CHAPTER 2

THEORY BACKGROUND

2.1 Introduction

This business plan provides the theoretical overviews related to the purposes of the thesis. The purpose of this thesis is to identify the furniture market situation in Philippine, and how is the competition among the main player, to identify the internal and external condition of Olympic furniture in Philippine market, and to decide whether is it feasible to open a representatives office in Philippine and give alternatives strategy to expand the market. This chapter discusses the concept of marketing and its element, marketing mix and strategy, SWOT analysis, NPV and other investment rules; especially in a market expansion program to overseas countries.

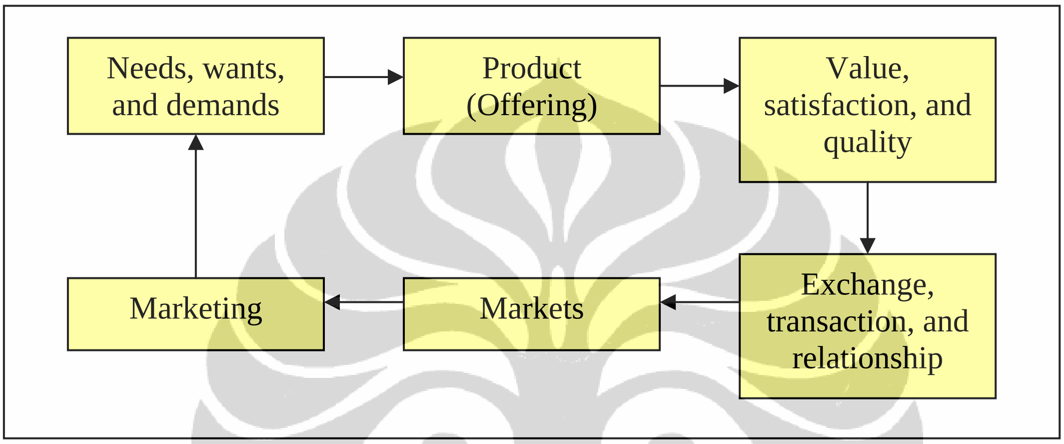
2.2 Marketing

Marketing deals with identifying and meeting human and social needs. One of the shortest definitions of marketing is “meeting needs profitably”. Marketing management is the art and science of choosing target markets and getting, keeping and growing customer through creating, delivering, and communicating superior customer value (Kotler, Keller, Ang, Leong, & Tan, 2006, p.5).

There are many definition of marketing, but the main idea is the same, it is a process that has a goal to create exchanges that will satisfy and benefit both the customer and the company. Marketing is the function of the company that identifies its current and potential customers, creates products or services that meet the needs and wants of customers, informs and persuades the customers to purchases these products or services and reinforces the customers to make a purchase.

The core concept of marketing covers several aspects such as needs, wants, and demands, product, value, satisfaction and quality, exchange, transaction and relationship and markets (Kotler, Amstrong, Brown, Adam, & Chandler, 1998). This concept shows in the figure below.

Figure 2.1 - Core Concept of Marketing



Source: P. Kotler, G. Amstrong, L. Brown, S. Adam and Chandler, *Marketing*, 1998, p.7

Customers are those who create revenue for the company, that's why the purpose of business is to create and maintain profitable customers. Profits must be generated for the company to continue doing its business. The concept of marketing changes due to the changes in the marketplace. This means that nowadays, each company must hold the concept of the societal marketing concept. The concept seize to satisfy the consumer while at the same time develop its contribution in the society.

2.3 Company Orientation Toward Market Place

The competing concepts under which organization have conducted marketing activities include: the production concept, product concept, selling concept, marketing concept, and holistic marketing concept (Kotler *et al*, 2006, p.15). Further Kotler *et al* (2006) describe this concept as below:

1. The production concept

   This is the oldest concept in business, its hold that consumers will prefer products that are widely available and inexpensive. Managers of production-oriented business concentrated on achieving high production efficiency, low cost, and mass distribution.

2. The product concept

   This concept holds that consumers will favor those products that offer most quality, performance, or innovative features. Managers in these organizations focus on making superior products and improving them over time.

3. The selling concept

   This concept holds that consumers and business, if left alone, will ordinarily not buy enough of the organization's products. The organization must, therefore, undertake an aggressive selling and promotion effort.

4. The marketing concept

   Instead of a product-centered "make and sell" philosophy, business shifted to a customer-centered, "sense and respond" philosophy. The job is not to find the right customer for the products, but the right products for the customers.

5. The holistic marketing concept

   This concept is based in the development, design, and implementation of marketing programs, processes, and activities that recognizes their breadth and interdependencies. Holistic marketing recognizes that "everything matters" with marketing such as the consumers, employees, other companies, competition, as well as society as a whole, need integrated perspective.

2.4 Segmenting, Targeting and Positioning

The marketplace is made up of different types of consumer. It differs based on consumers' preferences on product and services that can satisfy their needs and wants. That is way it is important for a company to give more satisfaction to its targeted consumers. As a result, the company must develop its STP – Segmentation, Targeting, and Positioning (Kotler *et al,* 1998, p.296)

Kotler *et al,* (1998) further explain that market segmentation is dividing a market into direct groups of buyers who might require separate products or marketing mixes. It is the process of classifying customers into groups with different needs, characteristics or behaviors. Major variables that can be used for market segmentation are geographic segmentation, demographic segmentation, psychographic segmentation, and behavioral segmentation. Market targeting means that after identifying market segmentation, the company must be able to decide its target market. Target market is a set of buyers sharing common needs or characteristics that the company decides to serve.

After the company has identified its target market, it must decide what position it wants to carry on for its target market. Positioning is the act of designing the company's offering and image of occupy a distinctive place in the mind of the target market. To build a position, the company must be capable to deliver and communicate its positioning strategy. The elements of the marketing mix are important devices to create an effective positioning

2.5 Marketing Mix

Marketing mix is the set of controllable marketing variables that the company blends to produce the response it wants in the target market (Kotler *et al,* 1998, p.57). The component of marketing mix is product, price, place, and promotion, well known as four Ps. Further Kotler et al (2006) describe the four components as follow:

1. Product

   Product can be defined as anything that can be offered to a market for attention, acquisition, use or consumption that might satisfy a want or need. This can be a physical goods, services or combination of goods and services that the company offers to its consumer

2. Price

   Price is the amount of money customers have to pay to obtain the product. It can be defined as the amount of money charged for a product or services, or the sum of values consumers exchange for the benefits of having or using the product or service. The company must know how much the consumer is willing to pay for the product.

3. Place

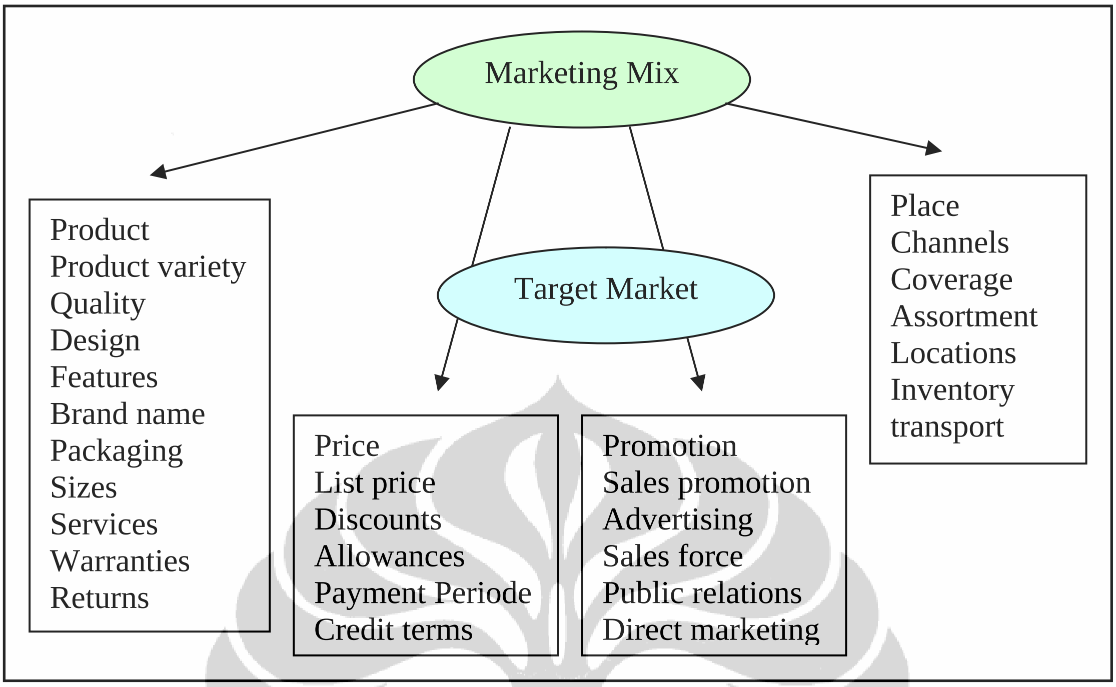
   Place related to the activities that make the product or service available to target customers, where the customer meets the product. The company needs to make sure the product or service it is offering is in the appropriate location where its target markets can reach it

4. Promotion

   Promotion mix as a company's total marketing communication program, it is the specific mix of advertising, personal selling, sales promotion, direct marketing and public relations a company uses to pursue its advertising and marketing objectives. It includes activities that communicate the value of the product or service and persuade target customers to buy it. The result of an effective promotional activity is the knowledge of the customers about the product or service that the company is offering.

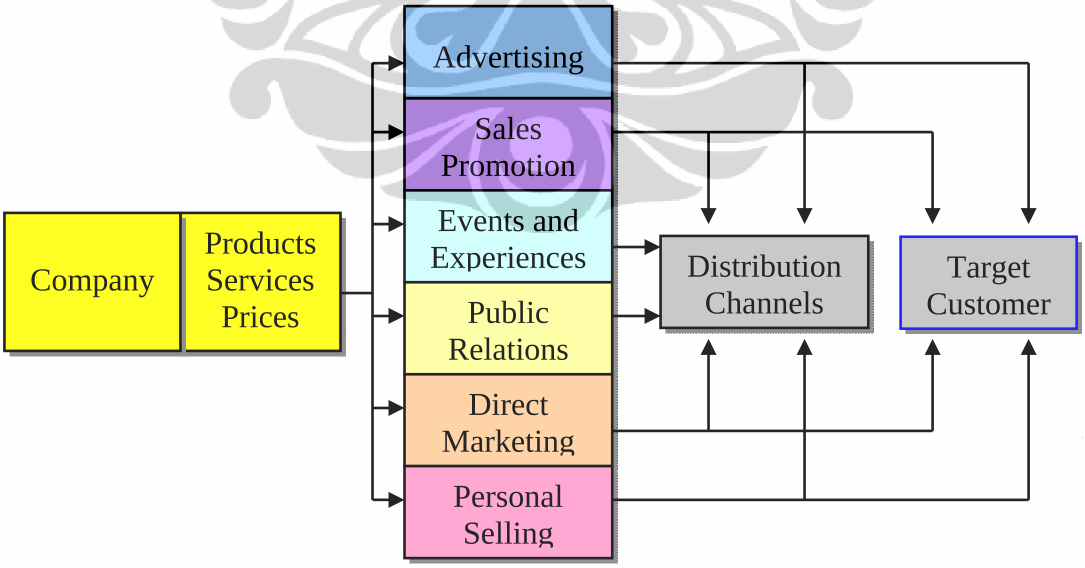
As shown in figure below, marketing mix decision must be made for influencing the trade channels as well as the final consumers. The four Ps represent the seller's view of the marketing tools available for influencing buyers. From a buyer's point of view, each marketing tools is designed to deliver a customer benefit.

Figure 2.2 - The Four P; Components of the Marketing Mix



Source: P. Kotler, K.L. Keller, S.H. Ang, S.M. Leong, C.H. Tan, *Marketing Management; An Asian Perspective*, 2006, p.19

Figure 2.3 - Marketing Mix Strategies



Source: P. Kotler, K.L. Keller, S.H. Ang, S.M. Leong, C.H. Tan, *Marketing Management; An Asian Perspective* 2006, p.20

Figure 2.4- Seller’s Four Ps in relation with Customer’s Four Cs

Four Ps	**Four Cs**
Product	Customer solution
Price	Customer cost
Place	Convenience
Promotion	Communication

Source: P. Kotler, K.L. Keller, S.H. Ang, S.M. Leong, C.H. Tan, *Marketing Management; An Asian Perspective* 2006, p.20

From the figure above, it can be seen that customer solution can be satisfied by the product (goods and services) offering. The price of the product or service reflects the cost to acquire or purchase the product. Place means that the consumers can get the product where it is convenience for them to obtain it. And the promotion element in which it tries to communicate and influence consumer to buy the product.

2.6 International Marketing

Marketing is a creative activity involving the planning and execution of the conception, pricing, promotion, and distribution of ideas, products, and services in exchange that not only satisfy customer’s current needs but also anticipates and creates their future need at a profit (Masaaki Kotabe & Kritiaan Helsen, 2008). Kotabe (2008) further defined 5 stages characterizing the evolution of global marketing as describe below.

1. Domestic Marketing

   In this stage, many companies focus solely in their domestic market. Their marketing strategy based on information about domestic customer needs, wants and demands plus PESTEL (Politic, Economy, Social, Technology, Economy and Law) of domestic market. However, today is highly conceivable that domestic competition is made up both domestic and foreign competitors. Globalization makes distance not as a limitation or barriers, internet provide huge information about domestic market for foreign competitor in make suitable product to export to domestic market.

2. Export Marketing

   This is the second stage of global marketing. It began with unsolicited order from foreign customers. External pressures also encourage companies into export marketing activities. Saturated domestic markets may make it difficult for a company to maintain sales volume in an increasingly competitive domestic market, and will become more serious when foreign competitors begin marketing products in domestic market. The stage of Export Marketing is as follow:

   1. Indirect Marketing

      This is the early stage of export marketing. Exporters tend to rely on export management companies or trading companies to handle their export business

   2. Direct Marketing

      This is the second stage of export marketing. There are some progresses where the exporter got more involved in the process.

      The company management obtain favorable expectations of the attractiveness of exporting based on experience, have access to key resources necessary for under taking additional export related task such as availability of physical, financial, and managerial resources, and the company management is willing to commit adequate resources on export activities.

3. International Marketing

   When the company still try to seek new direction for growth and expansion after doing export marketing activities, they will began to do International Marketing. This is polycentric orientation with emphasis on product and promotional adaptation in foreign market whenever necessary.

Polycentric orientation refers to a firm predisposition to the existence of significant local cultural differences across market, necessitating the operation in each country to be viewed independently.

4. Multinational Marketing

   In this stage, the companies do marketing in many countries around the world. Company's management realized the benefit of the economic of scale in product development, manufacturing and marketing by consolidating some of activities on a regional basis. Product planning may be standardized within a region, and products may be manufactured regionally as well. Similarly, advertising, promotional and distribution cost may be shared by subsidiaries in the region.

5. Global Marketing

   Global marketing refers to marketing activities that emphasize the following three activities:

   1. Standardization effort
   2. Coordination across markets
   3. Global integration

   This doesn't meant the company should have standardize products, promotion, pricing, distribution, etc, but proactively willing to adopt a global perspective instead of country by country or region by region perspective in developing marketing strategies.

2.7 Country Attractiveness

Evaluating country attractiveness involves not only issues of market potential and growth, but also consideration of environmental factors such as political developments, trading bloc membership, competitive intensity, and entry barriers. A country's attractiveness factors need to be weighed against each other systematically, and the sensitivity of the final choice to alternative scenarios of political developments and of competitive reaction should be assessed. The internet and other sources provide up-to-date economic and political data on countries and regions, and independent research agencies will provide customized analysis on specific products and markets. To forecast sales for a country, the manager has to combine subjective estimates with whatever objectives data are available (Johny K. Johansson, 2006).

Johny K. Johansson, (2006) introduce systematic screening procedures and discuss how to handle various obstacles and special factors complicating the systematic process. He describes the various data sources available, stressing the emergence of online database, and end with description of several different approaches to forecasting sales in foreign country.

1. Political Risk Research

   Many firms concern about political risks, the danger that political and military upheaval will change the nation's economic rules and regulations overnight. The factors need to be considered can be arranged in a descending order of importance for the investors, as shown in the table below:

Table 2.1 Political Risk Factors

Factors	Examples
Level 1: General instability	Revolution, external aggression
Level 2: Expropriation	Nationalization, contract revocation
Level 3: Operations	Import restriction, local content rules, taxes, export requirements
Level 4: Finance	Repatriation restriction, exchange rates

Source: Johny K Johansson, *Global Marketing; Foreign Entry, Local Marketing and Global Management*, 2006, p.102.

2. Environmental Research

   It is not useful to research customer evaluation of a product if its basic functionality is not understood. To do a market research, it is common to distinguish among environmental dimensions; physical environment, socio cultural environment, economic environment, and regulatory environment.

3. Researching Competitors

In most markets, local marketer faced competitors from both domestic competitors and foreign competitors. Research is important to identify who they are, what are their strengths and weaknesses, and how they are likely to react to a new competitor..

4. Entry Evaluation Procedures

The actual process of evaluating candidates for foreign market entry can be divided into four stages as follow:

a. Country Identification

Typically the company decides to enter a particular trade area, and then do a more in depth analysis within each of the regions to identify where to place their sales headquarters and which country to enter first.

b. Preliminary Screening

This involves rating the identified countries in macro levels indicators such as political stability, geographic distance, and economic development.

c. In-Depth Screening

This stage is the core of the attractiveness evaluation. Data here are specific to the industry and product markets, if possible even down to specific market segments. This stage involves assessing market potential and actual market size, market growth rate, strengths and weaknesses of existing and potential competition, and height of entry barriers, including tariffs and quotas.

d. Final Selection

In this stage, companies objectives are brought to bear for a match, and forecast revenues and costs are compared to find the country market that best leverage the resources available. Typically, countries similar to those the company has already entered shows lower entry costs, less risk, and quicker returns on the investments required to build up the market franchise.

The final selection of the country to enter cannot and should not be made until personal visits have been made to the country and direct experience acquired by the managers. There is no substitute for on the spot information and the hands-on feeling of a new market.

5. Country Data Sources

Despite the important role of personal visit, most of the data used in the screening of countries come from secondary sources, not primary sources. A useful start when doing research is to look t the easily available data sources, such as the U.N publications, the OECD and GATT/WTO reports, and the Department of Commerce reports in the United States. A large number of organizations, consulates, commerce departments, newspaper and magazine affiliates, information agencies, can be helpful.

6. Forecasting Country Sales

Economic and demographic data might not be available or not be comparable because of different classifications. The marketer often has to leverage past data from other market, including the home market, into kind of "bootstrap" forecast of what is likely to happen in new market. Forecasting sales in foreign market is a matter of combining technical skill and country knowledge imaginatively.

The common example of forecasting country sales is Mazda Shorthand Forecast. Computing the forecast sales then was simple, as follow:

Sales Forecast =	Industry sales x Import shares x share for the Japanese x share for Mazda among the Japanese

This is proven method for sales forecast for Mazda. The time and cost to develop the forecast is negligible, and the accuracy is almost perfect.

7. Industry Sales

There are five main alternative methods to estimate industry sales as follow:

a. The Build Up Method

For the early stages of introduction the best estimates of future sales usually come from industry experts and knowledgeable channel members. The build-up method is come from the fact that the market sales are estimated on the basis of separate estimates from individuals knowledgeable about certain segments of the market. These single estimates of various part of the market are aggregated ("built up") into evaluation of total market size.

b. Forecasting By Analogy

The basic premises underlying this method is that sales in one country will show similarities to sales in another leading country where the product is already marketed. Since 160s, when the theme of global interdependence and convergence first emerged strongly, such similarities have been used to forecast a similar rate of acceptance in many different countries, especially those belonging into common regional grouping.

c. Judgmental Forecast

This technique generally attempt to introduce a certain amount of rigor and reliability into otherwise quite arbitrary guesses. The techniques are as follow:

1. The Jury Technique

The use of executive judgment based on first-hand experienced and observation in estimating foreign sales is indispensable. The jury technique is basically a structuring of the standard executive committee meetings, in which the members are asked to submit their separate forecast, either before or after intensive discussion. The concept is that group of experienced executive would have more insights when combined than any single one.

2. Expert Pooling

Without a firm's having previous experience in a new country's markets, the reliance on independent expert is almost unavoidable.

3. Panel Consensus

Like the jury of executive opinion, the panel consensus tries to pool the available information from more than one source, and taking averages across each team member's subjective rating.

4. Delphi Method

This method consist of a series of rounds of numerical forecast from a pre selected number of experts. These experts may or may not know the identify of the other members of the panel. They are asked to provide individual estimates, independently of their colleagues. The estimated are tailed, the average forecast is computed, and summary statistic are returned to the experts.

d. Time Series Extrapolation

When the product in the market country has reached a more mature stage in the product life cycle, forecasting using past data becomes possible. Time series data represent a form of history in numbers. In other words, statistics are based on past performance, behavior and developments, and the statistical analysis of the data generated by these histories will simply ferret out what happened in a more comprehensive and objective manner than subjective evaluation.

e. Regression-Based Forecast

The first consideration involved the use of some prior knowledge to develop a forecasting equation, and the relevant dependent variable need to be determined. Second, the forecaster must try to identify what factors will affect the dependent variable selected.

8. Forecasting Market Share

Market share forecasts are usually done best by breaking up the problem into its separate components. First, the likely competitors must be identified, including domestic firms and multinational companies operating in the country. Second, country specific advantages of the domestic companies over foreign competition should be well understood.

Third, the company’s strengths and weaknesses against the other firm have to objectively assessed, particularly against other foreign firms operating in the country.

2.8 SWOT Analysis

SWOT is an acronym for the internal Strength and Weakness of a firm, and the environmental Opportunities and Threats facing tat firms. SWOT analysis is technique through which managers create a quick overview of a company’s strategic situation. (Pearce and Robinson, 2007, p.153).

On its own, it is said that a **SWOT analysis** is meaningless. It works best when part of an overall strategy or in a given context or situation. This strategy may be as simple as:

1. Goal or objective
2. SWOT analysis
3. Evaluation or measures of success strategy
4. Action

The SWOT analysis tool is great for developing an understanding of an organization or situation and decision-making for all sorts of situations in business, organizations and for individuals. The SWOT analysis headings provide a good framework for reviewing strategy, position and direction of a company, product, project or person (career). Doing a SWOT analysis can be very simple, however its strengths lie in its flexibility and experienced application. Remember the capture is only part of the picture

2.8.1 SWOT Description

Pearce and Robinson (2007) further explain about the definition of Strength, Weakness, Opportunity and Threats as describe below:

1. Opportunity

   An opportunity is a major favorable situation in a firm's environment. Key trend are one source of opportunities. Identification of a previously overlooked market segment, changes in competitive or regulatory circumstances, technological changes, and improved buyer or supplier relationship could represent opportunities for the firm.

2. Threat

   A threat is a major unfavorable situation in a firm's environment. Threats are key impediments to the firm's current or desired position. The entrance of new competitors, slow market growth, increased bargaining power of key buyers or suppliers, technological changes, and new or revised regulations could represent threats to a firm's success.

   Once managers agree on key opportunity and threats facing their firms, they have a frame of references or context from which to evaluate their firm's ability to take advantages of opportunity and minimize the effect of key threats, and vice versa

3. Strength

   A strength is a resource or capability controlled by or available to a firm that gives it an advantage relative to its competitors in meeting the needs of the customers it serves. Strength arise from the resources and competencies available to the firm.

4. Weakness

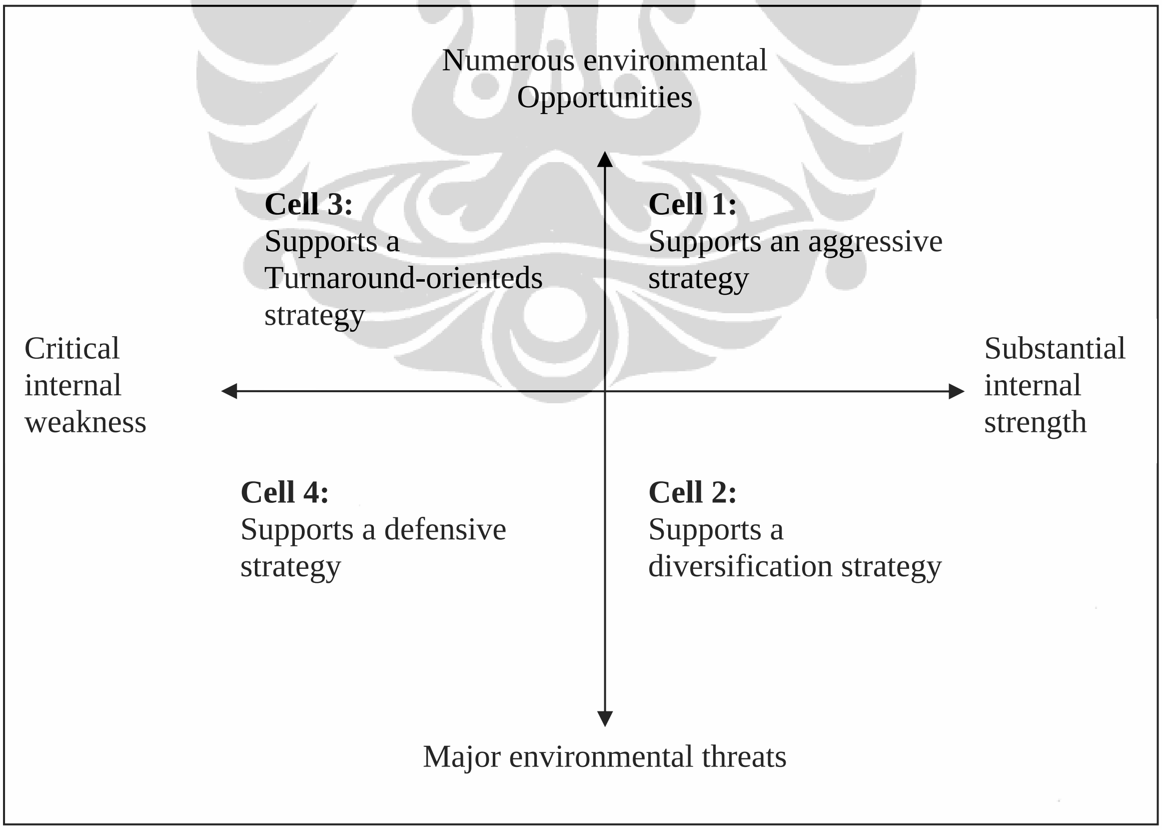
   A weakness is a limitation of deficiency in one or more of a firm's resources or capabilities relative to its competitors that create a disadvantage in effectively meeting customer needs.

2.8.2 How To Use SWOT

The most common use of SWOT analysis is logical framework guiding discussion and reflection about firm's situation and basic alternatives. This often takes place as a series of managerial group discussion. What one manager see as an opportunity, another may see as threat. Likewise, a strength to one manager maybe a weakness to another. The SWOT framework provides an organized basis for insightful discussion and information sharing, which may improve the quality of choices and decisions managers subsequently make.

Figure 2.5 below illustrate how SWOT analysis might take managerial planning discussion into slightly more structured approach to aid strategic analysis. The objective is identification of one of four distinct patterns in the match between a fir's internal resources and external situation. Cell 1 is the most favorable situation; the firms faces several environmental opportunities and has numerous strength that encourage pursuit of those opportunities. This situation suggest growth oriented strategies to exploit the favorable match.

Figure 2.5 - SWOT Analysis Diagram



Source: J.A. Pearce and R.B. Robinson, *Strategic Management*, 2007, p. 155

In Cell 2, a firm that has identified several keys strengths faces unfavorable environment. In this situation, strategies would seek to redeploy those strong resources and competencies to build long-term opportunities in more opportunistic product markets. In Cell 3, a firm faces impressive market opportunity but is constrained by weak internal resources. The focus of strategy of such a firm is eliminating he internal weakness so as to more effectively pursue the market opportunity. Cell 4 is the least favorable situation, with the firm facing major environmental threats from a weak resource position. This situation clearly calls for strategies that reduce or redirect involvement in the products or market examined by means of SWOT analysis.

2.8.3 Limitation of SWOT Analysis

SWOT analysis has been a framework of choice among many managers for a long tile because of its simplicity and its portrayal of the essence of sound strategy formulation, matching a firm's opportunities and threats with its strength and weakness. But SWOT analysis is a broad conceptual approach, making it susceptible to some key limitation. Pierce and Robinson (2007) further describe the limitation as follow:

1. A SWOT analysis can overemphasize internal strength and downplay external threats

   Strategies in every company have to remain vigilant against building strategies around what the firm does well now (its strength) without due consideration of the external environment's impact on those strength.

2. A SWOT analysis can be static and can risk ignoring changing circumstances

   A frequent admonition about the downfall of planning processes say that plans are one time event to be completed, typed, and relegated to their spot on a manager's shelf while she or he goes about the actual work of the firm.

3. A SWOT analysis can overemphasize a single strength or element of strategy

   The Hewlett-Packard-Compaq merger created the world's largest PC company, and its strategy for PC success was built around the economic of scale afforded by that size. That strategy has failed to work. Creating one of the largest PC Computer companies in the world, while a potential strength, proved to be an oversimplified basis around which to base the company's strategy for survival and growth in the global PC industry of the last five years.

4. A strength is not necessarily a source of competitive advantages

   Cisco System Inc has been a dominant player in providing switching equipment and other key networking infrastructure items around which the global computer communication system has been able to proliferate. It has substantial financial, technological and branding expertise. Cisco Systems twice attempted to use it vast strength in these areas as the basis to enter and remain in the market for home computer network and wireless home networking devices. It failed both times and loss hundreds of million dollars in the process. It's possesses several compelling strengths, but none were sources of sustainable competitive advantages in home computer networking industry. After leaving that industry for several years, it recently choose to reenter by acquiring Link-Sys, an early pioneer in that industry. Cisco management acknowledged that it was doing so precisely because it did not posses those source of competitive advantages and that, furthermore, it would avoid any interference wit that business lest it disrupt the advantage around which Link-Sys's success has been built.

2.9 Net Present Value and Other Investment Criteria

Any firm possessed a huge number of possible investments. Each possible investment is an option available to the firm. Some options are valuable and some are not. The essence of successful financial management is learning to identify which are which (Ross, Westerfield and Jordan, 2008).

Ross, *et al* (2008) further explains some approaches to analyzed potential business ventures to decide which are worth undertaking as describe below:

1. **Net Present Value (NPV)**

An investment is worth undertaking if it creates value for its owners. In the most general sense, we create value by identifying an investment worth more in the marketplace than it cost to acquire. For reason that will be obvious in a moment, the differences between an investment's market value and its cost s called the net present value. In other words, net present value is a measure of how much value is created or added today by undertaking an investment

Table 2.2 The NPV Formula

$$NPV = -Io + \sum \frac{CFt}{(1 + r)^{t}}$$

Where Io = investment value or initial outlays

CFt = cash flow at the end of period t

r = discount rate

t = project's age.

Source: S.A. Ross, R.W. Westerfield, J. Jaffe, & B.D. Jordan, *Modern Financial Management*, 2008, p. 162

The accept and reject criteria is as follow:

If NPV $\geq$ 0 : Accept the project

If NPV < 0 : Reject the project

2. Pay Back Period

Payback is the length of time it takes to recover initial investment. Payback period is the amount of time required for an investment to generate cash flows sufficient to recover its initial cost.

Table 2.2 The Pay Back Period Formula

$$\text{Payback period} = \frac{\text{Investment}}{\text{Proceed}}$$

Source: S.A. Ross, R.W. Westerfield, J. Jaffe, & B.D. Jordan, *Modern Financial Management*, 2008, p.163

The accept and reject criteria for pay back period involves wether the project's pay back period is less than or equal to the firm's maximum desired pay back period.

3. Internal Rate of Return

Internal rate of return or universally known as IR is closely related to NPV. With the IRR, we try to find a single rate of return that summarizes the merits of a project. Furthermore, we want this rate to be an internal rate in the sense that it depends only on the cash flows of a particular investment, not on rates offered elsewhere. IRR is the discount rate that makes the NPV of an investment zero.

Table 2.3 The IRR

$$NPV = \sum^{n} \frac{CFt}{(1+IRR)^{t}} - IO = 0$$

Where: CFt = Cash flow at the end of period t

IRR = Discount Rate

IO = Initial Outlay

Source: S.A. Ross, R.W. Westerfield, J. Jaffe, & B.D. Jordan, *Modern Financial Management*, 2008, p.169

If, IRR > Cost of Capital, shows investment that will be done can result higher return than what we expected before.

If IRR < cost of capital, shows investment that will be done can result smaller return than what we expected before

If IRR = Cost of Capital shows investment that will be done can result return same as what we expected.

To evaluate the business plan, the writer will use SWOT analysis to get clearer view of the external opportunities and threat, and internal strength and weakness. By combining this internal and external analysis, the writer can get good alternative strategies to expand PT. CSF market to Philippine. If SWOT analysis result a strategy to expand the market to Philippine, Investment analysis will be used to check whether the project is feasible or not.