

5.23: Entry Strategies - Timing

In addition to selecting the right mode of entry, the timing of entry is critical. Just as many companies have overestimated market potential abroad and underestimated the time and effort needed to create a real market presence, so have they justified their overseas' expansion on the grounds of an urgent need to participate in the market early. Arguing that there existed a limited window of opportunity in which to act, which would reward only those players bold enough to move early, many companies made sizable commitments to foreign markets even though their own financial projections showed they would not be profitable for years to come. This dogmatic belief in the concept of a first-mover advantage (sometimes referred to as "pioneer advantage") became one of the most widely established theories of business. It holds that the first entrant in a new market enjoys a unique advantage that later competitors cannot overcome (i.e., that the competitive advantage so obtained is structural and therefore sustainable).

Some companies have found this to be true. Procter & Gamble (P&G), for example, has always trailed rivals such as Unilever in certain large markets, including India and some Latin American countries, and the most obvious explanation is that its European rivals were participating in these countries long before P&G entered. Given that history, it is understandable that P&G erred on the side of urgency in reacting to the opening of large markets such as Russia and China. For many other companies, however, the concept of pioneer advantage was little more than an article of faith and was applied indiscriminately and with disastrous results to country-market entry, to product-market entry, and, in particular, to the "new economy" opportunities created by the Internet.

The "get in early" philosophy of pioneer advantage remains popular. And while there are clear examples of its successful application—the advantages gained by European companies from being early in "colonial" markets provide some evidence of pioneer advantage—first-mover advantage is overrated as a strategic principle. In fact, in many instances, there are disadvantages to being first. First, if there is no real first-mover advantage, being first often results in poor business performance, as the large number of companies that rushed into Russia and China attests to. Second, pioneers may not always be able to recoup their investment in marketing required to "kick start" the new market. When that happens, a "fast follower" can benefit from the market development funded by the pioneer and leapfrog into earlier profitability. For a more detailed discussion, see Tellis, Golder, and Christensen (2001).

This ability of later entrants to free-ride on the pioneer's market development investment is the most common source of first-mover disadvantage and suggests two critical conditions necessary for real first-mover advantage to exist. First, there must be a scarce resource in the market that the first entrant can acquire. Second, the first mover must be able to lock up that scarce resource in such a way that it creates a barrier to entry for potential competitors. A good example is provided by markets in which it is necessary for foreign firms to obtain a government permit or license to sell their products. In such cases, the license, and perhaps government approval, more generally, may be a scarce resource that will not be granted to all comers. The second condition is also necessary for first-mover advantage to develop. Many companies believed that brand preference created by being first constituted a valid source of first-mover advantage, only to find that, in most cases, consumers consider the alternatives available at the time of their first purchase, not which came first.

 Minicase: Starbucks' Global Expansion (Starbucks: A Global Work-in-Process (2006); <http://www.starbucks.com>)

Starbucks' decision to expand abroad came after an extended period of exclusive focus on the North American market. From its founding in 1971, it grew to almost 700 stores by 1995, all within the United States and Vancouver, Canada. It was not until the next decade that Starbucks made its first entry into international markets. By 2006, Starbucks operated approximately 11,000 stores, with 70% in the United States and 30% in international markets, and international revenue had grown to almost 20% of Starbucks' total revenue. Starbucks offered the same basic coffee menu internationally as it did in the United States; however, the range of food products and other items, such as coffee mugs stocked, varied somewhat according to local customs and tastes.

Along with many other companies that pursue global expansion, Starbucks continually faces questions about where and how to further increase its global presence. Should the emphasis be on growth in existing countries or on increasing the number of countries in which it has a presence? How important is the fact that international markets so far have proven less profitable than the U.S. and Canadian markets?

Starbucks in Japan. Interestingly, Starbucks' first foreign move (i.e., outside the United States and Canada) was a joint venture in Japan. At the time, Japan had the second largest economy in the world and was consistently among the top five coffee importers in the world.

The decision to use a joint venture to enter Japan followed intense internal debate. Concerns among senior executives centered on Starbucks' lack of local knowledge, and questions were raised about the company's ability to attract the local talent necessary to grow the Japanese business quickly enough. Starbucks was acutely aware that there were significant differences between doing business in Japan and in the United States and that it might not have enough experience to be successful on its own.

Among other factors, operating costs were predicted to be double those of North America, and Starbucks would have to pay to ship coffee to Japan from its roasting facility in Kent, Washington (near Seattle). In addition, retail space in Tokyo was 2 to 3 times as expensive as in Seattle. Just finding rental space in such a populous city might prove to be a tremendous challenge. Starbucks concluded it needed to form an alliance with a local group that had experience with complex operations and real estate.

Starbucks executives worried that a licensing deal would not be the right solution. Specifically, they were concerned about possible loss of control and insufficient knowledge transfer to learn from the experience. A joint venture was thought to be a better answer, and, after a long search, Starbucks approached Sazaby, Inc., operators of upscale retail and restaurant chains, whose president had approached Starbucks years earlier about the potential of opening Starbucks stores in Japan. Similarity in values, culture, and community-development goals between Starbucks and Sazaby were important considerations in concluding the 50-50 deal. The two companies were equally represented on the board of directors of the newly created Starbucks Coffee Japan. Starbucks was the sole decision-making power in matters relating to brand, product line advertising, and corporate communications, while decisions regarding real-estate operational issues and human resources were handled by Sazaby. Despite strong local competition, the venture was successful from the start. By fiscal year 2000, Starbucks Coffee Japan became profitable more than 2 years ahead of plan.

Starbucks in the United Kingdom. Unlike its expansion into Asia and (later) the Middle East, Starbucks chose to enter the United Kingdom through acquisition rather than partnerships. Speed was a major factor in Starbucks' decision to enter the fast-growing UK market by acquisition. In addition, the culture, language, legal environment, management practices, and labor economics in the United Kingdom were considered sufficiently similar to those that Starbucks' management already knew. This meant that a 100%-owned UK subsidiary could be successfully established from the outset. In May 1998, Starbucks acquired the Seattle Coffee Company, which had a presence in the United Kingdom for some time. This fast-growing chain was modeled on its own style of operations and, at the time of the purchase, had 56 retail units. The Seattle Coffee Company was an attractive acquisition target because of its focus: relatively small market capitalization and established retail units. By 2005, Starbucks had 469 stores in the United Kingdom, which made it the third largest country, after the United States and Japan, to serve Starbucks coffee.

Licensing in China. In a number of developing markets, including China, Starbucks chose to enter into minority share licensing agreements with high-quality, experienced local partners in order to minimize market-entry risks. Under these agreements, the local partners absorbed the capital costs (real estate, store construction) of bringing the Starbucks brand abroad. This eliminated the need for substantial general and administrative expenses by Starbucks and enabled it to establish a presence in foreign markets much more quickly than it would have if it had to invest its own capital and absorb start-up losses.

Risk was also a major consideration when Starbucks looked to enter China. While offering high-volume opportunities in an untapped coffee market, the prevailing culture and politics in China potentially posed significant problems. In April 2000, Beijing city authorities ordered Kentucky Fried Chicken to close its store near the Forbidden City when its lease expired in 2002. Similarly, under pressure from local authorities, McDonald's removed its golden arches from outlets near Tiananmen Square. These incidents demonstrated China's ambiguous attitude toward a growing Western economic and cultural influence.

Another major concern with starting operations in China was recruiting the right staff. Uniformity of customer experience and coffee quality was the key driver behind the Starbucks brand; failure to recruit the staff to ensure these key criteria not only would mean failure for the Chinese retail outlets but also could harm the company's image globally.

Although these factors made licensing an attractive entry model, with growing experience in the Chinese market, Starbucks is steadily reducing its reliance on the licensing model and switching to its core company-operated business model to increase control and reap greater rewards.

Starbucks' globalization history shows that while it was a "first mover" in the United States, it was forced to push harder in international markets to compete with existing players. In Japan, Starbucks was initially a huge success and became profitable 2 years earlier than anticipated. However, just 2 years after Starbucks Japan had become profitable, the company announced a

loss of \$3.9 million in Japan, its second largest market at the time, reflecting a major increase in local competition. Additional international challenges were a result of Starbucks' chosen entry mode. Although joint ventures provided Starbucks with local knowledge about the market and a low-risk entry into unproven territory, joint ventures did not always reap the rewards that the partners had anticipated. One key factor was that it was often difficult for Starbucks to control the costs in a joint venture, resulting in lower profitability.

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