

How to build a global presence

Although the globalisation of the world economy has been going on for several decades, many major corporations have only recently embraced the challenge of building a global presence.

This is true not only for the majority of corporations in emerging economies but also for many large companies in the industrialised nations. For example, even industry leaders such as AT&T, Wal-Mart and Marriott have made serious efforts towards globalisation only since the late 1980s.

In fact, many established multinationals, such as Citicorp and Motorola are still in the early stages of building a presence in the major emerging markets of Asia, Latin America, eastern Europe and Africa. To build global presence in a way that minimises risk and maximises returns, a company must address the following four questions:

- Which product line or lines should be used as the launch vehicle for globalisation?
- Which markets should be entered first?
- What would be the optimal mode of market entry?
- How rapidly should the company expand globally?

This article provides guidelines to help firms make these decisions systematically and intelligently.

Choice of products

When any multi-product firm chooses to go abroad, it must ask itself whether it should globalise its entire portfolio simultaneously or use a subset of product lines as the launch vehicle.

It is often wiser to do the latter, given the fact that global expansion poses a high risk to any firm entering the world arena for the first time – simultaneously globalising the entire portfolio compounds this risk dramatically. The question then becomes which product line or lines to globalise initially. This choice should be driven by the twin goals of maximising returns and minimising risk. These requirements are illustrated by the case of Marriott hotels (see right).

Choice of markets

No firm can be regarded as truly global unless it is present in all strategic markets. But how does a firm decide which markets are strategically most important and when to enter these markets?

A market's strategic importance is determined by several factors, some having to do with "market potential" and some with "learning potential".

Market potential refers to both current market size and growth expectations for a particular line of business.

Learning potential is driven by two things: the presence of sophisticated and demanding customers for a product or service, who force the company to innovate continuously; and the pace at which technologies are evolving in that market.

The timing of a firm's entry into strategic markets depends on its ability to exploit them. This ability is a function of the height of entry barriers and the intensity of competition within a market.

Entry barriers are likely to be lowest in markets that are geographically, culturally and linguistically close to the domestic market and where no regulations constrain trade and investment.

But even when entry barriers are low, intense competition can hinder a company's potential for exploiting a market. For example, the large US market has historically proved to be a graveyard for foreign entrants in the retail industry precisely because of the intensity of local competition.

Figure 2, on page 11, presents a conceptual framework that companies can use as they consider which markets to enter – and when. It combines the two key dimensions of a market's strategic importance and a company's ability to exploit it.

A firm should enter rapidly those markets characterised by high strategic importance and high ability to exploit. By comparison, a firm can afford to be much more opportunistic and ad hoc with

Summary

Even for companies that we regard as long-standing multinationals the journey towards true globalisation is relatively new. In this article **Anil Gupta** and **Vijay Govindarajan** provide a checklist for building a global presence. They show how companies should address the key questions: which product to use as the launch vehicle for globalisation; which markets to enter first; what the best mode of market entry is; and how rapidly a company should expand globally.

Case study

Marriott

In the late 1980s, US hotels group Marriott Corporation was still essentially a domestic US company. It had two principal lines of business: lodging and contract services.

The lodging sector included four distinct product lines:

- Full-service hotels and resorts ("Marriott" brand)
- Mid-price hotels ("Courtyard")
- Budget price hotels ("Fairfield Inn")
- Long-term-stay hotels ("Residence Inn")

Contract services encompassed three product lines:

- Marriott Management Services
- Host/Travel Plazas
- Marriott Senior Living Services (retirement communities)

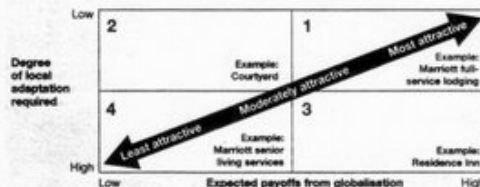
As the company embarked on globalisation, it had to confront the question of which product line (or lines) to start with.

Figure 1 presents a conceptual framework to identify those product lines that might be preferred candidates for early globalisation. As indicated there, each line of business in the company's portfolio should be evaluated along two dimensions – one pertaining to potential returns (expected pay-offs from globalisation) and the other pertaining to potential risk (degree of local adaptation required).

The first dimension focuses on the magnitude of globalisation's pay-offs. In Marriott's case it is clear that such pay-offs are potentially much larger for full-service lodging than for the retirement community business.

A framework for choosing products to globalise initially

Attractiveness of product lines as launch vehicles for globalisation



The primary customers of full-service lodging are globetrotting corporate executives. In such a business, worldwide presence can create significant value because a company can use a centralised reservation system, develop and diffuse globally consistent service concepts, and leverage a well-known brand name that assures customers of high quality and service. In contrast, none of these factors matters much in the retirement community business.

The second dimension in the framework refers to the extent to which different lines of business would require local adaptation in order to succeed in foreign markets. To what degree would new product and/or service features need to be developed locally as opposed to the cloning of proven and pre-existing concepts and capabilities?

Since any new development involves risk, the greater the degree of local adaptation required the greater is the risk of failure – particularly when such development is accompanied by the already significant "liability of foreignness".

For Marriott, the retirement community business requires more local adaptation than full-service lodging. Thus, full-service lodging offers the potential of both greater pay-offs and lesser risk, and emerges as an attractive vehicle for globalisation.

respect to those markets that have low strategic importance but that are easier to exploit.

In the case of markets with high strategic importance that are very difficult to exploit, we recommend a phased approach where market entry is preceded by the development of needed capabilities.

Such capabilities can be developed by first entering a *beachhead market* – that is, a market very similar to the targeted market and which provides a lower-risk opportunity to learn how to enter and succeed in the chosen market.

Some examples of beachhead markets often used by companies are Switzerland and/or Austria for Germany, Canada for the US, and Hong Kong and Taiwan for China. Finally, a firm should stay away from those markets that are neither strategic nor easy to exploit.

Mode of market entry

Once a company has selected the country or countries to enter and the product line(s) that will serve as the launch vehicle, it must determine the appropriate mode of entry.

This issue rests on two fundamental questions:

1 To what extent will the company rely on exports versus local production within the target market? Here the firm has a range of choices – from 100 per cent export of finished goods, through export of components but localised assembly, to 100 per cent local production.

2 To what extent will the company exercise ownership control over those activities to be performed locally in the target market? Again, it faces a range of choices, from 0 per cent ownership modes (such as, licensing or franchising), through partial ownership modes (such as joint ventures or affiliates), to 100 per cent ownership modes.

In answer to the first question, greater reliance on local production would be appropriate under the following four conditions:

- The local market is larger than the minimum efficient scale of production. The larger the local market, the more local production will translate into scale economies while holding down tariff and transportation costs. Japanese tyre group Bridgestone's entry into the US market by acquiring the local production base of Firestone instead of exporting tyres from Japan is an example.

- Shipping and tariff costs associated with exporting to the target market are so high that they neutralise any cost advantages of producing anywhere other than the target market. This is the main reason why cement companies such as Cemex and Lafarge Coppee engage heavily in local production in every country that they have entered.

- The need for local customisation of the product design is high. Product customisation requires both a deep understanding of local market needs and an ability to incorporate this understanding in the company's design and production decisions. Localisation of production in the target market significantly enhances a firm's ability to respond accurately and efficiently to local market needs.

- Local content requirements are strong. This is one of the major reasons why foreign auto companies rely heavily on local production in markets such as the European Union, China and India.

The second question relates to the extent of ownership control over locally performed activities.

Entering the market via an alliance permits a company to share the costs and risks associated with market entry and allows rapid access to local knowhow. But it also has the potential for various types of conflict. Alliance-based entries are often more appropriate under the following conditions:

- The company is short of capital. Such a lack drove Xerox Corporation's decision in the 1950s to enter the European market through an alliance

Which markets to enter and when

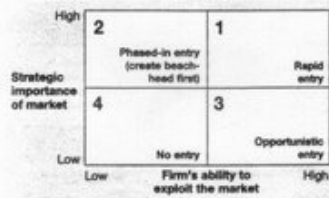


Figure 2

with the UK's Rank Organisation.

- **The physical, linguistic and cultural distance between the host and the home country is great.** The more dissimilar and unfamiliar the target market, the greater is the need for a firm to rely on a local partner to provide local knowhow and networks. Conceivably, it could obtain these assets through an acquisition. However, in highly unfamiliar markets, a firm's ability to manage an acquired subsidiary is often very limited.

- **The subsidiary would have low operational integration with the rest of the multinational operations.** Shared ownership of a local subsidiary puts major constraints on a firm's ability to reshape the subsidiary's goals or operations to fit with changing needs in the rest of its global network. The resulting lack of congruence is less of a liability where the subsidiary was not well integrated to begin with.

- **The risk of asymmetric learning by the partner is low.** In the typical joint venture, the two partners pool different but complementary knowhow and learn from each other as their core operations interact. In effect, the alliance is often a learning race. If one firm learns faster than the other it may sooner or later seek to dissolve the alliance with its still-disadvantaged former partner.

- **Government regulations require local equity participation.** Historically, several countries with very large market potential (such as China and Brazil) have been successful in imposing the joint venture option on foreign entrants even in those cases where all other considerations might have favoured the choice of complete ownership.

Speed of global expansion

Having begun the journey towards globalisation, a company must still address one final question: how fast should it expand globally?

Rapid globalisation enables a firm to grow aggressively but can also spread managerial, organisational and financial resources too thinly. This can jeopardise a company's ability to defend and profit from the global presence it has created.

Faster global expansion is more appropriate under the following conditions:

- **It is easy for competitors to replicate a firm's recipe for success.** This possibility is obvious for fast food and retailing companies such as Kentucky Fried Chicken and Starbuck's, where once the concept has been proved in one market competitors can easily replicate it in an occupied market with relatively low investment.

- **Scale economies are extremely important.** Very large economies of scale give the early and rapid globaliser massive first-mover advantages and handicap slower globalisers for long periods. This is why tyre manufacturers such as Goodyear, Michelin and Bridgestone that have globalised at a rapid rate now have considerable advantage over slower globalisers such as Pirelli and Continental.

- **Management's capacity to manage global operations is high.** For example, consider the case of experienced global companies such as Anglo-Dutch Unilever or Swedish-Swiss ABB. Should either of these companies successfully introduce a new product line in one country, it would be relatively easy and logical for it to globalise this line rapidly.



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Case study

Wal-Mart's meticulous strategy



Building global presence is never exclusively the result of a grand design. Nor is it just the outcome of a sequence of opportunistic and random moves.

The wisest approach, which might be called "directed opportunism", maintains opportunism and flexibility within a broad direction set by a systematic framework that addresses the four major issues discussed in this article: choice of products; choice of markets; mode of market entry; and speed of global expansion.

US retail chain Wal-Mart provides an excellent illustration of some of the key elements of this framework. Wal-Mart focused on the Americas and Asia for its initial foray into globalisation.

Mexico, the second most populous country in North America, was the first country Wal-Mart entered. Given the significant income and cultural differences between the US and Mexico and the fact that this was Wal-Mart's first globalisation move, the company realised that it had a lot to learn and so set up a 50-50 joint venture with a local Mexican retailer.

As Wal-Mart expanded further in Latin America it targeted the two next largest markets, Brazil and Argentina.

The entry into Brazil was also through a joint venture with a local partner. However, given the ability to leverage its learning from its Mexican experience, Wal-Mart chose to set up a 60-40 joint venture in which it had a controlling stake.

As the company's Latin American experience became more significant, it entered Argentina through a fully owned subsidiary.

Given the similarities in income and culture between the US and Canadian markets, Wal-Mart entered Canada through a straight 100 per cent acquisition.

Wal-Mart's moves into Asia also appear to be quite logical. It started by targeting three of the largest markets - Japan, China and Indonesia. However, because of the significant linguistic, cultural and geographic distance between the US and these markets, the company chose to rely very heavily on strategic alliances in all of these markets.

Finally, it is noteworthy that Wal-Mart used Hong Kong as a beach-head for subsequent entry into China.



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"Our control is now much greater and clearer."