Retail internationalisation: an organising framework

STRATEGIES

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If retail internationalisation was easy, it would have happened a long time ago. Adapting to new markets is a subtle process: 'learning how to learn' is critical to success

Only 15 years ago, retailing was a domestic sector. Internationalisation had been tried, but few firms were involved, the scale of investment was normally small and often these early attempts did not succeed.

New retail concepts and processes were transferred across countries, but this rarely involved direct investments by firms of the county where the innovation originated. Most often it was transfer of know-how.

The supermarket, a formula developed in the US in the 1930s, spread after the Second World War throughout Europe, but it was European firms which were behind this diffusion, not American ones. Although large companies such as A&P already existed, they seldom tried to export their formulae abroad.

Retailing's strong ties with its local customer base seem to have made it difficult for foreign firms to do what was being done extensively in manufacturing, as a large number of US companies came to Europe and established subsidiaries.

However, in the last 15 years, things have changed. In a short spell of time the process of retail internationalisation began and accelerated. The arrival of Wal-Mart in Europe and the actions and reactions that it has caused (for instance, the merger between Carrefour and Promodès), epitomise the beginning of a truly global strategic interaction among the largest retailers.

What are the reasons behind this change? Did markets converge to such an extent as to reduce the dependence of retailers on specific contexts and to make internationalisation possible? How did retailers engineer the adaptations that are needed to establish their stores in different countries?

At least with respect to developed economies, the present flow of investment often does not involve new retail

formulae, but better ways of handling existing ones. Running an existing formula "better" is a more subtle process than introducing a new one, so it is worthwhile delving deeper into the sources of the advantages retail firms can exploit when they enter new markets.

Much has been written about retail internationalisation. A lot of it is helpful, but a unified treatment of retail internationalisation is still lacking. So, taking advantage of previous literature, here are some possible starting points.

- *Internationalisation is a way to sustain growth and capitalise on firm competitive advantages.*

Internationalisation is not separate from all other options that firms have to create value, namely product diversification and assortment extensions, and should be considered within this framework. So is internationalisation – when, where and to what extent – the best option to capitalise on the competitive advantages that firms may have? And how does this happen in retailing?

- *Diversification is now more risky and internationalisation is becoming the central option to sustain growth.*

In the 1980s and early 1990s, a number of large retailers diversified their portfolio of formats.

Retailing developed late but is now a mature sector in most developed countries. The number of different retail formats has increased and diversification has become more risky since specialists exist in most formats. This has prompted firms to focus on their core business, developing competencies that could be exploited in other markets.

Internationalisation thus becomes their central option for growth, especially when their domestic market is saturating. Metro, one of the companies which diversified more extensively in the past, recently re-focused its portfolio of formats. Kingfisher has been doing the same. Other retailers have followed the opposite path, but their diversification involved formats near to their core business. Carrefour, a French hypermarket specialist, acquired Comptoirs Modernes, a retailer with a large chain of supermarkets. Auchan, another French hypermarket specialist, did the same, acquiring Docks de France and La Rinascente in Italy. In both cases the diversification remains within food retailing, where economies of scope and scale can be exploited.

- *Successful internationalisation can be based on one or more of the following: innovation advantages, economies of scale, economies of scope.*

Although financial considerations help explain retailers' choice of target markets and timing of entry, in themselves they do not explain internationalisation. To succeed, firms must think they have (ex-ante), and eventually have (ex-post), some competitive advantage with respect to

Most retail internationalisation does not involve new retail formulae, but better ways of running existing ones. This is a much more subtle process

incumbents. These advantages can be based on some form of innovation or accrued through the economies of scale or scope that internationalisation makes possible.

- *The scope for internationalisation is reduced by adaptation costs incurred in entering and establishing stores in different markets.*

Moving away from a core business requires some adaptation of the knowledge accumulated by firms. To a lesser or greater extent, firms' know-how has time and physical dimensions. Moving away from a core business and incurring increased adaptation costs may reduce any original competitive advantage. Innovation is not easily transferable and making consumers aware of its existence in new markets can be expensive. Costs increase further if this innovation is easily copied by incumbents, who can also take advantage of their established relationships with their local customer base. If internationalisation is motivated not so much by innovation advantages but by the search of economies of scale and scope, then adaptation costs can easily match potential savings.

These starting points introduce three central questions which need to be answered if we are to account for retail internationalisation.

1. What are the innovation advantages and economies of scale and scope in retailing that may lead to internationalisation?

2. To what extent are they limited by adaptation costs that firms have to face to enter into foreign markets?

3. In what ways do the answers given to questions 1 and 2 influence the choice of the target markets and the means used to enter them – own stores, acquisition, joint venture, alliance, franchising, buying groups, technical collaboration, and so on?

The first question has already been researched extensively. Economies of scope and scale are important, especially within homogeneous contexts where consumers are similar – allowing for economies of scale in marketing, such as loyalty cards – where suppliers are the same (lowering buying costs) and where logistics can be centralised.

But ultimately, their role in retail internationalisation is unlikely to be decisive. The real scope for internationalisation depends very much on innovation advantages, which are elusive and fragile.

The answers to question 3 also depend largely on how innovation advantages pan out, so what follows focuses on possible answers to question 2.

Knowledge, trust and innovation advantages

Following the resource-based view of the firm, the success of a company in a given

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Economies of scope and scale can be important when internationalising, but ultimately their impact is not decisive. Real success lies with innovation advantages

(competitive) market is based on two main assets: knowledge and trust.

Proprietary knowledge, in all the different forms it can take, generates innovation and helps the firm establish a relationship with clients. This relationship helps build trust, which in turn generates new knowledge, new innovation – and more trust. Trust plays a central role in this representation of firms – it is not just a consequence of knowledge. It gives a dynamic dimension to the construction of knowledge through time, underlining the importance of ties established with a set of consumers and, particularly in the case of retailing, in a certain physically defined area.

By definition, internationalisation implies the application of some form of proprietary knowledge that was developed in a given context and was, at least to some extent "local" to a particular market. Adapting existing knowledge to a new market, and building up trust with local customers, can be a costly exercise.

Thus, successful internationalisation depends on:

- *the value of innovation advantages in new markets*. Innovation can be more or less significant, depending on the similarities of the consumer base, on the structure of incumbent firms, and so on, and on costs incurred to adapt to them
- *speed and ease to recreating trust in new markets*. Communicating to potential clients is costly and has a crucial time dimension. Besides, if the time needed to build up trust is long, returns on investment are deferred.

Innovation advantages can be judged only with respect to the target market. They are therefore relative. What is new in one market, say a retail format or a supply chain practice, might be well established in another. The nature of innovation available is therefore the main factor explaining the direction of internationalisation.

So what is the nature of innovation in retailing, and how does it help retailers enter foreign markets? (To avoid confusion, the term "product" is used here to indicate retail formulae offering consumers a different service, that is, a different way to obtain the goods they need. The term "goods" is used to indicate items sold in stores). In retailing, innovation advantages can be exploited in three ways:

- *product innovation*. Entirely new formats or formats with differentiated features which offer a better service to some consumer segment.
- *process innovation*. Reducing the cost of providing the service/retail format that in all other dimensions is the same as that offered by rivals. These savings can be used to lower prices or increase service levels while keeping prices in line with rivals. In retailing, it is useful to distinguish

Superior know-how is important. But adapting existing knowledge to a new market and building trust with local customers can be a costly exercise

capabilities that refer to physical distribution processes; organisational processes (in particular those involving personnel and staff motivation); marketing processes (promotion, communication, customer relations, loyalty cards); and sourcing processes

- *innovation concerning goods*. Exclusive products which offer an advantage over existing alternatives. This may involve goods sold under the name of the retailer or brands controlled by the retailer. Competencies and related competitive advantages may relate to production technologies; production costs; quality controls; knowledge of consumption patterns; and trends of innovation.

With respect to formats, there are three relevant positions which a retailer can occupy when entering a new market:

- an entirely new retail format, or one substantially differentiated in terms of the mix of services provided. This may involve different degrees of process innovation, but what matters is the novelty of the format for the target market
- an existing format, either with lower prices or improved service (trading up) due to process innovation, or to economies of scale and/or scope
- an existing format without price or service advantages. It is just another trading name with some marginal degree of differentiation.

Taking into account that it is possible to offer an assortment entirely or substantially made up of private labels in all these three cases, there are six possible positions (see Exhibit 1).

A. *New format and new goods*. This is the strongest position as the retailer introduces a new format with respect to incumbents and also provides an assortment of exclusive goods.

B. *Better and/or lower priced service with exclusive goods*. Incumbents already propose or have imitated the format and the advantage lies in higher effectiveness (better service at a comparable price) and/or efficiency (lower prices due to process innovation or economies of scale) and on exclusive goods.

C. *Similar format with exclusive goods*. This is the most crowded area as it applies to most specialists proposing private labels – the format is similar to existing specialised stores but goods are unique.

D. *New format with existing goods*. In this case private labels do not matter much. What matters is the novelty of the formula.

E. *Better and/or lower priced service with existing goods*. The strength of the company lies either in its efficiency and/or in its greater effectiveness.

F. *Same format, effectiveness, efficiency and goods*. There is no innovation or cost advantage.

The same company can find itself in

Exhibit 1: **Innovation of retail formats and goods and internationalisation positioning**

	New format	Existing format	
		Lower price/ better service	Same price and same service
Private labels	A New format and new goods	B Better and/or lower priced service with exclusive goods	C Existing format with exclusive goods
Existing goods	D New format with existing goods	E Better and/or lower priced service with existing goods	F Same format, effectiveness, efficiency and goods

different positions, depending on circumstances. When Aldi, the leading German food discounter, first entered foreign markets, it was in position A. But then it often found itself in position B, or even in position C (for example, when anticipated by Lidl, as happened in France).

Decathlon, a French retailer operating large stores specialising in sporting goods, started in position D, found itself increasingly in position E, and moved into position B with its policy of private labels. Many companies which started with significant advantages in foreign markets ended up in position F and then left.

So the position of the same firm changes through time in a given market and across markets.

Adaptation costs

Adaptation costs reduce the value of proprietary knowledge that a company wants to transfer from a market to another. The positions in Exhibit 1 and the advantages they are built on are all influenced by adaptation costs.

Adaptation costs relate both to knowledge and trust. Just what they are likely to be when a retailer enters a new market will depend on how localised its learning are, and on firm-specific traits.

Knowledge and the competitive advantages built on it are the result of a complex circular interaction between a firm and the market. But for convenience they can be considered as either external (say, related to the environment) and dependent on the time and place where resource-based advantages have been developed, or internal and firm-specific (organisation and culture).

Knowledge based on external factors

- *External resources on which the firm can draw.* Formats, processes and goods are all dependent on societal resources. For example, physical distribution processes are developed taking into account existing infrastructure, the existence of third parties involved in transport and storage, and standard practices among the participants in the supply chain. The cost of land can make certain formats not viable. Process innovation based on a given environment can be inapplicable or involve high adaptation costs.
- *"Rules of the game"*. Especially when the environment is "sticky" (unwritten rules and personal relationships are important to "move" within a market) this kind of knowledge can play a significant role (obtaining permission to open new stores, build up favourable public relationships, establish ties with financial institutions, regulatory authorities, and so on). By definition this knowledge is local and can be difficult to transfer into a new market. This means adaptation costs can vary significantly across potential target

A new entrant may enter a foreign market with significant competitive advantages. But such advantages can change quickly, or evaporate

markets, thereby influencing choices and entry strategies.

- *Public policy and regulations.* Innovation, both of formats and processes, can be a response to constraints imposed by public regulations. The effect can be positive, pushing firms to develop more advanced competencies (stricter environmental regulations could enhance research and lead to process innovation), for example. Or they can be negative, inhibiting the development of new formats, or limiting competition and reducing the need to innovate. Both effects can influence innovation paths taken by firms. The success of convenience stores tied to service stations in Germany is partly explained by store opening time regulations which, until 1997, were strict. Carrefour failed in its first attempt to enter Italy because it was not allowed to open hypermarkets.
- *Competitors.* With respect to all three dimensions of innovation, the competitive environment has strong effects. The existence of innovative companies, the degree of concentration and the extent to which economies of scale and scope can be exploited, plus the possibility of drawing from a well-established sectoral know-how all influence the path of development of retailing in different contexts.
- *Customer base.* Customers are by definition local, but some customer knowledge can be abstracted and applied to different contexts. For example, a retailer's ability to serve the needs of ethnic minorities in one market may reduce adaptation costs in a new market. Such customer knowledge can relate to the understanding of consumer preferences, buying patterns, and reactions to stimuli in the store (promotion, merchandising).

Knowledge based on internal factors

Many internal factors can help give a retailer a unique competitive advantage. Some of the main factors include:

- *Corporate governance.* Relationships between shareholders and management influence decision processes and management styles. For example, shareholder attitudes may affect the amount of resources devoted to foreign investments, the choice of target markets, and the speed and form of adaptation.
- *Organisational structure.* The degree of centralisation/decentralisation (say, in operating the store network) is a significant element of every retailer's organisational structure. In part, this depends on format. Hypermarkets need/allow for more decentralisation than supermarkets, for example. It's also, in part, a feature of firm culture. Either way it can become an important influence on adaptation costs.
- *Learning capabilities.* This is the most important and elusive type of knowledge. Companies learn how to enter new

Local regulations, different customer preferences, different competitors: the new entrant has to adapt to many different circumstances, all at the same time

markets from sometimes bitter experience. In the last 10 years companies such as Carrefour, Ahold and Ikea have entered some 20 countries around the world, giving them an opportunity to learn how to deal with external, environment challenges, read different customer bases, and so on. Such learning can significantly reduce adaptation costs.

The variety of possible situations and circumstances makes any generalisation difficult. Nevertheless, Exhibit 2 summarises the incidence of adaptation costs on innovation advantages based on products (formulae), processes and goods (private labels) depending on different types of competency.

With respect to formats, adaptation costs involve knowledge of consumers and competitors, public regulations and organisational structure. Adaptation costs concerning process innovation depend critically on external resources and consumers (marketing processes).

Competitive advantages based on exclusive goods involve adaptation costs particularly with respect to knowledge based on consumers and competitors. If local suppliers are needed, external resources may also involve adaptation costs. Fast learning reduces adaptation costs for all kinds of innovation.

Trust

Customer trust is based on the appreciation of a complex mix of attributes of the company's goods and services which contribute to its image and its relative position with respect to competitors.

Customers have to evaluate the relevant attributes and compare them with those of other retailers. Since the competitive context is new, the build up of trust may involve adaptation costs of different types:

- costs to facilitate consumers' evaluation
- costs to modify attributes due to the characteristics of incumbents' offer
- costs to modify attributes due to differences in customer perception of their relative importance.

In all these instances adaptation costs depend on the company's distinguishing traits, namely its brand attributes including:

- *price*. A retailer can be trusted for its low prices. This is probably the most common situation in retailing. A reputation for low price can be established easily and quickly. Evidence of this is the fast internationalisation of retailers offering discount formats in different sectors
- *service*. It is difficult to offer both the best service and the best prices at the same time. Better service tends to push prices up and a reputation based on service is more difficult to establish because it involves a complex evaluation of the retail mix. Creating such a reputation may

Exhibit 2: Types of knowledge, innovation and importance of adaptation costs

Knowledge	Type of innovation		
	Format	Processes	Goods
external resources	++	+++	+
"rules of the game"	+	++	+
public policy and regulations	+++	+	+
consumers	+++	+++	+++
competitors	+++	++	+++
corporate governance	+	+	+
organisational structure	++	+++	+
learning capabilities	(+++)	(+++)	(+++)

therefore take longer

- *assortment exclusivity*. Trust based on the positive evaluation of an assortment based entirely, or at least substantially, on a private label offering requires consumers not only to change stores but also to alter the goods they buy. Two instances of brand loyalty are involved. This approach is therefore likely to require higher communication costs and more time.

Adaptation costs in foreign markets

All the six positions in Exhibit 1 are influenced to different degrees by the adaptation costs outlined above. Innovation advantages which depend on external factors are particularly important in retailing. This becomes quite apparent as soon as we look at how retailing has evolved in different countries.

In the US, non-food discounting is key. In France, the hypermarket is central. In Germany, hard discount stores set the agenda. In the UK, superstores represent the main format.

Internationalisation of formulae and companies is now reducing these differences across countries. This makes it all the more important to evaluate different firms' competitive advantages and their likely adaptation costs when entering foreign markets.

When a new entrant introduces a completely new retail formula, the innovation is so significant that high adaptation costs are still worth incurring. But if local rivals have already established franchises with similar formats, the innovation advantage is reduced and adaptation costs may become crucial.

This situation applies to position D and, to some extent, also position A in Exhibit 1. On the one hand, convergence of market structures and consumption patterns are an advantage, since they reduce adaptation costs. On the other hand, innovation involved in internationalisation also is reduced as most formulae now exist everywhere. We can see the importance of adaptation costs by looking at retail history.

The failure of the hypermarket in the UK and the US (position D) can be explained by differences in consumer behaviour and in the structure of competition (well-established variety stores and non-food specialists).

To adapt the hypermarket would have required a radical transformation of the formula and loss of competitive advantages. It is not by chance that the US format most similar to the hypermarket, the supercentre, was developed by an incumbent – Wal-Mart.

The success of hypermarkets in Spain and Latin America was based on lack of competition and ready acceptance of the formula by consumers – adaptation costs proved to be low.

The success of Ikea in most countries

The more innovative the new entrant, the more able he is to sustain high adaptation costs. But as retailing internationalises, opportunities to innovate decline

(position A) has been based on low (sometimes very low) adaptation costs due to lack of similar formulae and assortments. The speed of consolidation was also helped by low prices, as they allowed Ikea to build trust and loyalty quickly and then extend this trust to both service and exclusive goods.

Position E is now the most common for investments across developed economies. It depends on process innovation and, especially if price advantages are not significant, on building trust based on better service. Apart from advantages based on economies of scale and scope, this is where learning capabilities play an important role. Better performance on some processes (marketing, organisation, and so on) may be easily counterbalanced by adaptation costs. What really matters is the ability to adapt quickly to different environments.

Position B – which is similar to E but with exclusive assortments – has an advantage in this respect. Differentiation is stronger though it may take time to build trust, thereby delaying returns on investment.

Marks & Spencer is a case in point. The formula the firm proposed when entering new markets was mature, its price advantage was not particularly significant, and its good-value-for-money position was difficult to communicate to customers outside the UK. Although it is probably in position B, many consumers in foreign countries might perceive it in position C. Given its mass-market orientation, this is a difficult position.

Across developed economies, position C is a favourable one for specialists, however. Convergence of consumption patterns and the use of low-cost entry modes made possible by small stores (such as franchising) allows players to enter markets with low adaptation costs. However, because this type of retailer serves a well-defined consumer segment, its growth prospects may be reduced.

In many ways, position C is similar to that of manufacturers entering foreign markets and having to establish their brands. It is not surprising that retailers which combine wide assortments with a strong reliance on private labels, as in the case of Marks & Spencer, find it difficult to create strong brands in new markets.

Position F is less and less tenable and is often the result of past investments, based on different environmental conditions. It is the position which leads to market exit.

Adaptation to new markets and feedback effects

Retail adaptation to new environments is a dynamic process (entry, consolidation, "nationalisation") that continues through time and involves feedback effects on the market of origin. There are therefore two

Some strategies need more time to generate critical mass than others. 'Lower price' is an immediate attraction. Building higher levels of trust takes longer

main questions to deal with:

- what is the path of adaptation that a firm may follow?
- what is the nature of the feedback mechanism to the market of origin?

The process of entry, consolidation and "nationalisation" can be described as a combination of direct and indirect adaptations. The firm responds to the new environment, adapting its stores to make them fit its target customer base.

However, at least to a certain extent, markets also adjust to new entrants. Ultimately, it is the customer who selects the store, and not the store which selects the customer, so the store could end up with a customer base very different from that of its domestic market.

Benetton might seem to be the same everywhere, for example. But its market positioning varies greatly from country to country. Sometimes it is middle-low, sometimes middle-high or even high in developing countries.

In the last stage of the adaptation process, when the firm becomes "national", it can find itself in four relevant positions depending on the degree of adjustment made on its format and on the reliance on adjustments made by customers (Exhibit 3).

- *Same format and same customer base.* Adjustments have been small – the format did fit the new environment and attracted the expected consumer segments. This is a truly global position.
- *Same format and different customer base.* The firm did not adapt the format and relied on a process of self-selection by the customer base, which ends up being different from the one in the original market. The firm is apparently global, but is in fact multinational.
- *Different format and same customer base.* The process of adapting the original format to the desired customer segment leads to substantial changes. The firm becomes multi-local.
- *Different format and different customer base.* Over time, the firm evolves in unforeseen ways and develops a different concept addressed to a new customer base. The subsidiary becomes more and more independent and the format less and less related to the original core.

There is no guarantee that the same retailer will find itself in the same position in all markets in which it operates. In markets which are similar to its origins, it is more likely to take a global position. But as it moves further away, it could end up in a multinational, multi-local or even a conglomerate position.

By adapting to new markets, firms can obtain new knowledge which can be used to improve efficiency/effectiveness in the domestic one, and, more generally, in all markets where they operate. If the firm has "learned to learn" it will be able to

Customers choose stores, stores don't choose customers. Thus, the new entrant may end up with a customer base very different from its home market

reduce adaptation costs and transform them into new knowledge, to benefit its overall activities.

Learning to learn is a central issue for the internationalisation of retailing, but so far we have scant evidence about these feedback mechanisms – they offer up a fruitful area for further research.

The above organising framework has focused on the resources of knowledge and trust that underlie innovation advantages for retailers entering new markets, and the adaptation costs they incur along the way.

The main conclusion which can be drawn from the framework is that the complexity of international positions of retail firms defies any simple definition or classification. There is not a retailer which can be said to be global or multinational. Or if there is, it is an exception.

The adaptation process in internationalisation has a tendency to create asymmetries both in time and place – positions held by the same firm can change significantly from market to market and through time.

As the firm's geographical coverage increases, the situation is likely to become ever-more complex. In retailing at least, the debate about what is global and what is not runs the risk of oversimplification.

Successful international retailers will be good at applying their competencies to new situations and reducing adaptation costs. They will also be able to use these experiences to feed their capability to innovate and become more efficient.

Within retailing today, that is probably still a rare combination.

Further reading

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Exhibit 3: Positions in a new market

		Supply: adaptation of the retail format	
		Low	High
Demand: customer self selection	High	1 Same format and different customer base multinational	2 Different format and different customer base conglomerate
	Low	3 Same format and same customer base global	4 Different format and same customer base multilocal