



Retail Doesn't Cross Borders

Here's why and what to do about it.

by Marcel Corstjens and Rajiv Lal



Marcel Corstjens is the Unilever Chaired Professor of Marketing at Insead.

Rajiv Lal is the Stanley Roth Sr. Professor of Retailing at Harvard Business School.



Globalization's lure is almost irresistible. With the U.S. economy struggling to expand and Europe on the brink of recession, fast-growing markets in the developing world offer the best opportunities for boosting revenues and profits today. Many companies in the developed world are keen to follow in the wake of corporations in a variety of industries—such as Boeing, Coca-Cola, DuPont, General Electric, Hewlett-Packard, IBM, Oracle, Unilever, and Disney—that appear to have succeeded in going global.

Globalization is no panacea, however. Success abroad varies widely, and it's often tough to boost profits by investing overseas. Because most studies look at cross-industry patterns to draw lessons about how to succeed at globalization, they can be

misleading. When we focused on one industry—grocery retailing—we found that, with a few exceptions, globalization's benefits had not accrued to retailers.

In contrast to other industries, grocery retail is still dominated by local players in most countries. International players are almost entirely absent from even the largest retail markets. And every grocery retailer that has ventured overseas has failed as often as it has succeeded. Moreover, our research shows that on average, the extent of internationalization does not have a significant effect on retailers' revenue growth rates or their profit margins. Some industries clearly can't travel across borders as well as others.

A few grocery retailers have succeeded in globalizing by developing strategies that take into account the idiosyncrasies of their industry—and have found

Why Retailers Go Global

Grocery retailers' sales are much larger than those of grocery suppliers, but investors still expect retailers' earnings to grow faster. Since retailing is a low-margin business, big chains have been forced to move into overseas markets.

EXPECTED EARNINGS PER SHARE GROWTH RATE

GROCERY RETAILERS

Carrefour

20%

(2011 SALES: \$120 BILLION)

Walmart

10%

(\$422 BILLION)

Tesco

9%

(\$94 BILLION)

GROCERY SUPPLIERS

Coca-Cola

9%

(\$35 BILLION)

Danone

6%

(\$23 BILLION)

P&G

2%

(\$80 BILLION)

*AVERAGE EPS GROWTH RATES IMPLICIT IN COMPANY VALUATIONS

SOURCE THOMSON-ONE BANKER DATABASE

new paths to growth at home as well. Extrapolating from their experience, we propose some retail-specific rules for globalization that may also be useful for any company venturing abroad.

The Pressure to Globalize

Retailers wish to enter global markets for a number of reasons. Common ones include a quest for greater economies of scale and scope, a need to diversify risks, a desire to attract fresh talent and create new opportunities for existing leaders, and a need to make up for constraints imposed by regulatory agencies when a retailer becomes too big for its home market.

Growth is the main impetus for globalization, though. Retailing is a low-margin business, so companies have to expand rapidly if they wish to remain attractive to investors. One example: In 2009 Walmart's expected sales growth, as per its stock price valuation, was 8.5%. That implied an increase in sales of \$34 billion that year, and a rise in revenues from \$400 billion to \$600 billion over five years, according to the stock investment database ValueLine. In contrast, investors expected the consumer goods giant P&G to grow by just 5.5%. That meant sales growth of \$4.5 billion in 2009 and an increase in sales from \$83 billion to \$108 billion over the next five years—less than a fifth of Walmart's expected sales.

Because of the unrelenting pressure to grow, many globalization gambits are opportunistic and jeopardize carefully crafted long-run strategies. For example, Walmart's move into the UK in 1999 through the purchase of Asda was unplanned. The American retailer had intended to invest in its undersized German operation at the time, but quickly stepped in when Asda announced its plans to merge with a British white goods retailer, Kingfisher. It jumped at the opportunity because Asda was a good fit with its positioning and operations, but the move was internally controversial—Walmart's international head, Bob Martin, eventually resigned over the matter.

Retail's pattern of geographic expansion is puzzling. The sales of the world's 10 biggest retailers tripled from 2000 to 2011, but their global sales more than quintupled—admittedly from a very low base. It would be logical to expect that grocery retailers would enter the world's biggest markets—the United States, Germany, Japan, the UK, and France—to boost revenues and profits. Yet no retailer is present

in all of them today. Walmart doesn't operate in either continental Europe or Japan, and neither of the other two biggest American chains has made an overseas investment yet. France's Carrefour, the world's second-largest retailer, doesn't have a presence in the U.S., Japan, or Germany, although it has tried to break into all three countries. Britain's Tesco, the world's third-largest chain, has had no European business since it pulled out of France and has only recently developed a small presence in Japan and the United States.

Every retailer has tasted failure abroad. Walmart has succeeded in Canada and Mexico, but it had to pull out of Germany and South Korea. Tesco has carved out market share in South Korea and Malaysia, but it failed to establish a presence in France or Taiwan. Germany's Metro took off in Poland and Romania, but its forays into the UK and Denmark ended in failure. Carrefour has exited several markets in Europe—including Austria, the Czech Republic, Germany, Norway, Portugal, Slovenia, and the UK—but it has broken through in others, such as Spain, Belgium, Greece, Italy, Romania, Poland, and Turkey, during the same period.

It could be argued that the grocers' failures are due to differences in consumer tastes, particularly for food products. However, companies like Mars, Nestlé, Kraft, P&G, Danone, and Unilever have succeeded in creating global food brands. These suppliers have had presences in the biggest retailing markets for more than 15 years, so international retailers' lack of success must be attributable to other factors.

To be sure, some companies are making inroads. Big retailers, especially those from the U.S. and

No grocery retailer today operates in all five of the world's biggest markets.

Idea in Brief

Many companies, especially those in the developed world, have tried to grow faster by investing abroad, and retailers are no exception. But it's tough to make money overseas, particularly for retailers.

Local retailers still dominate most markets, and almost every chain that has ventured overseas has tasted failure. In fact, the data suggest that traditional globalization strategies don't work well in retail.

Research also shows that the extent of internationalization doesn't contribute significantly to either retailers'

revenue growth or their profit margins; the home market's growth is the major driver.

Retailers face serious obstacles in going global: It takes time to break into foreign markets, returns accrue only over time, and foreign entrants have to take on well-established local incumbents.

Some retailers' experiences suggest that to succeed abroad, firms must bring new things to market; focus on differentiation, not synergies; and enter at the right time.

France, have invested in Latin America, and the European giants have targeted Central and Eastern Europe. Still, international players are remarkably absent in most countries. In numerous markets, local retailers occupy the number one and number two spots (see the exhibit "Room for Global Growth"), suggesting that standard globalization strategies haven't worked in retail.

Globalization's Financial Impact

Given this spotty track record, it seemed worthwhile to investigate whether globalization helps retailers meet financial goals. We conducted an econometric study comparing international and predominantly national grocery retailers. Growth rate in sales and increases in net profit margin were the two performance indicators we used, and internationalization was one of the independent variables.

Our findings surprised us:

- The degree of internationalization, measured by any yardstick, doesn't significantly affect a retailer's sales growth rate or profit margin.
- The GDP growth rate of the home market is a major driver of the retailer's sales growth rate.
- The sales growth rates at home have a significant impact on the retailer's profit margin.
- Neither the size of the home-market population nor the retailer's size, measured by sales, influences its sales growth rate or profit margin.

Clearly, retailers need to rethink their attitudes toward globalization as well as their strategies. If they are investing overseas to boost sales and margins in the short run, they will be sorely disappointed. Globalization is likely to contribute to revenues and profits only in the long run. Paying closer attention to the domestic market will be important in the meantime, not just to achieve faster growth but also to boost margins. Whatever the retailer decides to do globally, the home market is critical to its

performance. This may be as true for big retailers as it is for small ones.

Factors That Influence Retailers' Globalization Strategies

Since few have achieved universal success, retailers should think hard before entering foreign markets. Their decision-making processes should take into account the unique characteristics of their industry. Three factors stand out:

Retailers face many barriers to entry in foreign markets. It's tough for retailers to enter overseas or foreign markets by acquiring local players. In developed markets, few retailers want to sell. Even well-established chains have trouble making acquisitions work—as Walmart's trials in South Korea and Carrefour's tribulations in Japan and Belgium show. It's equally difficult for grocery retailers to grow organically because of real estate costs, entrenched competition, and the lack of suitable sites. In emerging markets, few chains have developed large networks of stores. Retailing is usually local in those nations, and the industry is highly fragmented.

Moreover, foreign entrants struggle to bring offerings to developed countries that shoppers perceive as new, different, and valuable. The mixed response to Tesco's new U.S. venture, Fresh & Easy, illustrates this problem. Consumers didn't feel the format was novel enough, and the choice of locations left much to be desired. Even more worrisome, the team Tesco had sent to get the venture off the ground was made up of its brightest and best executives. In developing countries, on the other hand, consumers perceive foreign retailers to be premium players, even though they may not offer the services that local grocers do, such as free delivery, credit, and custom packaging. In addition, in many parts of the world, including the otherwise open market of India, laws protect local retailers from foreign competition.

How Retailers Fare

Grocery retailers offer shelf space, pretty much a commodity, whereas consumer goods manufacturers must tailor their products to local tastes in every market. Yet suppliers have successfully entered many more countries than retailers have.

NUMBER OF COUNTRIES IN WHICH THE COMPANY OPERATES

GROCERY RETAILERS

Carrefour
38

Walmart
15

Tesco
13

GROCERY SUPPLIERS

Coca-Cola
200
(APPROX.)

Danone
120

P&G
180

SOURCE
PLANET RETAIL
AND COMPANY REPORTS

A strong position at home is critical to sustaining investments overseas.

Grocery retailing is a high-fixed-cost, low-margin business with returns that accrue only over time. Companies have to operate a large network of stores in each country to benefit from the economies of purchase, supply chain investments, and technologies that drive worker productivity. However, most retailers don't enter a country all at once; they enter one city, then another, then a region, and so on. The process of building a network of stores to a profitable scale takes a long time and entails large investments that may not pay off for decades. Walmart broke even in China in 2010, after 15 long years of investment.

Moreover, unlike grocery suppliers, which can profitably cater to one consumer segment across a country, mass-market retailers must compete for every consumer in the economically diverse trading area of each store. They don't enjoy the luxury

of selecting slices of consumers; they have to make every store profitable despite the mix of clientele in the surrounding area.

Foreign entrants often have to take on incumbents that operate exclusively in one country. These "country killers" understand local preferences and tailor offerings to local consumers' needs. Outsiders, on the other hand, have to respond to large variations in shopping habits across an extensive network of stores, which makes them prone to errors. Moreover, the advantages of global supply chains vary greatly by product category, with food products offering fewer global buying opportunities because of the heterogeneity in local tastes and habits. Gains grow when nonfood offerings become more important.

How Retailers Can Get Globalization Right

None of this means that retailers should avoid moving into foreign markets. However, the nature of the business is such that globalization isn't for every retailer: Each player must think through the unique challenges the industry poses, understanding that even successful chains won't reap financial rewards for a long time. Retailers will do better overseas if they apply four rules:

Rule 1: The home market is the linchpin of globalization. Retailers often make two mistakes when they venture overseas. One, they perceive opportunities outside the home market to be larger, less constraining, and easier to tap into than those in the home base. Two, they divert their attention from what's happening at home. Both errors can prove costly.

The stronger the retailer's market position at home, the better its chances of sustaining overseas investments. Walmart's leadership position in the U.S. is undoubtedly the key to achieving its global ambitions. Conversely, Carrefour's problems spring from its precarious position in its home base, where it has lost market share and its profits fell by 40% in the first half of 2011.

The Retailer's Golden Rules of Globalization

First explore all options for profitable growth in your home market.

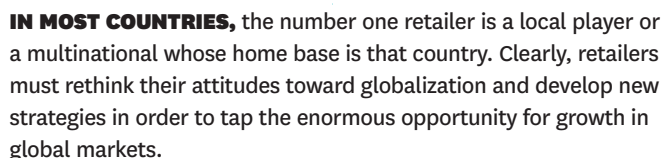
Continued success in the home market is necessary, but not sufficient, for success internationally.

Unless you enter by acquiring a strong local player, **make sure you bring something new to the market.**

Focus on local success and differentiation in each new country before exploring and leveraging synergies across your portfolio of countries.

Don't enter too early; you will fail.

Don't wait too long. Opportunities dry up, and competitors may become unassailable incumbents.



The keys to Aldi's success have been the format's simplicity and a focus on lowering operating costs,

As Poland attracted the attention of other European retailers, Jerónimo Martins adopted a new approach. Lacking the resources to compete with the new entrants, it sold off the cash-and-carry business and the hypermarkets and focused on developing Biedronka, a chain of 48 small stores, as a hard

Strategies for Growing the Home Market

The hype about globalization shouldn't blind retailers to opportunities in their home markets. Here are three ways retailers can grow faster at home.

Grow existing formats

Some retailers, such as Spain's Mercadona, the Netherlands' Jumbo, and Dollar General in the U.S., have found room to grow even in mature markets. And their success isn't because of the size of the opportunity; they represent small (Jumbo), midsize (Mercadona), and large (Dollar General) home bases.

Mercadona, for example, is obsessed with satisfying the shopper, whom the company calls The Boss. Mercadona is able to offer high-quality products at low prices because it manages operations extraordinarily well. Founded as a family-owned supermarket in 1977, the company generated sales of more than €16 billion from 1,200 locations in 2010. Sales per employee have risen consistently over the past 13 years, more than doubling over the period to €232,000 per employee.

Expand into new formats

Another option is to expand the number of retail formats at home. Sainsbury's in the UK, Denmark's Dansk Supermarked, and Walmart Mexico, which operates independently from Bentonville, Arkansas, have all grown by serving different customer segments and offering different kinds of experiences such as bulk, top-up, and convenience shopping.

Wal-Mex, as it is commonly known, has built a \$25 billion business this way. Its Bodega Aurrera and Mini Bodegas cater to less affluent segments, while Walmart Supercenter, Sam's Club, and the convenience-store format, Superama, focus on more-affluent consumers. Wal-Mex operates VIPS restaurants on the same premises as its hypermarkets; it also has a casual clothing chain, Suburbia.

Using different formats to focus on different consumption occasions and segments allows Wal-Mex to compete for a

higher share of wallet. For example, within a two-mile radius of Mexico City, Wal-Mex has as many as 17 stores. What's more, with a portfolio of formats, Wal-Mex can take advantage of a variety of real estate opportunities as they become available. By contrast, a company with a single format must find locations that fit its format. Flexibility is another benefit; when a community becomes richer, for instance, Wal-Mex can convert a low-end store into a hypermarket and thereby keep pace with consumer needs.

Leverage the brand

Retailers must leverage the equity—values, beliefs, and perceptions—they enjoy with customers by identifying new product categories and services that are consistent with those qualities. We call that a “weightless” brand strategy because it allows retailers to float into new markets, escaping the forces that keep them in their traditional areas of expertise.

Consider, for instance, Tesco, the British retailer, which is expanding into banking and insurance as a way around the UK Competition Commission's concerns about its 30% grocery market share. By capitalizing on the trust consumers have in the company along with its value-for-money reputation, Tesco hopes to keep growing.



discounter. A local team applied retailing principles that were new to Poland: very small stores, low prices, limited assortments (800 SKUs), quality private-label products that accounted for 60% of sales, and obsessive cost efficiency in all activities.

Jerónimo Martins then went a step further. It ran Biedronka as a stand-alone business with no operational links to its other businesses. Polish shoppers saw the brand as one of their own in a market full of foreign interlopers, and the company reinforced

this image by procuring 95% of its products from Polish suppliers. Fifteen years after its acquisition, Biedronka operates 1,800 stores in Poland and plans to open another 1,200 by 2015. With Biedronka generating 60% of its sales and 90% of its profits, Jerónimo Martins has effectively become a Polish company with a subsidiary in Portugal.

Rule 3: Differentiation is more important than synergies. The benefits from international expansion are often supposed to accrue from in-

When multinational retailers try to capture gains from global procurement, they often end up selling what they have bought instead of buying what they can sell.

creased scale and scope economies. However, small local players often outperform international players because the synergies from globalization are not always as big as anticipated.

Back-office efficiencies, IT, finance, real estate management, logistics, and central purchasing are part of the potential cost efficiencies that can result from international expansion. However, the share of central purchases in retailers' sales is never as large as expected; more than 70% of sales usually originate from local producers. Notwithstanding their claims, most multinational retailers aren't organized enough to capture gains from global procurement. Even if they are, they run the risk of overloading local assortments with products from global suppliers. These retailers end up selling what they have bought instead of buying what they can sell.

Economies of scope are beneficial only if the retailer's core competencies are relevant for a new market. Walmart struggled in Germany partly because its low price proposition didn't stand out in a market where hard discounters control 47% of grocery sales. It couldn't gain benefits from using its IT and logistics systems because of the operation's lack of scale. Finally, Walmart's people policies were out of tune with the unionized, high-wage German labor force.

Leveraging synergies globally while providing each country operation the independence to adjust to local needs is a critical balancing act. For instance, the more consumers value local food products, the fewer synergies the retailer will be able to derive and the more it will struggle to compete with country killers. The key is to find synergies that add to the consumer offering rather than conflict with it.

Rule 4: Timing is critical. Retailers need to think carefully about when to enter a market. They often enter markets too early. For instance, Carrefour, the most international retailer, failed in several de-

veloped markets because shoppers weren't ready for the hypermarkets concept. Also, it usually takes retailers longer than they expect to grow in overseas markets, which frustrates them because the business is capital-intensive. This is particularly a problem if the retailer is expanding in scattered markets rather than trying to build critical mass in a few.

At the same time, internationalization can't be postponed forever. Strategic windows close, especially for retailers operating in large home markets. If Kroger and Target, the number two and number three U.S. grocery retailers, wait much longer, they may miss the most attractive opportunities overseas and their future growth will be limited. One key dimension in determining the optimal time to enter a market is format. Cash-and-carry retailers can enter a country early because they can serve mom-and-pop stores. Hard discounters can also enter fairly early because there will always be some shoppers interested in their value-for-money proposition. However, if hard discounters go in too soon, they will face issues such as the lack of reliable private-label suppliers or few other formats present in the market, making it difficult to set up a differentiated value-provider positioning.

THE NUMBER of countries in which a retailer operates should never be a proxy for its international success. Even grocery retailers that have gone global would do well to stop planting flags and focus instead on a limited set of opportunities where they are most likely to be successful in generating operations of scale. They can do that by using strategies similar to those they use at home—such as moving into more locations, deploying more formats, and offering more products and services. Only then will global retailers' expansion become aligned with a superior understanding of shoppers' needs and wants. ▀

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