Globalisation strategies: How to crack new markets

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With two out of three retailers failing outside their home market, foreign expansion is no easy task. The most common mistakes? Overconfidence and poor timing.

In Brief...

- Two out of three retailers fail when entering markets outside their home country.
- The classic mistake many retailers make concerns market timing: they enter the market too soon, or too late.
- Developing a successful retail operation in a foreign market requires time, investment and patience.
- The principles of retailing are universal, but their implementation varies by country, market and culture.

Most companies regard new and attractive global markets as a metaphorical gold mine. But two out of three retailers actually fail outside their home market. This failure is often due to poor timing of market entry and the tendency to simply "clone" a tried-and-tested format. Wal-Mart is a classic example of how a retailer with a proven track record in its domestic market can fail overseas. In the US, Wal-Mart looks invincible, but it is having trouble in Germany. Its "Always Low Prices" formula does not work there. German consumers already have even lower priced grocers such as Aldi and Lidl; and finding land on which to build a 200,000 sq ft store is not so easy in Europe as in the US. In China, Wal-Mart has been in the market for a few years, but it is finding it difficult to compete against Carrefour, which got there first, and Hualian, a local chain that has the significant advantage of knowing how the Chinese like to shop. Wal-Mart entered Indonesia a few years ago, but ran into problems and ultimately withdrew.

Wal-Mart is not the only retailer to have problems entering foreign markets. From 2002–06, more than 40 retailers exited foreign markets. Many retailers underestimate the difficulty involved. Their overconfidence stems from their experience in their home market. By the time a retailer thinks about foreign expansion, it has usually opened many hundreds of stores, most of which will have been successful (after all, it is the successful retailers that think about foreign expansion). Each retailer believes it has the secrets of successful retailing all worked out.

But while the principles of retailing might be universal, the methods by which those principles are implemented vary by country, culture and context. Too often, the entrant assumes that its domestic format is the right way to go, when it may well not be. The need for growth, combined with overconfidence, leads to aggressive expansion plans that make the subsequent failure all the more pronounced.
We conducted a quantitative survey of more than 50 global and regional retailers over three years (2002–05), with in-depth qualitative interviews conducted to capture best practices in global retail. The survey covered strategic, financial, operational and tactical aspects of global retail strategies. It confirmed that the “get big fast” theory of international entry is well-engrained among retailers. However, the record shows that this is not true. Success comes to those who follow two rules. First, enter a country a few years before you wish to rely on sales growth from it. You need to think about which countries will be “hot” five years before it happens and develop adequate timing strategies. Second, be prepared to experiment with the format, which means giving local managers substantial authority.

The globalisation of retailing

The retail industry is becoming increasingly global:

- Middle and upper-middle income groups are expected to double in size over the next ten years.
- Retailers have dramatically increased their global coverage, entering more than 85 markets over the past five years.
- It takes less than eight years for developing markets to move from traditional to modern retail. This process took 30–50 years at the beginning of the century. Moreover, consumers in emerging markets are leapfrogging development stages. They are clamouring for Starbucks coffee and high-tech products, in areas where modern food retail is not yet fully developed.

Retailers cannot afford to ignore globalisation; 15 of the world’s top 20 retailers operate globally in terms of sales. Among the top ten players, 27 per cent of sales come from international markets. Of the top five retailers, 33 per cent of sales come from outside their home markets. The percentage of sales from international operations is expected to rise.

Timing strategies

When retailers discover they have a successful concept, they capitalise on this by opening multiple stores. At some point, however, their domestic market starts to saturate and executives inevitably decide to export the concept to foreign markets. History is replete with case studies of retailers who stumbled at that point. Marks & Spencer opened stores around the world, only to withdraw from most after its traditionally English format failed to attract customers in the way the store’s executives anticipated. Sainsbury’s, which entered – and then exited – Egypt must have felt that the country was on the cusp of strong demand for western-style supermarkets, but was quickly proved wrong. How can major, well-run, sophisticated companies make mistakes like this, over and over again?

A sure-fire way to fail is to enter a new market with a strong conviction that you have the right solution. The smartest firms enter with a learning mentality, with a view to trying some things and seeing what works. There are also clear advantages to entering a new market as the country’s (retail) economy starts to lift off, including occupying the best locations, learning customer needs and developing customer loyalty. The trick is to combine these two points. Enter early enough, so that by the time the market takes off, you have already developed the right concept. In watching such missteps, as well as the more infrequent successes, we have identified three strategic lessons that will resonate with all large retailers.

1. **Enter early**: There is a five to six-year window of opportunity to enter an emerging market. If you miss that window, there’s a good chance you will not succeed. The size and timing of capital investments and repatriated profits are highly uncertain.
2. **Develop the right capabilities**: A team, preferably one involving nationals of the target country, needs to be assembled early on. Team members should be familiar with the local culture, be willing to live there for many years, and have the confidence of senior management.
3. **Know your destination**: Detailed regional analysis within a country must also be performed prior to entering. Be prepared to experiment with different formats in a region. The most successful retailers use models such as system dynamics to anticipate the next moves of local retailers.

We may condense these concerns into two factors that require management attention: time, and timing. Think ahead by several years, and choose the timing of entry carefully.

Judging country timing

It is not easy to sum up the attractiveness of a country in a few statistics, but over the past several years, we have developed a methodology and tested it with retailers in different industries. We have analysed and ranked...
the key macroeconomic and retail variables for more than 180 countries, using objective and reliable data drawn from World Bank reports, Euromonitor, EuroMoney, Planet Retail, field work from A T Kearney consultants, as well as other sources. The four main components are:

1. **Country risk**: How ready is the country to support a highly capital-intensive business? Here we have analysed factors such as political risk, economic performance, debt indicators, credit ratings, access to bank finance, access to short-term finance, access to capital markets, discount in forfeiting.

2. **Market attractiveness**: Are there plenty of affluent people, preferably concentrated in accessible locations? This analysis includes retail sales per capita, law and regulation, population.

3. **Market saturation**: How advanced is the retail market? The analysis here includes share of modern retailing, modern retail sales area per inhabitant, the number of international retailers, the market share of leading retailers.

4. **Time pressure**: How quickly is the retail sector growing? We measured time pressure by the sum of the compound annual growth rate of retail sales from 2000–05, and the retail sales area weighted by the development of the economy in general (CAGR of the GDP from 2000–05).

Figure 1 (see PDF or print magazine) shows these parameters in more detail and provides a ranking of country attractiveness as of 2006. Figure 2 (see PDF or print magazine) shows what countries the model would have advocated in 1995. Not surprisingly, the ranking has changed significantly in the past decade: with the exception of Chile, not one of the top ten markets in 1995 is in the top ten group for 2006. In 1995, the top three markets for retailer entry were South Korea, Poland and Brazil; in 2006, the top three markets are India, Russia and Vietnam. Poland and Brazil are now saturated, and South Korea has fallen to 13th place.

The most significant shift, however, is at the regional level. In 1995, one out of every four countries on the model was in the Americas. Today, that figure is one out of ten. Instead, Eastern Europe has become the focus of the list, capturing 40 per cent of the top 30 spots.

Using modern retail sales growth as an indicator of market performance, the top tier of countries outperformed the other two tiers on many dimensions. Between 1995–2000, the top tier had a CAGR of 5.8 per cent, while the bottom tier grew by just 1.5 per cent. Looking over an even longer time horizon, 1995–2004, the top tier posted nearly nine per cent CAGR, while the bottom tier grew at 4.5 per cent.

Many of the top-tier countries experienced significant macro-level pressures, such as natural disasters and the currency crises in Asia and Latin America. But despite these challenges, top-tier countries significantly outperformed the other two tiers over a period of time. Their success underscores the opportunities for retailers that take a longer-term view to entering developing markets, recognising that return on investment will not happen quickly and that economic or political instability could be among the costs of first-mover advantage.

Just how important is timing? Figure 3 (see PDF or print magazine) illustrates the shift in opportunity over time based on a country's ranking. This analysis highlights a pattern in modern retail evolution for the different markets. The window of opportunity for retailers to enter markets early lasts from five to ten years on average. For example, India is at the peak of its attractiveness today, while Russia and China are beginning to level off.

Overall, poor timing is often the source of many retailers' decisions to leave emerging markets. Over the past five years, the number of companies exiting markets has risen steadily. Tesco, for example, entered the Slovak market at the end of the nineties, an optimal time for market entry. Today it holds a 13 per cent share of the market. Other retailers, such as Ahold, Carrefour and Tengelmann, entered in late 2001, but have been unable to build more than a five per cent market share. Edeka entered the Czech Republic too late in 2000 and exited in early 2004. PriceSmart entered Mexico in 2002 and exited in 2005.

**A success story**

One company that seems to be frequently successful at retail entry is the British supermarket chain Tesco. Its CEO, Terry Leahy, described the company's approach: "It worked in our favour that we didn't start out believing we had all the answers... We needed countries where we would be early entrants, countries that were stable, and countries with sufficient spending power per capita, and with growth potential... This thinking led us to identify the former Communist countries of Eastern Europe, and a few overlooked emerging countries in Asia...

Even today, with 65,000 employees overseas, there are only 70 of our UK managers living abroad. And they are trainers, not operating managers. We've told local managers that they must aim to be number one in their country, but we don't tell them how to do it. As a result, their enthusiasm is sky high" (Bell, 2002).

A more general reason for Tesco's success is that it has a culture of empowerment. Employees are measured based on results rather than whether they follow orders. This might not always be the right solution in countries where the correct format is well understood, but it certainly works when the right retail model is uncertain.
The bottom line

We have suggested two explanations for the unseemly haste with which retailers enter countries: overconfidence and an urgent need for growth. If we take these as a given, what is such a company to do? The answer is to consider an acquisition, or to enter a country where retailing is mature enough that the correct approach is not in question. Wal-Mart’s most successful foreign foray was in the UK where it bought one of the country’s leading supermarket chains, Asda. Asda had been emulating Wal-Mart’s operating style for some years prior to the acquisition and, though Tesco is a vigorous opponent, the rules of the retailing game in the UK are quite clear. Wal-Mart’s logistic and merchandising skills are ideal for those conditions. Another successful acquirer was Ahold, which bought Stop and Shop in the US. There is no mystery about what is needed to succeed in the US market and Ahold sought to export its logistic and private-label expertise to the US market. But for those for whom size does not permit such large-scale actions, the only resort is to plan ahead and be open-minded.

We are not the first to suggest that foreign entry can be challenging. But without some means to evaluate the attractiveness of countries, all countries are bound to look equally attractive. That is where mistakes are made. Retailers are very sophisticated when it comes to logistics and to understanding customers, but we suggest that some of that skill needs to be applied to understanding national economics. The model we have developed might be a good starting point. We have developed similar models for other industries, including energy and transportation, with similar insights on windows of opportunities.

It was all the rage to become a conglomerate in the sixties, presumably based on the notion that good management principles were universal. It had become clear by the eighties that this was not true; managing cinemas is different from managing steel plants. In the same way, retailing in the US is different from retailing in Malaysia. Though we have taken the retail industry as a case study, the caution of time and timing applies to all.

References


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