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Retail Globalization
Navigating the maze

Executive summary

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Stop or go?

Over the past decade, a growing number of retailers in developed countries have reduced their dependence on their home markets, where sales have stagnated in recent years, and made expansion into more attractive foreign markets a priority growth strategy. However, globalization can be risky and require a substantial investment of time, money, and resources. As retailers have moved into unfamiliar and unpredictable territory, many have been unprepared for the unique challenges posed by a different economic, political, and cultural environment. Proper due diligence into both the obstacles and the opportunities can help retailers set and achieve realistic goals for increased sales and profitability as they tap into new growth markets.

Not for the faint-hearted

Every retailer that has expanded into foreign markets or has even thought about it knows only too well – globalization adds layers of complexity to every aspect of doing business, creating greater risk exposure. Merchandising, marketing, store operations, real estate, human resources, reporting requirements, tax policy – all must be reevaluated in light of a new consumer culture, competitive set, or regulatory environment. In addition, economic uncertainty, political instability, currency fluctuations, and other macro environmental factors or disruptive events beyond the retailer's control add to the risk of doing business in foreign markets. Before a retailer can decide what role, if any, international expansion will play as part of its overall growth strategy, it is important to evaluate and manage the company's threshold for risk across these multiple dimensions.

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There are several key issues that often do not receive the attention they deserve as companies consider their appetite for risk. Among the most important are realistically managing return on investment expectations; ensuring brand integrity; and assessing the retailer's corporate global leadership capacity, functional capabilities, and resources. These issues are under the retailer's control, but without careful consideration they can become stumbling blocks to successful globalization.

Payback expectations: Take the long view. While international sales have contributed to growth for most of the world's largest retailers, return on investment has not always followed – at least not as quickly as expected. Different countries are in different stages of maturity with regard to economic and retail development and pose different levels of risk. As a result, different timelines for payback will be experienced. In emerging markets, where a host of country-specific hurdles can impede progress, it can take years simply to break even. Payback delays can result from protectionist governments, underdeveloped infrastructure, the condition of the local supplier market, and bureaucratic red tape or corruption.

Ensuring brand integrity. Because retailers sell products to the end consumer, they must be careful to ensure the utmost integrity of their "brand." This is an issue that all retailers need to pay attention to, but it is critically important for single-brand retailers where the retailer is the brand. This requires that they understand, plan for, and monitor the many potential risks to brand integrity that could result from foreign activities up and down the value chain including manufacturing standards and product safety, working conditions, and sales tactics.

Capability assessment. The ability of corporations to run global operations is another critical risk assessment factor. A retailer's globalization potential depends on an honest assessment of its corporate global leadership capacity, functional capabilities, and resources. If the organization underestimates the internal capabilities and resources needed to operate in a new environment, it can pay a steep price, including expansion delays and/or financial overruns, while it scrambles to align its competencies and workforce with the organization's global objectives.

The growing power of local competitors

Over the past two decades, the ability of foreign retailers to bring leading-edge practices to relatively unsophisticated markets has resulted in a migration from traditional retailing to modern, organized retail formats in developing markets around the globe. However, as the transformation of the retail sector progresses in these markets, many strong national and regional players also have emerged across formats and product categories. One obstacle that foreign retailers often underestimate when assessing the opportunity in emerging markets is the growing power and sophistication of the local competition, which is often stronger than it may appear.

The need for strategic localization

Retailers' close and personal relationship with consumers makes for a complex business – especially if those consumers are scattered around the globe. Consumption is a sociocultural process as much as it is an economic interaction. Therefore, in addition to understanding the demographic characteristics of the population, such as age, income, and family size and structure, retailers need to be responsive to local culture and traditions, tastes and preferences, and shopping habits, which can be quite different from one country to another and sometimes within a single country.

In addition to the degree of localization required to succeed in a given market, retailers need to decide what method of market entry will allow them to best adapt to local market conditions. In fact, the two issues are intertwined: the more different the market, the greater the need for adaptation; the greater the risk, the less likely retailers are to go it alone.

No perfect entry strategy

In addition to the degree of localization required to succeed in a given market, retailers need to decide what method of market entry will allow them to best adapt to local market conditions. In fact, the two issues are intertwined: the more different the market, the greater the need for adaptation; the greater the risk, the less likely retailers are to go it alone.

There are five primary routes for retailers to enter a foreign market: wholesale distribution, licensing, franchising, joint venture, and owned expansion (greenfield and/or acquisition). A set of parameters – ranging from the required level of investment and time to payback, to internal capabilities and knowledge of the market, to ensuring brand integrity and human resource requirements – drives the selection of entry method. Essentially, the choices represent a tradeoff between speed and control, risk and reward.

Market potential vs. ease of expansion tradeoff. When contemplating a new market entry, retailers also face a tradeoff between market potential and ease of expansion. Retailers naturally are attracted to developing markets, such as the BRIC countries, based on their sheer size and economic growth, along with a significant relaxation of restrictions on investment. In addition to a burgeoning middle class, these markets boast lower retail saturation levels, increasing urbanization, growth of retail space, and greater Internet penetration – all leading to increasing retail sales per capita. Despite the potential of emerging markets, retailers may miscalculate their own individual market prospects by focusing too much on macroeconomic factors while underestimating the operational difficulties of doing business in these markets. Key considerations should include real estate, tax policies, security and privacy standards, and labor laws.

First steps: Familiarity breeds comfort. Taking "baby steps" into a similar market, especially one close to home, is a lower cost, risk averse strategy. Especially for retailers inexperienced in international expansion, ease of market entry may be a reasonable tradeoff for market potential – at least until they get their feet wet – because it reduces uncertainty. In addition to market proximity, ease of entry is facilitated by cultural and demographical similarities as well as a similar competitive set. Tactical similarities also make doing business easier than in other, more "foreign" countries – for example, a similar regulatory environment and labor practices.

Hedging bets – online retailing. Internet retailing is the fastest growing retail channel globally and on a national or regional basis. It has emerged from the recession stronger than ever, boosted by an increase in the number of Internet connections, increased use of credit cards, and a large and growing population of consumers that spend considerable time online and are comfortable with e-commerce. For these reasons, some retailers view online retailing as the best way to connect with international customers for the first time.

The human resource challenge

Retailing is one of the largest sources of employment in most countries. However, the supply of trained employees with an understanding of the retail business is often inadequate compared to the needs of organized retailing – especially in emerging markets. Meeting the talent requirements of an international company also demands greater attention to management staffing needs by recruiting and retaining people who are willing to travel extensively or serve as expatriates. For these reasons, finding and retaining good people is one of the biggest headaches faced by global retailers – at both the corporate and local levels.

Developing the organizational and governance structure

For retailers operating across geographies, it's not only where you operate, but how you operate. The enterprise governance structure, starting with the selection of home office location, has important implications for the organization's overall cost structure, processes and controls, knowledge management activities, taxation, and financial reporting requirements. The key is finding the right balance between centralization and localization to support the retailer's expansion strategy, including the eventual size of the international business, the character and mix of markets to be entered, and the local ownership models to be employed. The governance structure, therefore, must be dynamic, evolving to support the retailer's expansion over time.

The time to act is now

The issues presented here highlight two realities of retail globalization: First, it requires a substantial investment of time, money, and resources. And second, getting it right is difficult. As retailers raise their exposure in global markets, they will need strong risk management skills to navigate the minefields. The cost of managing these risks will complicate the achievement of profitable growth.

That said, as mature economies stagnate, global expansion is becoming crucial to long-term growth for more and more retailers. Old markets have become saturated, and new ones must be found. But attractive markets are becoming increasingly crowded. Many of the world's biggest retailers have already set up shop, and they are determined to defend and fortify their positions. Competition from domestic retailers is intense. Despite the many inherent problems and risks, postponing an international growth strategy is no longer a viable option. The bottom line is that the easy growth is over, and there is no going back. The time to act is now.

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