiveness Programme (CTCP) is designed to grow and develop the textile industry. The Clothing and Textiles Competitiveness Programme (CTCP) is designed to grow and develop the textile industry. This program is divided into the Improvement Programme (CTCIP), and the Production Incentive (PI). The

CTCIP makes 65% grants to individual companies and 75% grants to company clusters. The PI grants at 7.5% of individual company manufacturing value addition. These grants are to be used for interventions that improve competitiveness. For example, companies can use the grant money in their business for uses such as upgrades and expansion of capital equipment, increasing productivity, enhancing employee skills, improving products and processes, reducing costs and making interest payments on debt.

Although there are currently no restrictions on foreign ownership in the public or private sector for this industry, President Zuma has announced that he will launch a land reform bill that restricts foreign ownership. As a result, this bill will convert existing foreign-owned land to long-term leases. Enacted in 2013, the Promotion and Protection of Investment Act was designed to make foreign and domestic investors equal. From a foreign investor's point of view, this bill was anything but equal. The bill stated that if expropriation took place, the matter would be dealt with in accordance with the constitution. According to the constitution, compensation for expropriation would be an amount that is “just and equitable” rather than fair market value. In 2015, the Protection of Investment Act 22 was passed in parliament. This act removed the expropriation section, but still mentions that the South African government can take any measures (including possible expropriation) to redress historical inequalities, uphold the values and principles of the constitution, promote cultural heritage, foster economic development, and protect the environment.

High crime rate, increasing social unrest (strikes and demonstrations), high levels of corruption, and structural issues in electricity supply and logistics may be factors that would negatively impact our processes. South Africa has a complex tariff schedule because of the existence of nearly forty different rates. Most tariff rates fall within eight levels ranging from 0% to 30%. The value-added tax (VAT) is 14%. VAT is required to be paid by all imports unless the goods are used in manufacturing or resale by registered trades. The total tax rate in South Africa is 28.8%, compared to the U.S. total tax rate of 44%. South Africa has a mixed economy in which there is a variety of private freedom, combined with centralized economic planning and government regulation.

South Africa is a member of the South African Development Community (SADC). In recent news, South Africa was looked over for hosting the 2023 Rugby World Cup despite being recommended by World Rugby itself. Many believe that this is because of current political unrest and crime. Factors that affect the political unrest include Africa’s ongoing political tensions from state capture, the upcoming ANC leadership elections, and an economy weakened to the point of junk status. As of March 11, 2016; one U.S. dollar was equal to 15.23 South African Rand. The same date in 2015 and 2014 were 12.26 and 10.79, respectively. Notable peaks of the value of the South African Rand were in 2002 at 11.47 and 2009 at 10.32. The 2002 peak reflected the economic fallout of terrorist attacks of September 11, 2001. In 2009, the global recession was the influence of the global economic crisis of 2008.

In current events, President Zuma has called for tax hike and an expenditure cut. Opposition to Zuma says that the South African government needs to address wasteful expenditure, and corruption before a tax raise should be implemented. It is feared, if the government doesn’t address these issues prior to raising taxes, that tax morality will dip and as a result, taxpayers will find ways to avoid paying tax. As a result of higher taxes, it is expected that issues with economic growth, growing unemployment, and limited revenue collection will continue or leave South Africa worse off. Restrictive labor regulations and a lack of skills and educational development have contributed to large-scale unemployment.

The best place for manufacturing in South Africa is Johannesburg. What was once well known as a mining city has now been overtaken by the services and manufacturing industry. 50% of all goods arriving in Cape Town and Durban ports make their way to Johannesburg. Durban, Pretoria, and Bloemfontein also have strong manufacturing sectors. The best places to market would be anywhere where our product would be used in most abundance. For towels, anywhere near the coast, especially areas that are densely populated by hotels and resorts, are ideal.

South Africa has many attractive assets for investors. Positively: an important demography, a diversified, productive and advanced economy, abundant natural resources, a transparent legal system, and a certain political stability. Negatively: the country suffers from high crime rate, increasing social unrest by way of strikes and other demonstrations, high levels of corruption, and structural issues in electricity supply and logistics.

Business Activities

Marketing. The South African market seems to be a good opportunity for selling our products and expanding into emerging markets (Wyk, 2004). The South African household product market reached a value of $1,146 million by 2014, suggesting the economic viability of a market specializing in home goods for the future (MarketLine, 2015). The market is not overly saturated and has had steady growth in recent years, indicating that the South African market provides and opportunity for increasing international sales. Additionally, a small business enterprise represents a unique opportunity for developing countries such as South Africa. Poverty can be ameliorated by employing unskilled and uneducated workers in warehouse, manufacturing, and transportation positions (Luiz, 2002).

Residents of South Africa currently do not have a great deal of disposable income; due to this high end retailers are struggling to make a profit (Gama, 2017). This creates a concern for our company because we market our towels as high quality. However, it is likely that consumers would be more willing to purchase higher quality towels over less practical items such as designer clothing, expensive jewelry, and luxury cars. The poverty trend in South Africa has declined since 1980 and is likely to continue to decline in the future. However, there are still some challenges hindering poverty reduction including low skill levels, low employment levels, and weak economic growth (Magombeyi & Odhiambo, 2015). As a company we can contribute to poverty reduction in South Africa by expanding the number of low-skill jobs available. There are more concerns to take into account before deciding on expanding into South Africa. The country has a volatile currency and has experienced rather slow GDP growth, which has taken a toll on consumer demand for products (IHS Global Insight, 2012).

As most new entrants to the South African market know, the best way to get products into the market is through supermarkets and hypermarkets. These two distribution channels alone count for almost 70 percent of the market share. In order for Katambas Co. to open individual retail stores, we would have to market other linen-type products.

If we were to enter the South African market, the best way is through retail stores such as Woolworths, which has a major market in the Johannesburg area. Individual retail stores count for almost 23% of the market share. Also, we would consider selling to household products wholesalers who make catalogs for hotel chains and boutique hotels. The probability of our company getting involved with large hotel chains is slim, as they already have relationships with their respective wholesalers. We do see opportunity in boutique hotels that are considering building more hotels along the South African coast.

The South African market is the most diverse market on the continent. Besides the multiple languages spoken, English is the most common language in the business world. With the lack of competition in our area, we forecast acceptance of our products by the South African culture. However, we realize that for our customer base to continually grow at a steady pace, we need to introduce different types of products to give consumers more options. Research shows that if we do not go into South Africa with a "go big or go home" mentality, we will not have much success as competitors have gotten into most supermarkets. The biggest mistake entrants make is not understanding the importance of relationship building with South African businesses. Katambas Co. must adapt to the needs of this unique consumer base.

Manufacturing. A lack of infrastructure would not pose a problem as South Africa has recently invested billions of Rands improving it. Most renovations have already taken place prior to the 2010 World Cup, which revived the South African economy. The two biggest investments in improvements took place in the two cities we are considering moving our operations to: Cape Town and Johannesburg. Over one billion Rands were invested in improving the transportation systems for these cities. Improvements include new roads and renovated ports, which will benefit our future distribution networks. While the infrastructure may be less maintained in poor areas, Cape Town and Johannesburg have had no issue maintaining their newly renovated infrastructures due to their rich economies.

No matter what locations at which Katambas Co. will manufacture, we will need warehouses. It seems our company will have no problem finding warehouse spaces, as such properties are advertised at economical prices in both Durban and Johannesburg. Rent ranges from 17,000-24,000 Rand, depending on the size of facility. The uncertainty of long term success in South Africa creates difficulty in the leasing process.

Communication is valuable even more in international business than in domestic business. When a company plans to export its goods to another country, it has to go through many networks to reach the redistribution stage of transportation. It is imperative that upper management keeps a communication channel between the shipping and receiving departments. This ensures that the products make it to the destination in a timely manner and can be sent to warehouses/customers on arrival. If our company decides on solely exporting our towels to South Africa, we will need to ensure the existence of an organized line of communication.

There are many locations across South Africa that have proven to have suitable climates that attract a fair amount of tourism (Fitchett, 2017). Tourism-heavy areas will have a number of lodging options that we could sell towels to. We could also produce a new line of beach towels marketed towards the coastal areas of South Africa.

Summary of Findings

The South African market seems to be a good opportunity for selling our products and expanding into emerging markets. The market is not overly saturated and has had steady growth in recent years. We can hire low-skilled workers, which would contribute to lowering unemployment rates in South Africa. The country struggles financially, so residents do not have a great deal of disposable income. However, poverty has been on a steady decline over the past couple years.

Expanding into South Africa will be challenging, but may be an opportunity to increase international sales. Distribution channels include supermarkets, individual retailers, and hotels. Recent improvements in South African infrastructure and the availability of warehouse space make this opportunity even more attractive. If an organized line of communication is maintained during the entire shipping process, our company will be successful in our exports throughout South Africa. The climate in South Africa is favorable for expansion due to a high amount of tourism.

To increase profits through this expansion, we will need to increase our cost of goods sold (COGS), since the currency is at a lower rate. Manufacturing domestically in existing plants will be advantageous because most major competitors are already established in the industry. Katambas Co. must increase marketing in South Africa to increase brand recognition. Overall, we will be able to stabilize and potentially increase our profits in the future by decreasing manufacturing costs.

Expansion Options

Exporting through Strategic Alliance/Partnership

If Kitambass Co. enters South Africa through export, we would maintain manufacturing in Florida. Low-to-moderate in risk was the first decision criteria for our expansion strategy and through exporting by establishing a strategic alliance/partnership significantly lowers our expansion risk into South Africa. However, there are several issues that increase the risks involved with exporting. According to Export.gov (2017) the South African market already has well-established players from Europe and Asia; subsequently, many European companies have a trade advantage with their products being able to enter South Africa at lower rates than U.S. companies. In addition to, South Africa's companies generally carry a market bias and stick to their known suppliers (South-Africa Market Challenges, 2017). Furthermore, these factors not only increase the risk of exporting but potentially increase the likelihood and/or risk of being able to form a strategic alliance/partnership; due to the established relationships with European, Asian and local companies. Moreover, within the last decade the U.S. government has increased their efforts in establishing a South African presence and forming relationships especially through the Trade and Investment Framework Agreement (TIFA) which serves to increase cooperation, trade and investment opportunities between the two countries (Trade & Investment Framework Agreements, n.d.). These efforts improve the ease of exporting because there is a growing presence and acceptance of building mutually beneficial long-term relationships with U.S. companies (Exporting to South Africa-Market Overview, 2017). Furthermore, based on our expansion criterion of 100 percent management control, by exporting and strategic alliance we will maintain the majority management control even though we may be sharing costs, people, distribution, etc. with another company are operations will virtually remain in our control. Due to the welcoming of foreign investors and the relatively lower cost of investing needed for exporting we would also be able to enter the market at a moderate speed. However, South Africans are keen on relationship building and it is imperative to establish trust before a business relationship can form (Exporting to South Africa-Market Overview, 2017). Subsequently, this would significantly slow down our entry time and possibly increase the cost of exporting because we would devote resources (in particular time) to develop and grow a relationship prior to establishing the strategic alliance/partnership. A company we could do business with is Edcon Limited, a non-food retailer from South Africa that owns a multitude of specialty store, similar to the average U.S. department store (Bloomberg, n.d.). Edcon's Edgars and Jet division are both department stores aimed at different target markets and income levels, with Edgars being more high end and Jet is similar to a discount retailer. If we were able to partner with Edcon, that would also us to work with a company that has established distribution channels throughout South Africa and the Southern African region. In addition to, having Kitambass Co. towels into the Edgars and Jet locations would be the equivalent of having our products in a Kohl's and Target. Moreover, it would be beneficial for Edcon to form a strategic alliance with us because we have 15 percent market share and

Joint Venture through Mergers and Acquisitions

low to moderate risk tolerance

management control of 100 percent

moderate speed of entry into market

company to do business with

impact on profits of currency appreciates 10 percent

Ethic

Recommendations

Other than manufacturing and marketing, we had other business decision criteria that we had to consider as we move into South Africa. Others criteria include outbound sales logistics, human resource management for training purposes, increased profitability margins. We know that it will be challenging to be successful in South Africa due to competition. We believe that it would be best for Katambas Co. to export our products from the United States and sell through our international partners. Due to this we would be solely marketing in South Africa. A joint venture would be difficult to initially but can be an option in the future.

We plan to export our inventory via cargo ship. We can purchase a container under a 1-year lease for approximately $100 per month. It will take approximately 28-30 days for the cargo to arrive at the Cape Town terminal, from there the container will be sent to our warehouse. The inventory would then be delivered to our customers via third-party distributors. The distribution process is depicted in greater detail on Visual #3.

Overall, our gross profit would increase as revenues and cost of goods sold increase. When evaluating profit, the critical ratios are gross profit margin and return on assets. As stated earlier, our gross profit and sales revenue would increase when we export our products. This would create a positive percentage for profitability. For our return on assets ratio, we will divide our total assets exported by overall net income to determine if our invested capital is profitable.

Based on our decision matrix, it would be preferable for us to expand into a market with a well-developed infrastructure because it would ease our entry into the market. Three cities really stand out with this trait: Cape Town, Johannesburg and Durban. Warehouse space is necessary for storing inventory before it is shipped to the consumer. Communication is key to ensuring operations run smoothly and allow us to solve problems quickly. We would need the assistance from the U.S commercial service to get the right people in place for constant updates. South Africa has a year-round warm climate and could substantially benefit sales year-round.

A developing market is important because it allows us to forecast future growth expectancy of the market. And whether or not consumers would be willing to buy our products. Distribution channels would be another key criterion that lets us analyze what streams of business we can sell through, whether its retail, wholesale, or online. In order for our products to become a household name it needs to be accepted by the South African culture. This will prove to be a challenge due to existing towel manufacturers having well-developed brands. These decision criteria would support our business level strategy of having a broad target market at higher cost and our corporate level strategy of expansion with horizontal integration.

The first couple of years following the expansion could be challenging. Issues include getting our cargo to South Africa on time with the appropriate amount of inventory and finding the best distribution routes. If we find that South Africa is profitable, a Joint Venture could then be a considered to further increase profits. We would merge with an existing international towel manufacturer with the same business level strategies. However, for now Katambas Co. will market in South Africa and manufacture domestically. We will export our inventory and partner with South African supermarkets, boutique hotels and waterparks.

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