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Entry modes decisions: Walmart in South Korea

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Abstract:

Nowadays the globalization of markets has set the foundations for more integrated economic systems (Marino 2016). As inferable, firms consider of paramount importance the need to expand the geographical scope of their activities so as to take advantage of opportunities given by foreign markets. The international expansion is one of the greatest challenges faced by the modern enterprise and when firms contemplate the possibility to expand internationally, three main decisions must be carefully addressed, specifically which markets to enter, the time of entrance (early or late entrance) and the entry mode, which, if chosen properly, can be the starting point for the overall success in foreign markets. To address the topic, the research will analyze the venture of Walmart in South Korea, from which it was forced to withdraw following a series of wrong strategic decisions. Contrary to the destiny of Walmart and other retailers, the British retailer Tesco experienced an outstanding success in the same market. Based on the different outcomes, the research will attempt to investigate the factors that contributed to the failure of Walmart and to the success of Tesco in South Korea.

Keywords: International expansion| Entry mode decisions| Walmart| South Korea

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1. Introduction

The concept of internationalization has embraced different meanings; Luostarinen and Welch (1988) defined it as “*a process of increasing involvement in international operations*”, while Turnbull (1987) tended to describe it as “*the outward movement in a firm’s international operations*”. The global expansion of corporations has been facilitated by the remarkable efforts of nations to welcome foreign investments, to deregulate markets, to privatize state-owned companies, to increase competition, which allowed both small and large firms from advanced or developing countries to expand globally (Marino 2016). However, not all the 196 nations have the same degree of attractiveness, which depends on the assessment of costs, benefits and risks related to the management of operational activities overseas (Marino 2016). As in such, the international expansion is one of the greatest challenges faced by the modern enterprise and when firms contemplate the possibility to expand internationally, three main decisions must be carefully addressed, specifically which markets to enter, the time of entrance (early or late entrance) and the entry mode, which entails different implications in terms of control, risk, political and cultural awareness. As inferable, foreign market entry decisions seem to profoundly affect not only the competitiveness of the parent company but it accounts as well for the performance of foreign subsidiaries abroad (Huang & Sternquist 2007). To address the topic, the main dominant frameworks include Transaction Cost theory and Institutional theory. Moreover, in view of selecting the right mode of entry, it is not possible to limit the attention just to one single framework, but it is necessary to consider a unified framework in which different factors can be related and analyzed by taking into consideration what each contribution prescribes and suggests when firms seek to penetrate foreign markets (Hill, Hwang & Kim 1990). The globalization phenomenon has led different firms from several sectors to expand the geographical scope of their activities in search for higher growth (Coe & Lee 2006). However, there are some sectors in which the need for geographical expansion is more emphasized. This is the case of the retailing sector in which retailers have realized their incapability to grow at an acceptable growth rate in their domestic markets due to the saturation of markets, highly competitive conditions of the industry and increasing vertical integration of distribution channels (Vida & Fairhurst 1998). Furthermore, economic and political trends, such as the fall of trade barriers and the establishment of free trade agreements, have contributed to increase the number of cross-borders retailers (Sternquist 1997). Among these retailers, Walmart is of particular interest as it is a global retailer, but still develops its competitive position overseas by replicating its business model based on US customers’ preferences (Gandolfi & Strach 2009). The company, founded in Bentonville, tends to unfold

its international expansion through a combination of green-field investments, acquisitions and joint-ventures (Gandolfi & Strach 2009). These strategies have resulted to be effective and successful in some markets where it achieved outstanding growth, but unfortunate in other markets, such as South Korea from which it was forced to withdraw in 2006. As inferable, the purpose of this paper is to show the potential causes of its failure in the South Korean market by both analyzing how it unfolded its venture and drawing a comparison with its counterpart Tesco, that in South Korea has reported an outstanding success through the joint venture with a local partner (Coe & Lee 2006).

2. Literature Review: Entry modes decision, theoretical frameworks

Entry modes' decisions have received a lot of attention from business research for many decades. The classical approach to entry modes decisions revolves around choosing the option that offers the highest risk-adjusted return on investment (Anderson & Gatignon 1986).

When a MNC contemplates the possibility to expand its operations overseas, it has to choose whether to enter through a non-equity investment, such as strategic alliances, or with an equity-based mode through which the foreign subsidiary is either wholly or partially owned (Harzing 2002). Regardless of the classification adopted, the decision of each mode of entry cannot disregard the consideration of three variables: *degree of control*, defined as level of authority over strategic and operational decision making, *country risk*, defined as a range of risks in foreign markets, and *asset specificity*, defined as dedicated assets that cannot be deployed in alternative uses without the loss of their value (Hill, Hwang & Kim 1990). Researchers have long attempted to explain that the selection of the mode of entry is mainly driven by transaction costs motivations (Brouthers 2013). Recently scholars have started drawing the attention to combine the transactions costs perspective with the institutional theory, as “*it refers to conditions that undermine property rights and increase risks in exchange*” (Delios & Beamish 1999).

2.1 Transaction costs Theory

As the level of risk and return implied in each entry mode depends on the optimal degree of control, the transaction costs theory, by combining elements from industrial organization, organizational theory and contract law, seeks to investigate the main drivers that determine the optimal degree of control, namely asset specificity, external and internal uncertainty, and free-riding potential (Anderson & Gatignon 1986).

Broadly speaking, asset specificity refers to both human and physical investments, whose value can be lost in alternative uses (Williamson 1981), and tends to create contracting hazards in case of firm specific know-hows and tacit knowledge due to the opportunistic behavior of the counterpart (Brouthers 2013). As inferable, if the company owns specific know-hows and decides to grant permission to a licensee or local partner to use it within the manufacturing process or just to market the product overseas, it inevitably exposes itself to the dissemination risk and the likelihood that the know-how will be used for different purposes increases exponentially, unless there is a safeguarding mechanism in place (Hill, Hwang & Kim 1990). Taken into account the aforementioned arguments, it is possible to identify two possible sources of transaction costs: those incurred in searching, selecting, negotiating and monitoring the counterpart that exist due to the bounded rationality, and those arising from the expected loss in case of opportunistic behavior (Hill, Hwang & Kim 1990). As a result, the establishment of wholly-owned subsidiary eliminates or at least reduces significantly the dissemination risk and if the reduction of the outlined transaction costs is significantly greater than the bureaucratic costs of establishing and running a channel to transfer know-hows, the wholly-owned subsidiary would be certainly preferable (Hennart 1982). Moreover, the preference towards wholly-owned subsidiary is even more enhanced if the tacit nature of the know-how is taken into consideration. Indeed, the transfer of tacit know-hows and informal routines is easier if it occurs among intra-organizations because of the ability of the MNC to use its own human capital and existing organizational routines to tackle the transfer issue (Hill, Hwang & Kim 1990).

The asset specificity, however, may contribute to enhance the external uncertainty, an additional driver of the optimal degree of control, as when the former is high, the latter may increase the need of control (Anderson and Gatignon 1986). The external uncertainty, defined as the unpredictability of the firm's environment, is characterized by environmental factors, namely *country risk*, *location familiarity*, *demand* and *competitive* conditions, which will impact on the resources commitment and on the strategic flexibility (Hill, Hwang & Kim 1990). Country risk considers *political risk*, regarded as political instability, *ownership risk* in terms of expropriation, *operational risk* as consequence of price control or local content requirements and *transfer risk* imputable to the currency inconvertibility (Hill, Hwang & Kim 1990). Location familiarity, instead, is the perceived distance between the home and host country in terms of economic systems and business practices and depends on both the physic distance and the prior experience in that market (Hill, Hwang & Kim 1990). In case of high country risk and low location familiarity, MNCs should choose entry modes that would reduce their exposure to that risk and would allow at the same time to facilitate the market exit without incurring in

significant sunk costs (Brouthers 2013); under such scenario, low or medium control entry modes, such as licensing or joint ventures, will be favored (Hill, Hwang & Kim 1990). Furthermore, demand and competitive conditions revolve around Harrigan's arguments (1985), who predicts that the nature of competition and volatility of markets have direct impact on how organizations decide to carry out their activities. Harrigan (1985) suggests that when future demands levels are unstable or difficult to forecast and markets are highly volatile and competitive, MNCs should reduce the resource commitment by preferring low or medium control entry modes as they allow the strategic flexibility necessary to respond proactively to changes in the market.

As opposed to the external uncertainty, also the internal environment of the firm plays a role in the determination of the optimal degree of control, defined as the difficulty of the firm to assess its agents' performance with fair output indicators (Anderson & Gatignon 1986). Such difficulty contributes to make high control modes more desirable regardless of the level of asset specificity involved as they offer the subjective judgment required to monitor inputs and behaviors of employees (Williamson 1981).

Lastly, the potential problem of free riding is the fourth driver considered in the evaluation of the optimal degree of control and occurs when "*one party can free ride on the efforts of others without bearing the costs*" (Anderson & Gatignon 1986). The free riding problem is particularly common in case of a high value of the brand name in which high control entry modes will enable the MNC to prevent from diluting it or from confusing the international positioning of the brand (Holton 1971). The transaction costs perspective, however, should be combined with the institutional perspective, as the latter offers the platform in which the transactions costs occur (North 1990).

2.2 Institutional theory

The external environment is made up by political, cognitive and sociological elements such as laws, norms, habits and cultural belief (Handelman & Arnold 1999). DiMaggio and Powell (1983) have pointed out that the external environment affects organizational behavior and firms are pulled to follow and embrace certain behaviors to gain legitimacy. The institutional environment exerts its influence not only on the firms' growth but also on the intra-firms' relationships, which shape the decision-making process of organizations both from a macro and micro perspective (Huang & Sternquist 2007). Extending these notions to the international expansion of firms, it is possible to assert that the macro-environment (both home and host country) and micro-environment (the firm itself) play a crucial role in the selection of the

appropriate mode of entry (Huang & Sternquist 2007). Taking into account this view, firms face two types of pressures when they enter a foreign market, namely the need to adapt to local markets and to its characteristics, and isomorphism, which is “*the constraining process that forces one unit of the population to resemble other units that face the same set of environmental conditions*” (Di Maggio & Powell 1983). The institutional theory is characterized by three pillars, namely regulative, normative and cognitive.

The regulative pillar entails legal and political factors faced by MNCs and arise from governments’ policies or laws, which can be grouped in two regulative forces, namely *imposition* and *inducement* (Grewal & Dharwadkar 2002). Imposition implies to strictly follow the law and due to the stringent restrictions, acting as potential barrier for the international expansion, it is the regulative force, which may make a country less attractive, resulting in a preference for low control modes of entry (Huang & Sternquist 2007). On the flip side, inducement is the regulative force, which enables to attract foreign firms, in terms of tax incentives or lower foreign exchange restrictions (Grewal & Dharwadkar 2002). In such a scenario, low control modes of entry will result both in a limitation of potential gains and in a sharing of these benefits among third parties, which increases the likelihood to choose high control entry modes (Huang & Sternquist 2007). At the same time, Huang and Sternquist (2007) have pointed out that also home country regulations shape the internationalization decisions, as, if they turn out to be less favorable, MNCs will have an additional reason to seek growth opportunities abroad. This trend has found empirical confirmation and evidence mainly in the European retailing market, where European retailers have been among the first to internationalize due to the strong and restrictive domestic regulations (Grewal & Dharwadkar 2002). Conversely, considering US retailers, such as Walmart, whose expansion started only some decades after the European retailers, it depicts that its later internationalization process is the result of the lenient and favorable retail regulations in US (Huang & Sternquist 2007).

The normative pillar depicts moral beliefs and internalized obligations in the attempt to behave appropriately in a social situation in accordance with the others’ expectations and standards of conduct (Scott 1995). The normative pillar shapes MNCs decision-making by taking into account the cultural and market distance. A stylized fact emerging from the dominant literature is the propensity of firms to choose more attractive, but at the same time less risky markets, which are economically stable and culturally similar (Brouthers 2013). When firms enter economically stable and culturally similar markets, they intend to maximize the return on investment through high control entry modes (Brouthers 2013). However, an intermediated

form, such as joint-ventures, is often chosen if markets present a high-risk investment, which is associated to the need for local knowledge and to the exposure of assets (Brouthers 2013). As this risk gradually increases, firms may gain local knowledge through a joint venture approach since it is a reasonable solution that allows to mitigate the risk but at the same provides lower costs due to the pooling of information (Brouthers 2013). Furthermore, the normative pillar recalls the concept of location familiarity enriched by the introduction of a long term and accumulative adaptation process, which mitigates the greater perceived distance between the home and host country (Huang & Sternquist 2007).

The third pillar of the institutional theory concerns with the cognitive dimension that starts from the basic assumption that past decisions will influence future ones (North 1990). This assumption clearly postulates that the decision-making process is not only socially determined but also historically located (Simon 1959). Organizations are characterized by inertia and habits, which lead firms to take the same decisions when situations seem to be similar to the previous experience (Huang & Sternquist 2007). The influence of past decisions is often regarded as *imprinting*, which means that, once a practice has been successfully implemented in the past, the likelihood to consider alternative options in similar contexts is reduced (Huang & Sternquist 2007). Furthermore, another standpoint of the cognitive pillar is the argument that firms do not operate in isolation but, their decisions are indirectly shaped by other organizations (Huang & Sternquist 2007). This occurs because taking those decisions adopted by other firms increases the legitimacy of organizations and this is particularly true in case of uncertain contexts, which encourage imitation (DiMaggio & Powell 1983). As in such, the mimetic behavior can take the form of *frequency-based* and *trait-based* (Huang & Sternquist 2007). The former refers to the imitation of behaviors adopted by a large number of successful firms, known also as “*follow the leader*” syndrome, whereas the latter indicates the imitation of decisions or practices of other MNCs (Lu 2002). As inferable, the cognitive pillar also contributes to explain why MNCs use the mode of entry adopted by other firms when entering similar markets or the same entry mode during their international expansion (Huang & Sternquist 2007).

2.3 Impact of international strategy on entry mode decisions

A further perspective that offers insight into entry modes decision is characterized by the type of international strategy. Research in international business tends to consider four types of strategies that can be pursued during the internationalization process, namely international,

global, multidomestic and transnational according to the need of local responsiveness and to the pressure for costs reductions (Harzing 2002). However, as international strategy may not be viable in the long run and the transnational one may be difficult to pursue due to the conflicting demands placed on the company (Marino 2016), this section will focus only on the global and multidomestic strategy. The former has the strategic focus on efficiency and on the need to achieve economies of scale, which leads MNCs to integrate and rationalize their production in a very cost-efficient manner (Harzing 2002). National subsidiaries act as merely “*pipelines for the headquarters*” and are not supposed to adapt themselves to local needs (Bartlett & Ghoshal 1987). Conversely, MNCs, pursuing a multidomestic strategy, tend to compete on a domestic level, which requires to adapt products and services to the needs of different markets (Harzing 2002). In such a scenario, in view of pursuing local responsiveness and aware of substantial differences among home and host market in terms of consumers preferences, legal and political settings, MNCs will assign strategic operations to the national subsidiaries (Bartlett & Ghoshal 1987).

To better understand the link between international strategy and entry mode decision, two perspectives can be taken into consideration, related to the firm specific advantages (FSAs) and to the extent of internal versus external isomorphism that drives the behavior of national subsidiaries (Harzing 2002). FSAs are split in *location bounded* and *non-location bounded* (Dunning 1988). While the former ones cannot be transferred and used in another location without strong adaptation, the latter ones can be used on a global scale, as their transfer can occur without additional costs or substantial adaptation (Rugman & Verbeke 1992). Furthermore, location advantages essentially come either from the home or from the host country (Harzing 2002). Linking location and firm specific advantages to the two types of international strategy, it is possible to point out that MNCs, pursuing a global strategy, tend to exploit non-location bounded firm specific advantages, while the use of host country advantages is merely limited to the exploitation of low cost areas, which allows for cost-efficiency, crucial for the global strategy (Bartlett & Ghoshal 1987). Consequently, setting up operational facilities from scratch by incorporating corporate production requirements and technologies is more convenient rather than following the requirements of a local partner or accepting the already existing operations of an acquired subsidiary (Harzing 2002).

Conversely, MNCs, pursuing a multidomestic strategy, exploit location bounded firm specific advantages, combined with host country location advantages so as to tailor products to local circumstances (Harzing 2002). The tailoring of products to local needs require a high degree of responsiveness to national markets that can be gained only through accessing to the knowledge of a local partner or by hiring a local work force (Bartlett & Ghoshal 1987).

The second dimension, instead, suggests that the choice of a particular entry mode depends on the need to facilitate internal or external isomorphism (Harzing 2002). The former will be much easier to realize through green-fields as headquarters can shape structures and policies to their specific preferences, which may be, instead, hindered in case of acquisitions or joint ventures due to the likely difficulty to change the already existing structures and policies (Harzing 2002); conversely, when an alignment with the characteristics of each national market is required, MNCs will prefer entering through acquisitions or other entry modes that allow to exploit location bound firm specific advantages by using host country specific advantages (Harzing 2002).

Brouthers (2013) has found out that firms, taking into consideration what each theory suggests, tend to achieve better performance both financially and not-financially. This is possible because a holistic framework enables both to enhance the *operational efficiency*, typical object of transaction costs theory, and the *value enhancement*, object of the institutional and cultural contest (Brouthers 2013). Furthermore, when dealing with which mode of entry is more suitable, it is not possible to rule out the strategic posture of the firm (Hill, Hwang & Kim 1990).

3. Methodology

The methodological approach will be based on a case study analysis, which has been widely recommended in the international business research as a valid tool to examine a specific situation within the boundaries of a specific environment, situation or organization (Yin 2003). The purpose of the case study analysis is to investigate the potential causes of the failure of Walmart in South Korea and to assess whether it is entirely imputable to the wrong entry mode decision or to a combination of factors that decreed the pull-out from the market in 2006. The analysis will be enriched by drawing a comparison with the British retailer Tesco, which has reported an outstanding success in the same market, and will provide additional insight into the mistakes made by Walmart.

4. Analysis

4.1 Walmart International Expansion

Walmart Stores Inc. is a US multinational retailing operator, running large discount warehouses and superstores (Marcilla 2014). Founded in 1962, Walmart mission is to serve its customers at the “*lowest possible prices anytime, anywhere*” in order to help customers save money and

live better (Marcilla 2014). Nowadays, the US retailing giant continues to dominate the global marketplace with a 10% share of modern grocery retailing and the outstanding position has been achieved by relying on fierce price competition and aggressive store openings (Euromonitor 2017). On an aggregate level, Walmart corporate strategy is split in two branches. On one side, Walmart is willing to maintain affordability and convenience so as to capture the most valuable market segment (Euromonitor 2017); whereas, on the other hand, the strategic focus is also on consolidating its international footprint, characterized by 52% of its outlets and 24% of total sales (Figure 1). While expansion in terms of stores openings both internationally and domestically has slowed down as a result of the actual focus on improving and boosting profitability of the current stores (Figure 2), international sales, instead, showed a slight increase of 25%, made possible because of elimination of exchange rates fluctuations (Euromonitor 2017), (Figure 3).

The current outcomes are the result of three distinct periods in which Walmart has unfolded its internationalization. The international expansion of Walmart was mainly triggered by market saturation and changes in the US market (Kim 2008). The latter was profoundly affected by the evolution of its demographics in which family sizes were decreasing and the baby boomer segment was increasing, resulting in a lower growth of demand conditions (Kim 2008). Moreover, the US retail giant was coming to terms with the cannibalization of its stores as a result of the opening of more than 200 stores per year, all placed close to each other (Kim 2008). A further reason driving Walmart internationalization came from domestic competition. For decades, Walmart had established its positioning as market leader in the retailing sector due to the aggressive pricing offering, but its supremacy was threatened when other US retailers started adopting similar strategies and were able to run a retail format with a superior technology and with lean business operations (Kim 2008). Consequently, consumers were less incentivized to visit Walmart stores and all these factors contributed to enhance the strategic priority to seek future growth overseas, developed in three periods (Gandolfi & Strach 2009). Firstly between 1991-1994 it entered adjacent markets in Mexico and Canada following the enforcement of the Agreement of Free Trade of North America (Durand 2007). The second one (1995-1998), instead, shows an opening and increasing interest towards the rest of the world by entering as well geographically distant and emerging countries, following the adoption of more favorable regulations. The third phase (1999 to present days), however, is centered around the need to boost its performance and has also marked out few withdrawals from some markets such as Germany and South Korea (Durand 2007). Currently Walmart is present in 28 international markets, which have enabled to gain a broad global footprint

(Euromonitor 2017). Considering the international expansion of Walmart as a whole characterized by successes and failures, experts have advanced the existence of certain factors that can help to understand and address the heterogeneity of Walmart's performance abroad, such as the exercise of market power and sensitivity to local labor standards (Durand 2007). The exercise of market power depends on the possibility to build strong supply networks in neighbouring countries, on the impact of the free trade agreement and on the ability of Walmart to impose its own data processing and control systems over local supply chains (Durand 2007). In the case of Walmart, proximity benefits are crucial both in determining the success or withdrawal in foreign markets and in increasing its market power as a result of the possibility to connect supply chains internationally, which in turn, generates higher economies of scale (Durand 2007). Furthermore, in the case of Walmart there is concomitancy between the beginning of its international expansion and trade liberalization, as it started its internationalization process shortly afterwards the end of the cold war and when the major treaties on free trade were signed (Durand 2007). Equally important in gaining market share is the ability of firms to implement its control systems in the local supply chains so as to minimize the asymmetries of information and to constraint the bargaining power of local suppliers, which is an additional undeniable element in the internationalization process of Walmart (Durand 2007). As retailing is a low skilled intensive activity, it is reasonably to think that labor standards play a role in explaining the performance of retailers abroad. It is broadly acknowledged that a company can easily adapt to lower labor standards with respect to its domestic market rather than manage new constraints (Durand 2007). As inferable, the initial success of Walmart took place in areas where there was and still is clear hostility towards trade unions. Conversely, one of the main causes of withdrawal from the German market is imputable to the impossibility to apply the same US labor management (Durand 2007). Besides the failure in Germany, another historical withdrawal is from South Korea, entered in 1998 and left in 2006, which this paper will address.

4.2 Walmart Business Profile

When Walmart entered in South Korea in 1998, it ranked as fourth largest company in US and twelfth in the world by recording \$117.9 million of sales and \$3.5 million of earnings (Annual Report Walmart 1998). These results were imputable to three key success factors, namely the choice of location, the supply chain process and the EDLP strategy that contributed to shape its venture in the market at issue and are still today the sources of its competitive advantage both in US and abroad. Location has influenced both consumers in how they do their shopping and suppliers in how they deliver the products into the stores (Marcilla 2014). Location

advantages have been driven by the need to keep each store close to the other, resulting in a reduction of shipping costs and in the exploitation of economies of density (Marcilla 2014). The logistics strategy, known as “*radiating*”, has allowed to rely on a dense network of stores which, in turn, makes easier and cheaper the delivery of products (Euromonitor 2017). Apart from having devised stores in order to be geographically close to each other, another peculiar feature of location advantage is the location itself in which stores are established. Walmart has always placed its stores mainly around highways with a twofold implication; on consumer side it allows to provide large parking areas as customers tend to go shopping by their own cars and on supplier side, it is easier for them to reach the departments for products delivery (Marcilla 2014). Supply chain processes, instead, have been devised so as to provide high quality products at lowest possible prices. To fulfill its strategy, Walmart has adopted Electronic Data Interchange, which has allowed to reduce significantly the costs of ordering products and paying bills (Marcilla 2014). Furthermore, Walmart’s strategy has been strengthened by the adoption of the cross-docking inventory and by the reliance on its own transportation system. The former allows to gain control over the time connected with products delivery and to keep storage costs significantly low, whereas the latter allows to restock stores more rapidly (Marcilla 2014). Strictly linked to the EDLP strategy, it is noteworthy to point out that it has contributed to keep at the lowest the advertising budget expenses with respect to its competitors as the low-price concept is well positioned in the minds of its US customers (Annual Report Walmart 1998). However, over the years the cost-leadership strategy has been characterized by a standardized production, limiting to the greatest extent the customization of the service, and by paying low wages, locating production facilities in areas where rents are somewhat cheap, outsourcing and by minimizing distribution costs (Marcilla 2014). As inferable, Walmart has always faced two potential weaknesses, arising from the poor labor conditions, which have contributed to foster negative brand reputation, and from the absence of differentiation (Marcilla 2014). The latter will result in a double-edged sword when customers will no longer be driven by prices in the purchase of products; but at the same it has affected Walmart positioning in those foreign markets characterized by high levels of local responsiveness in which the possibility to meet local needs is significantly compromised, resulting in a competitive disadvantage. Nevertheless, this is not the case of Mexico and of Canada where in 1998 Walmart reported an outstanding success and achieved a 40% market share (Annual Report Walmart 1998). Based on such outcomes, Walmart was willing to further enlarge its international footprint, by entering markets in the Asian region so as to gain additional experience and growth, which at the time were particularly appealing following the regulatory improvements embraced by local governments.

4.3 South Korea market overview

South Korea is one of the emerged East Asian markets and since the mid-1990s, it experienced an unprecedented economic growth, which increased demand for modern shopping environments (Coe & Lee 2006). The South Korea market was essentially closed to foreign retailers due to strict protectionists policies and was mainly characterized by small shops namely *mom-and-pop* stores that accounted for the 80% of the retail South Korean market. The overall protectionism present until 1995 has profoundly contributed to undermine the distribution industry, but a change of course came only in the mid-1990s when the government, in response to internal and external pressures for deregulation, adopted a more liberalized orientation (Coe & Lee 2006). The deregulation process led to abolish the requirements in terms of floor space and number of stores and allowed the opening of a large number of previously restrictive service sectors (Coe & Lee 2006). Despite the less stringent regulations, the South Korean retail market still presented some obstacles for foreign retailers to conduct properly and successfully their businesses. One of the main barriers came from the high price of real estate assets and from the rental systems, which required an upfront payment of 70% of the property value rent (Coe & Lee 2006). A further swing towards the opening of South Korea to the world was offered by the financial crisis between 1997-1998, which on one side allowed foreign retailers to buy assets at lower and cheaper prices and on the other side contributed to shape a new type of customers, more price conscious (Coe & Lee 2013). The price consciousness of customers, who previously massively purchased in department stores, allowed the opening of discount stores and set the favorable conditions to provide low cost goods and high levels of service (Coe & Lee 2006). Furthermore, the financial crisis enabled the government to see in a new light the benefits that the foreign retailers could bring to the South Korean economy and started to figure out an attractive program to induce inward FDI (Coe & Lee 2013). To make foreign direct investments more attractive, the government relaxed the stringent regulations associated with M&As by abolishing the requirements of foreign shareholdings in domestic companies and it also struggled to reduce the number of *chaebols*, Korean word standing for conglomerates, as they were considered to be extremely diversified (Coe & Lee 2006). The reduction of conglomerates opened the doors to potential M&As with foreign retailers or to the sales of their distribution activities. As result of such improvements to make the market more appealing, several multinationals entered and expanded their activities in South Korea (Coe & Lee 2006). Through its gradual market opening, the South Korean retailing sector has experienced significant changes among consumers, mainly witnessed among middle income ones, whose purchasing power increased substantially (Coe & Lee 2006). The higher disposable income required the introduction of new retail formats to

replace the traditional mom-and-pop stores and to better address the diversified consumers' needs (Suh & Howard 2009). Since 1996, new formats, including discount stores, online shopping, TV home shopping and convenience stores, have witnessed a rapid growth of their sales (Figure 4). Although department stores represented the only competitive modern retail format until the mid of 1990s, the entrance of foreign retailers and the higher competitive intensity led many South Korean retailing companies to renew their businesses in order to survive (Suh & Howard 2009). This renewal was mainly centered around the diffused adoption of the discount store format, which has experienced a rocket growth between 1996-2006 (Figure 5). The opening of South Korea to the world has contributed to the improvement of management practices among domestic retailers through knowledge transfers and exposure to the world best practices (Suh & Howard 2009). At the end of 1990s the South Korean retailing market was dominated by 98 retailers of which 76 were Korean, 8 American and only 14 came from different countries (Han *et al.* 2002). The main actors were Walmart, Tesco-Samsung, E-Mart, Lotte Mart and Carrefour that started a fierce competition among themselves so as to take advantage of the high growth rates experienced by the retailing sector (Suh & Howard 2009). Figure 6 shows that, although the 14 retailers from other countries and American retailers reported higher average sales per operating day (W337.36 million and W234.45 million respectively) compared to Korean retailers' sales (W224.69 million)¹, on the other hand, however, foreign retailers as whole paid an average rent, being twice as much as the one of their local counterparts (Han *et al.* 2002). Coming to analyze the intrinsic characteristics of the South Korean retailing sector, it is possible to identify two extremely important differences with regards to the Western one. Firstly, the system is mainly owned and controlled by manufacturers, who also hold significant market power in distribution channels (Han *et al.* 2002). Secondly, retailers tend to establish their presence in the market by adopting "*development utilization strategy*" which is widely diffused and consists of building stores mainly close to the main transportation hubs, source of competitive advantage for local retailers, as it relies on a stylized fact among Koreans which is the frequent use of public transportation for a wide range of purposes rather than of private cars (Han *et al.* 2002). An additional peculiar feature of the South Korean retailing sector is the distribution system. Contrary to what happens in most of developed countries, in South Korea, instead, there is an absence of well-developed infrastructure, which hinders the synchronization of demand and supply (Bowersox *et al.* 2000). Furthermore, as the price of retail estate is significantly higher and given the small size of South Korea, it is somewhat impossible and inconvenient to

¹ Exchange rate on January 2000: 1\$=Won 1245.32

replicate economies of scale through the building of a multiple chain store (Han *et al.* 2002). The successful integration of the supply chain is even more hindered by the lack of trust between manufacturers and retailers, who tend to hold rather than share information (Han *et al.* 2002). As inferable, a vendor managed system and cross-docking system, employed by many Western retailers such as Walmart, cannot be materialized in South Korea, unless a cultural shift occurs (Bowersox *et al.* 2000). Further obstacles for a successful supply chain integration can be found in the propensity of many local retailers to distribute at least 10% of total products as untaxed through unofficial distribution channels in order to enrich their competitiveness (Han *et al.* 2002). This malpractice is enhanced by the awareness that violations are hard to be detected as the local retailing regulations do not envisage the availability of electronic devices (POS) among methods of payment, which tend to be mostly cash-based. Consequently, foreign retailers struggle to remain competitive in the market and alliances with local suppliers, accustomed to elude VAT payments, remain highly unlikely (Han *et al.* 2002). A further impediment for overseas retailers arises from the nature of South Korea economy that, being a cash-based transaction economy, prevents foreign retailers from investing money in other value-added activities as they are required to maintain large cash balances in their bank accounts (Han *et al.* 2002). Having analyzed the main economic and political trends in South Korea, it is paramount at this stage to incorporate a further perspective by taking into consideration South Korean culture through the Hofstede's model (Figure 7). According to the framework, each culture can be described using mainly four dimensions, namely *power distance*, *uncertainty avoidance*, *collectivism* or *individualism*, and *masculinity* or *femininity* (Marino 2016). South Korea has scored 60 and 85 in power distance and uncertainty avoidance respectively, showing that the society is hierarchically centralized and has a high level of uncertainty avoidance, leading the country to rely on rigid codes of belief and behavior to minimize risks associated with the uncertainty (Marino 2016). Furthermore, South Korea is a society that highlights a long-term commitment towards the group and whose dominant values revolve around loyalty, quality of life and solidarity (Marino 2016). However, in order to capture the willingness of the society to maintain its links with the past, while facing the challenges of present and of future, Hofstede has added a fifth dimension known as *Confucian dynamism* or *long-term orientation* (Marino 2016). With a score equal to 100 on this dimension, South Koreans tend to live being guided by virtues, whereas organizations are keen on serving the stakeholders rather than only shareholders. The culture analysis depicts a country in which customers are ethnocentric leading to hostile attitudes to foreign products, but at the same time the intrinsic hostility can be won by devising proper marketing efforts,

taking into account that younger South Korean shoppers may show purchase patterns closer to the Western ones (Gandolfi & Strach 2009).

4.4 Walmart in South Korea

In light of the outlined scenario Walmart entered the market in 1998 by purchasing the existing and dismissed facilities of Korean Makro and by entirely restructuring so as to incorporate the features of the US business model. Its entrance took place when South Korea was fully dealing with an economic crisis that marked a significant decline of the domestic currency (Coe & Lee 2006). Despite that, Walmart had hopes about the long-term potential of its operations in South Korea that in turn would increase the sales of its international division (Gandolfi & Strach 2009). Throughout its international venture in South Korea, however, Walmart was not able to understand local consumers preferences, which in turn, led to minimal revenues, incapable of covering the substantial upfront investments (Gandolfi 2007). It is possible to depict mainly four circumstances, which prevented Walmart from implementing its successful model: consumer behavior, pricing strategy, market penetration and positioning, and IT system (Kim 2008). With regards to consumer behavior, in South Korea, Walmart failed to create the conditions necessary for the “*value exchange*”, concept introduced by Grant and Schelsinger (1995). This concept highlights the importance of tailoring products and service in accordance with the value determined by customers rather than relying on competitor-based performance or considering customers’ preferences all equal cross-borders (Kim 2008). While in North America the value exchange was well matched with American customers as they were more willing to accept the trade-off between quality and low price, it did not fit, instead, with South Korean customers whose preferences and tastes differ significantly with respect to American customers (Kim 2008). They highly value the freshness of products and goods, which leads them to visit supermarkets or corner shops daily so as to grant a small volume of fresh products, whereas American customers tend to prefer long storage products (Kim 2008). As a result, South Korean consumers would only have visited Walmart stores when they had needed non-food products, whereas they would keep on preferring the local retailers for food purchases and daily-use products, highlighting the incompatibility of South Korean consumer behavior with Walmart retail format, which was aimed at serving infrequent bulk shopping (Kim 2008). A further difference between South Korean and American customers is the definition of value. While the low pricing offering matches the value expectations of American customers, South Korean consumers tend to show a different definition of value. Indeed, they tend to be more receptive to free products or promotional sales rather than to everyday low prices (Kim 2008).

The “Everyday Low price” strategy, source of competitive advantage in US and in other foreign markets, was not perceived as a determinant of value for South Korean customers, who are more quality conscious, more brand loyal and less incentivized to switch to less expensive products (Gandolfi & Strach 2009). Consequently, the EDLP strategy was perceived to be insufficient in value for local customers (Kim 2008). The lack of understanding of local preferences was also reflected in the stores layouts. All Walmart stores were centered around the expectations of US consumers who seek warm, standardized and friendly greeting layouts, but this type of layout does not fit with the characteristics of South Korean customers that, being visually-oriented customers, are attracted by aesthetically pleasant shopping environments and consequently they perceived Walmart stores as a warehouse-like atmosphere and cheap marketplace with poor quality products (Gandolfi & Strach 2009). An additional misstep was the choice of store location. To that aim, it is necessary to grant commercial and high traffic locations in order to consolidate the competitive position in foreign markets (Kim 2008). In the case of South Korea, this necessity is even more stronger for two reasons. Firstly, local consumers used and are still accustomed to purchase more frequently in metropolitan areas and prefer those stores with close proximity, and secondly, at that time local retailers had already set their activities in key commercial areas (Kim 2008). Conversely, the US retailer giant, in line with its business model, placed its stores mainly outside of cities, where the land prices were low, resulting in a replication of the US strategy of smaller city store build-up and affecting its marketing positioning (Kim 2008). Indeed, Walmart owned 16 stores throughout South Korea of which just one was in the metropolitan area of Seoul. Being not strategically positioned, stores failed to attract a large number of customers and to generate sufficient traffic. Figure 8 shows that out of 98 total retailers, those that placed (25) their store location in the metropolitan area of Seoul have experienced on average higher sales (Han *et al.* 2002). With regards to the IT system, Walmart faced several challenges for its implementation in South Korea. Its superior information technology system is a source of its competitive advantage as the US retail giant can have access to the supplier operational process and costs, can negotiate the vendor prices and can capture the American customer (Kim 2008). The implementation of this integrated system in South Korea, however, was hindered by local retailing conditions such as local protectionism and supply chain fragmentation (Han *et al.* 2002). Furthermore, South Korean vendors were not willing to have a disclosed communication with Walmart through the EDI and they were able to exert a relative market power, being able to rely on a wider range of local retailers (Kim 2008). Not being in the position of benefiting from its market power and lacking control over the supply chain, Walmart was not able to develop a centralized distribution network, resulting in the impossibility to fully replicate its business model which

compromised its price competitiveness (Kim 2008). Figure 9 summarizes the main outcomes of Walmart venture in South Korea. Although the findings are dated back to 2000 when Walmart owned only five stores throughout South Korea, they already depict what would have been its destiny in the region, which is not the success to which the US giant was and is still accustomed to. Walmart reported on average the lowest sales compared to the other retailers, being equal to W216.27 vs W242.95 million and was paying on average rental fees twice as much its counterparts in the region (Han *et al.* 2002). The rent per square foot, being bigger than the sales per square foot, clearly shows how Walmart was incapable of covering its renting expenses through sales. Hence, the results confirm that disadvantageous position that Walmart had suffered since 2000 as result of scarce knowledge about the market, which will end up with its withdrawal few years later after having sold its stores to Shinsegae in a deal worth 800 billion Won (Gandolfi & Strach 2009).

4.5 A comparison with its counterpart Tesco

Differently from Walmart, the British retailer, Tesco, has entered international markets by choosing the entry mode according to the extent to which foreign markets allow for standardization or demand for localization (Coe & Lee 2006). Following the consolidated position achieved in the British distribution sector, Tesco started planning the feasibility to expand in East and Southeast Asian markets, given the overall economic conditions of the region. Indeed, in 1998 the burst of the economic crisis made particularly attractive for European and American companies to reach out the country as the prices of Asian companies fell dramatically (Suh & Howard 2009). At the time speaking, on one side, there was Tesco looking for a company to take over in South Korea, and on the other side there was Samsung Corporation that, providing customers with consumer goods and groceries through its discount retail stores, was coming to terms with the economic crisis and with an internal restructuring strategy. Samsung was suffering from the consequences of the financial crisis in terms of lower consumer confidence and higher costs of financing, which resulted in an accumulated loss equal to approximately \$200 million, but at the same time it did not want to abandon the attractive retailing sector and was looking for foreign companies to raise capital (Suh & Howard 2009). Conversely, Tesco realized that it could not survive in the South Korean market given the existing multinational and local companies and recognized the importance to join forces with a local partner so as to create synergies and benefit from its knowledge about the country (Suh & Howard 2009). In light of that, Tesco entered the South Korean market through a joint venture with the Samsung Corporation distribution unit and opened its Homeplus chain

in 1999 (Coe & Lee 2006). Initially, Tesco secured the 51% of stake within the firm that in a later stage it was increased by 8% (Suh & Howard 2009). The terms of the deal entailed to maintain all Samsung employees and to appoint local managers as CEOs of Samsung Tesco. These choices already reflect the intention of the British retailer to be highly responsive to local needs. As a result of the joint ventures, there were mutual benefits for both parties. On Tesco side, being completely unknown in the South Korean market, the joint-venture enabled to rely on a valuable local partner in a market, characterized by strong nationalistic outlook and fierce competition among local rivals (Coe & Lee 2006). Conversely, from Samsung perspective, the joint venture allowed to sort out the liquidity problems that were affecting the corporation by injecting additional and sought-after funds (Suh & Howard 2009). Liquidity problems arose from the wrong decision to open the major stores simultaneously during the period in which the economic crisis unfolded, resulting in higher financing costs and less liquidity (Suh & Howard 2009). As inferable, joining forces with Tesco has enabled to clear all debts and rehire those employees that were dismissed during the crisis (Coe & Lee 2006). The joint venture secured Tesco-Samsung rapid revenue growth and the recognition as the second largest discount store in South Korea, summarized in Figure 10. The partnership allowed Tesco to conquer a strong market position, becoming the second largest retailer since 2002 and lagging only E-Mart². The rapid growth and success in a market, where other transnational retailers were forced to quit, are imputable to the joint venture with Samsung, which provided a competitive advantage both in terms of consumer understanding and adaptation, and of its ability to pick the key traffic generating locations (Suh & Howard 2009). The choice of the mode entry has allowed the strategic localization, deemed crucial to survive in the South Korean market (Coe & Lee 2013). In a nutshell, the joint venture between Samsung-Tesco has set the foundations for the development of a “*glocal administration*”, through which its core competences were combined with a local workforce and with a detailed assessment of consumer preferences and tastes (Suh & Howard 2009). Indeed, Homeplus took on Tesco business model, its balanced scorecard approach to performance management, its innovative and operative systems, but still keeping the focus on Korean customers’ needs (Suh & Howard 2009). Having understood the importance of being locally responsive, Tesco maintained the same name developed by Samsung to market its products, willing to deliver the image of a still Korean rather than of a foreign retailer (Coe & Lee 2013). Homeplus stores were operated as *value stores* in order to combine the attributes of discount and department stores and at the same time to offer a unique and differentiated combination of price and quality (Coe & Lee

² E-Mart is the leading South Korean retailer that will acquire Walmart stores after its withdrawal.

2006). The value store was aimed at providing an “*one stop living*” service to its customers (Suh & Howard 2009). The concept of this new format revolves around the recognition that a store cannot simply be a place for shopping but it should be devised so as to provide customers with solutions to problems affecting the everyday life. (Suh & Howard 2009). Also, the access to the knowledge of a local partner gave Tesco the insight on how to shape the power relations among different actors involved in the retailing sector such as suppliers, local manufacturers and other retailers (Coe & Lee 2006). The supply chain of Tesco-Samsung has been devised to provide high quality products to South Korean customers. Even though some standardized products were sourced globally, a large proportion was mainly sourced through direct procurement channels with local manufacturers and producers (Coe & Lee 2006). The main focus on local sourcing reflects the retailing South Korean market in which manufacturers, dominated by the South Korean conglomerates, are still dominant as they offer several products to retailers (Suh & Howard 2009). In the attempt to offset the high bargaining power of manufactures, Tesco-Samsung has adopted different strategies (Coe & Lee 2006). On one side, it seeks to increase the number of private labels to gain more market power, as it can foster control over the supply chain and enhance growth by setting the conditions for differentiation from competitors (Coe & Lee 2006). The second component of its strategic behavior, instead, refers to the efforts of the company to build cooperative relationships and to spread its vision with local manufacturers, vendors and suppliers through frequent meetings carried out by category managers (Coe & Lee 2013). Moreover, the success of the joint venture is even more remarkable if the efforts of Tesco to avoid culture collision are taken into account. It was deemed crucial that only the hybridization of the South Korean and British culture could both offset one of the potential side-effects of the joint venture and win the initial hostility of local employees and gain their loyalty. In view of it, the CEO of Tesco-Samsung created the *Shinbaration*, which combines the excitement of the South Korean culture and the rationality typical of the British business culture (Coe & Lee 2013). This concept implies a strong sense of community in the business environment, team orientation and a flexible approach (Suh & Howard 2009). A further feature of Samsung-Tesco joint venture was the high degree of autonomy in terms of decision making granted to the local CEO with the overall intent to be perceived as a local retailer (Suh & Howard 2009). Under these circumstances, Tesco-Samsung was able to shape its own strategic pattern in terms of markets niches, investments and employment policies (Coe & Lee 2013). With regards to the latter, it is noteworthy to mention the measures taken to improve the attitudes of local employees, such as English-Language skills, information technology and capability development, regarded paramount to ensure the shift towards a more global corporate culture (Coe & Lee 2006)

5. Conclusions

The comparison of the different outcomes of the two biggest retailers in the same market has undoubtedly shown that the decision of an entry mode rather than another has implications in both how a MNC is able to develop a competitive advantage and how it can affect its positioning in the minds of local customers (Kim 2008). Nevertheless, Walmart's failure in South Korea can be regarded both as strategic and operational one (Gandolfi & Strach 2009). Firstly, Walmart should have realized that, being the South Korean market already saturated even before its entrance in South Korea, entering through a brownfield investment and in a later stage increasing its ownership in terms of new stores were not suitable with the structure of the market and prevented it from successfully allocating capital and resources. Moreover, the type of entry mode failed to gain insight into the needs of local customers, resulting in wrong operational decisions in terms of value proposition, management of operations and choice of the proper location, which ultimately failed to attract South Korean customers (Gandolfi & Strach 2009). Conversely, the joint-venture approach of Tesco has resulted to be more successful and granted rapid growth than a direct market entry pursued by Walmart (Suh & Howard 2009). The reason mainly revolves around the knowledge provided by the local partner, which is an undoubtedly value-added to the multinational as the domestic partner possesses the relationship capital that the foreign firm lacks (Suh & Howard 2009). Nevertheless, the analysis has shown that the choice of the entry mode has not been the only and main factor of Walmart's failure in South Korea, as it also derives from having overestimated the market prospects by paying more attention to macroeconomic factors, such as favorable economic growth and liberalization of the South Korean retailing sector, rather than focusing on the significant differences between US and South Korean customers and on the intense competition among major retailers (Kim 2008). Consequently, Walmart should have realized whether South Korea was so crucial for its international expansion and if so, it would have been paramount to find a balance between US business model and local customers' instances. However, as a qualitative paper, the use of a single case study can provide little basis for the generalization of findings and conclusions and may suffer from biases, influencing the direction of conclusions and its validity (Yin 2003).

6. Appendix

Figure 1: Walmart International Value Sales by Country 2016 (Walmart Annual Report, *retrieved from Euromonitor 2017*)

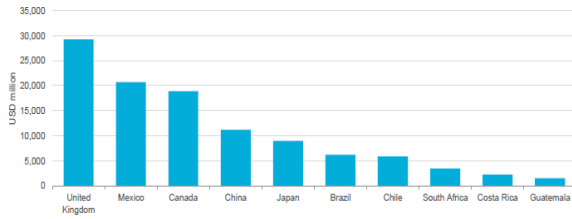


Figure 2: Domestic and International Store Counts FY 2012-2017 (Walmart Annual Report, *retrieved from Euromonitor 2017*)

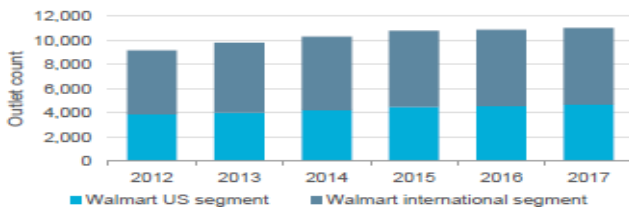


Figure 3: Walmart Domestic vs International Sales 2011-2016 (Walmart Annual Report, *retrieved from Euromonitor 2017*)

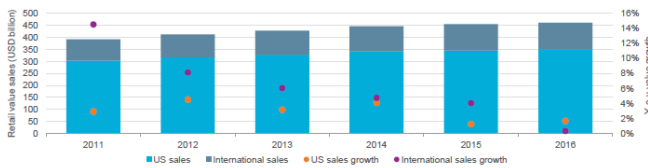


Figure 4: South Korean Market structure from 1996 to 2006 (Woori Investments & Securities Co, *retrieved from Yong-Gu Suh & Elizabeth Howard, 2009*)

	Sales by channel (billion won)	
	1996	2006
Discount stores	2.50	23.5
Department stores	12.4	17.1
Online shopping	0.03	7.90
Supermarkets	5.50	7.30
TV homeshopping	0.58	4.98
Convenience stores	0.90	4.40

Figure 5: Discount Stores Growth in South Korea until 2006 (Korea Federation of small and medium Business 2006, *retrieved from Yong-Gu Suh & Elizabeth Howard, 2009*)

	Number of stores	Sales (billions won)
2000	163	10.5
2001	198	13.8
2002	232	17.4
2003	250	19.5
2004	276	21.5
2005	307	23.5
2006	342	25.4

Figure 6: Sales and Costs of retailers based on their nationality (Monthly Discount Merchandise published by Korean Superchain Association 2000, retrieved from Han et. al. 2002)

Variables	Total (N = 98)	Korean (N = 76)	American (N = 8)	Others (N = 14)
Sales per operating day	W241.58	W224.69	W234.45	W337.36
Sales per square foot	W0.8654	W0.8722	W0.6730	W0.9388
Rent per square foot	W0.5051	W0.4097	W0.8487	W0.8286
Rate of change in sales over 1998	14.46% (n = 88)	18.30% (n = 71)	9.07% (n = 8)	- 11.05% (n = 9)

Figure 7: Hofstede model applied to South Korea (Source available at <https://www.hofstede-insights.com/country-comparison/south-korea/>)

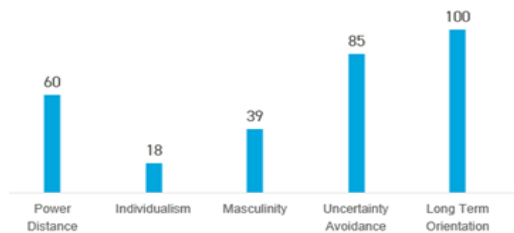


Figure 8: Sales and cost information (MIn Won) based on the type of location (Monthly Discount Merchandise published by Korean Superchain Association 2000, retrieved from Han et. al. 2002)

Variables	Total (N = 98)	Seoul (N = 25)	Others (N = 73)
Sales per operating day	W241.58	W299.93	W221.60
Sales per square foot	W0.8654	W1.1094	W0.7819
Rent per square foot	W0.5051	W0.5928	W0.4751
Rate of change in sales over 1998	14.46% (n = 88)	19.56% (n = 22)	12.76% (n = 66)

Figure 9: Comparison between Walmart and other retailers (Monthly Discount Merchandise published by Korean Superchain Association 2000, retrieved from Han et. al. 2002)

Variables	Total (N = 98)	Wal-Mart (N = 5)	Others (N = 93)
Sales per operating day	W241.58	W216.27	W242.95
Sales per square foot	W0.8654	W0.5784	W0.8809
Rent per square foot	W0.5051	W0.8539	W0.4864
Rate of change in sales over 1998	14.46% (n = 88)	5.44% (n = 5)	15.0% (n = 83)

Figure 10: Sales Performance in Won of the top retailers in South Korea from 1999 to 2006 (Korea Chain Store Association, retrieved from Neil M. Coe & Yong-Sook Lee, 2013)

	1999	2000	2001	2002	2003	2004	2005	2006
E.Mart	1318	2358	3430	4658	5125	5831	8106	7343
Homeplus	512	562	1271	2146	2575	3035	3568	4065
Lotte-Mart	248	1011	1274	1893	1494	2328	3205	3708
Carrefour	785	1039	1149	1374	1460	1604	1667	
Wal-Mart	302	402	569	747	786	776	728	
Homever								1821
Costco	242	255	333	415	439	447	511	621

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Disclaimer: *The following Work Project has been written and will be defended in accordance with the rules of the Double Degree Program between Luiss Guido Carli (Rome) & Nova SBE.*