

Controlling International Expansion

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Despite the apparently inexorable march of globalization, many firms struggle for long periods to make their foreign ventures a success. Sometimes they fail altogether. This article argues that the key to success is to stay in control of the process of internationalization. To achieve this, firms need to follow a set of basic principles that will cause their expansion to unfold in a consistent pattern. They should build on the company's existing knowledge base, give priority to expansion via greenfield investment (not acquisition), avoid home-grown mental inertia, and match the pace of their expansion with their capacity to assimilate.

Direct investment in foreign countries continues to rise and will soon reach over a trillion dollars per annum, according to United Nations forecasts. But the performance of firms outside their domestic borders is decidedly mixed. Some firms achieve huge profit gains while others seem to accumulate mounting losses.

Consider Ahold, a large retailer from the Netherlands, which has successfully concentrated on operating high-quality supermarkets. About a decade ago, Ahold decided to expand abroad. It targeted the US, where it acquired TOPS markets and, later, continued to grow through the takeover of chains such as Stop & Shop and Giant Landover. Today, turnover in the US alone is over \$20bn, representing 60% of the company's total sales. The company also set up operations in a number of countries in Latin America, and in Southern and Eastern Europe, all of them profitable. Recently, it has set foot in the Far East. The share price has tripled over the last five years.

Around the same time, HBG, another large company from the Netherlands, also decided to expand abroad. HBG had built up superior technological skills in the area of construction works, dredging, civil and maritime engineering. It started ambitiously, acquiring large companies in various countries, and especially in Germany. HBG, however, has been struggling with its affiliates ever since, forced to report huge losses on foreign operations year after year, giving its shareholders no increase in share price at all. Finally, HBG terminated many of its foreign ventures.

Why is one company so successful while another one, in comparable circumstances, fails big? To answer this question, I collected data on the foreign expansion of 25 Dutch multinationals – including Ahold and HBG – and analyzed them using various statistical techniques. From these analyses, a remarkable conclusion emerged. It was not that the unsuccessful

companies like HBG had made bad individual decisions: considered in isolation their decisions made good sense and were generally well thought through. The problem consisted in how these decisions related to one another: all of them were treated as *individual* moves. Successful companies like Ahold, by contrast, revealed clear and consistent patterns in their expansion over time.

Why do firms need to expand by means of a consistent pattern, rather than through individual, ad-hoc ventures? A strange, foreign country requires a firm

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to adopt many new skills and develop additional knowledge. In this article, I argue that these new skills and additional knowledge can be obtained and fully exploited only if a firm expands systematically.

Each step must follow logically from the prior one. If treated in isolation, a firm will not be able to grasp the new experiences presented by a foreign venture and, as a consequence, will not be able to manage it. Therefore, firms have to expand following a logical path, where established affiliates act as stepping-stones from which to launch further expansions (see also Yip *et al* 1998).

Does this mean that a firm needs to plan ahead its entire path of international expansion? Certainly not. The dynamics of the international arena require a firm to be flexible in responding to opportunities and threats when and wherever they emerge. Instead, what a firm needs to do, when assessing its (next) foreign venture, is to follow a number of basic rules. These principles, that serve as “footholds” for international market entry, will restrain a young internationalizing firm from overburdening its capacity to learn, and will cause an expansion path to unfold in a consistent and coherent manner. My research revealed a series of four rules, summarized in the Figure.

Build on the Company’s Existing Knowledge Base

The first principle when setting up a subsidiary in a foreign country is to establish the venture based on what the company already knows. This means that the firm should try to minimize everything that is new about a venture, on top of the unfamiliar

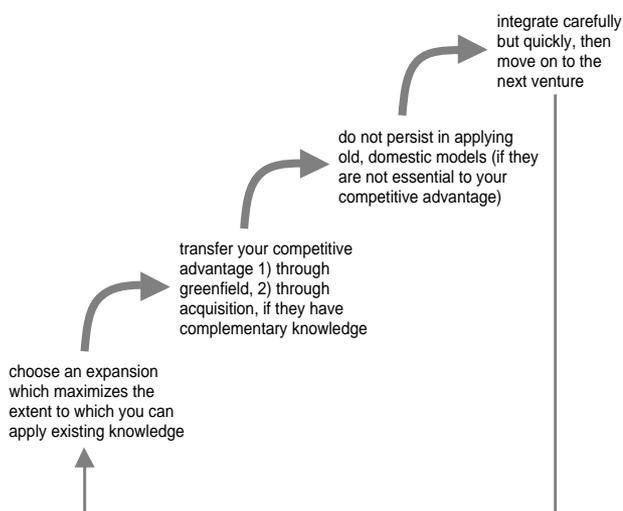
circumstances created by the fact that the venture is taking place in a strange country.

It is easy to underestimate the number of things that one does not know about doing business in another country. Cultural differences, language barriers, infrastructure, institutional and legislative differences, different consumer preferences, competitors with a different repertoire, and so forth. Together they form what is often referred to as “the liability of foreignness”; a foreign company has a fundamental disadvantage compared to its local competitors, who do know all these things.

Hence, if a firm wants to beat its competitors, it needs something – some competence, resource, or skill – that helps it to overcome the liability of foreignness. Therefore, when a company seeks to expand abroad it should identify its strongest competitive advantage and select the country where this can best be applied.

Ahold, for instance, first expanded abroad in the supermarket business. This was sensible. A company’s best bet is usually in its core business. Only after getting to know how to operate in its core business in the new country with all of its idiosyncrasies (in this case the US), can a firm start to conquer adjoining markets. Now that Ahold has learned how to manage supermarkets in the US, it is moving into online ordering – for example through the acquisition of the internet grocer Peapod – and business-to-business deliveries – for example through the recent acquisition of US Foodservice.

Successful International Expansion: Four Steps



Moreover, a company's best opportunity usually lies in a country that is culturally similar to its home market. It is here that its competitive advantage is most likely to catch on. A major temporary employment agency from the Netherlands, for example, based its competitive advantage on its ability to operate in close co-operation with unions, employers, and legislators. One of its first ventures, in Russia, did not become a success. The institutional framework in Russia appeared so different that it did not support the application of a Dutch-grown competitive advantage. Indeed, research indicates that companies that sequentially enter countries with increasing cultural distance outperform companies that take large leaps into the unknown (Barkema *et al* 1996). Organizations need to gradually build up their capacity to operate abroad.

Market knowledge is not the only area where firms should carefully build on their existing capabilities. Partnering is another one. Often, when firms want to set foot in a foreign market, they decide to do it through a joint venture. They figure: "We have the knowledge about the product and the business, but lack the skills to operate in this country. They have the knowledge about the local market, but could use some keen production skills". And forces are joined.

Partnerships might work. However, they often don't. It is easy to overlook that partnering is a skill in itself. According to the chairman of Corning Glass, partnering skills include "the ability to cope with the constant compromise and give-and-take that successful joint ventures require", and the ability, when necessary, to "sit back and let someone else be in the driver's seat". Partnering is never easy. But partnering with a firm from a strange foreign culture is particularly intricate.

A joint venture with a local partner will work only if the firm has a lot of experience co-operating – perhaps in its home country – or when the firm is already familiar with the foreign market. If a firm lacks both types of experience, it is a hazardous enterprise (Barkema *et al* 1997). For example, some time ago, Peugeot saw itself forced to wind down its joint ventures in both India and China. Yet, the failure of these ventures did not come as a surprise: Peugeot was neither used to sharing control over its manufacturing plants, nor did it have much experience in the region. If co-operating with a foreign partner is not related to anything an

organization has dealt with before, it will not be able to grasp what it takes to make the venture work.

Make Greenfield Investment, Not Acquisition, the Default Option

Once decided what sort of a subsidiary the company wants and where – given its current knowledge base – the second rule is to first consider building it up from scratch. Only if a company feels it is in need of something that it cannot develop itself should it consider taking over an existing firm. Making an acquisition on the basis that "I will turn it around, infuse it with my own superior knowledge, and boost its performance" is a perilous affair.

"a greenfield investment forces you to exactly define what is likely to give you your competitive advantage"

Often, when managers have set their mind on a certain market, they start searching for a suitable acquisition candidate. Why? Because a greenfield operation can be superficially more intimidating than an acquisition. Greenfield involves building from scratch. This is laborious, may take many years to come to fruition (perhaps beyond retirement), and looks like a risky undertaking.

There are two reasons why a company should first consider the feasibility of greenfield rather than acquisition when expanding into a new foreign market. First, a greenfield investment forces you to exactly define what is likely to give you your competitive advantage. Second, a competitive advantage is often much more difficult to exploit through an acquisition.

Consider the position of Cisco Systems when planning its biggest foreign expansion ever, in Amsterdam. The affiliate is meant to enable Cisco to further apply and exploit its current capabilities in the European market. For this purpose, Cisco does not acquire another company; it builds up the entire affiliate from scratch, including the hiring and training of about 5,000 people, the entire infrastructure, and accommodation. Doing this enables Cisco to incorporate its firm-specific advantages from the outset, which is grounded in a complex combination of technology, culture, and management practice.

Building up a new affiliate stimulates a firm to define what the precise basis of its competitive advantage is,

The Research

The propositions put forward in this paper are based on research over the past five years on the development paths of 25 Dutch multinationals. All the foreign expansions of these firms during the last three decades – acquisitions, greenfield investment, and joint ventures, a total of 829 cases – were analyzed in terms of a number of indicators, such as their success rate, timing, business domain, and geographical location. In addition, these indicators were related to the overall performance of the expanding companies. What resulted were clear patterns of (un)successful expansion. The results are supplemented with insights from the research of others who have uncovered similar patterns for American and Japanese firms (Chang 1995, Li 1995).

and forces it to translate and transfer it to the foreign setting. Yet, doing so will also clarify what it is the firm should *not* transfer to the subsidiary. As a result, it becomes clear what the local affiliate needs to do to adapt to local circumstances (Das 1993). Yahoo!’s webpages, for example, have a similar design everywhere, and they offer the same services, but the content is carefully tuned to local needs. Likewise for Compuserve and, nowadays, Amazon. These companies have created foreign subsidiaries that are based on the same business concept and technology, but where local employees tailor content, marketing, and customer service.

Acquisition, on the other hand, is a daunting operation to transfer competitive advantages to a strange, foreign market. Changing an acquired organization is always a complicated and lengthy process even in a domestic context – one that is often underestimated. Trying to change an established company from an unfamiliar culture in such a way that it can be infused with the (superior) technology and work methods of an alien, acquiring firm is far more so: integration problems will grow exponentially. HBG found this out during its (failed) attempts to make its German subsidiary profitable. A foreign firm simply lacks the in-depth knowledge of the local context necessary to make such a complicated process work.

So, when should a firm acquire? An acquisition *can* be very useful, but only if done because it has something to offer that the expanding firm cannot feasibly develop by itself. For example, the only reason why Cisco engages in acquisitions is to obtain new capabilities. Likewise, a foreign company should not be acquired to change it into the spitting image of the acquiring firm by installing all sorts of home-grown methods and routines. Then you are better-off with greenfield. It should be acquired precisely because of its own, current capabilities: the marketing knowledge to reach specific local customers, the human resource skills necessary to attract and manage a local workforce, or the connections with local government, suppliers, and institutions. Thus, an acquisition in a strange country should never be done out of superiority, but solely from a mindset to learn from the acquire (Vermeulen and Barkema 2001a).

Ahold, the Dutch multinational retailer, has been a favorite of analysts and investors on the Amsterdam Stock Exchange for many years, largely because of its remarkably successful acquisition record. Ahold, however, does not set out to take over underperforming firms. As Cees van der Hoeven, CEO of Ahold puts it: “We don’t fancy poorly running companies, but want companies with good management and good performance.” The attitude is to engage in an exchange of knowledge, and to learn from each other: “Our people are trained not to say ‘we know everything better’. Rather they are expected to learn from it.”

And this might work. A diversity of subsidiaries within one organization may prove to be fertile soil for the development of innovative ideas and competencies (Barkema and Vermeulen 1998). The different subsidiaries may learn from each other what their specific setting has inspired them to do best. Certain strengths, developed in a local setting inspired by specific circumstances, may prove to be of value in other parts of the organization. Ahold, for instance, found that Dutch supermarkets had developed superior skills regarding the efficient use of shop-space and shelving. This is not surprising given the smallness of the shops in the Dutch cities and communities. American supermarkets appeared to have superior skills in managing customer relations, because of the service-oriented nature of the US market. US supermarkets now adopt Dutch-grown routines on the use of shop-space, while Dutch supermarkets adopt

US routines on the maintenance of customer relations, such as the use of customer-cards.

In sum, I do *not* argue against all use of acquisitions in foreign expansion; I caution that foreign acquisitions rarely work out if it concerns under-performing companies that are expected to boost their performance through the adoption of the acquirer's work methods. If mere expansion and exploitation of existing competencies is what you have in mind, you are much better off with greenfield investments. Acquisitions may succeed, however, if one adopts the attitude to learn from them, and seeks to engage in a mutual exchange of knowledge.

Avoid Home-grown Mental Inertia

Once established, a foreign subsidiary is often granted quite a lot of autonomy. Sometimes it is attached to the parent company as a separate unit or division. Some practices may be transferred to the affiliate, and financial controls will be implemented, but considerable freedom is given to it, and its initial financial performance is treated with tolerance. This stage is referred to as "the honeymoon": things are new, things are exciting, and we are of good cheer.

What happens when the honeymoon is over? After a while, when performance is consistently below expectations, top management at headquarters begins to wonder what is wrong, and sets out to investigate, often to discover that the foreign subsidiary does not quite follow company prescriptions on how to produce, manage, and market.

The result is a foregone conclusion. The way things are organized and managed in the home country are the result of years of experience, and have brought the firm (and its directors) success and prosperity. Hence, top management takes control. It orders the subsidiary to clearly follow company regulations, and to produce and market following the proven formula. New management may be sent to the affiliate and new, strict directives will be issued. This time, they think, we will make it work.

But often it doesn't, as BMW found when it tried to impose its working methods onto Rover, or as Lincoln Electric discovered persistently when it tried to transfer its incentive system to various countries. Despite the considerable efforts and strict procedures, performance does not pick up. What is worse, it may

actually drop, sometimes quite dramatically. What is going wrong? What prevents the old models from working?

For sure, the company is trying hard enough. But it is doing the wrong things. It is trying to apply beliefs and practices from its own home country in a strange foreign setting. The old home-grown models simply do not work in the new situation. Incentive schemes from one country may not work in another, due to cultural differences; supplier schedules may not be workable in a country with a different infrastructure; and marketing campaigns may not appeal to people from a different culture. What is more, trying harder will just make things worse.

Consider the example of a German bank that set up a subsidiary in Singapore. It had prepared well, for example issuing clear descriptions of the financial products and services to be brought to the market, and how. What it had overlooked is that the Singaporean market is in many respects very different from the German one. The employees in the subsidiary, however, found this out quickly. They turned to sell their products through local intermediaries, who helped patch things up and make services more in tune with the local situation. Despite this palliative, the financial performance of the subsidiary was lagging behind expectations at German headquarters. Yet, headquarters' response was not to question the effectiveness of its products in the Singaporean market, but to issue the directive that all use of intermediaries was to be stopped.

The example represents a typical response for an internationalizing company in distress, and a sort of organizational behavior well known to management researchers. It is related to a phenomenon known as "the success trap"; when successful organizations are confronted with the failure of their established models, they do not respond by developing new ones, but by myopically trying to extend their existing ones (Hastings 1999, Sull 1999). But this actually aggravates the situation. In trying to dig themselves out of the hole, they just deepen it. Firms often set up foreign subsidiaries with the idea of further applying and exploiting what they have been doing so well in their own country. This is a good idea: they *should* build on their existing knowledge base. But it does

not mean that they should do everything exactly the same as in their home country. A different country means a different context, and in a different context one should do things differently. If the established models do not result in the same positive performance as back home – which is far from unlikely – the firm should not respond by trying harder, by taking control, and becoming stricter than ever. Its response should be to question and investigate what aspects of “the old way of doing things” can and should be preserved and which ones should be altered and adapted to the local circumstances (eg James 1994).

How can companies avoid failures? The first answer is that they can't. At least, not entirely. And that is an important lesson in itself. You can't learn to ride a bicycle and expect to never fall off. Likewise, you can't expand abroad and expect to get it right the first and every time. Organizations venturing abroad should be well prepared. This includes having the leeway to make mistakes and fail. Firms should reckon with foreign ventures not working out, at least not immediately. This also implies having the financial means to handle failure, and to forego returns for some period of time.

But although organizations will not be able to avoid all mistakes, they are, of course, hoping to minimize their probability. The way to do that is to maximize learning from prior experiences. That is what the principles described in this article help to do. They make actions and experiences interpretable. As such, firms should try to avoid failures by learning from them. *If* a mistake is made, the firm should carefully reflect, question, and interpret what caused it to happen. Too often, failures are denied, with “external circumstances” being held accountable. If failure occurs, it should be treated as an opportunity for learning. It may tell you how things should not be done and, hence, how you should do things differently the next time.

Match the Pace of Expansion with the Capacity to Assimilate

The final principle when expanding abroad is to carefully assimilate the subsidiary and, hence, not expand faster than you are able to assimilate. Firms should realize that a multinational organization is not

something you can (quickly) assemble, and that an international posture is not a position you simply choose and take up. A profitable multinational firm is a diverse yet coherent system, which consists of different, interacting elements. This is something you have to build one step at a time (Bartlett and Ghoshal 1989, Vermeulen and Barkema 2001b).

How much can you do? Consider Randstad. Randstad is the biggest temporary employment agency in the Netherlands (which has the most advanced temporary employment market in the world). Randstad has been very successful in its international expansion – a reason why its share price is now five times what it was five years ago. Randstad selects a country, penetrates it through a greenfield or an acquisition (dependent on local circumstances and the availability of high-quality candidates), and subsequently invests in its organic growth. When the company has established a strong foothold in the foreign market, its moves on to the next one. Moreover, it doesn't stop. It has upheld its pace for many years.

What makes Randstad successful is focus and patience. Entering a new market takes effort and time. The organization needs to invest in it, in terms of managerial attention and finance. Simultaneously expanding into a large number of countries scatters these efforts, which causes the subsidiaries to lack critical mass for too long. This is also true if one enters a country in very different lines of business at the same time. There is just so much an organization and its management team can grasp and accomplish. An organization cannot integrate large numbers of new elements *and* keep up its performance. It has to be able to assimilate them one by one.

Integration is necessary. If you do not integrate a company, you cannot learn from it, and if it doesn't get assimilated, it cannot benefit from you. In addition to the idea that an acquisition must have new knowledge to offer, Cisco uses three other criteria to judge whether a company is a suitable candidate for takeover:

- It must be relatively small;
- It must be comparable in organizational culture; and
- It must be physically close to one of its existing affiliates.

All these rules of thumb exist to smooth the company's integration process. Likewise for Ahold and Randstad. These companies pay great attention to the careful integration of their newly-formed foreign subsidiaries.

HBG on the other hand, the Dutch hi-tech construction company, made a big acquisition in Germany. But it left the new subsidiary largely autonomous (it even had its own foreign operations) – and it is not difficult to see why: the integration process of a large acquisition can lame an entire firm. The result, however, was unsatisfactory. The German affiliate never got to learn HBG's skills, and HBG never got to grips with the German venture. Currently, HBG is assimilating the parts of the subsidiary that it did not divest.

Certainly, you can quickly buy and start up a number of foreign subsidiaries. But for them to co-operate, interact, and benefit from each other as a coherent, integrated, international organization is something else again. It simply takes time and effort to assimilate newly-formed subsidiaries. What successfully-expanding companies such as Cisco, Ahold, and Randstad have in common is that they focus their efforts on a reasonably-sized venture, assimilate it, and then move on, without losing momentum.

Conclusion

When a firm decides that it wants to grow beyond the borders of its home country, it needs clear principles that will guide it through the expansion process. Setting up ventures in strange countries in a brash and precipitate manner will inevitably lead to failure (Monti and Yip 2000). The firm will simply not be able to interpret its experiences, and improve its actions in turn. This may ultimately force a firm to withdraw from foreign operations entirely, leaving it with a heavy debt burden, if it survives the adventure at all.

The principles described in this article and summarized in the box can assist a firm to make consistent choices on the time, place, and mode of its international ventures. Following these steps or "footholds" will constitute a coherent pattern, where one venture is the logical ramification of the prior one. This will enable a firm to grasp the challenges it faces, and keep it from straining its current abilities, thus putting it on a path of progressing international growth.

Together, the four principles comprise a logic for international expansion. They describe how to grow

Footholds for International Expansion

Build on the company's existing knowledge base

- *Look for the country that most resembles yours*
- *Let the new country be the only thing that is new about the venture*
- *Expand in a familiar business*
- *Use a (local) partner only if you have experience with partnering in your own country*

Make greenfield, not acquisition, the default option

- *Grow through greenfield investments if you seek to transfer and exploit a complex competitive advantage*
- *Do not acquire companies which you have to change extensively*
- *Explicitly set out to learn from each other – acquisition from acquirer and vice versa.*

Avoid home-grown mental inertia

- *Failures will be inevitable*
- *Do not automatically blame failure on external circumstances*
- *Interpret failure as an indication that you are doing the wrong things, rather than as an indication that you are not doing things well enough*
- *Question whether your old models are entirely appropriate in the new setting*
- *Adapt home-grown models to the local setting*

Match expansion pace with capacity to assimilate

- *Don't be seduced by opportunities in many countries, do not scatter your efforts, but focus your capacity to expand*
- *Treat subsidiaries as elements of a system; add them one by one, assimilate them carefully*
- *Expand at a constant, rhythmic pace*
- *Don't set too fast a pace*

as a young multinational organization. Setting up ventures in a strange foreign country coerces a firm to learn new things. New models have to be adopted and hence, old domestic ones unlearned. Therefore, an international firm has to expand incrementally, forming and adding elements in a clear and ongoing fashion, building on, and incorporating its experiences. In this manner, a company gradually masters how to operate and prosper abroad.

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