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Why foreign retail grocery stores fail in South Korea? Propositions for future research

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Abstract

International retailers have conducted business in South Korea since 1996 when the retail market was liberalized by the Korean government. Some retailers have succeeded while others have failed. This study critically reviewed the literature on the international grocery retail industry in South Korea through an analysis of 20 years of literature. A case study and ethnography were used to provide insight into the experiences of international retail companies, while at the same time providing information about the situation. The author proposed that further research be conducted on the failures of international retailers by examining some challenges of entering a foreign market. Additionally, the author offered a brief history of international grocery retailers and literature on international retailing in South Korea. Various problems encountered by international retailers in South Korea are discussed. The author proposed future research in the following six areas: (a) factors that international retailers used to enter the market, (b) steps taken to minimize the possible problems when entering the market, (c) methods for alternative market entry, (d) the approach for choosing the store format, (e) problems discovered after market entry, and (f) the research done to determine the preference of Korean consumers.

***Keywords**: Retail; grocery; international; South Korea; market failure*

Introduction

In 1996, the retail market was liberalized by the South Korean Government after years of protectionism allowing international retailers' full market access (Yu et al., 2011). The liberalization of the South Korean retail market was based on two factors: The Asian economic crisis in the late 1990s, which helped push through reforms, and the South Korean government's promise to implement the General Agreement on Trade and Services (GATTS) (Suh & Howard, 2009). When international retail companies entered South Korea in the late 1990s, the market was already saturated by domestic retail companies (Kim, 2008b). Such International retailers that entered the South Korean market included Costco, Carrefour, TESCO (which operates under the name Home Plus), and Wal-Mart (Kim, 2008b). Two of these four companies (Wal-Mart and Carrefour) failed, one company (TESCO) has divested from the South Korea market, and one company (Costco) has

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continued to succeed. Due to financial problems in the parent company, TESCO divested their ownership of Home Plus in 2015 by selling to a Hong Kong investment group. Home Plus and Costco are the only two foreign grocery retailers that remain in the South Korean Market.

The failure of international grocery retailers in South Korea raises the question as to why the failure rate so high. Six areas of international retailers will be explored. First, the challenges of international retailers entering a foreign market will be discussed. Second, literature on the failure of international retailers in South Korea will be reviewed. Third, the data and methods used in the study will be explained. Fourth, the benefits that South Korean retailers have gained from partnering with foreign retailers will be examined. Fifth, the problems that international retailers have encountered in the South Korean market will be discussed. Lastly, ideas for future research on foreign retailers entering South Korea will be recommended.

Literature review

Foreign retailers looking to expand into new markets face the growing challenge of finding ways to adapt a company's business practices with the culture and laws of the host country. Rapid expansion by global retailers has been possible by duplicating proven formulas used in the company's domestic market (Park & Sternquist, 2008). However, in *How Local Companies Keep Multinationals at Bay* (2008), Bhattacharya and Michael remarked that simply duplicating a company's domestic format in a foreign market is not a recipe for success. Bhattacharya and Michael stated, "The obstacles and opportunities that characterize emerging markets render useless most cookie-cutter strategies" (p. 86). Instead, companies in foreign markets must pursue a strategy of glocalization and tailor the goods and services to the needs of the local customers (Robertson, 2012).

When an international retail company chooses to expand into a foreign market, it is important to have a rational, decision-making process. Methods of market entry include exporting, foreign direct investment (FDI), wholly owned subsidiaries, franchise, Internet sales, joint ventures, licenses, and mergers and acquisitions (Alexander & Doherty, 2009; Kim & Gray, 2008). While the author of this paper will not directly address the types of market entry, it is worth mentioning that joint ventures have been the most commonly used market entry methods in South Korea.

International retail companies seeking to enter the South Korean market may have different motives for doing so: market saturation in the company's domestic market, an increase in sales revenue, or the desire to prevent a competitor from entering a specific market (Evans et al., 2008). Two closely related theories explain the decision making process used by international retail companies on how to enter a foreign market: internationalization and transaction cost economics.

Internationalization theory focuses on the external variables that a company may tackle including market competition, sources of comparative advantage, free trade, resource mobility, and knowledge transferability (Forlani et al., 2008). Internationalization theory is based on the idea that a company will continue to expand until the cost of an extra transaction inside the company is the same cost as one carried out on the open market (Alexander & Doherty, 2009). The most efficient and most frequently used method for entering a foreign market is through forming organizational relationships.

Closely related to the theory of internationalization is transaction cost economics, which compares the cost of a transaction occurring within the company to the cost of the transaction occurring outside the company (Owens et al., 2012). A joint venture allows an international company to share the risk involved in the venture, to distribute the cost of making the product, and to learn from the partner. Owens, et al. (2012) pointed out that Hennart (1988) viewed transaction cost economics as a choice between possible forms of ownership for foreign companies.

The theories of internationalization and transaction cost economics allow international retail companies to consider the methods of market entry available in a foreign company based on the economic impact. In some instances, a foreign direct investment would be better than a joint venture or vice versa. Companies that do not to consider internationalization theory and transaction cost economics are likely to encounter problems entering the market due to the selection of an inadequate market entry method.

The literature on international retailers in South Korea is abundant: Park (2005) examined the complaints of Asian shoppers toward Carrefour in South Korea. Kim (2008b) explored the difficulties that Wal-Mart had entering into a foreign market. Gandolfi and Strach (2009) analyzed Wal-Mart's mistakes in South Korea. Ryn and Simpson (2011) investigated the lessons learned from the failures of Wal-Mart in South Korea. Suh and Howard (2009) examined TESCO's entry into South Korea. Kim (2008a) addressed the failures of Carrefour and Wal-Mart as they applied to the institutional theory. Most recently, Aklamanu (2014) proposed an institutional framework for future research to understand the failures in international retailing. However, none of these authors compared the reasons for failure and success in South Korea.

In 1998, Wal-Mart entered Korea as a wholly owned subsidiary; the company bought four stores from Korea Makro, six undeveloped sites and then expanded to 16 stores (Gandolfi & Strach, 2009). In May 2006, Wal-Mart withdrew from South Korea and sold all of their stores to its domestic competitor Shinsegae (Kim, 2008b). French-based Carrefour entered South Korea in 1996 and expanded to 32 stores before exiting the market in 2006; Carrefour sold their stores its domestic competitor E-Land (Kim, 2008a). U.K.-based TESCO (Home Plus) entered South Korea in 1999 as part of a joint-venture with Samsung. Samsung divested its shares of Home Plus in 2011 making TESCO the sole owner. Home Plus expanded to 375 supermarkets, 140 hypermarkets, and 327 convenience stores in South Korea by 2015. In 2015, TESCO sold Home Plus to MBK, a Hong Kong based equity firm, for $6 billion due to financial problems within its parent company (BBC, 2015; Mundy, 2015). Costco entered the South Korean market in 1994 through a joint venture with Shinsegae (MMR, 2009). Since then, Costco has grown to 12 stores and the Yangjae location is among the highest annual sales in the world at approximately $450 million per year (Costco.com, 2016; Song, 2012).

Analyzing e-complaints towards Carrefour, Park noted some challenges the company faced: (a) the company used a globalized standardization policy; (b) the company used of a warehouse-type experience with concrete floors, high shelves and offered sold large quantities of goods at low prices, (c) its employees were rude and inattentive; (d) the store was crowded, hot, and noisy; (e) the quality of the products were low; and (f) the upkeep of the stores (escalators were unsafe, bad shopping carts, dirty bathrooms, and dirty seats) was poor (Park, 2005). Carrefour put no forethought into finding out what the preferences of Koreans were before opening their stores; instead, they used the same model as they did in other countries.

Numerous issues existed that undermined the success of Wal-Mart during its tenure in Korea (Kim, 2008b). Because of the tastes and preferences of Korean customers, it was difficult to create a strong value exchange between Wal-Mart and its customers (Kim, 2008b). Instead of low prices, Korean retailers offer complimentary products if consumers spent a certain amount of money (Kim, 2008b). The types of products that Wal-Mart offered did not meet the needs of the local consumers (Kim, 2008b). Because Koreans have a limited amount of storage space, they do not buy products in bulk; instead, they tend to shop on a daily basis (Kim, 2008b). In the United States, distribution and Information Technology (IT) systems allowed Wal-Mart to offer everyday low-prices (EDLP), whereas the company was not able to capitalize on that strategy in South Korea, as it was a late entry into the market (Kim, 2008b). Available store locations were also not convenient for customers (Kim, 2008b) as Wal-Mart chose to locate all of their stores in the outer areas of cities. Lastly, Koreans had difficulty compromising on the quality of the product and the customer service for lower prices (Kim, 2008b).

Gandolfi and Strach (2009) studied the failure of Wal-Mart in using an internationalizing strategy. Among the problems encountered by Wal-Mart was the failure to take into account the consumer preferences of Koreans. Wal-Mart also did not think through the implications of their marketing strategy in terms of the distribution, product mix, and promotional strategies (Gandofi & Strach, 2009). The business model Wal-Mart used focused on EDLP; the model failed to draw customers (Gandolfi & Strach, 2009). As noted by Kim (2008b), Korean shoppers tend to go grocery shopping more frequently than people in the United States. Additionally, Korean shoppers will buy less of a product due to limited space (Gandolfi & Strach, 2009). Most of Wal-Mart stores were located in outer areas of cities—not near customers (Gandofi & Strach, 2009). The large floor plan in the stores was not conducive to the type of shopping that Koreans like to do (Gandofi & Strach, 2009). Lastly, Wal-Mart did not aggressively expand in South Korea to catch up with their competitors (Gandolfi & Strach, 2009).

Ryu and Simpson (2011) explored the failures of Wal-Mart in South Korea. As stated by Kim (2008b) and Gandolfi & Strach (2009), Wal-Mart did not consider the type of retail format that would attract consumers in South Korea. Instead the company transplanted the format that is used in the United States (Ryn & Simpson, 2011). Wal-Mart was not able to use economies of scale to keep the cost of doing business low because Wal-Mart did not have control over costs, suppliers, distribution, and store locations as they do in the United States (Ryn & Simpson, 2011). Finally, a lack of diversification in other types of investments (such as manufacturing, real-estate, etc.) made it difficult for Wal-Mart to compete with the large Chaebols (Korean family owned business) in South Korea (Ryn & Simpson, 2011).

Kim (2008a) examined the tenure of Wal-Mart and Carrefour in South Korea and found that both companies failed to adapt and handle the local norms of employees, local suppliers, and customers. Wal-Mart customers shop where they seek value for their money and are leisurely shoppers (Kim, 2008a). Socially motivated Korean consumers use shopping in modern stores as a feeling of achievement and require a high-level of customer service (Kim, 2008a). It is normal for Korean consumers to buy fresh vegetables, fruits and seafood; Carrefour and Wal-Mart failed to provide these items (Kim, 2008a).

Human resource management practices at Wal-Mart and Carrefour were also contentious as the companies gave preference to store managers who were fluent in French and English and respectively (Kim, 2008a). The companies used expatriates who did not understand the local culture in management positions; such a practice, created communication problems with the staff, and made it difficult to create a corporate culture that integrated local and foreign employees (Kim, 2008a). Allegations of mistreatment of employees at Wal-Mart and Carrefour were made (Kim, 2008a). Carrefour had been particularly criticized for their salary system, which made it difficult for employees to get raises and be part of the union (Kim, 2008a). In 2002 and 2006 allegations of unfair trade practices were made against Carrefour. The company was fined by the South Korea Fair Trade Commission for passing expenses to suppliers (Kim, 2008a). As Kim (2008b) and Gandolfi & Strach (2009) stated, Wal-Mart and Carrefour failed to adapt their stores to the local market by not building a strong relationship with suppliers.

Finally, Wal-Mart and Carrefour were at a disadvantage in terms of the business structure in Korea, where Chaebols were dominating and had inroads to distribution, promotions, and real estate (Kim, 2008a). Pressures influenced success due to taxation, and regulations (Kim, 2008a). Korean retailers were given eight years by the Korean Government to plan for the liberalization of the retail market. Such liberalization would allow Chaebols to buy large amounts of real estate and leave very few locations for foreign retailers (Kim, 2008a). Some of the regulatory issues in South Korea continue to impede foreign retailers; such issues will be discussed later in this paper.

Failure in international retailing is defined by Aklamanu (2014) as the inability of a retailer in a foreign market to cope and respond to institutional pressure. This burden caused ongoing operational losses in sales, profits, market share, and customer patronage. Additionally, it results in excessive suppliers, employee turnover, and sanctions from the host government. The penalties in turn, result in the company exiting the foreign market. A proposed framework for failure in international retailing consists of four institutional environments: regulatory, normative, cognitive, and constitutes (Aklamanu, 2014). Each of these institutions applies pressure on an international retailer. The regulative pillar is applied by government in the system of laws, rules, and regulations. The normative pillar is applied by consumers, suppliers, competitors, human resources, and the general public (Aklamanu, 2014). Pressure from the cognitive pillar is applied by business systems and ownership, and the structure of the retail store. Lastly, constituent pressure is applied by the legitimacy of regulative, normative, and cognitive pillars (Aklamanu, 2014). In turn, the institutional pressures lead to the failure of international retailers.

Methods and data

This study critically reviewed the literature on the international grocery retail industry in South Korea. A case study and ethnography were used to provide insight into the experiences of international retail companies, while at the same time providing information about the situation.

The literature on the international grocery retail industry in South Korea spanned 20 years from 1996-2016. Research was conducted on international grocery retailers in South Korea with the objective to understand more fully its history. The author used literature on specific international grocery retailers and general literature on the international grocery industry.

Benefits of international retailers to local retailers

Due to strong competition from international retailers (Suh & Howard, 2009), South Korean retailers have benefited by re-examining the types of retail formats used in stores. In their research, Suh and Howard (2009) discussed the benefits of opening the market up to international retailers, as well as the ability of South Korean firms to enter into joint ventures. "This market opening may be expected to have improved South Korean retailers' management practices through knowledge transfer and by exposure to the world's best practices" (Suh & Howard, p. 33). An example of this type of partnership is the relationship between Shinsegae and Costco typifies this kind of partnership. When Costco expanded to South Korea in 1994 it operated its stores in a joint partnership with Shinsegae (MMR, 2009). Costco now has 12 stores in South Korea (Costco Korea, 2016). After Shinsegae divested its stake in the partnership with Costco, Shinsegae opened E-Mart Traders in 2010. E-Mart Traders now consists of 10 stores that use virtually the same store format as Costco does (E-Mart Traders, 2016; Shim, 2015).

The theory of glocalization was established by Robertson (1994) by combining the words "globalization" and "localization" (Matusitz & Forrester, 2009). Glocalization is defined by Matusitz and Forrester (2009) as the "the cultural synchronization and adjustment of norms and practices to cater to local worldviews and expectations" (p. 159). The theory of glocalization states that a multinational company should adapt its corporate culture, the store format, and product selection to fit the different tastes of the local culture.

Problems that international retailers encounter

International retailers continue to encounter challenges in the South Korean market. First, the use of glocalization by international retailers is important to the adaptation of the needs of Korean customers in order to be successful in the market. Second, carrying some Korean brands as well as having products in smaller product sizes would better cater to local customers' needs. Third, the use of expatriate managers by international retailers in South Korea causes cultural and communication difficulties that could be averted by creating a corporate culture that blends Korean culture into the work environment. Fourth, training employees would improve customer service and decrease the number of complaints as well as increase customer satisfaction and sales.

Finally, one of the largest challenges is government regulation. New regulations were put into place in early 2013 that (a) forced large retail grocery stores to close two Sundays per month, (b) forbade stores from operating in areas where a heavy concentration of small (mom-and-pop) stores operated, and (c) stated that large retail stores could not be open between midnight until 10 in the morning (Lee, 2013). The justification behind these new regulations is that large retail grocery stores hurt sales at small mom-and-pop stores (Lee, 2013). Additional ordnances were passed nationally that prevented large retail stores opening within a kilometer of traditional markets (Lee, 2013). Furthermore, large department stores (such as Lotte Department Store, Hyundai Department Store, and Shinsegae Department Store), all of which are owned by large Chaebols and sell groceries, are exempt from these types of regulations.

The challenges for international retailers in South Korea remain strong. In contrasting the success of Home Plus and Costco with failed international retailers (such as Wal-Mart and Carrefour), it is important to include an examination of the market entry methods used, whether consumer preferences were taken into account, store formats, and how issues like customer complaints and employee relations were handled. In the past, researchers have concentrated only on the specific issues of international retailer in South Korea. So far, no researcher has contrasted the successes and failures of international retailers in order to extrapolate why some companies succeed and others do not.

Ideas for future research

The proposed six research questions are based on the critical review of the literature that has been reviewed in this paper:

RQ1: What factors prompted the company to choose to enter the South Korean market?

RQ2: What other types of market entry were considered?

RQ3: What steps did the company take to minimize potential problems after market entry?

RQ4: How did the company choose the store format?

RQ5: What problems were discovered after the company entered the South Korean market and how were they handle?

RQ6: What research was done to determine Korean consumer preferences for products and services?

I would like to propose three other areas of research in the international retail industry that should be pursued. The first is to examine the relationship between employees and employers at international retailers in South Korea and how the integration of culture is managed. The second suggestion is to explore the ways in which a beneficial relationship can be formed between international retailers and Chaebols in South Korea. Lastly, it would be valuable to explore how international retailers might offer an assortment of products and services to Korean consumers to cater to their tastes.

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