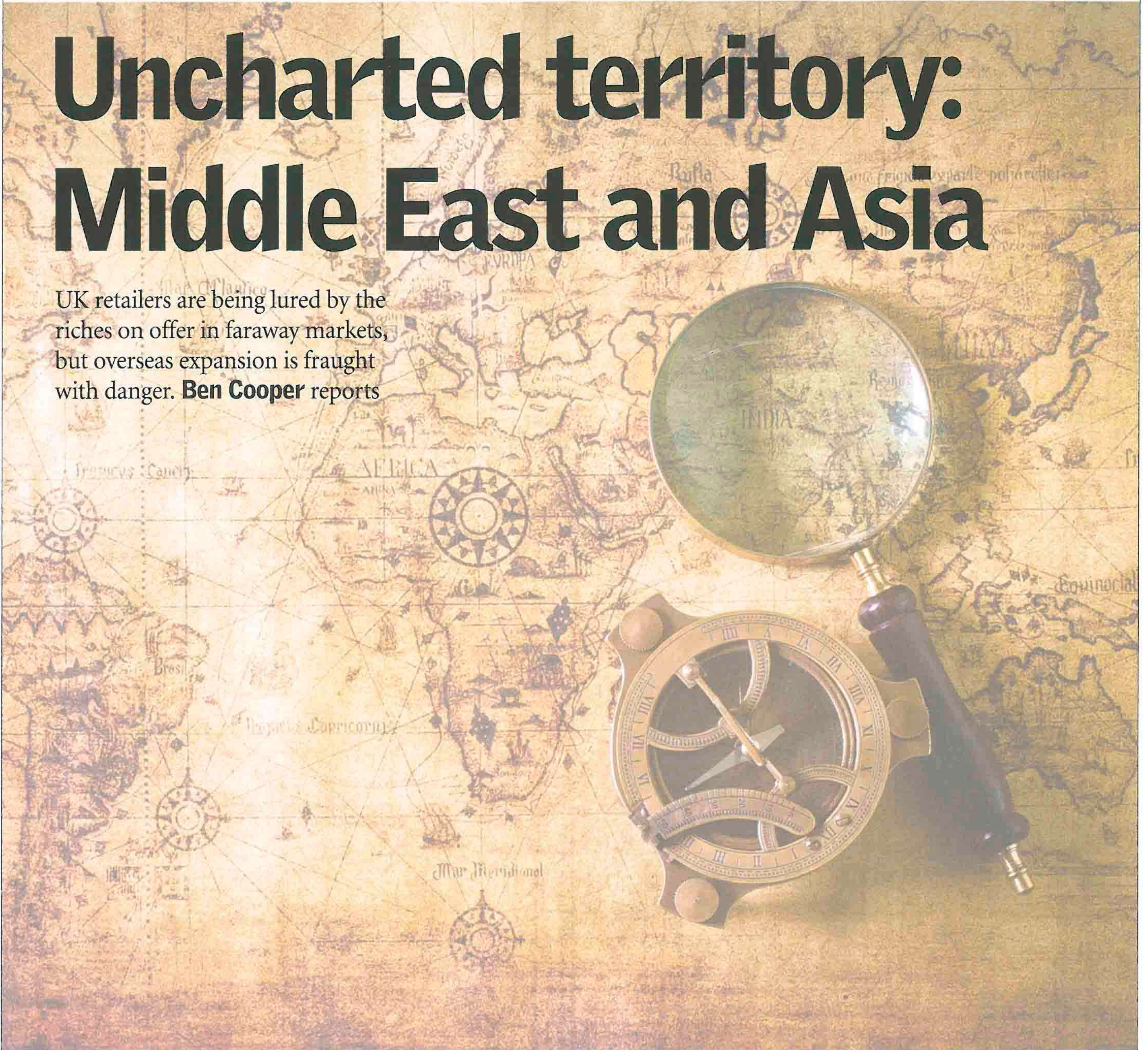
Uncharted territory: Middle East and Asia

UK retailers are being lured by the riches on offer in faraway markets, but overseas expansion is fraught with danger. **Ben Cooper** reports



When Cath Kidston first opened the doors of her small interiors store in Holland Park, she could not have imagined that 21 years later the retail empire that bears her name would have just opened its 100th international store and be poised for a major expansion into China.

Cath Kidston's success overseas is an instructive example of a significant trend. For even the most quintessentially British retailers, international expansion has become a natural step.

But as retailers increasingly look to grow their global footprint, a whole new set of challenges emerge, especially on the real estate front. Retailers looking to enter the lucrative Japanese market, for example, will find that floor space is measured not in square feet, but by the number of tatami mats that would fill it, and that in Taiwan 1,000 sq ft is equal to 28 ping. So as a new era of expansion dawns, what do retailers need to know before making the voyage into the unknown?

A new era

There are lots of new challenges for retailers expanding overseas, says Nigel French, chairman of international retail consultancy TRAUB Europe. "There are widely differing real estate laws, different cost structures, restrictive laws on opening hours, planning and construction that impede development. Retailers need to gain local knowledge from outside the appointed realtor, especially in markets where there's a combination of cultures, languages, shopping habits, employment laws and trading idiosyncrasies."

With so many potential headaches, where does a retailer begin? James Hawkey, managing director of Cushman & Wakefield's retail teams across the Asia Pacific region, says companies need to start with a clean slate and an open mind. "You're really back to the basics of retailing," he says. "You've got all the elements of starting out again in business. The customers are different in each country and they are looking for subtly different things. They might not even recognise your brand."

Aside from the obvious questions of which markets to enter and how the brand is going to be introduced, the next decision is what model you adopt for an international roll-out. There are four main approaches, each with benefits and drawbacks: you could enter a joint venture, own your own stores, use a franchisee or go down the wholesale route (see box). ↘

This decision, says Cath Kidston international director Dan Poppleton, should be the main priority before a retailer even thinks about finding real estate, because it affects everything from that point onwards.

He says: "The key question is what model you take, and whether you go with wholly owned stores or more cautiously with a franchise. The franchise relationship is a very powerful one. You're not going into a market on your own; you're going with someone who knows the market."

One of the most attractive markets for UK retailers has been the UAE, precisely because the franchise model dominates. From Debenhams and House of Fraser to WHSmith, Lakeland, Next and Arcadia, a host of high street brands have set up shop in the Emirates, keen to take a slice of a consumer spend estimated by Euromonitor International at AED766bn (£123bn) in 2014.

CBRE head of cross border EMEA retail Peter Gold says: "The markets of the UAE remain very alluring for many different reasons. In the Middle East there is a strong spending power, there's a low cap-ex so you can do it with relatively low risk and there are excellent partners in the region to go with."

Thanks to the rise of some major franchise companies in the Gulf such as Al Shayer and Al Tayer, the process is getting easier, particularly in terms of the property acquisition process.

But while the franchise model might seem like the answer to retailers' prayers, there are inevitably downsides. Neil Varnham, managing director of international retail property fund Pradera, says: "It's a trade-off. The question is will your brand be cherished and protected by a franchisee? Franchise operators know the market but it is about getting it right in terms of keeping control.

"They might have 12 or 15 brands on their books and they use that to leverage developers. It's not always in the interests of the retailers; you can end up giving away control."

Although this is a risk retailers must be aware of, Poppleton argues that the benefit of having the real estate managed by an experienced expert makes the franchise route worthwhile it if it's done right.

He says: "You can keep control if you have the right agreement in place. At Cath Kidston we say, 'freedom within a framework'. You have to allow the franchise partner to operate as they see fit. As long as there's a clear line on what is and isn't permissible, you have an acceptable level of control."

Of course, the UAE is only one region on retailers' wish lists. The rise of consumerism in the likes of India, China, Vietnam, Indonesia and Malaysia, and the consequent construction of thousands of new towns and cities makes these countries ripe for expansion, while the more mature markets of Hong Kong, Taiwan, Japan and South Korea are still rich with opportunities.

Knowing the market

This is a long and diverse list, and each market offers its own unique challenges, particularly when it comes to the finer details of the property markets. And outside of the Gulf, the franchise model is less common. Retailers may find themselves having to go down the wholly owned route, and that means getting to know a market intimately before taking the plunge.

Hawkey says it's not all plain sailing. "There are several differences to get used to, such as the units of measurement. Some local currencies can also be very volatile; there are only certain countries that are fluent in dealing with international currencies. And lease lengths are shorter in many countries in Asia, two to three years in some cases."

Without understanding these subtle differences, and without the local knowledge of a franchisee to fall back on, retailers can struggle, especially as the whole dynamic between landlord, agent and tenant can be completely alien from the familiar UK setup.

The customers are different in each country and they are looking for subtly different things

James Hawkey, Cushman & Wakefield

"For retailers it all comes down to real estate," adds Hawkey. "There are plenty of real estate issues and there are lots of companies that have struggled: they don't always choose the right sites, they don't get the design right, there are logistics issues and the landlord-tenant relationship is different. They can't always do it alone."

Of all the markets that encapsulate the opportunities and the challenges of overseas expansion, India is perhaps the most potent example. A vast sprawling country with a population of more than 1.27 billion, India is experiencing an explosion in shopping centre development that will increase the country's overall stock by 38% in the next three years.

A number of big international brands have been quick to seize the opportunity: H&M, Inditex, M&S, Clarks and Debenhams to name but a handful. Tellingly, all have done so in a joint venture, which Mark Richards, managing director of global real estate consultancy Turner & Townsend's India division, says is a wise move. "A joint venture with local players is key. You can't take anything at face value; you have to be very questioning and use a high level of due diligence. There is lots of autonomy for local state governments, so laws vary greatly from state to state and there can be huge levels of red tape and legislation."

If India is piquing the interest of many retailers, China is the holy grail for businesses intent on international expansion. With 160 cities boasting a population of more than ↘

Cath Kidston's flagship store on Huai Hai Road in Shanghai, China

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> **Dan Poppleton, Cath Kidston**

one million and 500 new shopping centres to be constructed by the end of 2016, it's not hard to see why. Cath Kidston has big plans for China. But whereas its first 100 overseas stores were largely opened via the franchise route, this time it's going it alone having already opened four wholly owned stores in Shanghai. So why, given all the risks, would it go down the direct route this time? Poppleton explains: "Because the opportunity is so big we wanted to make sure Cath Kidston was launched and communicated exactly as we wanted. We wanted to make sure that the first stores we opened were not only a statement for the consumer but also for the industry."

As Cath Kidston's experience demonstrates, there is no uniform approach to expanding overseas. The retailer has taken its quintessentially British style to new, exotic markets, each distinct and with its own challenges, and each requiring a subtly different approach.

But the fundamentals of retail property still apply no matter which model you adopt: get the location right, the design perfect, the right lease in place and a good deal on the store and you're half way there. The rest is a little trickier, but with such staggering development underway in China, India, and a number of developing Asian markets, Richards believes retailers are reaching the stage where they can't afford not to be there. ■

Tesco's travails in China

Tesco's experience in China is proof that excursions into overseas territories can be a challenge for even the biggest businesses. Last year, the UK's largest retailer revealed that after nine years of operating in the Chinese market it was abandoning its Tesco China business, which boasted 131 stores, and entering into a joint-venture agreement with the country's biggest retailer, the state-owned China Resources Enterprise, with Tesco taking a 20% stake in the new partnership. Tesco has pointed to the significant cost and operational synergies of the joint venture, which it says will move it more quickly towards profitability in China. Less charitable observers have interpreted it as a cry for help in cracking a notoriously challenging market. Either way, Tesco's foray into China has been far from a disaster. The brand may be gone but it now owns a significant stake in the biggest retailer in one of the world's fastest-growing consumer markets.

Four business models for international growth

1. Wholesale

It doesn't get you physical space, but it's a low-cost way of testing your brand on a market. Retailers and brands will need to find a local distributor, or the logistics of selling to local retailers will be too complicated to contemplate. But once your product is in a distributor's hands, there are no guarantees where it will end up.

2. Find a franchisee

Such is the scale of the opportunity throughout Asia and the Gulf that huge franchise companies are emerging with multiple brands in their stables. Going with one of these can be an advantage when it comes to tackling an unfamiliar market, especially when it comes to real estate expansion, but such big companies can become a vice on a brand if you don't set clear boundaries when you sign.

3. Joint venture

If Tesco's experience proves anything, it's that sometimes you just can't go it alone. After nine years of doing just this in China, the retailer has run to the safe haven of a joint venture partner. The deal, which keeps it in a strong position in that it owns 20% of the largest supermarket chain in the country, also spells the end of any independence it has and the Tesco brand is no longer in shoppers' minds.

4. Wholly owned stores

Taking on all the risk for the chance of reaping all the rewards is brave, but, if you want to make sure your brand captures the hearts and minds of shoppers, there's no other way. Going it alone requires inside-out knowledge of a market, its customs, its shoppers and the local property market.