

# 2 ASSESSING MARKET POTENTIAL: ESTIMATING MARKET SIZE AND TIMING OF ENTRY

**A**lthough the Internet boom grabbed all the headlines for speculative excess and managerial misjudgment in the 1990s, there was another decision-making arena in which western executives seriously underperformed—market assessment and entry decisions, particularly with regard to large emerging markets such as China. In a retrospective commentary on what it describes as an “infatuation” *The Economist* commented, “Few companies are stupid, but many have behaved stupidly in China.”<sup>1</sup> Similarly, Harvard economist Pankaj Ghemawat reflects that “companies routinely exaggerate the attractiveness of foreign markets.”<sup>2</sup> Not only have many foreign market investments proven unprofitable, but many multinationals are now trimming back their foreign investments. For many, this is an unprecedented retrenchment in the previously uninterrupted internationalization of their business.

How can such sophisticated companies make such a fundamental error as misreading the size of a large market? It must be acknowledged, of course, that the first phase of the

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1. “Infatuation’s End,” *The Economist*, September 25, 1999.
  2. Pankaj Ghemawat, “Distance Still Matters: The Hard Reality of Global Expansion,” *Harvard Business Review* (September 2001): 3–11.

process of internationalization—the decision to enter a foreign market—is perhaps the most challenging of all. To assess the potential and dynamics of a market from outside (often in the absence of reliable market research) is obviously a difficult case of decision making under uncertainty. That companies so frequently make occasional mistakes is therefore perhaps not surprising. Look a little deeper into the decision-making process, however, and one often finds that the decision was taken in such a haphazard fashion that the company gave itself little chance of having made the right call about which market to enter. Instead, many companies succumbed to an expansionary zeal in which attention to rigorous market analysis was less prominent in decision making than visions of huge potential sales growth in new markets and a belief that there was a limited window of opportunity for entering the new markets and staking a claim on future riches.

Thus, for example, western car makers overinvested in China, lured by the country's population and no doubt partly motivated by the threat of saturation in their established western markets. While some were acting in the belief that they could preempt competition and gain first-mover advantage, "through the 1980s and 1990s, China disappointed. Carmakers came, made losses, argued with their Chinese partners, lamented the leakage of their technologies, and often left again."<sup>3</sup> Despite this, new foreign investment in 2003 was estimated by the *China Economic Review* to be creating at least 20 percent overcapacity relative to growth in consumer demand.<sup>4</sup> Similarly, Nestlé and Unilever, two of the world's giants in the food business, invested heavily in the ice cream market in Saudi Arabia, judging the market to be highly attractive by using established measures such as the proportion of youth in the population and the climate of the country. Yet, by 2001, both firms had exited the market, unable to reach profitability in the face of cultural barriers such as the inability of women to drive to supermarkets and low acceptance of ice

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3. "The Great Leap Forward," *The Economist*, January 30, 2003.

4. *Ibid.*

cream as an eat-at-home dessert.<sup>5</sup> Note that in both these examples, the companies involved were experienced international firms with a cadre of seasoned international executives. Both focused on top-line indicators, such as population, as a guide to market potential and underestimated the difficulties of market-specific factors such as regulatory or cultural barriers to growth, or underdeveloped distribution channels.

This chapter examines the two critical decisions involved at this stage of internationalization. The first is the choice of which market to enter—particularly the forecasting of market potential; the second is the timing of entry—particularly the question of first-mover advantage, one of the most prevalent items of conventional wisdom in the managerial and investment communities.

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## PITFALLS IN FOREIGN MARKET ASSESSMENT

There are a number of traps into which companies can fall when assessing foreign market entry. The first is to exaggerate the size and attractiveness of a market. In the internationalization boom of the 1990s, “strategic visions” were used to justify investments based upon flimsy analysis of markets, such as those based upon national populations (hence, China could be viewed as the world’s most attractive market). From the late 1980s onwards, a number of large markets were opened up, either as communist states collapsed or as governments began the process of economic liberalization. From 1985–1998, at least 54 countries became “open” and joined the global economy, increasing the share of the world’s population in “open” economies from 22 percent to 76 percent, an increase of over 3 billion people.<sup>6</sup> Faced by maturing markets in the developed world, western

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5. David J. Arnold, “SADAFCO,” Harvard Business School case study 9-599-021. Boston: Harvard Business School Publishing.

6. Robert E. Kennedy, “Policy Reform, Globalization, and New Opportunities in Emerging Markets,” Harvard Business School Working Paper. Boston: Harvard Business School, 2000.

companies rushed into countries such as China, India, and Russia, attracted by their large populations and determined not to miss out on what appeared to be a once-in-a-century opportunity for new sources of revenue growth. At the time, the U.S. administration's export promotion strategy was built around the "Big Emerging Markets Policy," launched in 1994 after the Commerce Department was charged with answering the question, "If we look toward the next century, where will we find the engines of American growth? Which markets hold the most promise?"<sup>7</sup> As already noted, such a rush to investment appears to have been overly optimistic: in an article on the globalization "mistakes of the '90s" that noted that foreign direct investment (FDI) by American companies in East Asia excluding Japan decreased by 74 percent to \$1.33 billion between 1997–2000, *BusinessWeek* commented, "Corporate America doesn't talk much about emerging markets. Things were different a decade ago ... many of these bets fizzled or disappointed."<sup>8</sup>

There is indeed huge long-run potential in international markets, and in emerging markets in particular, but it is poor managerial judgment to confuse long-term potential with short-to-medium term realizable profits—or even revenues. The mismatch between the ambitions of western multinationals and the ability of emerging markets to yield income should be apparent from even a cursory market analysis. More surprising is the fact that most MNCs would not tolerate such loose market analysis in their domestic markets, but they insist on detailed and justified income forecasts based on solid market data. In those cases where a multinational has experienced rapid success in entering emerging markets, it has often been the result of close targeting of specific opportunities:

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7. United States International Trade Administration, *The Big Emerging Markets: 1996 Outlook and Sourcebook* (Lanham, MD: Bernan Press with the National Technical Information Service, 1996). The "ten big emerging markets" at that time were Mexico, Brazil, Argentina, South Africa, Poland, Turkey, India, South Korea, the ASEAN countries (Indonesia, Thailand, Malaysia, Singapore, and Vietnam), and the Chinese Economic Area (People's Republic of China, Hong Kong, and Taiwan).
  8. "Smart Globalization," *BusinessWeek*, August 27, 2001.

Procter & Gamble, for example, has penetrated a range of markets in categories such as shampoo, toothpaste, or paper products such as diapers or feminine protection, moving aggressively to establish first-mover advantage in categories in which their accustomed competitors had yet to enter the mass market in those countries.

This tendency reveals a second major pitfall of foreign market assessment, which is to base entry decisions upon visions or pressures from shareholders or competitors instead of market analysis. Often, much of the foreign overinvestment was made to show shareholders that the firm in which they had invested was aggressive enough in business development, for fear of falling behind competitors who were themselves investing, or through vague notions or “visions” such as the twenty-first century being “the Asian century” as the twentieth century was the American century. The idea that there was a limited window of opportunity was particularly influential, and it created competitive pressures, as exemplified by this statement made by Alex Trotman of Ford: “I can’t go down in history as the Ford Chairman who missed China.” These arguments are all vulnerable to the fact of market immaturity, even though there are first-mover advantages in some international markets, as discussed later in this chapter. Decades of economic development will be necessary before China or any other emerging market can constitute major profit pools, and in those decades of change there are likely to be opportunities for new entrants to flourish (as many local companies are in fact demonstrating). The fundamentals of market analysis remain as valid in emerging markets as everywhere else—the level of demand and likely market share will depend upon price levels relative to disposable income, competitive intensity, market segmentation patterns, and customer behavior and psychology.

The third major pitfall is to rely upon senior executives’ network of contacts as the basis for market selection. In fact, this amounts to abstaining altogether from assessment of candidate markets and substituting entry into a partnership for entry into a market. This method of market selection can take a number of forms, as is evident from the anecdotal history of the internationalization of almost any multinational.

In some cases, a former employee, who decided to return to his or her native country, was given the national exclusive distribution agency. Sometimes, a distributor in one country persuades an MNC to grant distribution in a neighboring country. More simply, many companies agree to persuasive proposals from prospective foreign representatives, who scout trade shows in number once a company makes news in the business media. For example, a prominent U.S.-based leisurewear company entered Italy as its first international market simply because it agreed to a proposal offered by an Italian entrepreneur at a trade fair. In some respects, this is a rational decision—the company had some excess capacity, so the economics looked favorable when costed on a marginal basis, and since the agreement involved the distributor taking title to the goods, the risk was minimal. But the longer-term unforeseen consequences have created difficulties: the Italian distributor positioned the company's brand very differently from its U.S. positioning, as did subsequent European counterparts, which created an international inconsistency with which the firm is still struggling. More generally, many MNCs find that the right distributor for market entry is the wrong partner for long-term market development, and they encounter difficulties in managing the international distributor life cycle (discussed in detail in Chapter 5).

The strongest general support for the network effect is the research on “psychic distance,” which demonstrates that companies often select markets that are culturally closest—U.S. companies often enter Canada and the UK before Mexico, for example, while Spanish companies are the major investors in South America.<sup>9</sup> Again, this can be justified as a rational decision, as it minimizes what might be described as the managerial risk of unfamiliarity with the market. But, in the long run, there is no substitute for market analysis and the resultant robust marketing strategies. This will certainly be a sounder basis on which to base a business plan than the level of comfort of the international company's executives.

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9. Shawna O'Grady and Henry W. Lane, “The Psychic Distance Paradox,” *Journal of International Business Studies*, Vol. 27, No. 2 (1996).

Moreover, although internationalization by minimizing psychic distance is an empirical fact, it should also be noted that many firms from countries without such obvious cultural paths, such as Switzerland or Finland, have internationalized early, extensively, and successfully.

The frequency with which companies make these errors is an example of how lower managerial standards that prevail in domestic marketing are sometimes accepted with regard to international operations. International market entry strategies should be based upon market analysis rather than country analysis, and they should follow a framework that allows for the evolutionary challenge posed by most international markets.

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## A FRAMEWORK FOR ASSESSING FOREIGN MARKETS

There is no shortage of country information on which to base entry decisions. The problem, from a marketing management perspective, is that it is the wrong sort of information. Specifically, there is a wealth of country-level economic and demographic data available from sources including governments, multinational institutions such as the United Nations or the World Bank, and consulting firms specializing in economic intelligence or risk assessment. These sources of data are valuable from an investment perspective, but they reveal little about the prospects for selling products or services at the operational level of the store or the sales representative. Yet, for two reasons, this information is frequently used for market assessment. First, this country-market data is readily available, whereas product-market information is often difficult or sometimes impossible to obtain.<sup>10</sup> In circumstances in which some product-market

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10. Country-market describes the situation when a “market” is defined by national boundaries (e.g., “the French market”), whereas product-market refers to a market defined by products (e.g., “the cosmetics market”). As used in this book, a product-market is a sub-set of a country-market (i.e., product-markets exist within country-markets).

research data is available, often from research organizations that publish market-sizing studies, it is utilized as second-priority information because the multinational intends to alter radically the size and structure of the market. This is connected with the second factor behind this pattern of overestimation of market attractiveness, namely that market entry decisions tend to be taken from an investment perspective by senior executives principally concerned with risk minimization. This information is certainly relevant, but it is incomplete: macroeconomic and national demographic data are often a poor predictor of market opportunity, as the mistakes of the 1990s demonstrate.

The U.S.-based firm Mary Kay Cosmetics (MKC) serves as an illustrative example of this distinction, and it will be used later in this chapter to reinforce the approach described. MKC is a direct marketing company, going to market via a force of independent “beauty consultants” who buy and resell cosmetics and toiletries to contacts either individually or at social gatherings (the “party plan” distribution channel). When considering market entries in Asia, the company arrived at a final decision between Japan and the People’s Republic of China (PRC).<sup>11</sup> By the standards of most country-level data, Japan was by far the most attractive: it boasted the highest per capita spend of any country in the world on cosmetics and toiletries, it had high disposable income levels, it already hosted a thriving direct marketing industry, and it had a high proportion of women who did not participate in the workforce. As MKC learned after participating in both markets, however, the market opportunity was far greater in PRC, principally because Chinese women were far more motivated to boost their income by becoming beauty consultants than were their Japanese counterparts. The entrepreneurial opportunity represented by what MKC describes as “the career” (i.e., becoming a beauty consultant) was a far better predictor of how many

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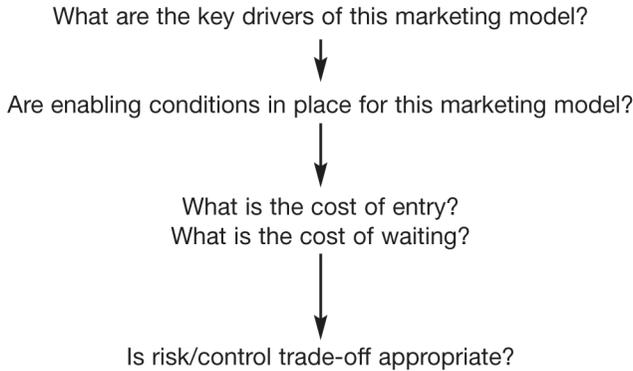
11. See Nathalie Laidler and John A. Quelch, “Mary Kay Cosmetics: Asian Market Entry,” Harvard Business School case study 9-594-023. Boston: Harvard Business School Publishing.

sales could be made than high-level data on incomes and expenditures. In fact, MKC has come to employ a business-specific indicator of market potential within its market assessment framework: the average wage for a female secretary in a country, which can then help the firm estimate the size of the opportunity provided to the average working woman by a career as a beauty consultant.

It is, of course, valuable for inter-country comparisons to be made in terms of GDP, population, regulatory requirements, tariffs, industry size and concentration, and all the other high-level data available. Approaches using this type of information are well established, and they are amply described in other publications.<sup>12</sup> This chapter will focus on digging deeper into marketing-oriented assessments of likely market size and growth prospects. The following simple framework (Figure 2–1) is designed to help international marketing executives ask the right questions when assessing alternative markets.

This framework is based upon analysis at the level of the product-market rather than the country-market, assuming that the dynamics of different industries are at least as different as the characteristics of different countries. In other words, a country that is attractive to one company might be unattractive to another firm because each requires different conditions in order for its business model to thrive. While country analysis might still be useful as a first screen in a hierarchical assessment process (to be followed by more detailed product-market level analysis), it is only at this more local product-specific level that accurate assessment can be realistically attempted. This is a fundamentally different method of market assessment from the prevailing country-level analysis, which is usually based upon macroeconomic or national demographic data. It is based upon two product-market-level concepts:

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12. See for example the excellent coverage of such analysis in: (1) Warren J. Keegan, *Global Marketing Management*, 7th ed. (Upper Saddle River, NJ: Prentice Hall, 2002); (2) Michael R. Czinkota and Ilkka A. Ronkainen, *International Marketing*, 6th ed. (Forth Worth: Harcourt, 2001).



**FIGURE 2-1** The Market Entry Decision—Screening Criteria

### MARKETING-MODEL DRIVERS

Different product-markets require different levers for the business to grow, a fact that is self-evidently true to anybody involved in marketing at the operational level. Some markets are brand-sensitive, while others will not grow without intensive distribution or a cadre of technically qualified salespeople. In the example already described, it is a significant insight for Mary Kay to identify that the entrepreneurial opportunity of becoming a beauty consultant is the real driver of its business rather than the overall level of expenditure on toiletries and cosmetics.

### ENABLING CONDITIONS

The second core concept is that of enabling conditions—the structural characteristics of the market that are necessary for the marketing model to operate effectively. Only if the enabling conditions are in place will a firm be able to realize its potential. For example, consider a market that is driven by a large number of impulse purchases (such as toys, soft drinks, or ice cream). For marketing to be effective in such product categories, the product has to be available at the moment of impulse, and so an intensive and well-developed distribution system is a prerequisite or an enabling condition. In fact, the

lack of such a distribution system is usually identified as the major barrier to market growth in many of the large emerging markets such as China or Russia.

### **COST OF ENTRY VS. COST OF WAITING**

Finally, the cost side of the business equation should be analyzed and weighed against the demand figures already calculated. This has two aspects. First, a company should have a clear idea of the economic costs of participating in the market. This will include questions such as whether local production and/or assembly are required, how many local employees will be required, tariff requirements, and so on. This is another area in which there will be significant differences between product-markets, depending, among other things, upon the bulk-to-value ratio of the products being sold—a lightweight and/or small product, such as a branded pen or an electronic component, incurs far lower transportation costs to import than a high bulk-to-value product such as a disposal bin, which makes the projected income statement for the first few years in the market look more attractive.

To illustrate this approach, consider the hypothetical case of two U.S.-based multinationals considering entry into Vietnam after the U.S. trade embargo was lifted by President Clinton in 1994.<sup>13</sup> “Chemical Corporation” is a specialty chemical company, focusing predominantly on industrial adhesives for use in a wide range of manufacturing applications. “Sports Corporation” markets sportswear and sports-oriented fashion in the footwear and apparel categories, which it traditionally markets through sports-celebrity endorsements. Both companies are global leaders in their industries, and both demand price premiums for their high-quality products (see Table 2–1).

The key driver of Chemical Corporation’s marketing model is its sales force. The challenge that members of the sales force face is to convince their key prospective buyers, who are probably

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13. This section draws upon David J. Arnold and John A. Quelch, “Vietnam: Market Entry Decisions,” Harvard Business School case study 9-597-020. Boston: Harvard Business School Publishing.

**TABLE 2-1** The Market Entry Decision—Vietnam Example

	KEY DRIVERS OF MARKETING MODEL	ENABLING CONDITIONS	NOTES
CHEMICAL	<ul style="list-style-type: none"> <li>• Sales personnel</li> <li>• Sophisticated customers</li> </ul>	<ul style="list-style-type: none"> <li>• Management</li> <li>• Relationships</li> </ul>	<ul style="list-style-type: none"> <li>• Low cost-to-serve</li> <li>• Strong local training required</li> <li>• Industrial customers present early</li> </ul>
SPORTS	<ul style="list-style-type: none"> <li>• Brand awareness</li> <li>• Development of sports fashion</li> </ul>	<ul style="list-style-type: none"> <li>• Media</li> <li>• Premium customers</li> <li>• Control of retail</li> </ul>	<ul style="list-style-type: none"> <li>• Strong competitive pressure</li> <li>• Attractive manufacturing base</li> <li>• Niche accessible in cities</li> </ul>

engineers, of the value of using chemical fastenings (i.e., adhesives) rather than mechanical fastenings (e.g., nuts and bolts). This is a relatively technical selling challenge, and it requires a professional level of cost/benefit analysis by the customer as well as the salesperson. The enabling condition for Chemical to consider a market attractive, therefore, is the presence of a number of sophisticated manufacturing client companies and the availability of an engineering-trained sales force.

Sports Corporation operates an entirely different model. Its products are aspirational—meaning that the consumer pays the premium not only for product quality, but also for identification with the high-achievement and high-fashion world of the sports stars who endorse it. For such a model to work effectively, therefore, the target market must have a well-developed sports industry, including intensive sports media, and it must also offer opportunities for event sponsorship. In addition, Sports will require a retail sector well developed enough to allow it to control distribution and merchandising, an important factor in maintaining the premium image of image-oriented brands.

Vietnam in the late 1990s looks like two different places from the perspective of these two companies. It is an attractive market for Chemical Corporation because of two critical factors. First, the enabling conditions are present at an acceptable level. The sophisticated manufacturing clients that it seeks are largely multinational firms rather than local Vietnamese concerns, and as soon as the trade embargo was lifted, a number of American firms joined the European and Asian companies that had already been attracted by Vietnam as a manufacturing base. Moreover, there was a pool of recently trained American engineering graduates who could be recruited as sales personnel—these were mostly second-generation members of the Vietnamese diaspora, originally displaced to the United States by the Vietnam War and now seeking to return to their ancestral home. The second critical factor that renders Vietnam attractive to Chemical is the low cost-to-serve. Adhesives are not bulky products, and they can affordably be exported from existing production locations in Asia, obviating the need for Chemical to establish local manufacturing.

The situation facing Sports Corporation is quite different on both counts. First, the enabling conditions are largely absent: whereas a cluster of manufacturing firms can establish their operations within a year or two of a market being opened, it takes several years or even decades for a previously communist society to adopt a western-style affinity for sports and for the attendant media, events, and retail sectors to develop. In addition, the income levels necessary to afford the premium prices of Sports Corporation's products will also take decades to spread to a critical mass of the population. In fact, the strongest attraction of Vietnam to Sports may be as a manufacturing base for reexporting rather than as a revenue-generating market. Whereas there is latent demand for Chemical's products in Vietnam, Sports faces a market in which neither latent demand nor enabling conditions are present, given its marketing model.

This method of analyzing markets can be characterized as “bottom-up” rather than “top-down,” as it is based upon product-market data that is then scaled up into a forecast of market feasibility rather than starting from high-level country data

and attempting to dig down to product-market forecasts. This approach will also be used to illustrate the forecasting of market size. Firstly, however, it is important to consider the type of data required for such an approach.

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## **GUIDELINES FOR MARKET RESEARCH IN ASSESSING INTERNATIONAL MARKETS**

One of the reasons market assessment is so challenging is that it often takes place in a data vacuum. In many countries, especially those usually categorized as “emerging markets,” market research is either simply not available or not feasible (most often in terms of cost). This might be because of a lack of the infrastructure necessary for market research, such as telephones or trained interviewers, or because customers simply lack any experience in the product category. Almost always, it is impossible to recruit a sample that is even close to representative of the target market population. This explains the lack of analysis underpinning many entry strategies and the reliance on published country data. However, experienced international marketing executives learn that there are ways of getting closer to the market data required to support a more rigorous and close-up analysis. The three key issues are the type of intermediary used for data gathering, the type of data gathered, and the use of analogous markets for estimation purposes.

First, the lack of market research firms with trained professionals should not justify a resignation to a lack of primary research. A number of other types of intermediary are nearly always available. A frequent first option is to turn to professional service firms such as accountants, management consultancies, or lawyers. Many of these types of organizations have internationalized early, have offices in nearly all countries, and have connections in local business communities. An internationalizing firm can often contact an office of a firm with which it has an existing corporate relationship for help in market research. A second option is to turn to local universities:

students, especially business students, are usually eager to undertake research projects, especially for international firms and particularly if such projects can be incorporated into their coursework for credit. A third option is that an international firm with existing subsidiaries or distributors in the region could turn to those units for research help and request a suitable executive to undertake the necessary research, including time spent in the target market.

Such sources may of course lack the training required to produce market research of a high professional validity and rigor, but experienced MNCs increasingly will use such intermediaries, and other types of ad-hoc agents may present themselves opportunistically. At the least, basic errors of misunderstanding about country-markets can be avoided by undertaking such research, and the essentials of a marketing plan, such as likely price levels and the extent of distribution networks, can usually be ascertained. In such projects, it is critical to have a local presence—somebody who has the contacts necessary to recruit researchers and can supervise those gathering data. Any of the three categories of intermediary described (e.g., a distributor in a neighboring country, a partner in a local professional services firm, or a local university professor) could potentially provide such a contact. The key principle is to use local researchers so that research can be executed close up to the market (e.g., in the local language and in line with local culture) and so that basic misunderstandings are avoided.

The second key issue is the type of data gathered. This will obviously vary according to product-market characteristics, and it may be constrained by local marketing and communications infrastructure. In the case of assessing Vietnam, for example, Chemical would need to know the number of trained engineers employed as buyers for manufacturing firms, while Sports would face the much more difficult challenge of measuring awareness of major sports stars. While acknowledging such situational considerations, it is still possible to make a few generalizations that apply to all situations:

- It is important to use multiple indicators. Reliance on a single measure for an estimate of market potential is certainly less reliable than use of multiple measures from which a conclusion can be triangulated. Experienced MNCs have assessment models that include perhaps a dozen or more key indicators of market dynamics that can be applied across any combination of country-markets.
- A company should develop customized indicators, which are specific to its own product-market and which have previously proven useful in predicting potential. A good example is Mary Kay Cosmetics' use of the average wage of a female secretary as a basis for estimating the potential earnings improvement for women who become beauty consultants—this information would be of little relevance to most other companies. Such company-specific indicators would clearly have to be based upon intelligent interpretation of previous experience in international markets.
- Never assess markets in isolation, but always conduct comparative assessments of multiple markets, even if the markets have little in common. Just as triangulation is an effective strategy for reducing uncertainty with regard to measures of market potential, so comparative assessment of markets will reveal questions that executives never discern when examining individual markets. This recognizes the fact that absolute measurement of market potential is impossible, thus increasing the value of a portfolio approach in which alternative priorities are considered.
- Favor observations of behavior, such as purchasing patterns or descriptions of distribution networks, over reports of opinion, such as likelihood to purchase or price sensitivity. This approach, always valuable, is particularly important in international markets in which accurate surveys of customer perceptions are often impossible. Customers are notoriously unreliable predictors of their reaction to new products or other future market developments. Reports of behavioral patterns in

the marketplace offer at least a basis for intermarket comparison, and they are usually also a sound basis for marketing planning when compared with opinion surveys. Because the product-market being researched is often underdeveloped or embryonic, it may be necessary to include in the research a brief measurement of behavior with regard to substitute products (for example, the consumption of tea, buttermilk, or any other relevant nonalcoholic beverage might be a useful market indicator for a soft drinks firm).

It is also important to take a flexible approach to the type of data gathered, recognizing that a variety of wider contextual factors may influence market activity in different countries. In Mediterranean countries, for example, a package delivery service could not schedule its usual 5 P.M. or 6 P.M. final pick-up, given the practice of an afternoon break followed by offices opening until perhaps 7 P.M. or 8 P.M. Similarly, products that women buy in supermarkets in the western markets would probably underperform in conservative Muslim countries such as Saudi Arabia since most women do not drive or shop alone and therefore seldom visit supermarkets. An expanded view of the contextual distance between countries is necessary, and a useful framework for understanding the types of issues to look for is provided by Pankaj Ghemawat in a paper entitled “Distance Still Matters: The Hard Reality of Global Expansion.”<sup>14</sup> Basing his analysis upon the high failure rates of foreign market entries in terms of meeting performance objectives, Ghemawat argues that even in a world in which telecommunications and other technologies appear to be reducing the importance of distance, there remain significant country-specific barriers to entry that constitute the “distance” involved in entering the market from outside. His CAGE framework identifies the cultural, administrative, geographic, and economic sources of intercountry distance, and provides guidelines on which

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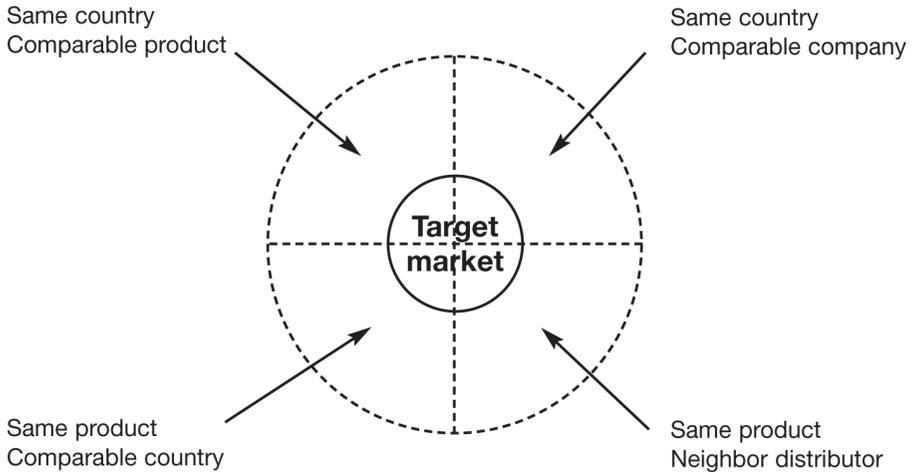
14. Pankaj Ghemawat, “Distance Still Matters: The Hard Reality of Global Expansion,” *Harvard Business Review* (September 2001): 3–11.

product-markets would be more affected by each. For example, cultural barriers such as different languages or social norms would be a significant source of inter-country distance for culturally-sensitive products such as television or movies; administrative barriers such as lower levels of intergovernmental cooperation will impact markets with high levels of regulation, such as aerospace, healthcare, or pharmaceuticals. It is worth noting that even in the movie or TV industry, in which U.S. firms and their products enjoy a global dominance, research shows that one of the key differentiators between the winners and losers in emerging markets is their willingness to localize their content. In China, for example, the customization practiced by STAR TV and MTV has given the companies an advantage over less adaptable rivals such as Time Warner.<sup>15</sup>

The third key approach in foreign market assessment is the use of “parallel” markets to forecast potential by analogy. When faced with a lack of data from a candidate market, experienced MNCs will use a number of surrogate measures from comparable markets as the basis for a market assessment. These might include data on a comparable product in the same country; the same product in a comparable country, the same product with a neighboring distributor, or a competitor or comparable company in the same country. The more data points that can be obtained, the better the internationalizing firm can triangulate and so reduce the uncertainty in its estimate of market potential. Figure 2–2 illustrates a number of ways in which estimates may be produced using this approach. For example, if a firm is estimating market potential in Argentina, and it knows that it already sells \$10 million in Brazil, it might initially estimate the potential at Argentina at \$2.3 million based upon the relative size of the two countries’ populations, and it may then double this to \$4.6 million to adjust for higher average disposable incomes in Argentina. Alternatively, Firm A may know that it sells 50 percent as much as its competitor,

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15. Lyn Baranowski, Nitin Nayar, Sheeba Philip, “Breaking New Ground: Foreign Media Companies Enter the Chinese Cable TV Market,” Student Field Research Paper, Harvard Business School, December 2002.



**FIGURE 2-2** Market Forecasting by Analogy

Firm B, in Brazil, and it knows that Firm B sells \$10 million in Argentina, so it estimates its potential there at \$5 million. These forms of extrapolation should definitely be regarded as a fallback position, and any form of direct data from the market in question are preferable to this form of estimation. However, situations do occur when this is the best information available. Moreover, it can always be useful to conduct this type of estimation exercise, even when direct market data is available, as an additional insight into likely market sales levels.

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## FORECASTING MARKET POTENTIAL

Forecasting market sales levels remains an exercise in the art of estimation rather than the science of marketing, and even after years of international marketing experience, the difficulty of this challenge explains many of the managerial errors in market entry strategy that have been observed. However, it is significant that in almost all cases, the error is in one direction—namely, an overestimation of market potential. This may be because other pressures, such as competitor entries or shareholder pressures for aggressive investment, are driving

market expansion strategies, and without robust market data, a firm errs on the side of optimism in its forecasts. The key approach to really reading a market is to start at the demand level rather than the aggregate level of country macroeconomic or demographic data, a distinction previously described as bottom-up as contrasted with top-down. These approaches will now be illustrated using data from the case study on the entry of Mary Kay Cosmetics into China.

### TOP-DOWN FORECASTING

The typical method of market assessment can be described as “top-down” because it is based upon country-level variables, and the data are then reduced to arrive at an estimate of sales. The progression is therefore from country data to product-level data. The two most commonly employed categories of indicator are macroeconomic and population data because both are readily available for almost any country. If a country’s GNP is known, for example, market size can be estimated by calculating the proportion of the population likely to have the necessary disposable income to buy the relevant product. Similarly, if the population is known, estimates can be made of the size of the relevant demographic segment (e.g., men aged 18–40). In some cases, one of these indicators can be used alone to produce a simple market forecast. For example, a company might know, from experience in other international markets, that there is a correlation between GNP and market size and that a GNP of  $x$  therefore supports a market forecast of  $y$ . More frequently, however, the national data is processed via a series of assumptions about the proportion of the economy or the population that will constitute the market. An example of this will follow. The final assumption, of course, will be to estimate the share of the market that the company will be able to achieve.

In principle, this is a perfectly good method of market assessment or forecasting because the variables are certainly relevant to market size. In practice, however, this method

tends to produce inaccurate forecasts, and in particular it is responsible for overestimates of market size because macroeconomic and population data provide a good indication of market *potential*, but no indication of the likelihood of potential customers (or “prospects” as salespeople call them) being converted into actual customers. The existence or availability of a certain number of prospects is certainly relevant to market plans, but a more fine-grained view of marketplace dynamics is necessary to arrive at realistic estimates of market revenues. Interestingly, many Internet businesses floundered after it was realized that “eyeballs,” or website traffic, was in fact only market potential.

As an illustration of this method of forecasting, Table 2–2 shows how Mary Kay Cosmetics might forecast market potential in China and, more specifically, in Shanghai province. This shows the typical “Dutch auction” process that such an approach entails (i.e., we start with an unrealistically high figure that is repeatedly reduced to arrive eventually at the forecast). Starting with the total population, a series of assumptions are made to adjust a limited set of known facts: 50 percent of the population is accessible nationally, but all in Shanghai province; 50 percent is female; 33 percent of females are in the right age group; a certain proportion (higher in Shanghai province) have the necessary disposable income; a certain proportion of the income will be spent on cosmetics and toiletries; and MKC can achieve a certain market share.

None of the assumptions is irrational, and it should be noted that this top-down forecast is working with some product-level data and not just national macroeconomic and demographic figures. Nevertheless, the resultant forecast is far higher than proved to be realistic and far higher than the bottom-up forecast discussed in the next section. This is because the forecast is produced using assumptions taken from static and established structures within markets and economies, and it completely fails to address the challenge of the change required before Chinese women purchase cosmetics and toiletries at these rates.

**TABLE 2-2** Top-Down Market Forecasting: Mary Kay in China

	NOTE	COUNTRY	SHANGHAI
TOTAL POPULATION		1.3 bn	60 mm
ACCESSIBLE	50% (80% E, 30% urban)	650 mm	60 mm
FEMALE	50%	325 mm	30 mm
AGE 18-35	33%	110 mm	10 mm
DISPOSABLE INCOME	41 mm > \$18K = 4% Assume 15% > \$10K Assume 20% in Shanghai	17 mm	2 mm
PER CAPITA SPEND	Shanghai: \$120 × 75% × 30%/mo. Country: Japan = \$400 Assume twice GDP ratio	\$45	\$320
MARKET VALUE P/A		\$765 mm	\$640 mm
MKC SHARE @ 5%		\$38 mm	\$16 mm

Estimates are for country and for Shanghai province.

1. It is known that 80 percent of the Chinese population live in the east and 30 percent in urban areas, which makes those portions of the population more accessible. It is assumed that all Shanghai province is accessible.
2. It is known that 41 million households have disposable income above \$18,000 per annum, and it is estimated that significant expenditure on cosmetics and toiletries begins at \$10,000.
3. Research indicates that the typical consumer in Shanghai has \$120 disposable income per month, of which 75 percent is spent on essential items (e.g., housing and food), of which 30 percent is spent on cosmetics and toiletries, resulting in potential spending of \$27 per month and equaling \$320 per year. It is known that the equivalent figure for Japan is \$400 and that Japan's GDP is some 20 times larger than China's. It is assumed that Chinese women spend twice as much of their disposable income on cosmetics than Japanese women do.

## BOTTOM-UP FORECASTING

By contrast, Table 2–3 shows a bottom-up forecast for Shanghai province. The restriction to the most prosperous province of the country in itself constitutes a more realistic starting point. More fundamentally, this forecast adopts an entirely different approach, starting from MKC’s customized indicator and building up to an answer to the question, What level of business would be required to offer secretaries the opportunity to increase their wage by 50 percent by becoming a Mary Kay beauty consultant? This quantifies the opportunity at an individual level, and it is assumed that the number of women for whom this opportunity is valid can then be estimated.

Some of the assumptions here are more robust because they are within the control of the company (e.g., the assumption that beauty consultants would have a revenue of \$4.50 per unit, representing a 50 percent margin, is based upon company costs and pricing decisions). This forecast also makes a number of other assumptions already seen in the top-down forecast (for example, that women in the target age and income group spend on average \$324 annually on cosmetics and toiletries and that MKC can achieve a 5 percent market share), but it employs them quite differently. In this case, the conservative assumption is made that all the expenditure is on items at the MKC price level of \$9, even though this is at the higher-priced end of the market.

This forecast produces an estimated market potential of \$324 million, compared with \$640 million in the previous top-down forecast. This reflects the quite different approach taken—put simplistically, it is based on answering a “What is required to achieve  $x$ ?” question rather than a “How large might the market be?” question. The task to be achieved, a 50 percent increase in income for the average secretary who

**TABLE 2-3** Bottom-Up Market Forecasting: Mary Kay in Shanghai**ASSUME IMPROVED AVERAGE FEMALE WAGE BY 50%**

<b>CURRENT WAGE</b>	\$125 × 12	\$1,500
<b>TARGET WAGE</b>	NB: In Taiwan, average consultant wage is \$3,000	\$2,250
<b>@ \$4.50/UNIT, TARGET =</b>		500 units
<b>AVERAGE CUSTOMER SPENDING =</b>	\$27 × 12	\$324
<b>@ 9/UNIT, TARGET =</b>		36 units
<b>= \$3/MONTH</b>	<b>= unrealistic!</b>	

**ASSUME 3 MKC UNITS/MONTH @ \$9 = 50% OF WALLET**

scales up to annual cosmetics spending \$648

scales up to annual disposable income \$2,880

**SHANGHAI TARGET POPULATION =**

if 2mm H/Hs > \$10,000, women @ \$2,880 = 2mm

annual spending @ \$13.50/month \$324mm

MKC share @ 5% \$16.2mm

number of consultants @ \$2,250 7,200

1. Assume that the Mary Kay opportunity is attractive if it can increase the average female wage in Shanghai by 50 percent to \$2,250. Note that this is high, as the average wage in Taiwan is \$3,000, and Taiwan has much higher levels of GDP and disposable income.

2. To earn \$2,250, a consultant must sell 500 units (@ \$4.50 gross margin per unit). However, at the average consumer price of \$9, this would consume all the cosmetics budget of the average earner for only three units per month or 36 units per year. This is regarded as unrealistic.

3. Alternatively, assume that a consumer purchases three Mary Kay units per month, and that this represents 50 percent of cosmetics spending. This scales up to an annual cosmetics spending of \$648 per year and (using the income structure from Table 2-2) an annual disposable income of some \$3,000 (about twice the average female wage).

4. We know that there are about 2 million households in Shanghai province with disposable income of \$10,000, so assume this equates to individual women at \$3,000. Assuming 5 percent market capture again, we can expect 100,000 customers, or a market size of \$16.2 million, which would support 7,200 consultants at the higher earnings level.

becomes a beauty consultant, is specific to the company and based on experience in other markets. It is quite typical that a realistic bottom-up forecast would produce an estimate of market potential much lower (in this case, 50 percent lower) than a “top-down forecast.” Such an approach, using benchmarks or hurdle rates, is commonplace in investment projects, but it is rarely used in international market assessments. In this case, the bottom-up forecast proved to be more accurate. In fact, sales were below the projected level in the first year, but they exceeded all forecasts after a few years in the market. Because the company had planned conservatively, based upon a realistic and market-driven forecast, it has been able to build a successful business in China without falling prey to initial overestimation of sales potential and the challenge of building the business.

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## FIRST-MOVER ADVANTAGE

Besides the estimation of market potential, the other major decision in market entry strategy is that of the timing of entry. This, too, has assumed great prominence in the international boom of the 1990s because so many entries, especially in emerging markets, were justified on the grounds of an urgent need to participate in the market early. Whereas the early internationalization of many firms was opportunistic and incremental, this wave of global expansion of the 1990s was characterized by a certain urgency, as if there existed limited windows of opportunity that would reward only those players bold enough to move early. Indeed, companies frequently acknowledged that any reasonable sales forecast would not estimate profitability for years to come, but they nonetheless entered the market because of a belief in the concept of first-mover advantage (sometimes referred to as pioneer advantage), one of the most widely established theories of business in the minds of executives and investors alike.

According to this theory, the first entrant in a new market enjoys a unique advantage that later competitors cannot overcome (i.e., the advantage is somehow structural, and therefore sustainable). For some companies, this reasoning is validated

by history. Procter & Gamble, 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 it, simply for reasons of European colonial history. Given that history, it is reasonable for Procter & Gamble to err on the side of urgency in reaction to the opening of large markets such as Russia or China.

For many companies, however, the concept of pioneer advantage was little more than an article of faith, and it was applied to country-market entry, to product-market entry, and, in particular, to the “new economy” opportunities created by the Internet. Although the “get big quick” philosophy of the dot-com boom has been rather discredited by the subsequent dot-com bust, the “get in early” philosophy of pioneer advantage remains largely accepted. To some extent, this is correct: the advantages gained by European companies from being early in “colonial” markets provide some evidence of pioneer advantage. Moreover, as will be argued later, there are a number of sources of pioneer advantage that are more likely to be present in emerging economies. Nevertheless, it should be emphasized that first-mover advantage is overrated as a managerial rule of thumb. Indeed, in many situations, there may be disadvantages to being first. These can be of two types. First, at a more general level, the absence of any pioneer advantage results in poor business performance, caused by a lack of return on the investment required for market entry. This is what has happened to many western MNCs who rushed into Russia and China in the early 1990s and a few years later were attempting to stem their losses. Second, and more specifically, there is the danger that a pioneer will not be able to recoup the investment made in marketing required to kick-start a new market.<sup>16</sup> In such cases, it may well transpire that a “fast follower” can benefit from the market development

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16. For a more detailed discussion, see Gerard J. Tellis, Peter N. Golder, and Clayton M. Christensen, *Will and Vision: How Latercomers Grow to Dominate Markets* (McGraw Hill, 2001).

investments of the first mover and, without those pioneering costs, leapfrog into earlier profitability.

An example of this is provided by Sony's attempts to develop and dominate the market for car navigation systems.<sup>17</sup> As a result of considerable investment in both product technology and marketing, Sony was the market leader in this category in 1993, at which time some 80 percent of worldwide unit sales were in Japan. However, the drivers of demand in Japan (a widespread love of technology, a complex and relatively poorly signposted road system, and extensive use of cars for leisure driving well away from the home) were not present to the same extent in North America and Western Europe. In those markets, large investments in marketing would be required to persuade customers that they needed an expensive technological addition to their car to replace a cheap paper roadmap. Moreover, product adaptations were required: Europeans needed multilanguage capabilities, and Americans, more concerned with traffic congestion than with directions, required links to live traffic information services. As a committed pioneer, these up-front costs would have to be carried by Sony, but there was nothing to stop later entrants from free-riding on this market development investment and picking up customers. In fact, later entrants completely outflanked Sony in Europe and America by going to market via the OEM channel instead of addressing consumers directly via the auto aftermarket, as had been the case in Japan.<sup>18</sup> It seems likely that later entrants benefited from Sony's market development investment, but they found an even better way of getting consumers to consider navigation systems: by allowing them to try them out in test drives or rental cars. As early as 1995,

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17. Yoshinori Fujikawa and John A. Quelch, "Sony Corporation: Car Navigation Systems," Harvard Business School case study 9-597-032. Boston: Harvard Business School Publishing.

18. OEM stands for original equipment manufacturer. In this case, it refers to automobile manufacturers offering navigation systems as optional extras on new cars or including them in cars in rental fleets. The aftermarket is a retail channel in which car owners buy accessories for their car after purchase.

Sony's market share was in decline even in Japan, and it remains well behind the leaders.

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 it offers insight into the two conditions necessary for first-mover advantage to accrue. Understanding these two conditions is essential for a critical understanding of the market entry situation, and it should inform all such decisions. For first-mover advantage to exist, the following two conditions must apply:

- First, there must be a scarce resource in the market that the entrant company can acquire.
- Second, the entrant company must be able to tie in that scarce resource so that it is not available to competitors.

If there is no scarce marketing resource, then it is clear that later entrants have full and equal access to the market and that, conversely, the pioneer has no advantage. For example, consider the widely held opinion that the first brand in the market can have the advantage of establishing the standard in its category and become the generic example of the product (like "Band Aid" or "Hoover"). In such cases, the scarce resource is at the front of the consumer's mind—or an established position in the limited attention or memory the consumer is prepared to devote to this category. In the case of car navigation systems, this appears not to have happened, and consumers did not regard the pioneer products as the gold standard. Alternatively, consider the role of government in markets in which it is necessary for foreign firms to obtain a 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—and for the same reason. The most common supposed source of first-mover advantage, brand preference from being the first brand known, is based on the idea that brand attitudes are unlikely to change once established. In fact, a long stream of research has failed to establish conclusively the existence of this phenomenon, and it is clear that in

many cases, consumers consider the alternatives available at the time of their first purchase. In other cases, such as contracts with distributors or other partners, it is clear that the advantage can be expected to last years rather than months, so it might provide a sustained competitive advantage.

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## SOURCES OF FIRST-MOVER ADVANTAGE IN EMERGING MARKETS

Having emphasized the need for caution and rigor in thinking about first-mover advantage, it should be noted that there are a number of potential sources of advantage, relating to structural aspects of the market or country, that are *more likely* to accrue in international markets than in the domestic situation. In particular, these structural factors are more likely to be present in emerging markets because in such less-developed markets, more resources are likely to be scarce.<sup>19</sup>

### GOVERNMENT RELATIONS

National and local governments, and other regulatory bodies are far more influential in emerging markets (EMs) than in developed-country market systems. This reflects both the recent history of many emerging-market countries as command economies or closed markets and the desire of many host governments to build local business as the economy grows and FDI inflows increase, rather than allowing foreign firms to capture all the growth. On a more operational level, it also reflects the importance of government-led infrastructure projects in the early stages of development. The early establishment of relationships with government can result in tangible benefits such as the granting of one of a limited number of licenses or permits; China, for example, has decided to restrict the number of western MNCs to which it gives joint venture

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19. David J. Arnold and John A. Quelch, "New Strategies in Emerging Markets," *Sloan Management Review*, Vol. 40, No. 1 (Fall 1998).

permits in many industries. In addition, many EM governments are still in the process of establishing a new pro-business regulatory framework for their countries, and MNCs already investing in an EM will clearly be favorably positioned to influence the regulation of the market in areas such as price control or the opening of communications media suitable for their promotional activities. On a more general level, early market entry may also demonstrate a commitment to an emerging market that wins longer-term government favor. Executives familiar with EMs invariably stress the greater importance of personal relationships with key local players (in both the public and private sectors), and MNCs that have participated longer in EMs can be expected to enjoy stronger and more favorable relationships than later entrants. First entrants also get access to the best government-nominated local joint-venture partners.

### **PENT-UP DEMAND**

A substantial reservoir of pent-up demand for previously unavailable but known western brands may exist in EMs, offering a platform level of sales not available in the new product-market spaces assumed by most models of first-mover advantage. In former command economies, surplus (i.e., unsatisfied) demand had prevailed for many years in a “seller’s market” in which choice was so restricted that cash was not spent.<sup>20</sup> In addition, customers may already have been aware of the product, even though it was previously unavailable in their country, via international travel, international media, or informal channels. In many cases, therefore, conditions may be different from those encountered in the introductory stages of product life cycles in developed markets, where slow diffusion of product awareness and familiarity often result in slow sales take-off after launch. The distinctive conditions of EMs provide first entrants with a nonrecurring beachhead of sales, which can be expected to provide medium-term advantages through repeat purchase.

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20. Avraham Shama, “Transforming the Consumer in Russia and Eastern Europe,” *International Marketing Review*, Vol. 9, No. 2 (1992): 43–59.

## MARKETING PRODUCTIVITY

The low cost base of EMs has long been recognized in production location decisions, but it is also relevant to the timing of market entry. In this case, the relevant comparison is not only with global costs, but also with future costs. Low advertising rates per capita in EMs enable brands to be launched and brand awareness to be built very economically. Advertising rates increase rapidly with economic development; for example, they increased ten-fold in real terms in Poland within five years of the fall of communism. Lower levels of competitive spending in EMs can also mean that marketing investments produce higher levels of awareness, share of voice (the proportion of total promotion in the market accounted for by one firm or brand), or shelf space.

## MARKETING RESOURCES

While an undeveloped marketing infrastructure is frequently used to justify delaying entry, it can also be seen as a plus. Resources such as distribution channels or media access are often more scarce in EMs. Although the number of managers with both emerging market and international experience is growing, it remains a constraint and thus a potential source of advantage to MNCs that have entered multiple EMs and have therefore developed an internal pool of managers with EM experience. This is a difference of degree rather than of kind; the preemptive advantage accruing from such factors is recognized in first-mover advantage research, but the effect is qualitatively more significant in EMs.

## LEARNING

EMs often demand and certainly provide opportunities for innovation in marketing or operations, and the consequent learning can be transferred to other markets. It is widely recognized that the differential ability of MNCs to leverage leading-edge ideas and best practices across operating subsidiaries, in marketing and other functional areas, can be a critical source

of competitive advantage.<sup>21</sup> For example, the absence of developed distribution infrastructures in many EMs has prompted MNCs to create innovative distribution processes or more robust product packaging that can prove transferable to developed markets. The scale of many EMs also offers opportunities: fast-food chain Kentucky Fried Chicken (KFC) is pioneering its largest restaurants in China. These restaurants are, on average, twice the size of outlets in the United States due to the greater emphasis on eat-in rather than take-out patronage. KFC's understanding, developed in EMs, of how to run large-scale outlets may be transferable to developed markets. Such "reverse learning" from emerging to developed markets, which can be driven by either the need to adapt to unique market conditions or by "second-time around" learning from previous mistakes, can give emerging-market pioneers a competitive advantage. Also important is the leverage possible from early development of a capability in managing emerging market operating units—given the steep learning curve facing MNCs and the fact that most feel obliged by competitive pressures to enter a series of EMs in quick succession.

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## SUMMARY

Assessment of foreign markets and estimation of international market potential constitute significant challenges that many internationalizing firms have failed to meet. It is critical that senior executives base their assessment on close analysis of a product-market rather than more general economic and demographic country data. Key points covered in this chapter include the following:

- The importance of forecasting demand as possible sales in a 3–5-year timeframe (as appropriate for the firm's

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21. Warren J. Keegan, *Global Marketing Management*, 5th ed. (Englewood Cliffs, NJ: Prentice Hall, 1995); Christopher A. Bartlett and Sumantra Ghoshal, *Managing Across Borders* (Boston: Harvard Business School Press, 1989).

planning cycle) rather than total long-run potential sales. This is one area of management in which a solely long-term focus can destroy value.

- The importance of gathering data at the product-market level rather than purely at the country level. The same country-market looks very different through the lens of different industries.
- The concepts of market drivers (the most influential elements of the marketing program) and enabling conditions (the critical success factors for that model). Again, these will differ significantly by industry.
- The importance of customized indicators for each firm; for example, the relevance of the average female secretarial wage for Mary Kay Cosmetics. Such indicators should be part of a multifactor database used for assessing market attractiveness.
- The value of a market-based “bottom-up” sales forecast rather than a country-level “top-down” forecast. The former is usually more conservative and more accurate.
- A rigorous definition of first-mover advantage: it requires sustainable appropriation of a scarce marketing resource rather than simply an early entry. The scarcity of some marketing resources in emerging markets in particular make first-mover advantage a real possibility.