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Brink's Entry into China 2007

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BRINK'S

Entry into China

2007

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Lit M. Maxwell

This case was prepared from various referenced sources and was developed solely for classroom discussion; the case is not intended to serve as an endorsement, source of primary data or an illustration of either effective or ineffective handling of a business situation. The authors gratefully acknowledge information and insights provided by Mr. Ron Rokosz, President of Brink's International and Mr. Nasser Chanda, Director of Corporate Development of the Brink's Company.

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INTRODUCTION

Ron Rokosz, the President of Brink's International was both pleased and distressed as he reviewed the financial results of International operations for fiscal 2006. Revenue had increased by 14% to \$1,568.6M, driven by strong gains in both EMEA (Europe, Middle East, Africa) and LA (Latin America). In addition, operating profit in International was up by 68%. (Exhibit 1)

On the downside, revenue in the AP (Asian Pacific) region decreased by 6%, primarily due to a loss of a key customer in Australia. However Rokosz was more concerned that revenue in AP represented only 3% of Brink's total revenues and 4.6% of Brink's International revenues. Rokosz reflected on the fact that Brink's had truly become a global company with 66% of its 2006 revenues coming from operations outside of North America. However he knew that in order for Brink's to become a true global power, it must establish a stronger presence in the AP region. The question was how, where and when to do this.

In discussions with key members of his staff, it became obvious that both China and India represented significant growth opportunities, both being developing countries with favorable economic conditions. China seemed to offer greater potential in terms of increased foreign investment by U.S. firms. Therefore, the challenge was to develop an entry strategy for The Brink's Company into China.

THE BRINK'S COMPANY

The Brink's Company is based on Richmond, Virginia and competes in the security industry through two wholly owned subsidiaries, Brink's Incorporated (Brink's) and Brink's Home Security, Inc. (BHS).

The company employs 52,000 people, 48,700 at Brink's and 3,300 at BHS. A significant portion of Brink's revenue is earned outside of the U.S., while all of BHS revenues are from North American operations.

BRINK'S INCORPORATED (BRINK'S)

Brink's is the oldest and largest secure transportation (armored cars) and cash logistics company in the U.S. It also has operations in approximately 50 countries with concentrations in Europe, Middle East and Africa, Latin America and Asia Pacific (Exhibit 2). Brink's ownership interest in subsidiaries and affiliated companies ranged from 20% to 100% in 2006. In some cases, local laws limit the extent of such ownership.

The major services offered by Brink's are contained in Exhibit 3. Customers of Brink's include banks, retail and other commercial businesses, investment banking and brokerage firms and government agencies (country's national banks). Specifically, Brink's provides cash transport between:

- 1) Commercial and central banks
- 2) Businesses and commercial banks

less than 10% of fiscal 2006 revenues. BHS feels that commercial installations represent a huge future growth opportunity. BHS does not have a global presence outside North America.

BHS markets, sells, installs, services and monitors its home security systems, which are designed to detect burglary, fire, and medical conditions. When an alarm is triggered, a signal is sent to a BHS central monitoring station and depending on the extent of the problem, a decision is made whether to alert the police. Police response is highly supported in North America, whereas it is less supported in many international markets. To get around this, many security monitoring companies subcontract response services from guarding companies that do a first visit to the alarm site and report on the validity of the alarm. CCTV cameras are also used to verify validity of alarms. After verification that the alarm is not false, police are notified. Police response or support is essential to obtaining customer confidence in the service.

In fiscal 2006, BHS had over 1.1 million systems under contract, with most containing an initial term of 3 years, renewable annually. A small but growing percentage of new residential and commercial customers use wireless communication to transmit signals versus the use of standard telephone lines and digital subscriber lines.

BHS OPERATIONS/VALUE CHAIN

The key activities in the BHS Value Chain include Procurement, Sales, Marketing, Information Technology, and Service. From a Procurement standpoint, BHS does not manufacture the equipment used in its security systems but purchases it from a limited number of suppliers including Honeywell, which has operations in China.

BHS installs and services alarm and monitoring systems using technicians, who operate in 66 branch locations. BHS also has an authorized dealer program to expand its geographical coverage. Approximately, 144 dealers in 44 states participated in this program in 2006; dealers install equipment and initiate and maintain service.

BHS markets its systems through television, direct mail, internet, alliance with service companies, inbound telemarketing and field sales employees. Marketing and sales is done at the branch offices. Each branch provides sales and service support for a market area defined by specific zip codes. BHS assists its dealers with sales opportunities, sales training, detailed weekly account summaries, sales support materials and on line account access.

BHS also obtains new accounts by working with home builders to install security systems and a variety of home networking, communication and entertainment systems. BHS does business with 17 of the top 20 residential home builders in the U.S.

BHS differentiates itself from competitors in several areas, beginning with the quality of the installed equipment to all service requests being routed through its customer care center. BHS uses a customized information system that provides customer care representatives with information regarding its subscribers and their security systems, including detailed account history.

Projected growth rates from 2006 to 2008 are 2.5% for the cash in transit and 12% for logistics and ancillary services, the latter driven by bank outsourcing trends and ATM global growth.

GLOBAL ARMORED TRANSPORT SERVICE COMPETITORS

The leading global competitors in this segment include Brink's, Securitas, Group 4 Securicor and Prosegur. In 2006, Brink's and Loomis (owned by Securitas) controlled approximately 50% of the U.S. market share.

TRENDS IMPACTING ARMORED SERVICES

Several trends will impact growth in armored services beyond 2006:

1. Consolidation in the banking industry; as banks merge relationships between armored service providers and banks will impact growth.
2. The value of cash in circulation is projected to increase.
3. Continued growth of armored transport use by retailers, fast food restaurants and convenience stores.
4. Cash processing/logistics growth through increased outsourcing by banks.
5. ATM/Back Office growth. These are nearly 2 million ATM's worldwide with prime growth occurring in non bank ATM's. Prime ATM services include cash supply, counting and collection of deposits and providing insurance.
6. The emergence of investment banks and brokerage firms as prime customers in developing countries.

CHINA

OVERVIEW/(2006)

China is the world's most populous nation and the one of 10 largest economic powers. The country is divided into 22 provinces, 3 municipalities (Beijing, Shanghai and Tianjin) and 5 autonomous regions. The latter function as provinces but are comprised of minority nationalities; over 80% of the 1.3 billion Chinese population resides in the eastern half of the country. Hong Kong and Macau are special administrative regions of China with a different government, history and culture. They are treated separately under China's two-system policy.

GOVERNMENT

China is a one party state with the Chinese Communist Party (CCP) in power since 1949. Beginning in 1979, the CCP embraced the concept of achieving economic growth through profit generation largely coming from foreign direct investment (FDI). This was in stark contrast to the Soviet Union where "strict socialism" prevailed.

The Chinese state government has also attempted to bring the state closer to the people by holding village elections which began in 1980's and spread throughout the 90's. The government

firms entering China are OH&S issues and piracy. Nike suffered significant problems in the late 90's by subcontracting to sweat shops.

Logistics is a unique problem in China because of its sheer size. There are 350 cities with populations of over 250,000. Therefore, moving goods from new plants to these cities is a formidable task. The existing distribution system is a combination of elements from free market systems and existing state owned entities.

The trucking segment of the Chinese logistics market is fragmented and highly competitive. Pricing pressure is intense and speed of delivery is becoming a must. Product differentiation is low with service being a key determinant. In order to spur logistics growth, the Chinese government has invested heavily in the construction of new roads and airports.

BUSINESS ORGANIZATIONS

Several options exist for a foreign company seeking entry into China:

1. Representative Office- Many foreign firms establish such an office as the first step into China. This is not a legal entity and can engage in limited business operations such as market surveys, product and service introduction.
2. Equity Joint Venture (EJV)-Legal entity established by two or more foreign and Chinese firms; usually a limited liability company (LLC); foreign investment must normally account for at least 25% of the invested capital.
3. Wholly Foreign-Owned Enterprise (WFOE)-Legal entity without a Chinese partner; prohibited in certain industry sectors; usually a LLC.
4. Holding Companies-Can be wholly foreign owned or a joint venture with a Chinese Company; are umbrella-companies that hold the equity interests of various LLC's established by foreign investors in China.

Relations between foreign investors and Chinese partners in a JV can be positive, but also have produced problems. It is very difficult for a foreign company to resolve disputes in a JV with a Chinese partner. As a result, WFOE's have become the preferred investment vehicle for a new foreign investor.

BANKING INDUSTRY

The Chinese Banking System is undergoing significant change. Before admission to the WTO, China's four major banks were state owned with a mission to provide funds to state owned businesses. With profit not a prime motivator in these businesses, many failed resulting in significant non performing loans for the banks. Also these banks did not offer other services such as insurance, security transaction, and credit cards.

After WTO admission, China moved towards transforming its major commercial banks from full state ownership to joint stock (including private) ownership. The Bank of China and China

The industry is concentrated in 3 regions: Shenzhen, Hangzhou and Tianjin, where an SP manufacturing, logistics and sourcing infrastructure has been established. However, many other industries such as telecom, construction, banking and building affect SP making it a very complicated industry. In addition, two governmental programs, Peaceful Cities and Strengthening Police through science and technology impact the industry. Lastly, the Chinese government, particularly the Ministry of Public Security plays a prime role in regulating the industry.

The SP industry in 2006 was very fragmented with many small and local competitors. There were many SP products and services available, but very few manufacturers or suppliers were able to satisfy demand. Consolidation is expected in the future with large manufacturing and outsource companies emerging. In addition, standardization of products and services will occur.

Several large companies have established a presence in the Chinese SP industry either as a joint venture or wholly owned operation. Siemens, G.E. Security, Busch Security, Honeywell Security, Tyco Fire & Security, and Samsung Electronics, and Ingersoll Rand along with many domestic companies, participate in different market segments.

Technology will play a major role in the growth of the SP industry, especially advances in the telecommunications industry. Satellite communications and wireless mobile systems will be key drivers.

CHINA ENTRY BY U.S. FIRMS

The U.S. – China Business Council (USCBC), an association that represents U.S. companies doing business in China reported that 81% of its 250 members had profitable operations in China in 2006. Such companies include Boeing, Coca Cola, Ford and IBM. A similar report in 1999 indicated a 50% profitability level. Therefore, the timing of a China entry looks promising; however entry has been a challenge for many firms. Despite the strong growth opportunities and improving dynamics, the overall level of profitability of companies operating in China is low due to shared labor cost advantages and low levels of differentiation. For many, China has become a growth trap. It represents desired growth, but many companies have not yet been able to extract any profits from the market.

Consider the contrasting fate of Wal-Mart and Whirlpool.

WAL-MART

Wal-Mart entered China in 1997 and in spite of having 50 stores it had not yet reached profitability in 2006. Wal-Mart's entry strategy was to replicate the low cost model it had achieved in the U.S. Such model was built on Procurement, Logistics, I.T., Operations and low cost labor advantages in its value chain, which resulted in offering the lowest prices.

3. Think end to end-companies that have superior supply and demand matching capabilities are more responsive to changing market conditions.
4. Leverage technology – state of the art technology is a must for any China bound company, specifically real time tracking of demand and supply chains.
5. Tap local talent.

BRINK'S ENTRY INTO CHINA

In early June of 2007, Ron Rokosz convened an off-site meeting of his staff to discuss plans to enter the Chinese market. He prepared a checklist of items to cover which included the following:

1. What do we want to bring to China; what does our company have to offer; i.e. – what is our entry strategy?
2. What resources do we need to establish an effective presence and gain competitive advantage in China?
3. Do we have sufficient knowledge of the Chinese Security Market?
4. Do we understand the logistical complexities in China?
5. Can we transfer competitive advantages achieved in other parts of the world to China?
6. Should we partner with an existing Chinese firm or establish a greenfield presence?
7. Can we recruit talented Chinese managers?

Rokosz knew that none of his major competitors had established a significant presence in China. Therefore, the opportunity for Brink's to achieve "first mover advantage" was now!

EXHIBIT 1

Summary of Brink's Results/2004 & 2006

<i>(In millions)</i>	Years Ended December 31			% change	
	2006	2005	2004	2006	2005
Revenues					
North America (a)	\$ 830.0	778.2	733.7	7	6
International	1,568.6	1,378.7	1,198.2	14	15
	\$ 2,398.6	2,156.9	1,931.9	11	12
Operating Profit					
North America (a)	\$ 69.9	49.4	55.2	41	(11)
International	\$ 105.3	62.5	89.5	68	(30)
	175.2	111.9	144.7	57	(23)
Cash Flow Information					
Depreciation and amortization	\$ 96.0	90.5	81.0	6	12
Capital expenditures	115.1	109.0	76.2	6	43

(a) U.S. and Canada

SOURCE – ANNUAL REPORT – 2006

EXHIBIT 3

List of Major Services offered by Brink's

The Major services offered by Brink's include:

- Armored car transportation;
- Automated teller machine ("ATM") replenishment and servicing;
- Currency, deposit processing and cash management services, including "Cash Logistics" services;
- Deploying and servicing safes and safe control devices, including its patented CompuSafe® service;
- Coin sorting and wrapping;
- Integrated check and cash processing services ("Virtual Vault Services");
- Arranging the secure transportation of valuables ("Global Services");
- Transporting, storing and destroying sensitive information ("Secure Data Solutions"); and
- Guarding services, including airport security.

SOURCE – THE BRINK'S COMPANY 10K - 2006

EXHIBIT 5 - GLOBAL SECURITY MARKET

Security Market	1995 Est. Market Size		2004 Est. Market Size		Estimated Compound Segments Growth (%)		Comments
	\$million		\$million		1995-2005E	2004E-2008E	
<u>Equipment</u>							
Homeland Security Detectors	100		2,200		33.8%	15.0%	Focus shifts to personal, carry on inspection
Alarm monitoring equipment	4,000	(1)	7,000	(1)	6.2%	7.0%	Tyco, GE, Honeywell, Bosch, Napco
Fire monitoring equipment	2,500		4,000		3.7%	4.0%	Consolidated industry, changing codes, modest growth
Video Surveillance	2,000		5,500		11.3%	15.0%	Digital, IT, networked video becoming the litmus test
Biometrics	300		1,200				US - Visit, TWIC, HSPD-12 could be reference sites for the commercial market
Access Control	675		1,200		11.6%	10.0%	Tyco, GE, Honeywell, Lenel
Electronic/photo systems	15,000		18,000		2.0%	2.0%	Assa Abloy, Stanley works, Mogol & Elbit perimeter
Door peripherals, fences, perimeter							
Smart cars/Token Cards	200		1,500		22.5%	20.0%	Europe still well ahead of U.S. installing systems
Electronic article surveillance	1,000		1,400		3.7%	4.0%	As retailers remain flat, its still Tyco (Sensomatic) vs Checkpoint
Bar Code Scanning Systems	3,200		6,600		7.9%	7.0%	Motorola acquiring Symbol Technologies
Radio frequency identification	650		1,800		11.5%	25.0%	Dealted buzzword. Wal-Mart vs suppliers, ROI, standards, privacy are issues
<u>Services</u>				(2)			
Alarm monitoring Commercial	6,500	(3)	9,000	(3)	3.6%	4.0%	Commercial is once again the "paradigm" for the industry
Residential	3,500	(3)	7,000	(3)	8.0%	6.0%	Sanity returns as profits, credit scores begin to mean something again
Guarding	25,000		34,000		3.5%	5.0%	Improving U.S. quality, margins, Whither Ira Lipman?
Consulting, intelligence & investigations	No estimate		8,000		No estimate	9.0%	Marsh & McLennan wants the post 9/11, post-Enron scandal world of Kroll
Armored transport	1,200		1,500				
Cash-in-transit services	450		1,500		2.5	2.5%	Slow growth, but brands like Brinks drive the faster growing logistics business
Logistics & ancillary services					13.5%	12.0%	ATM servicing, physical cash logistics now half of U.S. "armored car" revenues
Systems integration	1,500		4,500		12.2%	12.15%	Becoming a critical driver for industry
Computer Security (not covered in report)	1,500		7,000		30.0%	25.0%	
Other							
Total	No Estimate		122,800		No Estimate	10.8%	

(1) At Wholesale Prices
(2) At End-user (consolidated) prices
(3) U.S. only at wholesale prices

SOURCE Lehman Brothers - 2006