

[Field Research]

# Late Movers' Market Entry Strategies in the Chinese Retail Market: The Case of a Korean Company

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## Abstract

**Purpose** - This study aimed to analyze the strategy of late domestic entrants into the Chinese retail market, focusing on the case of Lotte-Mart, given that there are few studies on market entry strategies of domestic retail companies in China.

**Research Design, data, methodology** - The methodology of this paper is a case study approach, focusing on literature reviews and a few interviews. We conducted a survey by disseminating questionnaires and conducting interviews focusing on the Chinese retail market, and analyzed Lotte-Mart's market entry strategy in China.

**Results** - Lotte-Mart chose M&A as the mode of entry, pursuing quick market entry and rapid expansion. It chose small to medium size cities with relatively less competition. Subsequently, Lotte-Mart devoted significant effort towards localization, attempting to organize stores and assorting products to fit the Chinese consumers' preferences. It operated CSR programs to increase its brand awareness and to create a favorable brand image.

**Conclusions** - Lotte-Mart now needs to devise alternative corporate strategies for business expansion and growth. An understanding of the Chinese retail market and the case study analysis of Lotte-Mart's market entry strategy offers significant insights for domestic retail companies looking to expand into China.

Keywords : Chinese Retail Market, Market Entry, Localization, Chinese Consumers.

JEL Classifications: M10, M16, L10, L20.

## 1. Introduction

As retail companies compete globally to expand their markets worldwide, the economic role of distribution is becoming increasingly important in the twenty-first century. Currently, the structure of the world's retail market is changing rapidly with the complete opening

of the Chinese market, one of the retail markets offering the most potential. China's retail market is expected to grow larger because of the rapid growth in its economy, which is forecasted at an annual rate of 7~8%, and the increase in the purchasing power of Chinese consumers. Wholesale stores, retail shops, agencies, and franchises have been designated as foreign investment distribution industries after the implementation of the Regulation on Management of Foreign Investment in Commercial Sectors on June 1, 2004, following China's entry into the WTO in 2001 as of December 11, 2004, only commercial wholesale and retail companies financed entirely by foreign corporations were permitted (Oh, 2010).

Following the Notification on Delegation of Authority to Regional Sectors for Preparing the Evaluation of Foreign Investment Commercial Companies (December 9, 2005), China's Ministry of Commerce relaxed the then existing conditions, such as licensing procedures, beginning in March of 2006. It delegated the authority to ratify commercial companies to the regional governments and the National Economic Development Area Committee, with the exception of certain businesses and items, thereby making the expansion of foreign retail companies easier. With its limitless potential, the Chinese retail market is transforming into a fiercely competitive one as it completely opens up.

The Chinese market is rapidly gaining importance and status in the world retail market. It has been growing steadily for the last 20 years to become one of the six largest retail distribution markets, doing 1.3 trillion dollars in business as of 2010, a huge leap compared to 1990 when it ranked No. 11 with 280 billion dollars (KCCI, 2001). Additionally, the number of people with an income of 70,000 yuan or higher skyrocketed from 1 million in 1990 to 400 million in 2010, implying that the increase in income for Chinese consumers is the basis of the expansion of the retail market. China is estimated to emerge as the third most powerful retail and distribution center following the U.S. and Japan by 2020, surpassing the European retail markets of Germany, England, and France. Despite its large growth potential, however, the Chinese retail market is evaluated almost as a "red ocean" owing to fierce competition and many reports of failures. This stems from the fact that Chinese companies have an absolute advantage in the understanding of consumers and market environments because of the sheer scale of the consumer market and differences in regional markets.

Lotte-Mart's growth in China, the world's most ferociously competitive retail market, is remarkable. Major global business initiatives are underway, as the Lotte retail store in Russia and China expands. Ten retail companies including Wal-Mart, Carrefour, Metro, and Tesco

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are engaged in fierce competition over the 1.3-billion consumer market of China. Among Korean domestic retail companies, Lotte-Mart is the most engaged in overseas operations as of December 2011, with branches in China, Indonesia, and Vietnam. With the consecutive acquisitions of Makro in China in December 2007, Makro in Indonesia in October 2008, and TIMES in China in October 2009, Lotte-Mart has emerged as a multinational retail corporation with 124 supermarkets in three countries (94 in China, 28 in Indonesia, and 2 in Vietnam). This is the largest overseas operation among domestic retail companies, ranking in first place when the number of both domestic and overseas stores is taken into consideration. Moreover, with more overseas stores than domestic ones, it can be said that Lotte has acquired a retail chain that enables its growth into a global retail company.

This is the result of three years' preparation for overseas expansion, starting in 2006, despite late entries into the domestic and overseas market, especially China. Lotte-Mart continues to lay the groundwork in anticipation of assuming the leading position as the top retail company in Asia it does so by accelerating its projections into VRIC (Vietnam, Russia, India, and China) countries. As the demand in the domestic market stagnates and oversupply intensifies, companies face a growing need to find new growth markets, and Lotte has acted the quickest by pioneering new markets, reaping visible results.

Although the growth rate for domestic retail companies such as Lotte-Mart and E-Mart are accelerating, little research has been done on the kind of strategy these companies employed in entering foreign markets. Existing researches favor macro factors such as a response strategy to the open door policy of the Chinese retail market (Shim, 2008; Kang, 2006; Kim, 2005; Lee, 2005). Therefore, this study intends to determine what the successful strategies in the Chinese market are by prospecting current and future trends, along with a case analysis of the entry strategy of Lotte-Mart, which, despite its late entry, quickly carved a position for itself and expanded within a short period of time.

This study aims to suggest effective strategies for expansion into China by analyzing Lotte-Mart's entry strategy into China and conducting a documentary survey of the characteristics and problems of the Chinese retail business market. Chapter 2 will deal with the present state of China's retail market, and chapter 3 will introduce the present state of Lotte-Mart in China and its global management. Chapter 4 will be a case analysis of Lotte-Mart's entry strategy into China, and chapter 5 will deal with the conclusion and implications.

## 2. Analysis of the Characteristics of China's Retail Market

China's economy appears to have bright prospects, with expectations that urbanization and the increase in consumption by the middle class will spur future growth. Recent recessions put a halt to double-digit growth; the annual growth of 7~8%, however, is still expected to hold. Environmental analysis of the Chinese retail market should consider aspects such as consumers, present conditions of the

industry, and the real estate market.

### 2.1. Trends and Changes Among Chinese Consumers

With the formation of the middle class, a large gap in income and consumption levels can be observed between cities and rural areas, within the city's social strata, and between coastal areas and inland areas centered on the southeast coastal areas, following China's economic reform. Exact statistics are hard to obtain according to BNP Pribas Bank however, 13.5% of China's population belongs to the middle class. China's National Statistics Office views 5.04% of the population as belonging to the middle class, defined as households with an annual income of ¥60,000 to ¥500,000 (US \$7,230~60,240), and forecasts that the percentage will grow to 45% by 2020. Preferences for high-end products such as gentrified products, brand products, and luxury items are expected to grow within this consumer class, creating diversified, individualized, and differentiated consumer markets. The demands of the Chinese population have gentrified with the development of the middle class and the increase in income, with consumption concentration moving from necessities to expensive durable goods and services.

Furthermore, the language of Chinese consumption culture is rapidly changing to emphasize well-being, individuality, and trend-wise trading up (Kim, 2007). First, Chinese consumers are changing their consumption style to prioritize health and leisure. According to the Report on Standards of Living of the Chinese People 2006, published by the Horizon Research Consultancy Group in China, the increase in city dwellers' income and living standards has been followed by a shift from consumption to meet basic needs to consumption influenced by emotional factors such as health, comfort, convenience, and well-being.

Second, consumption takes the form of an emphasis on new products, change, and individuality that differentiates one consumer from another. According to the Report on Research of Trend Index Regarding Middle/High Income Citizens of China 2006, 74.5% of the respondents answered that they desire household items and clothing that differentiate them from others while capturing their individuality. Moreover, with the increased interest in new products among consumers who attach importance to change, the replacement cycle and trend cycle of products are becoming shorter.

Third, luxury consumption owing to trading up and consumption with an emphasis on trend are increasing. Until now, meeting basic needs was the traditional consumption behavior in China; with city dwellers, however, it is changing to a pattern of following trends according to personal style.

This change is evident in recent related studies. According to the annual consumer survey by McKinsey on 15,000 Chinese, Chinese consumers are becoming increasingly sophisticated, and with the increased options in products, the tendency to "take what really matters" is highly observed. A close reading of the survey shows that over the past two years, the average frequency of shopping by Chinese consumers has declined but customer transactions have increased. Many replied that they "enjoyed shopping" as a way of making good use of their spare time and over 30% replied, "I am

spending more time shopping than last year." This implies that the frequency of Chinese consumers visiting stores without making purchases is increasing. This indicates two tendencies: one is to check the information and compare the prices of products and the other is purely to enjoy shopping or "retailtainment," and thereby, compare one's own capabilities for discovering the best deals with others'.

Chinese consumers have high brand awareness and preference for famous brands; brand loyalty for certain brands, however, rates low. Over 40% of Chinese consumers believed that "products from a well-known brand will be relatively better." This tendency increased to 45% in 2010 from 41% in 2007. Consumption behaviors, however, displayed low rates of preference for a certain brand continuously, and in many cases, the actual brand choice was different at every time of purchase. If another product were better in factors of price and/or factors besides price, a different brand would be selected at the point of purchase.

## 2.2. Present State of Retail Companies in China

The Chinese government is actively pursuing the development of higher value-added industries along with development of the service industry to advance their industrial structure and, in the process, improve competitiveness by opening up China to the world (Park, 2010). Especially, since 2004, when the wholesale and retail business sectors were opened up in line with China's promise of entering the WTO, international retail businesses began expansion into China on a large scale amidst increasing competition, and China's retail businesses continually grew. Major international retail companies are expanding their business in districts inland because of their involvement with China's retail market, especially in the coastal city area. Chinese companies as well as large foreign companies are expanding their areas of influence. Korean retail companies, which found difficulty in actively expanding in the aftermath of the financial crisis, are also increasing investments through M&As.

<Table 1> Major Retail Businesses by Nationality

Nature	Name of Enterprise
Multinational company	Carrefour, Wal-Mart, Tesco, Lotus, Auchan
Chinese	China Resource Vanguard, Wu-Mart, Merry-Mart, Lianhua Supermarket Holdings, RenRenLe
Taiwanese/Hong Kong	RT-Mart, Trust-Mart, Parkson
Japanese	Itoyokato, Jusco
Korean	E-mart, Lotte-mart, Mega-mart

Source: Homepage of E-mart in China, 2011

The decision whether to expand into China is an important one for retail businesses as well as for manufacturers that have already expanded into China and export enterprises that export goods manufactured in Korea. Without effective distribution channels, even the best of products will have difficulty in reaching the customers and at times may even lose the initiative to retail enterprises. Considering the size of exports to and investments made in China, the task of determining how Korean companies should acquire and maintain distribution channels is one that must be addressed with urgency. Moreover, the mode of distribution is constantly changing in keeping

with thenew conditions and needs of the customers. Distribution routes and methods have diversified with the shortening of the product life cycle and technological advances, while entry procedures have been simplified. The development of non-store retailing has accelerated with the recent advances in communications, distribution systems, and the emergence of online and TV shopping and mail orders.

<Table 2> 2011 Sales Ranking of Retail Businesses in China

Ranking	Company	Total Sales (one hundred million)	No. of Store
1	Auchan+ RT Mart	14.2	210
2	Wal-Mart +Trust Mart	11.3	352
3	Suguo + Vanguard	9.5	540
4	Carrefour	9.3	203
5	Century Mart	3.6	158
6	A.Best	3.5	120
7	Tesco	3.1	110
8	Yonghui	3.1	145
9	Wu Mart	2.9	98
10	Renrenle	2.7	115
11	Lotus	2.7	76
12	Wuhan Zhongbai	2.4	170
13	Shanghai Nonggongshang	2.1	71
14	Beijing Hualian	2.0	78
15	Lotte Mart	1.8	94
20	E-mart	0.7	17

Source: Internal data of Lotte-Mart

With the development of retail businesses, companies are forming nationwide distribution channels through M&A of many small businesses or by establishing a large firm from the start. The Chinese government is also promoting policies to stimulate domestic consumption and support the development of a larger national brand through the merging of many small retail businesses. The appearance of department stores specializing in home appliances such as Gome and Suning are good examples. Over the last few years, small retail businesses have spread out over various cities and areas and have merged to form two large home appliances stores. They are pursuing a highly aggressive store expansion strategy, with Gome holding 1,362 stores and Suning holding 812. The two are expanding their business areas to second tier and third tier inland cities from the first tier cities in the eastern region. Gome and Suning rank first and second, respectively, among the top 10 retail businesses in China. The top five are Chinese enterprises, with only three foreign enterprises—Carrefour of France, Wal-Mart of the U.S., and Darunfa of Taiwan—ranking in the top 10.

## 2.3. Trends in Business Districts and the Real Estate Market in China

It is important that foreign enterprises planning to expand into China grasp local information pertaining to each business district, because in China, real estate markets differ between districts. An uneven balance between supply and demand still exists, despite governmental efforts to stabilize the supply of real estate. Analysis using data from McKinsey's annual consumer survey since 2005,

which classifies local economies into districts, is not enough to understand the Chinese market; elaborate information on each region and its consumers is indispensable. For example, even within the same category (i.e., personal necessities, clothing), there is a big difference in defined buying factors and product preference depending on the business district and its consumers; this implies that the possession of detailed information on local business districts is directly connected to the competitiveness of foreign enterprises seeking success in China.

Within China, real estate prices are dictated by the location, with each city's rent levels differing. Some cities continue to show an upward trend (i.e., Shenyang, Ningbo, Dalian, Tianjin, Hangzhou), and while rents are very high in some places, a downward trend in the rate of annual increase is observed in others (i.e., Chongqing, Qingdao, Nanjing, Wuhan, Xian). When measuring by the square meter, there is still a shortage of real estate, while the supply for commercial buildings and lands witnessed an annual growth rate of 11% over the past decade.

### 3. The Current Status of Lotte-Mart Abroad

#### 3.1. Status of Lotte-Mart in Asia

Currently, as of 2012, Lotte-Mart is actively pursuing global expansion. With branches in China, Indonesia, and Vietnam, Lotte-Mart is the most active domestic enterprise operating in the overseas market. With consecutive acquisitions of Makro in China in December 2007 and in Indonesia in October 2008 and of TIMES in China in October 2009, Lotte-Mart has positioned itself as a global retail enterprise with 124 stores (94 in China, 28 in Indonesia, and 2 in Vietnam) in three different countries. This is the largest overseas operation among domestic retail businesses and stands as the leader among domestic enterprises in terms of number of stores being operated. Moreover, with more overseas than domestic stores, Lotte-Mart can be said to have acquired a distribution network that enhances its potential to grow into a global retail enterprise. This is the result of a three-year operation that began with preparations for overseas operations starting in 2006. Lotte-Mart plans to accelerate the speed of store openings, with a focus on VRIC countries, and thereby to emerge as the number one retail enterprise in the Asian retail market. The current state of operations in China, Indonesia, and Vietnam is as follows.

Currently, Lotte-Mart operates 94 stores in China, where most of Lotte-Mart's overseas stores are situated. Lotte-Mart set foot in China in December 2007 with the acquisition of eight stores from Makro, the Dutch firm in China, and continues to expand in the region. In October 2009, Lotte-Mart acquired the stores of the Chinese supermarket TIMES and grew into the retail enterprise it now is, with 94 stores, including the ones acquired previously. Owing to these acquisitions, Lotte-Mart ranks 14th (by sales) in the Chinese retail market, giving it the resources to genuinely compete with other global retail enterprises as well as push its expansion from the existing northeast sector to the central east regions. Lotte-Mart can be characterized as

having high growth potential, especially since most of the stores are located in third to fifth degree medium and small cities. Lotte-Mart plans to become one of China's top 10 retail enterprises within the next three years through expansion into the central and south central regions.

Turning to Indonesia, Lotte-Mart currently operates 28 stores there. Lotte-Mart was the first to expand into Indonesia with the acquisition of 19 Makro stores in Indonesia in October 2008. Later, in August 2010, Lotte-Mart opened Gandaria City in Jakarta through direct investments, thereby increasing the number of its stores to 28. Unlike the wholesale store concept used in the previous stores in Indonesia, Gandaria City was designed under the retail store concept with a global product zone consisting of 2,000 products from 20 countries.

Indonesia's retail market has grown at an average annual rate of 10% since 2002 until the present. In the case of supermarkets, the average growth rate is 30%, and with 2,400 million people, the country ranks as the fourth largest market in the world. While multinational retail enterprises such as Carrefour, Dairy Farm of Hong Kong, and the local enterprise Matahari operate both large and small stores, Indonesia can be characterized as a market with high growth potential as the percentage of large stores is low compared to the entire retail market. As the first Korean retail enterprise to expand into Indonesia, Lotte-Mart is currently pushing ahead with its localization and differentiation efforts that recognize the characteristics of the local customers.

Finally, Lotte-Mart currently operates two stores in the Vietnamese market. Lotte-Mart was also the first Korean company to expand into Vietnam, with the opening of the South Saigon branch in December 2008. The South Saigon branch differentiated itself from other local enterprises by building up cultural and leisure facilities, with 10,579 m<sup>2</sup> of its 20,497 m<sup>2</sup> property devoted to movie theaters, culture, and bowling alleys; moreover, it is the largest among single story shopping complexes. The South Saigon branch, unlike other retail stores in the country, is a facility complex that accommodates both shopping and cultural activities. This three-story complex has stores and cultural facilities on the first and second floor and houses large leisure facilities including Lotte Cinema, family restaurants, bowling alleys, and billiard halls, making it the shopping center with the best recreational facilities.

In July 2010, with the opening of the second branch in Phu Tho, Lotte-Mart paved the way for its entry into the chain store era. Of products sold in the Phu Tho branch, 95% are representative goods of the top local companies, while products of top Korean, Chinese, and Japanese companies, among others, are arranged separately in the global product zone.

#### 3.2. The Present State of Lotte-Mart's Expansion in China

Most of Lotte-Mart's overseas stores are in China. Lotte-Mart launched in China in December 2007 with the acquisition of eight stores from the Dutch firm Makro and continues to expand. In October 2009, Lotte-Mart acquired the TIMES Chinese supermarket stores, growing into a retail enterprise with 94 branches in China alone as of January 2012.

&lt;Table 3&gt; Major Profile of Lotte-Mart's Entry into China

Date	Subject
2007. 12	Acquisition of 8 Makro China stores
2008. 6	Re-opening of 3 Lotte-Mart branches Acquisition of 8 Makro stores
2009. 3	Opening of Qingyang branch in Qingdao
2009. 8	Opening of Laosan branch
2009. 10	Became leader in terms of number of stores both domestic and international with the acquisition of TIMES China
2009. 11	Opening of Gongyixiqiao branch in Beijing
2010. 9	Opening of Yuhong branch
2010. 11	Opening of Beichen branch
2010. 12	Opening of Weihai, Chaohu, Tengzhou, Suzhou branches
2011. 1	Opening of Nantong Development Zone branch
2011. 6	Opening of Chuanying branch
2011. 8	Opening of Luyuan branch
2011. 9	Opening of Zhuozhou, Fengtai, and Rudong branches
2011. 10	Opening of Tongxing branch
2011. 11	Opening of Dangtu branch
2011. 12	Opening of Heping, Yanjiao, Dongying, Muhu, Jiading, and Zunhua branches
2012. 1	Opening of second branch in Shuyang

Unlike E-Mart, which localized its existing models to achieve expansion, Lotte-Mart expanded mainly through M&A. Lotte-Mart was a decade behind E-Mart in expanding overseas when it first began with the acquisition of eight Makro stores in 2007; however, it became the first to expand into Indonesia and Vietnam and continues to actively expand in the Chinese market with acquisitions such as that of TIMES China. In the past, Lotte-Mart focused on the northeastern regions. This is because the Shandong province itself was a sufficiently large market with a population of 70 million, equivalent to the population of the entire Korean peninsula. Now that they have consolidated their position in the north, Lotte-Mart is pushing southward.

## 4. Lotte-Mart's Late Market Entry Strategy into the Chinese Market

This chapter will analyze the entry strategies of first movers such as Wal-Mart, Carrefour, and Metro and then analyze Lotte-Mart's entry strategy as a late entrant.

### 4.1. Competitor Analysis: Wal-Mart, Carrefour, and Metro

#### 4.1.1. Wal-Mart

As the world's largest retail enterprise, Wal-Mart spent six years preparing for its entry into China. It established offices in Hong Kong to conduct concentrated market research following the ratification of China's State Council in July 1992. Detailed research was carried out on the economic policies of China, government support, urban economy, national income, retail market, level of consumption, and consumption behavior. Moreover, in 1996, the first shopping plaza, Sam's Club, was established in Shenzhen. Wal-Mart continues to spread across China with different development models to match each regional environment (Lee, 2002).

Wal-Mart's corporate strategy and performance can be categorized as follows. First, standardized and systematic management is at the heart. Wal-Mart introduced advanced business management using information systems, improving work efficiency. Stores are managed through mutual information exchange with the head firm via satellite; sales promotions are tailored to the consumer's psychology, and great emphasis has been placed on improving the corporate brand image.

Second is cost reduction through quantity purchasing. Wal-Mart purchases from famous international MNCs in large quantities, enabling it to procure products at a low price. For example, a quantity purchase at the headquarters of P&G in the U.S. gives them a price advantage over Chinese companies.

Third is the localization strategy. Prior to entering the Chinese market in 1996, Wal-Mart initiated the professional education of key officials at the management levels over eight years. Thus, Wal-Mart reaped success by emphasizing human resources and choosing management methods that fit the local environment.

Fourth, Wal-Mart devoted much effort to strengthening bonds with the Chinese government. Before China joined the WTO, restrictions on entry into the Chinese retail market were very prohibitive. Since the government ratification on retail business management in 1992, Wal-Mart has continually put great effort into maintaining relationships with the local governments in the cities where it is opening stores. By following legal procedures and gaining ratification, Wal-Mart earned the trust of these governments. Moreover, Wal-Mart maintained friendly relationships with local government officials by inviting them to its headquarters. Thus, Wal-Mart's establishment of stores has run smoothly.

#### 4.1.2. Carrefour

Internationally, Wal-Mart leads the retail industry. In China, however, with respect to both number of stores and performance, Carrefour is the leading enterprise. It has centered its operations in major cities like Beijing, Shanghai, and Shenzhen, establishing a significant brand image across China.

Carrefour's corporate strategies and performances can be categorized as follows. First, Carrefour established targets on the basis of thorough preliminary investigation. Before entering the Chinese market, Carrefour carried out detailed market research. As the market with the most consumer power and a huge potential, China classifies 16 cities as having populations of two million or more. After China opened its doors and as the standard of living increased, consumption demand and lifestyle changed as well. Carrefour estimated that there were 150 million people belonging to the emerging middle class, with an annual income of US \$1,500 ~ 3,000 this represented the strongest consumer class, and Carrefour chose it as its target market.

Second, Carrefour adopted a localization strategy. Carrefour calls itself a purely Chinese company. The staff localization at senior management level at the Chinese headquarters of Carrefour is higher than in other companies, and employee localization rates are at 98%. Staff localization strategy and the know-how for advancing into each area are the driving force behind Carrefour's continued expansion in the retail market. After expanding into China in 1995, Carrefour set up a goods procurement system that took into consideration local character-

istics and delegated sufficient authority to each branch, allowing them to adjust their merchandise easily. Having its own goods procurement network allowed Carrefour to place large stores in Beijing, Shanghai, and Shenzhen.

Third, Carrefour used a floor price strategy. China's income levels match those of a developing country, meaning the elasticity of demand according to price fluctuates greatly; thus, Carrefour pursued a low-pricing strategy in expanding into China and reaped great success. Carrefour's net profit is only 5% below that of other large retail enterprises in China, and even when the ratio of net gain on certain products is very high, consumers still recognize Carrefour as the store with the lowest price. Carrefour's low-price strategy is accomplished through the procurement of low-cost products, maintenance of high merchandise turnover rates, and reduction of decoration costs. By forming strong relationships with suppliers, Carrefour procures goods at a low price, and for some products, it adjusts prices even if it means absorbing losses.

Fourth, Carrefour maintains the freshness of its products. Considering that there is a great deal of interest in groceries in China, Carrefour devotes adequate resources to its grocery stores. For example, one can sample breads toasted French style and, unlike general supermarkets, one fifth of the store processes foods on the spot. As a competitor of Wal-Mart, Carrefour aims to be the leading retail enterprise and is growing at a rapid rate in the Chinese market, as it continues to expand by region. Compared to Wal-Mart, Carrefour's speed in opening new stores was sluggish, because it continued expansion without the ratification of the central government. Unlike Wal-Mart that focused on southern China in the early stages of its entry, Carrefour focused on regions in the east, north, and center; thus, the two companies did not intrude into one another's domains. With the development of the Chinese market and China's further opening up, the competition between the two has intensified. While Wal-Mart's strengths lie in acquiring a competitive price through the adjustment of production costs, access to information through their global network, and the know-how from American style discount stores, Carrefour's strengths lie in its hypermarket management ideology and strategy of expanding by regions. In other words, Carrefour holds the competitive edge over Wal-Mart as far as know-how in pioneering in foreign markets and comprehending the psychology of urban consumers are concerned. Whereas Wal-Mart began worldwide expansion in the 1990s and mainly focused on small and medium-sized cities, Carrefour began its overseas operations as early as the 1970s and pursued expansion strategies that focused on major cities (Lee, 2002).

#### 4.1.3. Metro

Metro Group ranks third among retail companies in China and second in Europe. After advancing into Shanghai in 1995, Metro employed its distinctive and successful management model to expand from Shanghai as the center. Metro established depot-style sales networks in Shanghai, Nanjing, Qingdao, Wuhan, and Wuxi, and the network itself is managed jointly with the company JinJiang. Metro plans to increase the number of its stores to 100 and is prioritizing the consolidation of advances into the inland regions of China. Metro's

membership-based depot style stores target professional customers from small businesses, restaurants, entertainment venues, and public departments like schools, hospitals, and governmental organizations. Its primary targets are business units, small retail businesses, hotels, and corporate bodies with ordinary customers as secondary targets, and it sells merchandise mainly on a membership basis (Kim, 2002).

The characteristics of Metro's corporate strategies are as follows. First, Metro concentrated on securing large markets rather than short-term profits. Metro's corporate strategy in the Chinese market aims to derive massive long-term profits through economies of scale rather than short-term profits. Metro's current profit margin in the Chinese market is 1%, and it aims to raise it to 2~3% hereafter. Metro's short-term policy emphasizes reducing the profit margin, gaining customer satisfaction through securing users, while setting a strategy to continuously expand and grow. Moreover, by managing its stores as depot-style retail stores, Metro has made group consumers and the public sector its primary target market. In other words, Metro's corporate strategy in propelling its operations is that of mass procurement of goods and mass merchandise sales.

Second, Metro uses C&C (Cash & Carry) management methods. Through cash settlements and a direct consignment (C&C) style of management, Metro expanded into 21 countries in Europe in a short period. Metro's operating system features cash settlements, rapid consignment of goods, voluntary transportation by suppliers and consumers, and reduction in distribution costs and time. Metro's system of cash settlements and voluntary consignment enabled Metro and its suppliers to reduce delivery time by 9~12 days, increase capital capabilities, reduce management risks, and reduce production costs through cash settlements and selling of merchandise through Metro's large network. Moreover, by establishing a cooperative relationship with suppliers to voluntarily take responsibility for consignments, Metro avoided having to set up distribution centers. It had manufacturers deliver products to the stores themselves, eliminating the need for retail stores to go to the manufacturers to withdraw the goods, and thereby reducing cost prices.

Third, Metro manages stores through an information system. Metro's computer-controlled system makes it easier to assess the amount of stocks, sales volumes, and the amount of warehoused products. If the quantity of products is below the preferred amount, the system automatically marks the products to be ordered and issues a related order notice to the manufacturer, thus securing product supplies.

Fourth, it limits decorations within stores and the range of customers. Metro has reduced operation costs and product prices by establishing branches near large cities with well-developed traffic networks. Moreover, interior design is almost nonexistent, and since Metro merges its warehouses and departments within each store, it does not place much weight on interior design. This enables it to cut prime costs and allows for faster distribution. Additionally, Metro's primary target market is group consumers, since wholesale stores have lower operating expenditures. In terms of store dimensions and employees, wholesale stores have lower operating costs that lead to reduction in prime costs.

Fifth, Metro localizes management. Metro also has plans to grow

into the largest retail enterprise in China through active localization strategies and establishing regional branches. After its entry into China, Metro employed advanced and successful management and operating models, all the while training employees using the lessons gained from its diverse experience, thereby fostering excellent management personnel and enhancing the localization rate of such personnel. In terms of products as well, while the average ratio of Chinese products on a shelf is at 95% among foreign-invested retail enterprises, in the case of Metro's Shanghai branch, the ratio is at 97%. The following table sums up the strategies of foreign retail enterprises.

<Table 4> Analysis of Corporate Strategy of Major Foreign Retail Enterprises

Corporate Strategy	
Wal-Mart	- Standardized and systematic management - Cost reduction through quantity purchases - Strengthening of ties with the Chinese government

Source: Wang (2010)

## 4.2. Lotte-Mart's Entry Strategy into the Chinese Market

### 4.2.1. Entry Strategy through M&A

Lotte-Mart pursues a different strategy from E-Mart in approaching the retail market. After setting up its first branch in China in 1997, E-Mart adopted a strategy that can be described as cautious, as it devoted seven years to market research before opening the next store. E-Mart began genuine expansion in China with the opening of its tenth branch in 2007. On the other hand, Lotte-Mart began by acquiring local stores when opening its first branch. It used M&A expansion strategy to overcome the late mover disadvantage it faced in entering the Chinese retail market. Therefore, Lotte-Mart began its advance into the Chinese market by acquiring the Dutch supermarket chain Makro in 2007 (Chosunilbo, 2009). Lotte-Mart had to pay 78 billion won for 49% of the shares of CTA Makro, the management company of Makro in China, following which, Lotte-Mart took control of the company. Makro China had five branches in Beijing and two in Tianjin. With the acquisition of Makro, Lotte-Mart could establish a foothold in the core regions of China.

*"We chose to enter through M&A because it was essential for Lotte-Mart to establish an 'economy of scale' within a short period due to Lotte-Mart's position as a late entrant and the high entry barriers of the retail industry. We are currently also pushing a green field strategy."*

— Excerpt from interview with the director of Chinese operations of Lotte-Mart.

As part of its M&A entry strategy, Lotte-Mart acquired TIMES Ltd., a Chinese retail company, in October 2009. TIMES owns 65 branches, 53 stores, and 12 supermarkets in the eastern regions of China. The acquisition of TIMES by Lotte-Mart is the largest M&A of a foreign company by a domestic retail enterprise. The reason

Lotte-Mart chose TIMES as its target for acquisition is that TIMES held 90% of the distribution network in the small to medium cities in central east China, thus providing high growth potential as the cities developed. With that acquisition, Lotte-Mart secured 75 stores in China, ranking 14th among retail enterprises in China.

Behind Lotte-Mart's entry strategy through M&A was the belief that it could never catch up with other international enterprises by building stores one by one; thus, it chose to catch up quickly through M&A. In other words, to enter a market where other developed enterprises were competing fiercely, it was important to attain an "economy of scale" within a short period hence, the decision to employ M&A strategies was taken. Through this strategy, Lotte-Mart supplanted E-Mart as the Korean retail enterprise with the most branches in China. Moreover, entry through M&A meant Lotte-Mart could secure the existing local employees of acquired companies, which was highly significant in terms of securing talent.

Thus, two years and nine months after expansion in December 2007, Lotte-Mart had successfully established an "economy of scale" to some degree. Lotte-Mart could then compete with world-class retail enterprises such as Auchan (1st in sales at the end of 2010), Carrefour (2nd), and Wal-Mart (3rd) and set a goal of ranking among the top ten in the Chinese market in terms of sales within the next three years (Chosunilbo, 2010).

### 4.2.2. Localization Strategy

Lotte-Mart made use of the fact the Chinese like to eat food within the stores; thus, they operate a short order department three to four times larger than that of other stores in Korea. Additionally, they trim meat and seafood products in front of the customers who order them, out of regard for the strongly suspicious nature of Chinese people. Considering that many locals pursue dual careers and so have developed a range of instant dishes to accommodate this lifestyle, the "Delica Corner," which sells instant dishes, was established and is twice as large as food outlets in other stores. Additionally, because of the food culture in which consumers buy fresh products in small quantities on a daily basis, half of the entire store is devoted to groceries and includes convenience facilities such as pleasure domes, which are not common in Chinese stores. In keeping with the Chinese belief that when products are stacked high there must be many inexpensive products, Lotte-Mart practices "volume displays" with products stacked two meters high.

*"Lotte-Mart is intensifying the localization of store product organization that reflects Chinese customs and food culture, when compared to competing enterprises. In terms of employees as well, we are pushing for localization of store managers and employees."*

— Excerpt from interview with the director of the Chinese operations of Lotte-Mart.

The Luyuan branch located at the outskirts of Changchun in the Jilin province is the 200th store, including both domestic and overseas branches, opened by Lotte-Mart. The Chinese authorities demolished the existing building to build a new apartment complex.

Wal-Mart, the number one enterprise in China, is already operating near the Luyuan branch with an eye on the potential middle class customers. Altogether, the three stories measure 16,000m<sup>2</sup>, with the second and third floor occupying 8,000m<sup>2</sup>. The store has been organized to suit the preferences of the local population. The store has a shabby look to it instead of the clean Korea-style interior, favorably impressing the locals.

The most notable products are the displays of livestock and seafood products. Live alligators and wild turtles, bullfrogs, and carp swim around in large water tanks—products that would be unthinkable in Korean stores. A whole piglet is also on display. Should the customer make an order, the piglet is sliced on the spot and packaged. Yong Joon Cho, the general manager of the Shenyang Lotte-Mart firm, commented that they "display various livestock and marine ingredients following the preference of local consumers who consider products fresh when prepared on the spot."

In the groceries department on the third floor, a large pile of mooncakes is stacked in the center of the hallway. Mooncakes are essential gifts for the Mid-Autumn Festival, the Chinese equivalent of Thanksgiving. Behind it on display stands over a meter tall is cooking oil, another essential in the Chinese diet, which includes lots of fried foods. Processed foods such as snacks are stacked on display stands 2.4 meters high. The idea is to create a sense that the products are inexpensive by stacking them wide and high.

The industrial products department is organized according to Chinese preferences; the food corners, however, meet the standards of Korean stores. This is because consecutive incidents involving food have led to a fall in the credibility of Chinese food. In such Korean grocery corners, kimchi and soju are on display along with the QooQoo rice pot and "Lock and Lock" airtight containers.

In the process of localizing store operations, Lotte-Mart in China took on the characteristics of a hypermarket rather than a retail store in Korea. Such localization efforts are in line with Lotte-Mart's expansion into other Asian markets as it selects business modes that fit the host country, operating under various forms such as wholesale shops, retail shops, and shopping malls.

#### 4.2.3. Selection of Location: Regional Expansion Strategy

Shinsaegae's E-Mart, which holds the record for the highest sales among domestic retail enterprises, is struggling uncharacteristically in China. E-Mart, which operates 25 stores in China, recorded 305.7 billion won in sales with net losses of 59.6 billion won in 2009. In 2008, E-Mart ran a deficit of 20.9 billion won. Lotte-Mart, which entered China a decade after E-Mart in 2007, recorded sales at 1.6 trillion won with operating profits of 12.5 billion won. The different results are owing to the differences in the two companies' selection of location and expansion strategies when entering the Chinese market.

First, the method and location of opening stores in China differed. E-Mart opened stores in large cities where competition is fierce, like Beijing and Shanghai. On the other hand, 90% of Lotte-Mart's stores are located in the regional small and medium cities where competition is much less fierce. Moreover, unlike E-Mart, which centered its store openings in large cities, Lotte-Mart attached more weight to the northeastern regions; therefore, Lotte-Mart embarked on a "southward

policy" after establishing itself in the northern regions to some degree. Lotte-Mart's plans detail expanding into major cities along the coastline with Beijing as the center base.

*"Because competition is fierce in the major cities of China, Lotte-Mart is targeting third and fourth line cities."*

— Excerpt from interview with the director of Chinese operations of Lotte-Mart.

While E-Mart was unable to increase the number of its stores within a short period by opting to select locations and build stores by itself, Lotte-Mart built itself up through aggressive M&A. With the acquisition of the local supermarket chain store TIMES (65 stores), Lotte-Mart became the 14th ranked enterprise with 78 operating stores. Another strategy Lotte-Mart has introduced to strengthen its advance into overseas markets is that of dominance. The dominance strategy involves the company opening as many stores as possible within a short period of time so as to acquire a dominant position in the surrounding cities before advancing into the major cities.

#### 4.2.4. CSR Strategy

Lotte is working hard to increase brand awareness and establish a new image of the Lotte Group among the Chinese. Lotte is advertising itself as a lifestyle company operating groceries, distribution networks, and so on, under the brand advertisement themed "有樂天·好明天 (A pleasant tomorrow because of Lotte)." Moreover, to maintain sustainable growth in China as a global enterprise, Lotte is actively participating in welfare contribution activities such as donating ¥1 million (130 million won) to the China Youth Development Foundation, a social enterprise which offers scholarships for Chinese youth. Such contribution programs are related to the domestic contribution program's theme, "The Proper Development of Prospective Talent," carried out in Korea.

As Lotte expands its social contribution program domestically, it is also modifying and supplementing it to fit the conditions of foreign sites. For example, to improve the living conditions of ethnic Koreans living in China, Lotte sponsored the cost of medical volunteer activities while also providing medical facilities in Indonesia, where there is a great desire for improved housing and living standards, Lotte delivered relief items when natural disasters such as earthquakes occurred as well as conducted fundraising campaigns. By these means, Lotte operates social contribution programs that fit the characteristics of foreign markets.

*"The social contribution programs of overseas operations were expanded in line with the promotion of domestic programs, all the while reflecting the environment and characteristic of each region to assist various localization strategies."*

— Excerpt from interview with the Strategic Shared Growth Team official of Lotte-Mart.

In short, while maintaining the promotional thrust of domestic con-



tribution programs for overseas operations including China, the business units are managed separately to reflect differences in regional characteristics this is in an attempt to become the driving force behind regional development through various activities, both domestic and international.

#### 4.2.5. Implications and Assessment of the Global Expansion of Lotte-Mart

Lotte-Mart was the first among domestic retail enterprises to establish a multinational store chain. Lotte-Mart's securing a new growth engine is significant in view of the fact that the domestic retail market is entering a stage of maturity with no guarantees of additional growth as the market is now saturated.

Korean "supermarkets" are the darling of the Korean distribution industry, taking the spotlight with their rapid growth and development over the last decade and becoming the top distribution sector as of 2004. The aggressive opening of stores by each distributor beginning in 1993, however, has left distributors faced with a crisis where the domestic market alone can no longer guarantee additional growth less than 20 years later. Thus, domestic supermarket companies turned to foreign markets in search of new growth potentials, resulting in entries into the Chinese, Indonesian, and Vietnamese markets. These activities attracted much praise since they laid the foundation and pioneered the way to new foreign markets, ahead of companies in the same line of business.

Moreover, these aggressive expansions into foreign markets are not limited to simply opening stores but also serve to strengthen global sourcing capabilities on the basis of experience in the foreign markets, thereby supplying inexpensive and excellent foreign products to the domestic market and spearheading the opening of foreign markets to excellent domestic products

## 5. Conclusion

### 5.1. Summary and Conclusion

This study aimed to analyze the strategy choices of late domestic entrants into the Chinese retail and distribution market, especially Lotte-Mart's. China's retail and distribution market can be considered the greatest beneficiary following China's economic development, and while many distribution enterprises around the world, including Korea's, have expanded or are planning to expand into China, existing research on the entry strategies of domestic distribution companies is lacking. Therefore, by analyzing the entry strategies for both international companies in China and domestic distribution companies, especially Lotte-Mart, we can provide implications for distribution-related industries and academic societies.

As a late entrant into China's retail and distribution market, Lotte-Mart chose M&A as the mode of entry, pursuing quick market entry and expansion and establishing an economy of scale within a short time. In entering and expanding markets, Lotte-Mart avoided major cities and chose small to medium cities with relatively less

competition, actively pursuing M&A and opening only a few stores as the criteria for decision making. Using this approach, they could have market domination in regional cities. Following the entry stage, Lotte-Mart devoted much effort to localization, attempting to organize stores and assorting products to fit the preferences and nature of Chinese consumers such as matching the likes of locals through product displays and interior decoration. Moreover, to increase the brand awareness of the Lotte Group and create a favorable brand image, Lotte operates CSR programs including scholarship programs, medical support programs, and so on. This can be viewed as a strategy that is in keeping with the current trend in the Chinese market that emphasizes social responsibility.

On the other hand, to strengthen their position and build on their success in entering the Chinese retail market, Lotte-Mart will now have to prepare another corporate strategies for entry and expansion into various markets. These strategies can be categorized into integrated operation, local management, and differentiation. The integrated management strategy in business operations pertains to merging the existing separated management systems and operation models found in stores along regional and branch lines established in the process of entry and expansion, to gain operation efficiency and continuous growth. Recently, Lotte-Mart has been seeking to boost operation efficiency and achieve synergies through the establishment and operation of its headquarters in China in 2011. Moreover, an integrated management system would make effective control and administration of local stores and personnel possible. The strategy of strengthening management by the local workforce means having capable native workers perform in the role of executives and managers; while Lotte-Mart runs a relatively local workforce-centered business compared to E-Mart, actual management by local staff is still at manager and employee level. Since Lotte-Mart thinks that its Chinese employees in management positions at the director level lack some required skills, the company must deal with strengthening management by the local workforce in order to catch up with leading retail companies having the experiences and know-how as first movers in the Chinese retail and distribution market. Finally, detailed specialization and differentiation strategies need to be introduced. The Chinese retail and distribution market may be highly attractive in terms of size and growth potential; however, considering the fierce competition among global and local retail companies, Lotte-Mart will need to research ways and means to position itself as the preferred supplier by Chinese customers, especially by offering an assortment of products that only Lotte-Mart can provide or unique store services.

The foregoing discussion on the Chinese retail and distribution market and the case analysis of Lotte-Mart's market entry strategy offers the following implications for domestic distribution companies planning to expand into China. First, companies should consider quick entry and expansion by actively examining the option to expand into China. China's economy still holds high growth potential, and with the prospect of rapid growth among large retail shops and the importance and status of the retail and distribution market, companies should still consider the market highly attractive, despite competition, while pursuing a differentiated business model that reflects and considers the various business areas and characteristics of its customers.

Second, care must be taken in selecting the location and modes of entry. Companies should seriously consider the fact that customer and real estate characteristics differ according to the region or size of the city when opening stores and should actively consider the M&A mode of entry because it allows for quick and easy entry into the market with the benefit of securing local personnel. Additionally, since potential competitors and cooperators are native Chinese companies, a strategic partnership with them can also be considered.

Third, companies need to actively employ local workers in market operations while maintaining effective control and management capabilities. To take this a step further, developing the capabilities of local personnel could be the key to advancing localization and differentiation through better understanding of the Chinese market and consumers.

Finally, and most importantly, is to have a thorough understanding of the Chinese market and its consumers and provide them with something specialized that they find desirable. While business districts and consumers with different characteristics within the larger market present an opportunity, companies should also consider the reality that many competitors have already expanded and are competing; therefore, they should look to provide something that both fits the needs of the consumers and differentiates them from others.

## 5.2. Limitations and the Direction of Future Research

Considering the weakness of existing studies on entry strategies by domestic distribution companies into the Chinese retail and distribution market, this study contributes significantly to the literature because of its focus on Lotte-Mart, a late entrant into the market, as a case study. Moreover, it is valuable in that it organized the corporate strategies of the early entrants into the Chinese retail and distribution market as well as the global distribution companies and comparatively analyzed Lotte-Mart's entry strategy with that of E-Mart. Despite the implications it holds, this study does have a few limitations, which could be overcome through additional or extended research.

First, it is difficult to say that the subject company, Lotte-Mart, and the comparative company, E-Mart, in this study, have reaped visible success in the Chinese retail and distribution market. Moreover, considering the fact that they are still in the process of developing their markets, they have limitations as research subjects. However, success and failure cases will need to be clearly identified and a comparative study with existing theories will be required, since both companies have been in China for a considerable period now and a case study on a domestic company's market entry is needed for academia and field staff.

Second, this study was centered on document research. Although some interviews were conducted with relevant individuals, they were used mostly as confirmations of, and to assist comprehension of, existing documents owing to several restrictive conditions. Because a case study is a methodology that emphasizes in-depth analysis of the subject and suggests implications, future studies will need to be more structured and make better use of internal corporate sources and interviews with the most relevant officials. In such cases, the purpose and

method can be expanded, including applying existing relevant theories to this case study or developing it as an educational resource.

Third, although this study employs comparative analytic perspectives to some extent, it mainly takes the form of document research on a single case. Thus, it is limited in its utilization for the development of theories or generalization of research results. Although it could be used as the basis for additional or extended related research domestically, future studies will make Lotte-Mart and E-Mart part of multiple case studies, enabling the verification of related theories, analysis of similarities and differences, and the development of a major thesis.

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