Seven Rules of International Distribution

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If local distributors are the best way to enter a new region, why do these relationships almost always blow up? Are distributors impossible to trust, or are they scapegoats for the more complex problems inherent in taking expansion to the next level? HBS professor **David Arnold** believes the latter. In this excerpt from his article in the *Harvard Business Review,* he offers some rules for managing this traditionally conflict-ridden relationship.

by David Arnold

Multinationals entering new markets make trade-offs among three worthy objectives, says David Arnold: wanting to control their business expansion at a strategic level; partnering with local distributors, at least for the first years, to benefit from the locals' expertise; and minimizing costs and risks in these new ventures.

"These are all good objectives," writes Arnold, "but finding the correct balance among them at any particular time is tricky."

In this excerpt, he explains three of his seven strategies for helping executives of multinationals find the right balance while anticipating and correcting potential problems.

1. Select distributors. Don't let them select you.

A foray into a new international market should be the result of a strategic decision based on an objective market assessment. But that's not how it usually happens. At almost every company I studied, initial moves into new countries occurred in reaction to proposals from potential distributors.

"They would approach us at trade fairs or come directly to our office, and if they seemed convincing, we would be inclined to go ahead because the marginal cost was low and the distributor was bearing most of the risk," says an executive from Loctite, the Connecticut-based specialty adhesives company acquired by German chemical giant Henkel in 1997.

In fact, the most eager potential distributors may be precisely the wrong people to partner with. As one executive from a leisure and sporting goods firm says, "In many cases, we end up with the distributors that also serve our two major competitors, because they're in the strongest positions, by far, with the retailers. Those distributors certainly have the market contacts, but they also want to control the category and keep us three multinationals in balance." Incumbent distributors with strong positions in the status quo are more likely to deliver a sales plateau, given their desire to maintain the market structure.

Loctite now focuses first on identifying the country, then finding a distributor. "Being market-led rather than distributor-led often results in our selecting a better distributor because of a more systematic and thorough assessment of potential partners," the Loctite executive says. Even the distributor search is market-led: Loctite contacts the largest potential customers and asks them to name their preferred suppliers.

2. Look for distributors capable of developing markets, rather than those with a few obvious customer contacts.

The choice of distributors and the terms of the relationships should serve the multinational's long-term goals. "The most obvious distributor is not necessarily the best partner for the long term," says a Loctite executive. Like most companies expanding internationally, Loctite used to look for partners with the best "market fit," meaning those already serving major customer prospects with similar product lines. But, says the executive, "The closeness of the market fit can be a liability as well as an asset, because the distributors represent the market's status quo, and we are selling a replacement technology and attempting to change the market."

The answer lies in the choice of partners. "We increasingly look for what we have come to call 'company fit'—a partner with a culture and a strategy we feel comfortable with, in terms of the investment they'll make, the training they'll give their people, and the support they'll ask from us," says the Loctite executive. "In many cases, this leads us to partners who have no experience of our market. The first couple of times, this felt risky, but our success with some of these partnerships has made us bolder in choosing distributors."

In effect, this means bypassing the obvious choice—a distributor who has the right customers and can therefore generate quick sales—in favor of a partner with a greater willingness to invest and an acceptance of an open relationship that draws on the multinational's experience in marketing its own products.

3. Treat the local distributors as long-term partners, not temporary market-entry vehicles.

Structure the relationships so that distributors become marketing partners willing to invest in long-term market development. One traditional way of doing this is to grant national exclusivity to a distributor, although such an agreement can become unproductive if conflicts of interest arise once entry is established. A more effective solution is to create an agreement with strong incentives for appropriate goals, such as customer acquisition or new product sales. After all, the local distributor is the de facto marketing arm of the multinational in its country.

Unfortunately, many companies actively signal to distributors that their intentions are only for the short term, drawing up contracts that allow them to buy back distribution rights after a few years. Such a strategy does avert one problem—it prevents a distributor from claiming that the multinational partner reneged on an earlier promise—but it creates other problems. Even with such a contract, a distributor might simply decide not to sell back the rights and might well be backed up in the local courts. In many countries, regulations favor local businesses over foreign vendors, so the multinational could face a protracted struggle over distribution rights. Additionally, under a short-term agreement, a local distributor doesn't have much incentive to undertake long-term business development. The Asia-Pacific manager of a consumer goods company reported that several national distributors, acting in the belief that sales revenues were the key to the reacquisition price, had cut prices, boosting overall revenues but undermining the company's market positioning strategies.

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