CHAPTER 13
Country Evaluation and Selection

OBJECTIVES

After studying this chapter, you should be able to

1. Grasp company strategies for sequencing the penetration of countries
2. See how scanning techniques can help managers limit geographic alternatives and consider otherwise overlooked areas
3. Discern the major opportunity and risk variables to consider in deciding whether and where to expand abroad
4. Know the methods and problems of collecting and comparing international information
5. Understand some simplifying tools for helping decide where to operate
6. Consider how companies allocate emphasis among the countries where they operate
7. Comprehend why location decisions do not necessarily compare different countries' possibilities
8. Fathom the conditions that may cause prime business locations to change in the future

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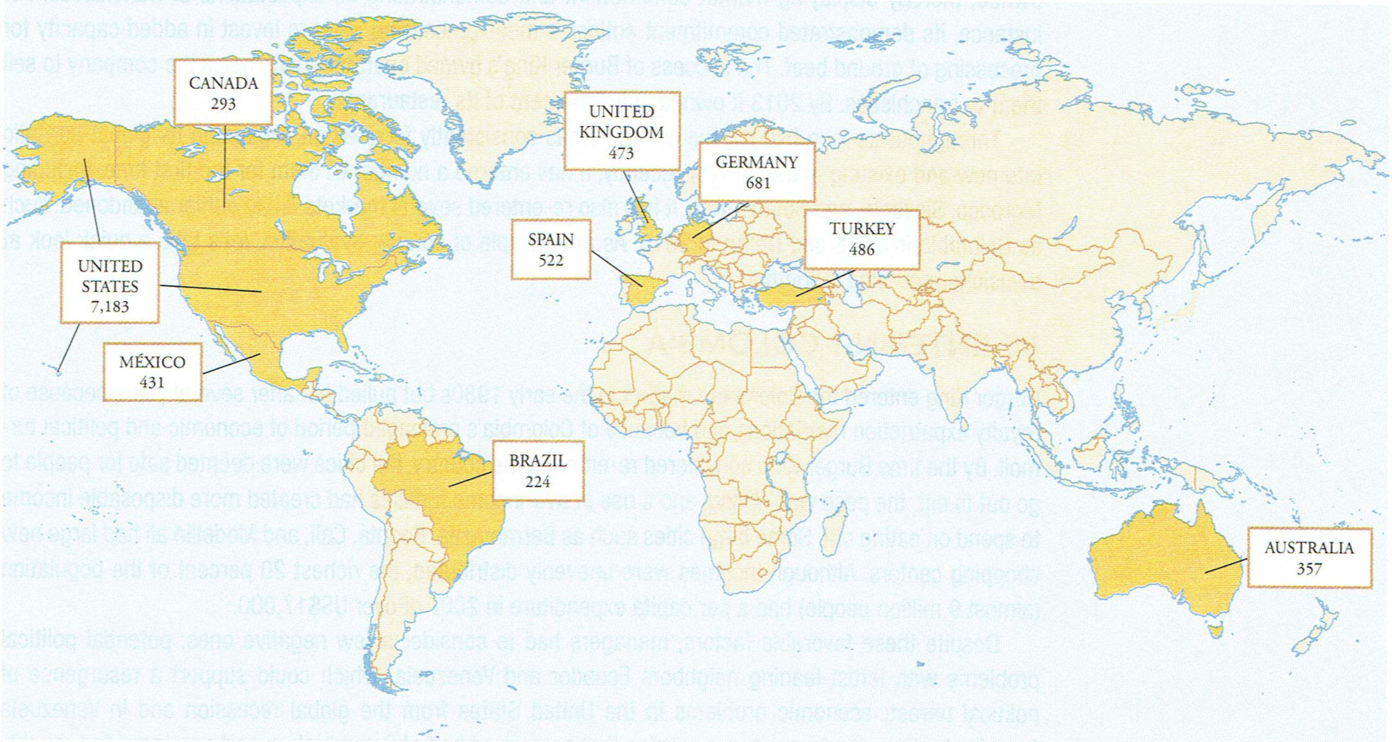
The place to get top speed out of a horse is not the place where you can get top speed out of a canoe.

—African (Hausa) proverb

Source: David Gee 4/Alamy

MAP 13.1 Burger King's Major Restaurant Locations by Country

Although Burger King had restaurants in 84 countries plus two U.S. territories at the start of 2013, 85 percent of those restaurants were located in only nine countries. These nine countries, along with the number of restaurants, are shown on the map. (In Australia, the restaurants use the Jack in the Box name rather than the Burger King name.)



country or group of countries by pairing a private equity firm with an experienced restaurant operator in a joint venture (JV). In some cases, Burger King has become the third party in the JV without committing capital to it.

Overall, Burger King has expanded abroad later than its primary rival, McDonald's, resulting in both advantages and disadvantages. On the one hand, later entry is a drawback in very small markets due to an inadequate number of suppliers, such as only one slaughterhouse whose owners may be unwilling to work with more than one customer. On the other hand, a late entry in larger markets may benefit from the product demand and supply infrastructure created by earlier entrants. In some later-entry markets, Burger King has been able to concentrate almost entirely on emphasizing its product (*HAVE IT YOUR WAY®*, good taste of flame-broiled burgers) without incurring early development costs. For instance, in Latin America and the Caribbean, McDonald's and Burger King compete in almost all countries and territories, with Burger King currently leading in the number of restaurants in about half of those markets.

Keep in mind that local firms also learn from the successes of foreign fast-food companies, sometimes altering their menus and flavorings to appeal to local tastes. Some notable examples are Bembos in Peru, Mr. Bigg's in Nigeria, Pollo Campero in Guatemala, and Quick in Belgium.

The Latin America and Caribbean group has many countries with very small populations, such as the Cayman Islands, Aruba, and Saint Lucia. So why did Burger King develop a presence in these markets long before entering places with much bigger populations, such as China, Russia, and South Africa? The answer is largely due to location—it remains headquartered in Miami, which is often called "the capital of Latin America." Because so many people from that region come to or through Miami, the Burger King reputation spilled over there early on, which simplified gaining brand recognition and acceptance. Further, the nearness of the Latin American and Caribbean countries to Miami enhances the ability of Burger King managers to visit these countries and for franchisees to visit headquarters.

In China, Burger King encountered laws requiring that it either form a joint venture with a Chinese firm or own and operate two or more stores for at least a year before starting franchise operations. The company chose the latter alternative, which delayed its start of franchising. Later, finding potential franchisees with sufficient financial and restaurant capabilities was difficult, particularly since the franchise concept was rather new to China. (Some of its competitors, mainly Yum Brands and McDonald's, made joint venture investments and expanded with owned stores.) In 2012 Burger King announced the formation of a three-partner JV to serve the Chinese market. One partner, the Carpesian Capital Group, is a global private equity company specializing in developing country investments. The other is the Korduglu family from Turkey, which is Burger King's largest franchisee outside the United States. Its plan is to open 1,000 restaurants in China within five to seven years.

In 2010 Burger King opened its first restaurants in Russia, a country it has found attractive not only because of the population and growth factors affecting all BRICs but also because it can serve as a contiguous area for further expansion into Eastern Europe. Indeed, Burger King's 2011 entry into Slovenia has benefitted from supply integration with the Russian operation. In addition, concluding that finding the right franchisee was essential for the Russian market, Burger King's managers spent over a year getting to know the eventual franchisee, Alex Kolobov, who owns Shokolanitsa, a chain of about 200 Russian coffee shops. Although the formation of the franchise known as Burger Rus has resulted in growth in Moscow and St. Petersburg, more capital has been necessary to expand outside those cities. In 2013 Burger King announced the formation of a joint venture between Burger Rus and Russia's VTB Capital in order to open several hundred new restaurants in the country within the next few years.

India is the one BRIC country Burger King has not yet entered. However, 2013 reports indicate the company is in discussions with Everstone Capital, which is both a private equity firm and the holder of controlling interest in India's largest restaurant group.

THE FUTURE

Recent experience indicates that Burger King's locational emphasis can affect its performance considerably. For the first quarter of 2011, same-store sales fell 6 percent in North America. However, the drop was largely offset by gains in the rest of the world, so the global decline was only 3.6 percent. During 2012, Wendy's overtook Burger King as the second largest burger chain in the United States. To counter this loss of position, Burger King has been augmenting its menu with new items, changing its advertising focus, and getting franchisees to modernize their stores. At the same time, as the case indicates, the company is planning unprecedented international expansion. In fact, some of its competitors have expanded abroad much more than Burger King, which may indicate that it has untapped potential. This raises a number of questions for management regarding location priorities: Should primary emphasis be on bolstering its domestic presence or on expanding internationally? If the former, should the company concentrate on adding more restaurants or on boosting sales within existing ones? If the latter, should it concentrate on entering new markets? (It is presently in only about 40 percent of countries.) If so, which look most promising? Or should it concentrate on sales within existing markets? Are there markets in which Burger King is under-performing? Should it work on bolstering that performance? Or should it pull out of those markets to use its resources more effectively elsewhere? These are all location questions that dog managers in any company with international operations. ■

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Case Review Note

QUESTIONS

13-1. Discuss the risks that an international restaurant company such as Burger King would have by operating abroad rather than just domestically.

13-2. How has the Burger King headquarters location influenced its international expansion? Has this location strengthened or weakened its global competitive position?

In choosing geographic sites, a company must decide

- Where to sell.
- Where to produce.

To answer those questions, managers need to answer two more: Which markets should we serve? And where should we place production to serve them? On one hand, the answers can be the same, particularly if transport costs or government regulations mean producing in the countries where you sell. Many service industries, such as restaurants, construction, and retailing (like Burger King), must locate facilities near their foreign customers.

On the other hand, large-scale production technology may favor producing in only a few countries and exporting to others, such as with companies in the capital-intensive automobile and steel industries. Finally, location decisions may be more complex, such as using multiple countries for sourcing raw materials and components that go into one finished product. Or a company may divide operating functions—locate headquarters in the United States, a call center for handling service in the Philippines, an R&D facility in Switzerland, and so on.

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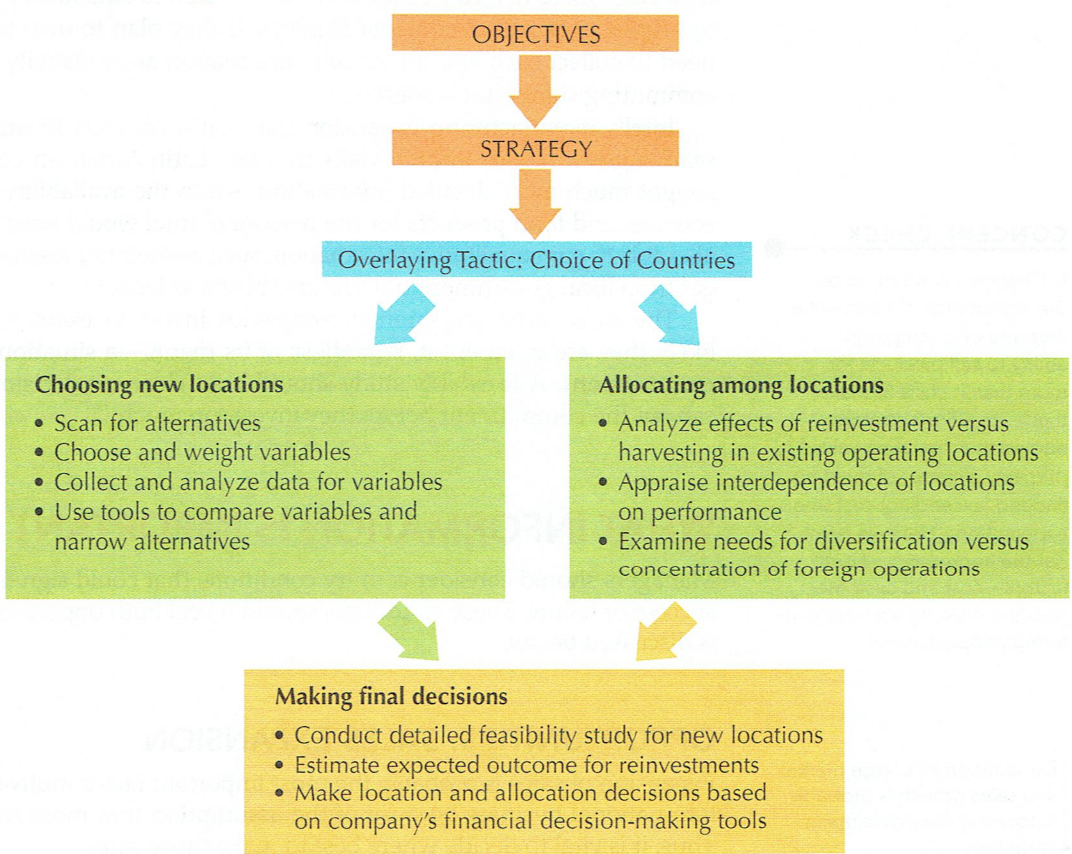
Flexibility in locations is important because country and competitive conditions change. A company needs to respond to new opportunities and withdraw from less profitable ones. Recall in the opening case that Burger King withdrew from Colombia because of prolonged economic and political problems along with difficulty in remitting earnings from royalties. There is no one-size-fits-all theory for picking operating locations because product lines, competitive positions, resources, and strategies make each company unique—a situation that, in turn, will be better realized in some countries than in others.[5] Moreover, hiring the right people to analyze country differences and implement company operations is critical. Highly skilled managers can sometimes compensate for location deficiencies, and poor managers can sometimes cause poor performance in the best locations. However, having skilled managers in the most appropriate locations is the best possible combination. Figure 13.2 shows the major steps international business managers should take in making location decisions. The following discussion examines those steps in depth.

FIGURE 13.2 The Location Decision Process

Location, location, location: Committing resources to a foreign location may entail risky trade-offs—say, forgoing or abandoning projects elsewhere. The decision-making process is essentially twofold: examining the external environments of proposed locations and comparing each of them with the company's objectives and capabilities.



Of course, managers would like to have sales figures for the type of product they want to sell, but such information may not be available, especially if the product is a new one. In such instances, they could make rough estimates of sales potential by basing projections on what has happened to sales for a similar or complementary product. For instance, they might project the potential sales of flat-screen televisions based on figures for DVD equipment sales. If complementary figures are unavailable, management can use economic and demographic data to project sales potential.

Of course, you should examine indicators related directly to your products. If you're trying to sell, say, luxury products, GDP per capita may tell you very little. Instead, you need to know how many people have income above a certain level. Take India: Its GDP per capita is low, but it has enough millionaires to support the sale of high-end luxury products.

Moreover, although your product or service may not appeal to the average customer, you may seek out niches within that market. Pollo Campero, a Guatemalan-based fast-food chain, and Gigante, a Mexican supermarket chain, have both entered the United States by going to cities with large Central American and Mexican populations.[7]

Companies must consider variables other than income and population when estimating potential demand for their products in different countries.

Examining Economic and Demographic Variables Primary considerations when examining economic and demographic variables are listed below, with some examples:

- *Obsolescence and leapfrogging of products.* Consumers in developing economies do not necessarily follow the same patterns as those in higher-income countries. In China, consumers have leapfrogged the use of landline telephones by going from having no phones to using cell phones almost exclusively.[8]
- *Prices.* If prices of essential products are high, consumers may spend more on them than what would be expected based on per capita GDP and thus have less to spend on discretionary purchases. The expenditures on food in Japan are higher than would be predicted by either population or income level because food is expensive and work habits promote eating out.
- *Income elasticity.* A common tool for predicting total market potential is to divide the percentage of change in product demand by the percentage of change in income in a given country. The more demand shifts in relation to income changes, the more elastic it is. Demand for necessities such as food is usually less elastic than for discretionary products such as flat-screen TVs.
- *Substitution.* Consumers in a given country may more conveniently substitute certain products or services than those in other countries. There are fewer automobiles in Hong Kong than one would expect based on income and population because the crowded conditions make the efficient mass transit system a desirable substitute for automobiles. Gasoline- and diesel-powered cars are also substitutes. Indian demand for the former fell and the latter increased when government regulations led to high fuel-cost disparities, thus forcing companies such as Suzuki, Toyota, and General Motors to alter their mix of vehicle production.[9]
- *Income inequality.* Where income inequality is high, the per capita GDP figures are less meaningful. Many people have little to spend, while many others have substantial spending money, as noted by Mercedes-Benz sales in India.[10]
- *Cultural factors and taste.* Countries with similar per capita GDPs may have different preferences for products and services because of values or tastes. The same is true for consumer sub-segments within countries. The existence of a large Hindu population in India reduces per capita meat consumption there as compared with some countries with similar per capita GDPs, yet there is a large niche market of Indians who are neither Hindu nor vegetarian.

conditions that can cause changes in labor availability and cost. For example, the HIV rate is very high in southern African countries, a problem that may drastically reduce their future labor forces.

When companies move into developing countries because of labor-cost differences, their advantages may be short-lived for one or more of three reasons:

- Competitors follow leaders into low-wage areas.
- There is little first-mover advantage for this type of production migration.
- The costs rise quickly as a result of pressure on wage or exchange rates.

Infrastructure problems add to operating costs.

Infrastructure Poor internal infrastructure may easily negate cost differences in labor rates. In many developing countries, infrastructure is both substandard and unreliable, which adds to companies' costs of operating. Consider Cadbury in Nigeria. Its workers spend extra hours getting to and from work on congested roads, which decreases their productivity. It uses its own power generators at two and a half times the cost of the unreliable publicly provided power to prevent assembly line stoppages that could cause food products to spoil. Because phone reception is often unreliable, Cadbury must send people out to visit customers and suppliers. When goods are ready for delivery, they must again face the slow roads and congestion.[16] (The adjacent photo shows a congested street in Mexico.)

The need to coordinate product, process, production, and sales influences location decisions.

Ease of Transportation and Communications Related to infrastructure is the advantage of locating near customers and suppliers. However, firms with rapidly evolving technologies need to tightly coordinate product and production technologies to speed new products' introduction and diminish competitors' opportunity to copy them.[17] This tends to push more production into developed countries, where such firms conduct most of their R&D.

Other factors also affect the efficient flow of goods. One is distance, which roughly correlates with time and cost of shipments; thus, a geographically isolated country like New

Although Mexico City has an extensive metro system along with some double-decker expressways, it remains one of the world's most congested cities, as the photo shows. Such congestion delays shipments and raises the cost of distribution.
Source: Paul Franklin/dkimages

RISKS

Any company decision involves weighing opportunity against risk. For example, a sales-seeking company may not necessarily go to the country showing the highest sales potential. Nor will an asset-seeking company necessarily go where the assets are cheapest. In both cases, this is because decision makers may perceive that the risks in those locales are too high.

Factors to Consider in Analyzing Risk Keep in mind several factors as we discuss specific types of risk:

1. *Companies and their managers differ in their perceptions of what is risky,* how tolerant they are of taking risk, the returns they expect, and the portion of their assets they are willing to put at risk.[28]
2. *One company's risk may be another's opportunity.* For example, companies offering security solutions (e.g., alarm systems, guard services, insurance, weapons) may find their biggest sales opportunities where other companies find only operating risks. (This is shown humorously in Figure 13.3.)
3. *Companies may reduce their risks by means other than avoiding locations,* such as by insuring. But all these options incur costs that decision makers should take into account.
4. *There are trade-offs among risks.* Avoiding a country where, say, political risk is high may leave a company more vulnerable to competitive risk if another one earns good profits there. And returns are usually higher where risk is higher.

Besides considering the individual nature of risk assessment, companies should consider several important factors, grouped into three categories: political, foreign exchange, and competitive. It is important to examine risks throughout complex supply chains because your suppliers, although located in low-risk countries, may depend, in turn, on suppliers in high-risk countries, who in turn depend on suppliers elsewhere.[29]

FIGURE 13.3 One company's risk may be an opportunity for another.

Source: Mick Stevens/New Yorker Cartoon Bank/www.cartoonbank.com

"Don't think of them as terrorist states. Think of them as terrorist markets."

companies, which could lead to boycotts or rule changes for MNEs or even expropriation of their properties. However, there is no general consensus as to what constitutes dangerous conditions or how such instability can be predicted. The lack of consensus is illustrated by the diverse reactions of companies to the same political situations.

Rather than political stability itself, the direction of governmental change seems to be very important. But even if a company accurately predicts changes that will affect business, how long the government will take to enact new practices is still uncertain.

CONCEPT CHECK

As we explain in Chapter 8, an exchange rate is the price of a currency; in Chapter 9, we discuss some of the causes of exchange-rate changes (including interest rates and those in floating rate regimes) and explain various methods of forecasting exchange-rate movements (such as focusing on trends in economic variables or trends in the rates themselves).

Companies may accept a lower return in order to move their financial resources more easily.

Foreign Exchange Risk Changes in exchange rates or the ability to move funds out of a country may also affect an MNE. Let's examine these two types of risks.

Exchange-Rate Changes The change in foreign currency value is a two-edged sword, depending on whether you are going abroad to seek sales or resources. Let's say a U.S. company is doing business in India. If it is exporting to India, then a deterioration in the value of the Indian rupee will make it less competitive because it will cost more rupees to buy the U.S. products or services. If it is producing within India to serve the Indian market, its competitiveness in India will not change, but its rupee profits will buy fewer U.S. dollars to bring back to the United States. If, however, it is seeking assets from India, such as Indian personnel to staff a call center, a fall in the rupee value lowers the dollar cost of the personnel.

Mobility of Funds If a company is to invest abroad, then the ability to get funds out of the country is a factor in country comparison. A theory that helps explain this is **liquidity preference,** which is much like option theory in that it relates to investors' desire for some of their holdings to be in highly liquid assets on which they are willing to take a lower return. They need liquidity to make near-term payments, such as paying out dividends; to cover unexpected contingencies, such as stockpiling materials if a strike threatens supply; and to be able to shift funds to even more profitable opportunities, such as purchasing materials at a discount during a temporary price depression.[31]

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The comparative liquidity among countries varies because of capital market activity and government exchange control. An active capital market, particularly a stock market, helps a company sell its assets, especially if it wishes to sell shares on a local exchange or sell the entire operation. In the opening case, Burger King moved from being privately held to being publicly held, which was facilitated by its U.S. location with a huge capital market. Thus, when comparing countries you may wish to include the existence of an active stock market as a favorable variable.

If the government restricts the conversion of funds (several countries have various degrees of exchange control), the foreign investor will be forced to spend some profits or proceeds from share sale in the host country. Thus, it's not surprising that, if other things are equal, investors prefer projects in strong-currency countries with little likelihood of exchange controls.

Competitive Risk The comparison of likely success among countries is largely contingent on competitors' actions. We now examine four competitive factors to be considered in choice of location: *making operations compatible, spreading risk, following competitors or customers,* and *heading off competitors.*

Companies are highly attracted to countries that

- Are located nearby.
- Share the same language.
- Have conditions similar to those in their home countries.

Making Operations Compatible Because companies operating abroad encounter less-familiar environments, they have more or different operating risks than local firms. Thus, managers initially prefer to operate where they perceive conditions to be more similar to their home country—provided, of course, that the location also offers sufficient opportunities in terms of sales or resource acquisition.[32] (The major types of attributes of similarity versus dissimilarity are shown in Table 13.1.) As they gain experience, they improve their assessments of consumer, competitor, and government actions, thereby reducing their uncertainty. In fact, MNEs have a lower survival rate than local companies for many years after they begin operations—a situation known as the **liability of foreignness.** However, those that learn about their new environments and manage to overcome their early problems eventually have

TABLE 13.1 The Distance Sensitivity of Industries: Indicators

Cultural Distance	Administrative Distance	Geographic Distance	Economic Distance
High linguistic content	Government involved in funding, procurement, regulating standard-setting, before international bodies, etc.	Low value-to-weight or bulk	High intensity of labor, other factors prone to absolute cost differences
Strong country of origin effects (vertical distance)	Strategic industry status (votes, money, staples, state control, national champions)	Hazards in transportation	Potential for international scale/scope/experience economies
Significant differences in preferences/standards (horizontal distance)	Specialized, durable sunk capital (and holdup potential)	Perishability/time-sensitivity	High income-related increases in willingness-to-pay
Entrenched tastes/traditions	Restraints on trade/FDI (e.g., agriculture)	Need to perform key activities locally (favors FDI over trade)	Differences in customers/channels/business systems

Source: Based on Pankaj Ghemawat, *World 3.0: World Prosperity and How to Achieve It*, (Boston: Harvard Business Review Press, 2011): 299, which is based on his earlier framework in "Distance Still Matters: The Hard Reality of Global Expansion," *Harvard Business Review*, 79:8 (September 2001): 140.

CONCEPT CHECK

Recall from Chapter 5 that a factor helping to explain trade patterns—why a country trades more with certain countries than with others—is the historical relationship between them, especially continued trade between a former colonizer with its former colonies.

In addition, historical ties between pairs of countries help explain companies' geographic preferences for foreign operations.[42] While many of these ties relate to common culture and ethnicity, others have a history of positive exchanges that reduce the perception of operating risk for companies in home countries and for stakeholders in host countries.

You should also try to ensure that a country's policies and norms are compatible with your company's competitive advantages. Blockbuster failed in Germany because the laws prevented it from operating on evenings, Sundays, and holidays—popular times in the United States and for last-minute impulse decisions to rent videos anywhere.[43]

Companies may also prefer locales that will permit them to operate with product types, plant sizes, and operating practices familiar to their managers. When examining locales, teams that include personnel with backgrounds in each functional area—marketing, finance, human resources, engineering, and production—will more likely uncover the best fits with their companies' resources and objectives.

Finally, companies should consider local availability of resources in relation to their needs. Many foreign operations require local resources, which may severely restrict the feasibility of given locales. A company may need to find local personnel or a viable local partner with an understanding of its type of business and technology. Or it may need to add local capital to what it is willing to bring in.

Geographic Diversification By operating in diverse localities, companies may be able to smooth their sales and profits, which, in turn, gains them a competitive advantage in raising funds.[44] They may further guard against the effects of currency value changes by locating in countries whose exchange rates are not closely correlated with each other.[45] Such a strategy is in many ways opposite to what we just discussed about preferring countries similar to the home country. This is because the best smoothing of sales and profits will likely occur from operating in economies that are the least correlated; however, the downside is that operating in these dissimilar economies may give rise to greater competitive risk because management is less familiar with operating conditions.

Given growing product complexity, companies cannot easily find all needed resources within a single country, especially those based on knowledge. At the same time, such resources are very country-specific because of long-term specialization. Although knowledge flows internationally and from one organization to another, MNEs enhance their access to it by having foreign subsidiaries in source countries. Because pieces of the knowledge emanate from different places, companies need multiple access points to gain a speedy

By being first into a market, a firm may more easily gain the best partners, best locations, and best suppliers—a strategy to gain **first-mover advantage.** Another first-mover advantage is the potential of gaining strong relations with the government, such as Volkswagen in China and Lockheed with Russia.[50]

Companies may also develop location strategies to avoid significant competition. PriceSmart, a discount operator, has all its warehouse stores outside its home country (the United States) and has succeeded by targeting locations in Central America, the Caribbean, and Asia that are considered too small to attract early entry of warehouse stores from competitors like Walmart and Carrefour.[51]

COLLECTING AND ANALYZING DATA

Information is needed at all levels of control.

- Companies should compare the cost of information with its value.

Companies undertake business research to reduce outcome uncertainties from their decisions and to assess their operating performance. The research includes finding answers to questions such as: Can we hire qualified personnel? Will the economic and political climate allow us to reasonably foresee our future? Are our distributors servicing sufficient accounts? What is our market share?

Clearly, information helps managers improve corporate performance. However, they can seldom get all the information they want, due to time and cost constraints. So managers should compare the estimated costs of information with the probable payoff it will generate in revenue gains or cost savings.

SOME PROBLEMS WITH RESEARCH RESULTS AND DATA

Because of the lack, obsolescence, and inaccuracy of data on many countries, research can be difficult and expensive to undertake. Such problems are most acute in developing countries. Let's discuss the two basic problems: inaccuracy and non-comparability.

Information inaccuracies result from

- Difficulty in collecting and analyzing data.
- Purposefully misleading data.
- Exclusion of nonmarket and illegal activity.

Inaccuracy For the most part, we can list five basic reasons why reported information may be inaccurate:

1. *Governmental resources may limit accurate data collection.* Countries may have such limited resources that other projects necessarily receive budget priority, such as spending to improve health and literacy rather than to measure them. Even if governments emphasize data collection, funds may be short for buying the latest computer hardware, software, and training programs. The result may be gaps in reliable and timely information.
2. *Governments may purposely publish misleading information.* Of equal concern to researchers is the publication of false or purposely deceptive information designed to mislead government superiors, the country's rank and file, or companies and institutions abroad. For instance, the European Commission rebuked Greece in 2010 for falsifying public finance data.[52]
3. *Respondents may give false information to data collectors.* Mistrust of how the data will be used may lead respondents to answer questions incorrectly, particularly if they probe financial details or anything else that respondents may consider private. For example, many government figures are collected through questionnaires, such as those in the United States to estimate international travel and tourism expenditures. People may misstate their actual expenditures, particularly if they did not report the true value of foreign purchases on incoming customs forms.
4. *Official data may include only legal and reported market activities.* Further distortions may occur because nationally reported income figures don't include illegal income from such activities as the drug trade, theft, bribery, and prostitution. Such income may appear in other economic sectors because of money laundering. Contraband figures do not appear

Government Agencies When a government wants to stimulate foreign business activity, the amount and type of information it makes available may be substantial. The U.S. Department of Commerce compiles news and regulations about individual foreign countries, disseminates specific information on product sales locations in the National Trade Data Bank, and can also help set up appointments with businesspeople abroad.

International Organizations and Agencies Numerous organizations and agencies are supported by more than one country, including the UN, the WTO, the IMF, the OECD, and the EU. All of them have large research staffs that compile basic statistics and prepare reports and recommendations concerning common trends and problems. Many international development banks even help finance investment-feasibility studies.

Trade Associations Trade associations connected to various product lines collect, evaluate, and disseminate a wide variety of data dealing with technical and competitive factors in their industries. Many of these data are available in the trade journals published by such associations; others may or may not be available to nonmembers.

INTERNALLY GENERATED DATA

MNEs may have to collect much information themselves, sometimes simply by observing keenly and asking many questions. Investigators can see what kind of merchandise is available, determine who is buying and where, and uncover the hidden distribution points and competition. Hidden competition for ready-made clothing may be seamstresses working in private homes; for vacuum cleaners, it may be servants who clean with mops. Surreptitiously sold contraband may compete with locally produced goods. Traditional analysis methods would not reveal such facts.

Companies already operating within a market offer another source of information. Limited Brands has used this source, such as meeting with Apple's management in China, to ascertain experiences encountered during entry.[55]

COUNTRY COMPARISON TOOLS

Once companies scan for information, they need to analyze it. Two common tools for this are *grids* and *matrices*. In preparing either, it is useful to have a team made up of people from different functions so that various perspectives are considered. However, once companies commit to locations, they need continuous updates.

Point

Should Companies Operate in and Send Employees to Violent Areas?

Point **Yes** Where there's risk, there are usually rewards. Companies should not shun areas with violence. Businesspeople have always taken risks, and employees have always gone to dangerous areas. As far back as the seventeenth century, immigrants to what are now the United States, India, and Australia encountered disease and hostile native populations. Had companies and immigrants not taken chances, the world would be far less developed today.

You can't look at the risk from violence apart from others. Although we don't have historical data, most situations are probably safer today. Disease is still a bigger danger than violence, but medical advances against a number of historical killers (polio, measles, smallpox, tuberculosis, etc.)

GRIDS

Grids are tools that
- May depict acceptable or unacceptable conditions.
- Rank countries by important variables.

Managers may use a grid to compare countries on whatever factors they deem important. Table 13.2 is an example of a grid with information placed into three categories. The managers may immediately eliminate certain countries from consideration because of characteristics they find unacceptable (companies vary in this). These factors are in the first category of variables, by which Country I is eliminated. The managers assign values and weights to other variables so that they rank each country according to attributes of relative importance to the company. In this hypothetical example, we've attached more weight to the size of investment needed than to the tax rate. For instance, the table graphically pinpoints Country II as high return–low risk, Country III as low return–low risk, Country IV as high return–high risk, and Country V as low return–high risk.

Both the variables and the weights differ by product and company depending on the company's internal situation and its objectives. For instance, managers in a company selling a low-priced consumer product might weigh population size heavily as an indicator of market opportunity, whereas those in a company selling tires might weigh heavily the number of vehicles registered. The grid technique is useful even when a company does not compare countries because it can set the minimum score needed for either investing additional resources or committing more funds to a more detailed feasibility study.

Grids do tend to get cumbersome, however, as the number of variables increases. Although they are useful in ranking countries, they often obscure interrelationships among them.

TABLE 13.2 Simplified Market-Penetration Grid

This table is simply an example: In the real world, a company chooses the variables that it regards as most important and may weight some as more important than others. Here managers rate Country II the most attractive because it's regarded as high return–low risk. Country IV also promises a high return and Country III low risk. Note that Country I is eliminated immediately because the company will go only where 100 percent ownership is permitted.

Variable	Weight	Country I	II	III	IV	V
1. Acceptable (A), Unacceptable (U) factors						
a. Allows 100 percent ownership	—	U	A	A	A	A
b. Allows licensing to majority-owned subsidiary	—	A	A	A	A	A
2. Return (higher number = preferred rating)						
a. Size of investment needed	0–5	—	4	3	3	3
b. Direct costs	0–3	—	3	1	2	2
c. Tax rate	0–2	—	2	1	2	2
d. Market size, present	0–4	—	3	2	4	1
e. Market size, 3–10 years	0–3	—	2	1	3	1
f. Market share, immediate potential, 0–2 years	0–2	—	2	1	2	1
g. Market share, 3–10 years	0–2	—	2	1	2	0
Total			18	10	18	10
3. Risk (lower number = preferred rating)						
a. Market loss, 3–10 years (if no present penetration)	0–4	—	2	1	3	2
b. Exchange problems	0–3	—	0	0	3	3
c. Political-unrest potential	0–3	—	0	1	2	3
d. Business laws, present	0–4	—	1	0	4	3
e. Business laws, 3–10 years	0–2	—	0	1	2	2
Total			3	3	14	13

ALTERNATIVE GRADUAL COMMITMENTS

Companies may reduce risks from the liability of foreignness by

- Going first to countries with characteristics similar to those of their home countries.
- Having experienced intermediaries handle operations for them.
- Operating in formats requiring commitment of fewer resources abroad.
- Moving initially to one or a few, rather than many, foreign countries.

As we've discussed, because of liability of foreignness, companies favor operations in areas similar to their home countries. Nevertheless, there are alternative means of risk-minimization expansion patterns they can undertake, as shown in Figure 13.5. As you examine this figure, note that the farther a company moves from the center on any axis, the deeper its international commitment becomes.

However, a company does not necessarily move at the same speed along each axis. In fact, it may jump over some of the steps. A slow movement along one axis may free up resources that allow faster expansion along another.

Let's examine Figure 13.5 more closely. Axis A shows that companies tend to move gradually from a purely domestic focus to one that encompasses operations in countries similar and then dissimilar to one's own country. However, an alternative when moving quickly along the A axis (and even jumping the intermediate step) is to move slowly along the B axis. The B axis shows that a company may use intermediaries to handle foreign operations during early stages of international expansion because this minimizes the resources it puts at risk and its liability of foreignness. It can then commit fewer resources to both international endeavors, relying instead on the intermediaries that already know how to operate in the foreign market. A related example is the foreign expansion of some high-tech companies from developing countries. Rather than first targeting nearby countries with characteristics similar

FIGURE 13.5 The Usual Pattern of Internationalization

The farther a company moves outward along any of the axes (A, B, C, D), the deeper its international commitment. Most companies move at different speeds along different axes.

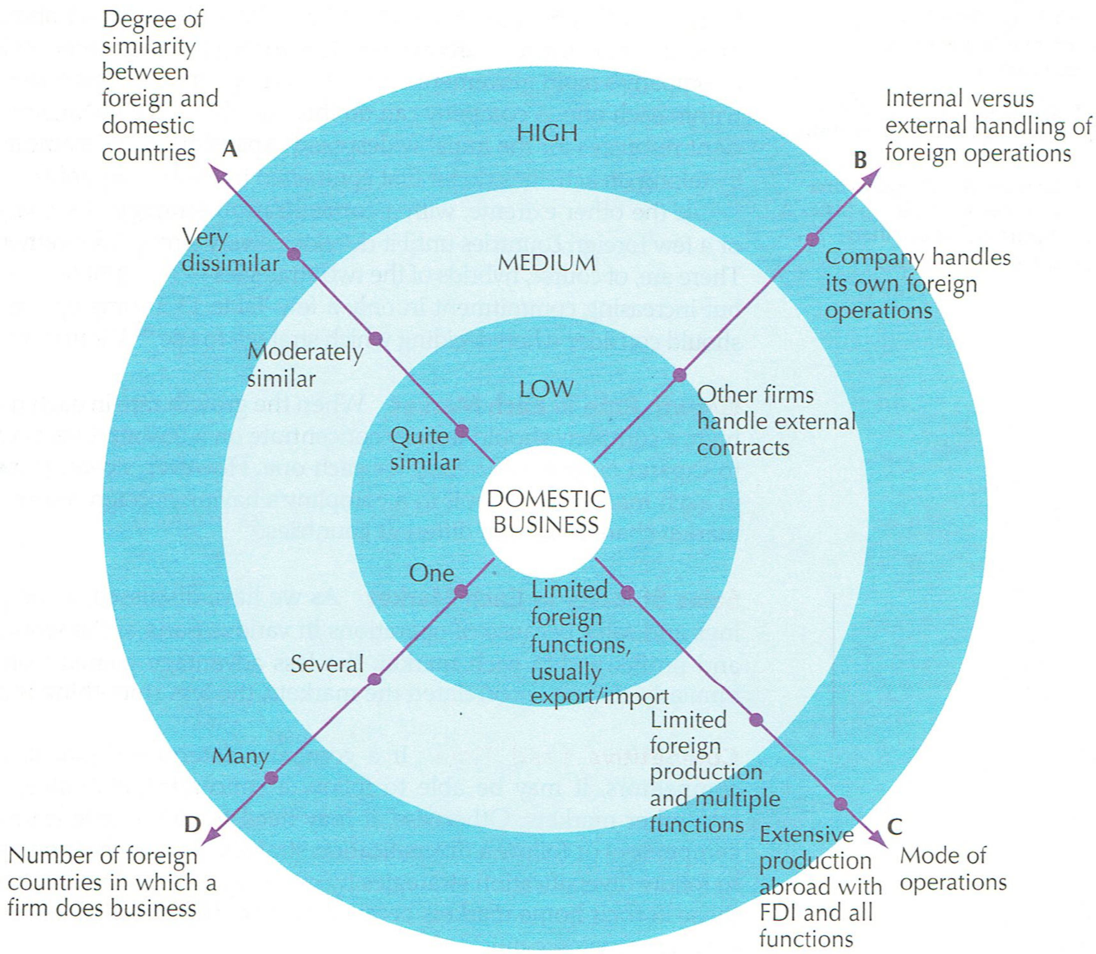


TABLE 13.3 To Diversify or to Concentrate: The Role of Product and Market Factors

If a company determines that "Product or Market Factors" satisfy the conditions in the column headed "Prefer Diversification," it may benefit from moving quickly into several markets simultaneously. If the same factors satisfy the conditions under "Prefer Concentration," it may decide to enter and work initially to develop a substantial presence in just one or a few markets.

Product or Market Factor	Prefer Diversification If:	Prefer Concentration If:
1. Growth rate of each market	Low	High
2. Sales stability in each market	Low	High
3. Competitive lead time	Short	Long
4. Spillover effects	High	Low
5. Need for product, communication, and distribution adaptation	Low	High
6. Program control requirements	Low	High

Source: "Marketing Expansion Strategies in Multinational Marketing," *Journal of Marketing* 43 (Spring 1979): 89. Reprinted by permission of the American Marketing Association © 1979.

Spillover Effects Situations in which the marketing program in one country results in awareness of the product in other countries are known as **spillover effects.** These are advantageous because additional customers may be reached with little additional cost, which can happen if the product is advertised through media sent cross-nationally, such as U.S. television ads that reach Canadians. When marketing programs reach many countries, such as by satellite television or the Internet, a diversification strategy has advantages.

Need for Product, Communication, and Distribution Adaptation Companies may have to alter products and methods of operating abroad—a process that, because of cost, favors a concentration strategy. The adaptation cost may limit the resources the company has for expanding in many different markets. Further, if the adaptations are unique to each country, the company cannot easily spread the costs over sales in more than one country to reduce total unit costs.

Program Control Requirements The more a company needs to control its operations in a foreign country, the more favorable a concentration strategy is. This is because the company will need to use more of its resources to maintain that control, such as by taking a larger percentage of ownership in the operation. Its need for more control could be for various reasons, including the fear that collaboration with a partner will create a competitor.

Subsequent Product Diversification The above discussion centers on initial movements into different countries. In addition, companies add new products to their portfolios and must decide where and how quickly to introduce them abroad. The more related the new products are to their existing products, especially those they are already selling abroad, the quicker they can move them into other markets. This is because the companies have experience that is more applicable to their products' introduction.[65]

REINVESTMENT AND HARVESTING

So far, we've discussed the sequencing of country entry. Then, once a company is operating abroad, it must evaluate how much effort to allocate to each location. With FDI, the company transfers financial capital and has physical and human capital in place. If the investment is successful, the company will earn money that it may remit back to headquarters or reinvest to increase the investment value. Over time, most of the value of a company's foreign investment, if successful, comes from reinvesting. If the investment is unsuccessful, the company may consider transferring capital elsewhere.

To begin with, companies sometimes need to respond quickly to prospects they had not anticipated. Many might need to respond to unsolicited proposals to sell abroad or sign joint venture or licensing contracts. Many might initiate export activity passively—that is, foreign companies or export intermediaries approach them to be suppliers. Similarly, undertakings may be onetime possibilities because a government or another company solicits requests. For example, Tasmanian development offices (Australia) proposed that Malaysia's Ta Ann Holdings use its veneer peeling technology by investing in Tasmania. For Ta Ann, it was a one-time opportunity to say "yes" or "no."[71] Or a government may change rules to allow foreign acquisitions, such as Nigeria did for banking.[72] Further, there may be a chance to buy properties that another company divests. When Enron faced bankruptcy, it needed to sell many of its foreign facilities, so companies such as Tractebel from Belgium and Royal Dutch/Shell bid on its Korean facilities.[73] Having discussed the competitive advantages of following customers' and competitors' moves into foreign markets, we know we cannot always foresee when the customers and competitors will move.

Another factor inhibiting the comparison of country operations is that their interdependence can keep them from being meaningfully evaluated separately. Profit figures from individual operations may obscure the real impact on overall company profits. If a U.S. company were to establish an assembly operation in Australia, the operation could either increase or reduce exports from the United States, thus affecting U.S. profit figures. Moreover, headquarters may have to incur additional costs to oversee the Australian operation and coordinate the movement of components into Australia. These costs are difficult to estimate and will likely not show up in the Australian income figures.

Or perhaps by building a plant in Brazil to supply components to Volkswagen of Brazil, the company may increase the possibility of selling to Volkswagen in other countries. As a result of the Australian or Brazilian projects, management would have to make assumptions about the changed profits for the company's total global operations. Finally, interdependence occurs because much of the sales and purchases of foreign subsidiaries are among units of the same parent company. The prices the company charges on these transactions will affect the relative profitability of one unit compared to another.

Clearly, companies cannot afford to conduct very many feasibility studies simultaneously. Even if they can, the studies are apt to be in various stages of completion at any given time. Suppose a company completes its study for an Australian project while continuing studies on New Zealand, Japan, and Indonesia. Can the company afford to hold off on making a decision about Australia? Probably not. Waiting would likely invalidate much of the Australian study, thus necessitating added expense and further delays to update it. In sum, three factors inhibit companies from comparing investment opportunities: cost, time, and the interrelation of operations on global performance.

Looking to the Future

Will Prime Locations Change?

Future sales- and resource-seeking opportunities and risks may shift among countries because of a variety of demographic, sociocultural, political-legal, technological, and economic conditions. We will concentrate here on population changes and where populations can and will prefer to work. In Chapter 5, we discussed how demographers expect a slowing in the growth of global population through 2050, with some countries experiencing declining populations. At the same time, growth should remain robust in many developing economies, particularly those in sub-Saharan Africa. The projection is that the percentage of people living in currently developed countries is expected to fall to 13.7 percent from a 2000 figure of 19.7 percent. The least developed countries will have the biggest population increase.

Further, because the world's population will continue to age, the share of what we now consider the working-age population should fall for developed countries and increase in many developing ones.

Shopping carts showing the Carrefour logo are outside a hypermarket.

Source: © Craig Joiner Photography/ Alamy

earlier—Metro from Germany and Auchon from France. Carrefour began operations in India in 2010, but it has expanded there only in smaller stores because of Indian governmental regulations. Despite other countries being low in priority on Carrefour's expansion list, it still continues to move into new ones, as shown in Figure 13.6.

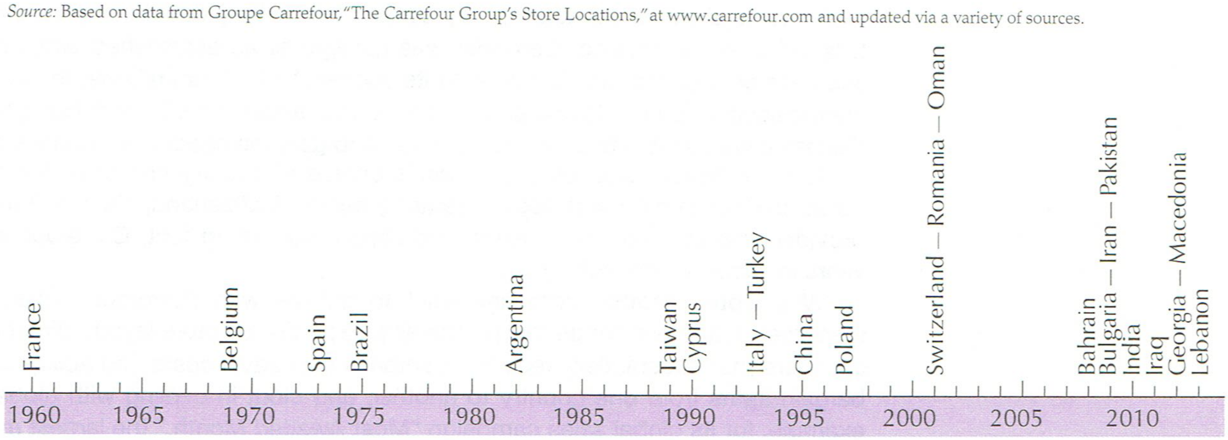
At the same time, Carrefour must decide what to do with underperforming stores and locations, including selling the stores and vacating the countries that offer fewer potential profits than capital invested elsewhere. For instance, in 2006 it sold its operations in South Korea and Slovakia while expanding heavily in Poland. Four years later it sold its stores in Thailand to put more emphasis on its domestic market. Two years after that, it divested operations in Colombia, Greece, Indonesia, Malaysia, and Singapore.

Carrefour sells in five types of stores: hypermarkets, supermarkets, hard discount stores, cash-and-carry shops, and convenience marts. Its hypermarkets account for the largest portion of sales (about 63 percent), retail space, and number of countries with retail operations.

FIGURE 13.6 Carrefour's Major Locations as of 2013 and Entry Dates

Data refer to mainly company-owned outlets and include some large franchises. The company also entered and exited some foreign locations including the United Kingdom, the United States, Japan, Thailand, Mexico, Russia, Greece, Malaysia, Singapore, Colombia, Indonesia, Portugal, and Russia.

Source: Based on data from Groupe Carrefour, "The Carrefour Group's Store Locations," at www.carrefour.com and updated via a variety of sources.



global consumer goods provide its stores with lower prices for a one-month sale). Carrefour also considers whether a location can justify enough additional store expansion to gain distribution economies. To help gain these economies, Carrefour and some of its competitors have recently been expanding via acquisition.

Carrefour has pushed global purchasing. When its stores in one country find an exceptional supplier, management passes on the information to the merchandising group in Brussels, which then seeks markets within stores in other countries. The Malaysian operation, for example, found a good local supplier of disposable gloves, and Carrefour now sells them in its stores worldwide. However, this approach implies a great deal of uniformity in store offerings and does not take into account demographic and cultural differences. Carrefour has recently given store managers more authority to alter inventories, such as carrying higher quality luggage in Monaco and more brands of chickpeas in French stores catering to a large North African population.

Carrefour means "crossroads," which is apropos because the company has been facing tough choices for improving its performance. Recent years have seen its share price fall in parallel with its market share drop in France. Some analysts believe its problems have stemmed from expanding too fast internationally, thus sapping resources needed to adjust to changes in the French market. For instance, although its hypermarkets have been the crux of its operations, demographic changes—a larger portion of older and single consumers—have shifted more purchases to smaller outlets. At the same time, a wide range of specialty retailers have been cutting into its market share of non-food items, while some analysts have criticized its entering so many countries rather than building a larger presence in fewer of them. Finally, some analysts feel that Carrefour will never become the world's largest retailer without a significant presence in the United States and the United Kingdom. However, the company's choice of countries will play a big role in its success whether or not it becomes the world's largest retailer.

QUESTIONS

13-3. What advantages and disadvantages would Carrefour likely have compared with domestic retailers where it operates?

13-4. Evaluate the reasons for following a geographic concentration versus diversification strategy as they apply to large retailers such as Carrefour.

13-5. Refer back to the Burger King case at the beginning of the chapter. Compare the applicability of the first-mover advantage in international expansion for Burger King versus Carrefour.

13-6. Carrefour has placed neighboring countries (Belgium, Italy, and Spain) in a higher priority than much larger countries such as Brazil and China. What are the pros and cons of doing so?

13-7. Carrefour has recently given store managers more autonomy in selecting merchandise to sell in their stores. What are the advantages and disadvantages of this policy?

13-8. When the three big global retailers—Walmart, Carrefour, and Tesco—have entered the same country, only one has generally succeeded. Are the markets in China and India so big that all can succeed there? Support your conclusion.

SUMMARY

- Because companies seldom have sufficient resources to exploit all opportunities, two major considerations facing managers are which markets to serve and where to locate the production to serve those markets.
- Companies' decisions on market and production location are highly interdependent because they often need to serve markets from local production and want to use existing production capacity.
- Scanning techniques aid managers in considering alternatives that might otherwise be overlooked. They also help limit the final detailed feasibility studies to a manageable number of those that appear most promising.
- Because each company has unique competitive capabilities and objectives, the factors affecting the choice of operating location will be different for each. Nevertheless, many consider similar-country comparative indicators when seeking advantages from foreign sales or foreign assets.
- Four broad categories of risk that companies may consider are political, foreign exchange, natural disaster, and competitive.