Latin America
Centre of
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Gallagher Group in Latin America: Premium Products, Local Partnerships and Persistence

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CASE HIGHLIGHTS:

- Gallagher's main focus on one business division for Latin American revenues
- Product differentiation and innovation for premium prices
- Local partners and local knowledge as key
- Market, regulatory and political risks
- Risk-minimising distribution model

THE COMPANY

More than 80 years since Bill Gallagher Senior and his 10-person team designed and delivered the country's first electric fence solution in 1938, Gallagher Group is one of New Zealand's most enduring, innovative and internationally successful technology manufacturers. It is a world leader in the fields spanned by its three business units. The Group stresses innovation; its watchword is "brilliant simplicity". Gallagher Group has received some 100 awards and recognitions over the years, including the titles of Supreme Winner and also Best Large Business in the 2018 ExportNZ Awards. In 2018 Gallagher ranked in the top five on the New Zealand Technology Investment Network TIN200 list, the highest-placed private company there. It is still in family hands. The CEO has for decades been Bill Gallagher Junior, who became Sir William in 2011.

Gallagher's headquarters continue to be in Hamilton, where around 800 staff are located, and it also has offices in Marton and Pukekohe. But about 80% of the total annual sales of $270 million come from exports to 130 countries, the biggest markets being Australia and North America. Gallagher now has 1200 employees, including at offices in seven countries overseas.

Gallagher began exporting in 1967 with electric fence solutions. In the 1970s, exports rose impressively and the Group doubled in size for three years in a row. From electric fences Gallagher has expanded to wider animal management systems, including weighing and electronic identification. It has also applied the technology to what Sir William drily calls "two-legged livestock" with a whole new division, Security. Its integrated security systems including electric perimeters are delivered globally to a range of markets including education, correctional facilities, critical infrastructure, mining sites and transport and logistics. In March 2019 Kahl Betham stepped from his role as Global General Manager of Security, to become Deputy CEO. Fuel Systems, which specialises in fuel pumps used on service station forecourts, is the Group's third line of business.

Gallagher has made several attempts at establishing Latin American markets since the mid to late 1980s, with what Stephen Hoffman, Global General Manager of Animal Management, calls "varying degrees of success" in "a difficult part of the world". The region brings in less than 2% of the Group's total turnover, at about $3 to $4 million annually. Animal Management has the most involvement there, with continuity since 2008; Security, considerably less involvement at around $1m annually, while Fuel Systems is yet to fully establish itself. Animal Management has offices in Chile, which accounts for some 60% of its regional business, and it also exports to Uruguay, Peru, Ecuador, Argentina and Brazil (the latter two serviced by the same distributor) in South America; and to Costa Rica and Mexico in Central America. Gallagher has in the past also made sales in Panama and Venezuela.

Challenges

Although Gallagher Group is one of New Zealand's most successful and innovative large businesses, it has met several challenges in its Latin American operations. This section discusses some of the more prominent, with particular reference to the Animal Management division.

Trade barriers and regulatory risk

Protectionist trade policies remain a feature of much of Latin America. Hoffman describes "terrible" duties of up to 40% premium wharf tariff in some countries, particularly for the MERCOSUR economic and political bloc, whose full membership comprises Argentina, Brazil, Paraguay, Uruguay and Venezuela. Tariffs are significant, eating into the cost-competitiveness of the company's products, but are at least a quantifiable and transparent hurdle. To varying degrees, much of the region is also affected by less transparent and predictable risks and barriers. With Chile as something of an exception, Latin America has a reputation for political and economic instability, which in turn entails regulatory uncertainty, bureaucratic burden and market risk. As Hoffman puts it, "the rules get changed – often through no fault of the person you are dealing with".

Latin America's currencies can be volatile and historically have undergone full-blown crises. A wave of devaluations occurred in 2018, and Venezuela, where Gallagher used to have a distributor, is in the middle of combined currency, economic and political crises that have completely stalled business. Latin America's banking systems, Hoffman says, are also "much more challenging" than New Zealand's.

In Brazil, Hoffman notes that the regulatory landscape is complex, making compliance onerous. For example, Gallagher at one point registered a company simply in order to hold some product approvals: "It cost us US$20,000 to set the company up. It was going to cost US$20,000 a year just to do the monthly tax returns… and then it cost US$20,000 to close it!" Even in Chile, which is much less bureaucratic than Brazil, Hoffman notes that setting up a company takes about 12 months, versus the half-day exercise in New Zealand that can be done online with a credit card.

Low-price, cost-driven customers; cultural differences

A major problem for both Security and Animal Management, with their innovative premium products is that, as Betham observes, the developing economies of South and Central America have so far largely focused on the lowest price and "cost, cost, cost", commoditising goods. Not only is agriculture often subsistence, but even large estates have little surplus to buy premium output. Animal Management's typical local competitor is "a manufacturer down on the corner store, manufacturing often a poor product, using low labour cost and no innovation and investing in no demand creation activity". Buyers with short time horizons may not grasp the better value of a machine that is, say, twice the price but lasts three times as long. Yet "even if you manufacture locally, you are unlikely to win the price battle".

More fundamental still is whether both distributors and consumers will pay. "The ability for our end user to actually pay is critically important," Hoffman emphasises. Moreover, since Gallagher's distributors are often entrepreneurs, "we end up working with people that have tight cash flows". Asked about payment culture, Hoffman recalls from Argentina the rather graphic example of being lumbered with a warehouse in the capital Buenos Aires as a form of payment; it took two years to sell.

The culture gap goes wider than payment practices, of course. Betham and Hoffman reiterate that Latin America is not Western. They also note that handshake deals, which Gallagher sometimes has to reply on at least partly or temporarily, and will itself honour, are fragile. The language barrier is an additional obvious challenge: Spanish is spoken everywhere except Brazil, which speaks Portuguese.

The opportunity cost dilemma

A dilemma for New Zealand exporters considering Latin America is the opportunity cost of earning revenue in that region versus expanding existing, more lucrative markets. To get another $4 million out of Latin America, Hoffman notes, Gallagher would have to more than double its revenue there. By comparison, the North American market would only need grow by less than 10%. Given the multiple challenges, "unless we can connect all those dots, we are far better off working in markets like Australia and Europe and North America". Speaking for Security, Betham concurs that there is a temptation to deprioritise Latin America for such developed country markets that have the ability and willingness to "pay a premium for innovation – which is everything we are".

STRATEGY

Focus for risk minimization

Gallagher Group has ventured cautiously in Latin America, choosing markets carefully and minimising risks. No Gallagher division is involved any longer in crisis-torn Venezuela, for instance, despite Animal Management having had a good distributor there in the past. Otherwise, some differences emerge between divisions. Animal Management has the greatest volume in the region, and Fuel Systems has yet to make a substantial entry despite an important certification from Chile's Superintendencia de Electricidad y Combustibles – a directorate monitoring electricity and fuels – in 2015 for its PULSE fuel dispensers.

Security particularly is a sophisticated area with a lot of government involvement. Gallagher's Security division have limited its involvement in the region in favour of focusing on lower risk and more receptive markets. In terms of selecting countries, "we stay away from the politically unstable areas deliberately. We stay focused on those more governmental-led countries because then that flows down to critical national infrastructure – banking and universities and health." Government procurement is therefore central to Security. Unfortunately, whilst the World Trade Organisation's (WTO's) Government Procurement Agreement, which New Zealand signed in 2015, represented potentially a "massive opportunity" according to a contemporary Gallagher press release, none of its 43 full Parties is a current Latin American customer, though some customer countries are Observers. Betham points out that as a young division, Security is also growing relatively quickly and has had larger priorities elsewhere – "Asia, North America and Europe largely speaking because they are the larger value items and also because of vertical market selection".

Throughout the region, to mitigate currency risk, all divisions of the Group insist on being paid in US dollars. This leaves distributors to deal with the local currency and conversion challenges in that problematic banking system. This ultimately effects the local selling price and offers little consistency from shipment to shipment

A trade agreement between New Zealand and Chile as part of the Trans Pacific P4 in 2006 provided an opportunity for the Animal Management division, bringing down trade tariffs. Chile is also a party to the recent Comprehensive and Progressive Agreement for Trans-Pacific Partnership or CPTPP, which is due to further liberalize market access among its current 11 signatories.

Not only is it more open to trade, Chile also appealed as a relatively economically advanced nation with an agricultural system closer to New Zealand's than that of other countries in Latin America. Not only does it share New Zealand's latitude but Hoffman points out that many Kiwi farmers had invested to set up pastoral farming dairy farms there. "Our product solution fitted into their farming model very, very easily and they also knew our brand." Moreover, because the New Zealand farmers insisted on ongoing support and service for those products, Gallagher had to go in (gum)boots and all. Chile got its own office, in the city of Osorno, and has seven Gallagher employees on the ground.

Local partners rather than local manufacturing: non-exclusive distributorship model

While Gallagher's Security division services the region from Houston in the United States, Animal Management operates directly in the region, only shipping product for Mexico product from North America.

Animal Management has avoided the option of manufacturing locally in Latin America, despite trade barriers. Its requirements – like injector mould plastics and assembling circuit boards – are relatively modest according to Hoffman and manufacturing locally was attempted in Brazil. However, this proved "very difficult because of the regulations and because of the volumes that we did not have." Quality is a concern too: "we have to build product which consistently meets the promise to the end-user". And even if it did produce superior product locally, the company's products would still be higher-cost than those of local competitor firms producing lower-quality products.

Rather than manufacture locally, Gallagher has developed local partners. Asked the most useful advice for New Zealand businesses, Hoffman responds that it is essential to find a local partner "who understands whatever market you are in, speaks the language, and has the financial and commercial resource to run a successful business".

Several tenets underpin the distribution structure. Sir William's approach until around 2010 had been to harness the energies of a local entrepreneur and take an equity stake. The use of entrepreneurs continues in Latin America and certain other non-English speaking markets, but in Latin America equity stakes were too risky, Hoffman says, with the exception of the distributor in Chile, who is a minority shareholder in that business.

Speaking for animal Management, Hoffman is "very reluctant" to make distribution agreements exclusive, giving distributors exclusive rights only in rare cases with a proven track record. Likewise, adds Betham, Security does not have a "single point of exclusivity anywhere". While honouring lifetime relationships with partners, Security has achieved "multiple parallel options running in different vertical markets which are non-competitive to a certain level as well. Provided we don't flood the market and we leave some level of skin in, and no exclusivity but a low number of competitors that aren't going to take the market down between them, it seems to work."

Local presence

Gallagher's Chilean distributor for Animal Management showcases the advantages of locally-embedded presence: a Chilean himself (therefore fluent in Spanish) working in agriculture in New Zealand at the time Gallagher spotted him, he was familiar with both New Zealand's and Chile's farming practices. When he wanted to return home to Chile, the company saw an opportunity. He eventually became Business Development Manager for Latin America and he now spends his time about 30% looking after Chile and 70% in Animal Management's other regional countries, with the exception of Mexico.

Having offices in Chile has been "critical" to the company's operations in the region. Gallagher's distributors are mostly bilingual in English and either Spanish or Portuguese, and Hoffman and Betham both travel extensively there. As of 2018, CEO Sir William Gallagher estimated he himself was on the road 150 days of the year. He has cited a study which found a Chief Executive's willingness to travel influences the whole company's focus towards exporting and creates a more successful impetus than if the travelling is done by other executives.

New Zealand Inc networking

Hoffman and Betham speak highly of New Zealand Trade and Enterprise (NZTE), especially in the last 10 years. With Trade Commissioners, Business Development Managers (the "matchmakers") and Beachhead Advisers in Chile, Brazil, Argentina and other countries, NZTE has in some ways been a "doorway" for the company. Betham says that they have adopted at least three of the recommendations developed by NZTE's Better by Design initiative: lean manufacturing and learning-first product innovation (both of which Gallagher now teaches to other New Zealand companies in tours) and consolidating the Group's business lines under one brand. Sir William has also observed the Group had a "better chance of getting recognition as an international technology brand with one brand" versus the many it had morphed into.

Referring to the importance of local partnerships, Gallagher notes that NZTE's trade shows can be helpful. NZTE hosts a New Zealand-only show annually in Chile and also facilitates attendance at one in Argentina and another in Colombia. Hoffman and Sir William have also joined trade delegations. In 2015, Rhiannon Berry, Trade Commissioner for NZTE in South America, praised Gallagher as a longstanding partner.

Besides benefiting from serving Kiwi-owned farms in Chile, Gallagher has also partnered directly with New Zealand companies: Hoffman mentions Giltrap Farm Machinery, based in Otorohonga, and Numedic Effluent Spreaders, out of Rotorua. Partnering with these two "gave us critical mass both to have some revenue down there to pay for our fixed cost and to ship full containers", rather than holding "ridiculous amounts of inventory".

Commanding a price premium through innovation and quality

Rather than try to compete on price, the Group is committed to delivering premium product, built on the company's investment in R&D, innovation and attention to quality, all lodged deep in what Gallagher calls its "orange DNA" (orange being the company colour and colour of its logo). The Group's Corporate Social Responsibility documents confirm that "[w]e strive to create ingenious products that [...] live up to the highest quality standards". Hoffman points out that in Latin America it would simply be easy to "give away" product, but not only may that not translate into profitable sales downstream, it also would risk leakage into the North American market. Sometimes it is a matter of "waiting for the economies to get to a point where they are not just cost, cost, cost", says Betham. Hoffman agrees: "You have got to go there with a value proposition which is sustainable with a higher price and you have got to be able to convince people to pay that price."

An example of premium-priced innovation in the Fuel Systems area is vapour recovery technology to stop the vapours that can be smelt on service station forecourts leaking from dispensers. Notably, says Betham, "We are not going to get into Chile with standard fuel pumps, because that is commoditised".

Loyalty, continuity and the long term

While winning Latin American distributors and customers over to a long term view has been a challenge, not all New Zealand companies themselves enjoy a reputation for seeing the longer term. In contrast, Gallagher is clearly playing the long game. Mirroring this is its commitment to loyalty, which Sir William has described as worth far more than volume in the end, evidently speaking out of not only enlightened self-interest and a win-win aim, but also much-honoured integrity.

In Security, where major installations might seem the natural key to revenue, in fact long-term relationships are particularly rewarded. Betham notes that 72% of Security's income comes from existing customers, because customers expand and buy new generations of technology. In Animal Management, Hoffman believes that a global reputation and the personal integrity shared by Gallagher's people has been worth more than the "few extra dollars' worth of sales" those values might have cost short-term. In 30 years with the company he has never fired a distributor, even when profitability was perhaps not being maximised. The handshake deals that Gallagher sometimes relies on require extreme consistency and continuity in people on both sides.

Asked what lets Gallagher demonstrate to Latin American and other stakeholders that it is in business for the long term, Betham replies succinctly: "Everything that we have done in the last 80 years". The company's longevity may owe something to private ownership by a single family, free from the short-term reporting demands of the stock exchange. The continuity in senior leadership is also evident. However, a succession plan is now being drawn up as Sir William, aged 78, prepares to step down as CEO to a role as an Executive Director. The attention to developing a reputation for quality, reliability and persistence will remain with the group as it grows globally and in Latin America's complex and demanding marketplaces.

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