MMS – III (F) 27-10-2009

SM 03

Common Paper for Strategic Management (HR/Operation/Finance) (Marketing)

Section I

Roll No - Total No of printed pages - 11

Total No of Questions - 5 (Sec. I + II) Max marks - 30

Duration (hrs) – 3 (Section I + II)

Notes – 1. Both questions are compulsory in this section.
2. Figures to the right indicate full marks
3. Section I & II To be solved on SEPARATE Answer Books.

Q 1. Read the attached Case Study and answer the questions given below it. **20**

Q 2. Write short notes on (any four) **10**

(a) Porters five forces analysis.
(b) BCG Matrix.
(c) Value chain analysis
(d) Mergers and acquisitions.
(e) SWOT analysis.
(f) Porter's generic business strategies

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Pepsi's Entry into India – A Lesson in Globalization

"Convincing India that it needs Western junk has not been easy."[1]

- A New Internationalist Magazine Article, commenting on Pepsi's struggle to enter India, in August 1988.

A LETTER TO PEPSI

In 1988, the New York office of the President of the multi-billion cola company PepsiCo received a letter from India. The company had been trying for some time to enter the Indian market – without much success. The letter was written by George Fernandes (Fernandes), the General Secretary of one of the country's leading political parties, Janata Dal. He wrote, "I learned that you are coming here. I am the one that threw Coca-Cola out, and we are soon going to come back into the government. If you come into the country, you have to remember that the same fate awaits you as Coca-Cola."[2]

This development did not seem to be a matter that could be ignored. PepsiCo's arch-rival and the world's number one cola company, Coca-Cola, had indeed been forced to close operations and leave India in 1977 after the Janata Dal came to power.[3] Even in the late 1980s, India had a closed economy and government intervention in the corporate sector was quite high. However, multinational companies such as PepsiCo had been eyeing the Indian market for a long time for a host of reasons. As the major market for PepsiCo, the US, seemed to be reaching saturation levels, the option to expand on a global scale seemed to have become inevitable for the company.

India was a lucrative destination since its vast population offered a huge, untapped customer base. During the late 1980s, the per capita consumption of soft drinks in India was only three bottles per annum as against 63 and 38 for Egypt and Thailand respectively. Even its neighbor Pakistan boasted of a per capita soft drink consumption of 13 bottles. PepsiCo was also encouraged by the fact that increasing urbanization had already familiarized Indians with leading global brands.

Given these circumstances, PepsiCo officials had been involved in hectic lobbying with the Indian government to obtain permission to begin operations in the country. However, the company could not deny that many political parties and factions were opposed to its entry into the country. It had therefore become imperative for PepsiCo to come up with a package attractive enough for the Indian government.

THE PROMISES THAT HELPED PEPSI ENTER

In May 1985, PepsiCo had joined hands with one of India's leading business houses, the R P Goenka (RPG) group, to begin operations in the country. The company, along with the RPG group company Agro Product Export Ltd., planned to import the cola

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1 'Pepsi's Push,' www.newint.org.

2 'Coke Returns from India Exile,' (Interview with Fernandes), *International Monitor*, July/August 1995.

3 In the regulatory environment of the late 1970s, foreign enterprises operating in any non-priority sector in India could not own more than a 40% stake in the ventures. Coca-Cola ran its operations through a 100% subsidiary. After the company refused to partner with an Indian company and share its technology, it had to stop its operations and leave the country.

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concentrate and sell soft drinks under the Pepsi label. To make its proposal attractive to the Indian government, PepsiCo said that the import of cola concentrate would essentially be in return for exporting juice concentrate from operations to be established in the north Indian state of Punjab.

In its proposal submitted to the Ministry of Industrial Development, company sources said that the objectives of PepsiCo's entry into India revolved around 'promoting and developing the export of Indian agro-based products and introducing and developing PepsiCo's products in the country.' However, the government rejected this proposal primarily on two grounds: one, the government did not accept the clause regarding the import of the cola concentrate and, two, the use of a foreign brand name (Pepsi) was not allowed as per the regulatory framework. The association with the RPG group too ended at this juncture.

Not willing to sit quietly on the issue, PepsiCo put forward another proposal to the government a few months later. The company knew that the political and social problems[4] that plagued Punjab were an extremely sensitive issue for India in the 1980s. PepsiCo's decision to link its entry with the development and welfare of the state was thus a conscious one, aimed at winning the government over. The fact that Punjab boasted a healthy agricultural sector (with good crop yields in the past) also played a role in PepsiCo's decision.

Reportedly, the new proposal gave a lot of emphasis to the effects of PepsiCo's entry on agriculture and employment in Punjab. The company claimed that it would play a central role in bringing about an agricultural revolution in the state and would create many employment opportunities. To make its proposal even more lucrative, PepsiCo claimed that these new employment opportunities would tempt many of the terrorists to return to society. This added a lot of 'plus points' to PepsiCo's proposal, since a large number of young people in the state had become terrorists during the 1980s, causing socio-cultural and economic problems of a serious nature for many families in the state.

Reportedly, even as the government contemplated PepsiCo's proposal, many Indian soft-drinks companies, and social and political groups strongly voiced their opposition to it. Protestors said that the company would siphon out money from the country in the form of profits, promotional fees, and various other means. Protestors argued that the same money could be used for the development of the country.

Some critics even cited the instance of PepsiCo's involvement in Chile's political turmoil to support their opposition to the proposal.[5] Most of the opponents said that allowing a foreign company into a non-priority sector went against the existing government's [of the Congress (I) party, led by the Prime Minister Rajiv Gandhi] foreign trade policies.

Meanwhile, to 'sweeten' the proposal, PepsiCo made many commitments to the Indian government – most of them highlighting the company's concern for the development of the areas it planned to operate in. Some of the important commitments were:

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[4] The rise of militant groups demanding the creation of a separate state, Khalistan, led to serious religion-based terrorism in Punjab throughout the 1980s and early 1990s. Hundreds of people were killed in terrorist violence and security forces and the police had a tough time bringing the situation under control. By the mid-1990s, the terrorist movement had been controlled to a large extent.

[5] In the early 1970s, Chile's pro-socialism President Salvador Allende was killed after a military coup toppled the government. According to reports, the United States (US) had a hidden role to play in this coup as it wanted to curb the growth of socialism in Chile. Reports claim that the then PepsiCo Chairman Donald Kendall had personally sought the US government's help for protection of the company's commercial interests in Chile.

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- The company would focus on food and agro-processing and only 25% of the investment would be directed towards the soft drinks business
- The company would not only bring advanced food processing technology to India, but also provide a boost to the image of products made in India in foreign markets
- Half of the production would be exported and the export-import ratio would be 5:1 for a period of 10 years (80% of the exports to be of food products manufactured by the company and 20% of the exports to be of food products from a select list manufactured by other companies)
- Creation of jobs for 50,000 people across the nation, of which 25,000 were to be in Punjab
- Foreign brand names would not be used
- An agricultural research center would be established.

The government was apparently quite impressed with the terms and conditions PepsiCo had proposed. Thus, despite continuing protests, the Pepsi Foods Ltd. (Pepsi) venture was finally cleared by the government in September 1988. Pepsi was a joint venture between PepsiCo, Punjab Agro Industrial Corporation (PAIC, a body established by the Punjab government) and Voltas India Ltd. (a company owned by the business house of Tatas) While PepsiCo held 36.89% of the venture's stake, PAIC and Voltas held 36.11% and 24% stakes respectively. The company launched the soft drinks business with great fanfare and an elaborate multi-media advertising campaign in 1989.

The success of PepsiCo's efforts to enter India generated a significant amount of attention. While the political groups opposing the company's entry continued to criticize the government's decision, there were many who appreciated the way in which PepsiCo had clinched the deal. Some years later, commenting on how the company effectively used megamarketing[6] to enter the Indian market, renowned marketing expert Philip Kotler said, "Pepsi bundled a set of benefits that won the support of various interest groups in India. Instead of relying on the normal four Ps for entering a market, Pepsi added two additional Ps, namely, Politics and Public Opinion."[7] He added that committing to work towards developing the rural economy and bringing in new food-processing packaging and water-treatment technologies turned a lot of votes in PepsiCo's favor.

PEPSI'S PROMISES – KEEP SOME, BREAK SOME!

Pepsi began by setting up a fruit and vegetable processing plant at Zahura village in Punjab's Hoshiarpur district. The plant would focus on processing tomatoes to make tomato paste. Since the local varieties of tomatoes were found to be of inferior quality, Pepsi imported the required material for tomato cultivation. The company entered into agreements with a few big farmers (well-off farmers with large land holdings) and

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6 Megamarketing refers to the strategic coordination of economic, psychological, political and public relations skills to gain the cooperation of a number of parties in order to enter or operate in a market.

7 As mentioned in *Marketing Management* (The Millennium Edition) by Philip Kotler. The four Ps being referred to are 'Product,' 'Place,' 'Promotion' and 'Price'.

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began growing tomatoes through the contract farming route[8] (though the agro-climatic profile of Punjab was not exactly suitable for a crop like tomato, Pepsi had chosen the state because its farmers were progressive, their landholdings were on the larger side, and water availability was sufficient).

Initially, Pepsi had a tough time convincing farmers to work for the company. Its experts from the US had to interact extensively with the farmers to explain how they could benefit from working with the company. Another problem, although a minor one, was regarding financial transactions with the farmers. When the company insisted on payments by cheque, it found out that as many as 80% of the farmers did not even have a bank account!

Soon other problems cropped up. When the crop was harvested at the end of 1990, the Zahura plant had still not been made operational. As a result, the crop could not be utilized as planned and the local farmers had to bear combined losses of Rs 2.5 million[9]. In addition, critics commented that Pepsi paid the farmers only Rs 0.75 per kg of tomatoes, when the market price was Rs 2.00 per kg. Pepsi's detractors also alleged that the company had selected only big farmers, deliberately neglecting the small and medium farmers.

Pepsi received a lot of criticism for failing to create jobs. The company had promised to provide jobs to 50,000 people, but by 1991 it had employed only 783 people as direct employees. By 1992, this figure increased marginally to 909 and by 1996 it rose to 2400. Pepsi claimed that it had provided employment to around 26000 people in the country through indirect employment.

Industry observers commented that the company had included even the small vendors who sold its soft drinks as indirect employees. They argued that all these vendors could not be regarded as the employees of Pepsi. Information given by the company revealed that more than 50% of its employees were working for the concentrate and bottling business, and not the food processing activities. This prompted critics to say that Pepsi was not focusing on generating employment in the agriculture sector.

Pepsi had a majority holding in Futura Polymers Ltd. (Futura), a company that was involved in the business of recycling plastic. This company was reported to be working towards replacing many workers with machines. A senior manager at the company, L R Subbaraman, said, "Later they will ask for more money, form organizations, may be unions. We are always trying to be more machine oriented."[10] This attempt at reducing the workforce seemed to go against the company's commitments to create jobs.

Pepsi devised a clever way to handle the commitment it had made that it would not use a foreign brand name in India. Its cola was named 'Lehar Pepsi' to differentiate it from Pepsi, as the product was known outside India. In the packaging and promotion, where the product name was visible, the name Pepsi was given a prominent position while the Lehar part of it was relegated to the background. Consumers thus invariably had a stronger, more lasting impression of 'Pepsi' than 'Lehar Pepsi.'

Pepsi also failed to adhere to its commitment to export 50% of its production. Since its agricultural initiatives were not turning out to be as productive as planned, its export of fruit/vegetable based products was negligible. To make up for this, Pepsi began exporting products such as tea, rice and shrimps. In addition, it exported glass

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[8] Contract farming refers to a farming arrangement. Under this arrangement, farmers enter into a contract with a buyer to supply a specific quantity of the produce at a pre-determined price and quality. The buying company provides some inputs and technology to the farmers.

[9] July 2003 exchange rate: Rs 47 = 1 US $.

[10] 'Dumping Pepsi's Plastic,' www.multinationalmonitor.org, September 1994.

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bottles, leather products and even champagne. Critics pointed out these products had always been exported from India and that Pepsi was deliberately not meeting its export obligations.

Pepsi's detractors, such as Fernandes, were still focused on proving that allowing the company to operate in India was not a good decision. In fact, the decision to allow the company to enter the country was the subject matter of many heated debates in the Indian parliament. In one such debate in 1991, Fernandes asked the Food Processing Ministry why Pepsi was not being forced to honor its commitments. Another parliament member, S K Gangwar, said that the fact that Pepsi was being allowed to function normally even though it had not adhered to many of its commitments was very disturbing. He said, "When the Pepsi company has not fulfilled its commitments, why it is being allowed to continue to function here?"[11]

To deal with this unrest, a team of government officials visited the company's plant in December 1990. The team included a Director (Food, Vegetable Products department) and a Deputy Secretary from the Ministry of Food Processing Industries. The team's findings corroborated most of the charges leveled against Pepsi. It found that Pepsi had not made any efforts to export 40% of the goods it manufactured and that it had not taken any concrete steps to set up an agro-research institute. The team then referred the matter to the Ministry of Commerce, which in turn issued a show-cause notice to the company.

However, even by late 1991, the company had not replied to this notice. Many parliament members demanded closure of the company's operations to punish it for its numerous violations. This was easier said than done, since the closure of a company needed the coordination of the Food Processing Ministry and officers of the Ministries of Commerce, Finance, Industry and Food Processing. An Inter-Ministerial committee was therefore set up to look into the matter.

All the above incidents prompted critics to comment that Pepsi never had any serious intentions of developing Punjab's agricultural sector. Many of them felt that Pepsi's proposal to better the lives of the state's people and develop the rural economy were just ploys to gain entry into the country.

Luckily for Pepsi, it did not have to face criticism on many of the above grounds for long.

INDIA LIBERALIZES – A BOON FOR PEPSI

In the early 1990s, the Government of India was facing a foreign exchange crisis. The country was finding it extremely difficult to borrow funds from the international markets due to a host of problems on the political, economic and social fronts. Organizations like the International Monetary Fund agreed to help the Indian government deal with the financial crisis, on condition that it liberalized the Indian economy. As a result, the government decided to liberalize the economy. The removal of the numerous restrictions on foreign trade and the increased role of private equity in Indian markets were the two most prominent features of the government's new economic policy.

Pepsi benefited from the economic changes in many ways. The removal of various restrictions meant that it no longer had to fulfill many of the commitments it had made at the time of its entry. The government removed the restrictions that bound Pepsi's investments in the soft drinks business to 25% of the overall investments and required

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[11] http://alfa.nic.in.

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it to export 50% of its production. The company took full advantage of the new economic policy. In 1994, it bought off its partners in the venture; while Voltas sold off its stake completely, PAIC's stake was reduced to less than 1%.

The company established a wholly-owned subsidiary, PepsiCo Holdings India Pvt. Ltd. (PHI), which was completely devoted to the soft drinks business. Soon, all of Pepsi's investments in the country were being routed through this new company. Under the new economic policy, the use of foreign brand names in India was allowed. Consequently, Pepsi changed its cola's name from Lehar Pepsi to Pepsi.

In 1995, Pepsi's decision to sell off its tomato paste plant to the Indian FMCG major, the Unilever-subsidiary, Hindustan Lever Ltd. (HLL), added to the negative publicity surrounding the company. The only link that Pepsi maintained with its agriculture related commitments was the contract farming of tomatoes over 3,500 acres of land. HLL used the bulk of the tomato paste produced by the plant for its tomato ketchup and puree offerings. The rest was handed over to Pepsi for export.

Developments over the next few years seemed to support the critics' view that the company's main focus was clearly on the soft drinks business. In 1995, the beverages business grew by as much as 50% and as a result, by 1996, PHI's turnover surpassed Pepsi's turnover by Rs 1.25 billion. By 1996, fruit/vegetable-based products formed a minuscule 1.5% of PHI's exports, whereas plastic exports (bottles manufactured at Futura) were as high as 67% (it was alleged that the plastic bottles business resulted in the emission of highly toxic material that was polluting the areas around the factory and irreparably damaging the ecosystem). Also, even by 1997, the agro-research center promised by the company was nowhere in sight.

PEPSI GOES FARMING – FINALLY

Though Pepsi attracted a lot of criticism, many people felt there was a positive side to the company's entry into India. According to a www.agroindia.org article, Pepsi's tomato farming project was primarily responsible for increasing India's tomato production. Production increased from 4.24 million tonnes in 1991-92 to 5.44 million tones in 1995-96. The company's use of high yielding seeds was regarded as one of the reasons for the increase in productivity in tomato cultivation during the same period.

Commenting on the above issue, Abhiram Seth, [Seth, the company's Executive Director (Exports and External Affairs)] said, "When we set up our tomato paste plant in 1989, Punjab's tomato crop was just 28,000 tonnes, whereas our own requirement alone was 40,000 tonnes. Today, the state produces 250,000 tonnes. Per hectare yields, which used to be 16 tonnes, have crossed 50 tonnes."[12]

Pepsi was, however, not as successful in the chili contract farming venture that was started soon after the tomato venture stabilized. While the area under cultivation was 1,750 acres in 1997, it was reduced to around 300 acres by 2000. According to company sources, the chili venture failed because the main market for Pepsi's processed chili paste was the South-East Asian region. Due to the financial crisis in the region in the late 1990s, the demand for chili paste petered out. As a result, Pepsi decided to cut back on chili farming and focus on more profitable crops.

[12] 'Pepsi into Groundnut Contract Farming,' www.hinduonnet.com, March 13, 2000.

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Pepsi offered its contract farmers advanced equipment such as transplanters (for planting tomato and chili saplings) and seeding machines (for groundnuts) to help them carry out their tasks efficiently and speedily. The equipment, which was offered free of cost to the farmers, had been imported and modified to suit Indian conditions.

Pepsi gradually expanded its contract farming network from Zahura to the districts of Amritsar, Patiala and Sangrur (in Punjab). Over the next few years, the contract farming initiative (for potatoes) was extended to Uttar Pradesh (in the city of Meerut), Madhya Pradesh (in the city of Indore), Karnataka and Maharashtra.

In the late 1990s, the company finally met its commitment to set up agro-research centers. Such centers were set up in Jallowal and Channo (in Punjab) and Nelamangala (in Karnataka). These centers carried out field trials for various crops, vegetables and fruits and maintained nurseries for tomato, chili, potato and basmati rice. Through a 'Pepsi Agri Backward Integration Program,' Pepsi encouraged Punjab's farmers to cultivate potatoes with low sugar content (potatoes with high sugar content are unsuitable for making chips).

In October 1999, inspired by the promising trial runs of its basmati rice farming efforts, Pepsi decided to give a special thrust on contract farming for this crop. In 2000, the company extended its contract farming initiative to groundnuts. It planned to grow about 34,000 tonnes over the next 3-4 years. Seth said, "The 34,000 tonnes (over two crops) will yield around 20,000 tonnes of shelled nuts, of which we plan to export 12,000 tonnes to European confectioneries, salters and roasters and another 2,000 tonnes to the Far East."[13] Pepsi planned to use a part of the crop to manufacture peanut butter for export.

The company chose Punjab for its groundnut project. It believed that groundnut production in the state had declined over the years only because the state had not paid adequate attention to the crop's cultivation. Pepsi sources also said that as compared to paddy, which required extensive water (a scarce commodity in the monsoon-dependent Indian agriculture sector), growing groundnuts (which requires comparatively less water) in Punjab made more sense.

The fact that the Punjab government was actively looking for means to replace one-third of its paddy cultivation with a less water-intensive crop made Pepsi's new venture very attractive. To encourage farmers to grow groundnuts, the company stated that it would help them in all possible ways to get good yields. Later on, groundnut farming initiatives were introduced in Gujarat also. Pepsi imported superior technology from China and transferred it to groundnut farmers in Punjab and Gujarat. As a result, the yield per hectare improved from 1 tonne to 3.5-4.5 tonnes.

In June 2000, while revealing plans to invest Rs 1.25 billion every year in Karnataka during 2000-02, Pepsi's President P M Sinha (Sinha) said that the company planned to further expand its raw material sourcing operations in the state. This was in addition to the Rs 1.4 billion already invested in the state. The company planned to further expand its operations related to the processing of guava, pineapple, sweet lime and ginger. In this context, it planned to work in association with the Karnataka government and various raw material suppliers.

Sinha said that since its entry into India, Pepsi had invested over Rs 18 billion by 2000 (of this, Rs 1.5 billion had been invested in Punjab, where around 8,000 people were working for the company). He said the company's agri-program had been successful because of its unique 'laboratory-farm-factory approach.'

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[13] 'Pepsi into Groundnut Contract Farming,' www.hinduonnet.com, March 13, 2000.

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DOING BUSINESS ON ITS OWN TERMS

The company's contract farming initiatives and its focus on improving Punjab's agricultural sector seemed to indicate that Pepsi had been working towards fulfilling its pre-entry commitments. However, the reality was quite different.

In 2000, the company's exports added up to Rs 3 billion. The items exported included not only processed foods, basmati rice and guar gum[14], but also soft drink concentrate. Though the company did not make the figures public, in all probability, the portion of soft drink concentrate in its exports was much higher than that of any other product. In fact, the company met the soft drink concentrate requirements of many of its plants worldwide through its Indian operations.

Even by 2000, of its annual requirement of 25,000 tonnes of potatoes per annum, Pepsi got only 3,000 tonnes from its contract farmers. Given these figures, it would be interesting to see how it planned to achieve its objectives of meeting its complete requirement of potatoes through the contract farming route by 2004.

Many analysts said that since the regulatory framework had changed entirely after its entry into India, Pepsi was not at all bound to honor its earlier commitments. They said that given this context, the fact that it had done so much for the country's agriculture sector was something to be appreciated.

Even in 2002, Pepsi entered into various contract farming deals. In August 2002, it joined hands with a Punjab state government body, Punjab Agri Export Corporation (Pagrexco), to process citrus fruits. The company planned to identify, source and process citrus fruits for its juices venture Tropicana. In the same month, Pepsi began farming two kinds of seaweeds in Tamilnadu that were used to make carrageenan (a product used in many FMCG and food products). This was the first instance of organized, commercial seaweed farming ever in the country.

By 2003, Pepsi's soft-drinks, snacks, fruit juices and mineral water businesses had established themselves firmly in India. While the cola and snack brands had enviable market positions, the mineral water and juices businesses were still experiencing growth pangs.

For millions of Indians, Pepsi had become a part of their lives in many different ways. A far cry indeed from the days when the cola giant was struggling to enter the country and had to use the crutches of agri-business initiatives and export commitments!

Questions for Discussion:

1. Why do companies like Pepsi need to globalize? What are the various ways in which foreign companies can enter a foreign market? What hurdles and problems did Pepsi face when it tried to enter India during the 1980s?
2. Critically analyze the strategy adopted by Pepsi to sell itself to the Indian government. Do you think the biggest factor responsible for the acceptance of its proposal by the regulatory authorities was its projection of its operations as the solution to many of Punjab's problems? Why/Why not?

[14] Guar gum is extracted from the seed of Cyamopsis tetragonoloba, a leguminous plant. It is used as an emulsifier, thickener, and stabilizer in a wide range of foods, cosmetics, and pharmaceuticals.

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3. How did the company react to the changes in the business environment after the liberalization of the Indian economy in the early 1990s? Critically comment on the allegations that Pepsi deliberately did not adhere to most of its commitments.

4. Examine the contract farming initiatives undertaken by Pepsi in India and explain the rationale for such initiatives from the company's perspective. Why is it important for multinational corporations to work towards the improvement of the economy of the countries in which they operate? What are the various other ways in which this can be done?

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Section - II

Maximum Marks: 30

Note: Attempt ALL questions. in this section.

Question No. 1 **(20 Marks)**

Explain the terms: (ANY FIVE)

1. Strategic Planning
2. Competitive Advantage
3. Management Control
4. Strategic Fit
5. Learning Organisation
6. Corporate Social Responsibility
7. Balanced Scorecard

Question No. 2 **(05 Marks)**

Discuss the potential advantages and disadvantages of using a group to make decisions. What are the requirements for effectively managing group decision- making?

Question No. 3 **(05 Marks)**

"Disintermediation is the removal of distributors or middlemen that separate provider from consumer. Internet accelerates the process of disintermediation across industries because it is much easier for suppliers and customers to communicate with one another." Take a position on this statement and provide relevant examples to support your arguments.

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