second edition

Dynamics of International Advertising

THEORETICAL AND PRACTICAL PERSPECTIVES

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CHAPTER ONE

Growth of International Business and Advertising

The keystone of our global economy is the multinational corporation. A growing number of corporations around the world have traversed geographical boundaries and become truly multinational in nature. As a result, consumers around the world write with Bic pens and wear Adidas running shoes, talk on Nokia cell phones and drive Toyota autos. Shoppers can stop in for a McDonald's burger in Paris or Beijing, and German and Japanese citizens alike increasingly make their purchases with the American Express Card. And, for most other domestic firms, the question is no longer, Should we go international? Rather, the questions relate to when, how, and where the companies should enter the international marketplace. The growth and expansion of firms operating internationally have led to the growth in international advertising. U.S. agencies are increasingly looking abroad for clients. At the same time, foreign agencies are rapidly expanding around the globe, even taking control of some of the most prestigious U.S. agencies. The United States continues to both produce and consume the bulk of the world's advertising. However, advertising's global presence is evidenced by the location of major advertising markets. In rank order, the top global advertising markets are the United States, Japan, the United Kingdom, Germany, China, France, Italy, Spain, Brazil, and South Korea. And today, 8 of the top 10 world advertising organizations are headquartered outside the United States (Johnson 2009). This chapter outlines the growth of international business and advertising.

HISTORICAL OVERVIEW

There have been three waves of globalization since 1870. The first wave, between 1870 and 1914, was led by improvements in transport technology (from sailing ships to steam ships) and by lower tariff barriers. Further driving this first wave of modern globalization were rising production scale economies due to advancements in technology that outpaced the growth of the world economy. Product needs also became more homogenized in different countries as knowledge and industrialization diffused. Communication became easier with the telegraph and, later, the telephone. By the early 1900s, firms such as Ford Motor, Singer, Gillette, National Cash Register, Otis, and Western Electric already had commanding world market shares. Exports during this first wave nearly doubled to about 8 percent of world income (World Bank 2002, 326).

The trend to globalization slowed between 1914 and the late 1940s. These decades were marked by a world economic crisis as well as two world wars, which resulted in a period of strong nationalism. Countries attempted to salvage and strengthen their own economies by imposing high tariffs and quotas so as to keep out foreign goods and protect domestic employment. It was not until after the Second World War that the number of U.S. firms operating internationally again began to grow significantly.

The second wave of globalization was from 1945 to 1980. International tensions—whether in the form of cold war or open conflict—tend to discourage international marketing. However, during this period, the world was, for the most part, relatively peaceful. This, paired with the creation of the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT) at the close of World War II, facilitated the growth of international trade and investment. Indeed, during this period, tariffs among the industrialized nations fell from about 40 percent in 1947 to roughly 5 percent by 1980. In 1950 U.S. foreign direct investment stood at $12 billion. By 1965 it had risen to $50 billion, and by the late 1970s to approximately $150 billion (U.S. Bureau of the Census 1995, 870).

The third wave of globalization has been from approximately 1980 to the present. Spurring this third wave has been further progress in transport (containerization and air freight) and communication technology (falling telecommunication costs associated with satellites, fiber-optic cable, cell telephones, and the Internet). Along with declining tariffs on manufactured goods (currently under 4 percent), many countries lowered barriers to foreign investment and improved their investment climates. After the September 11 attacks in the United States, some economists worried that the year 2001 would mark a reversal of the current era of globalization. Recession, U.S. security concerns, and resentment abroad seemed aligned against the forces that drove companies abroad in the 1990s in search of new markets. However, according to a PriceWaterhouseCoopers survey of 171 business executives at large U.S. multinationals, commitment to international expansion actually rose in the year after the September 11 attacks. Of those surveyed, 27 percent planned some sort of geographic expansion during the following year, up from 19 percent prior to the attacks (Hilsenrath 2002). And it appears that the same forces that drove globalization in the past might in fact be intensifying. A 2009 *Fortune* magazine survey reports that the top 500 multinational companies alone generated almost $25 trillion in sales in 2008. The United States led all countries, with 140 companies on the list (down from 153 the previous year); Japan ranked second (68 companies), and Germany third (38) (*Fortune* 2009). See Table 1.1 for ranking of the top 25 global firms.

In addition to these large corporations, thousands of smaller firms are engaging in international marketing. In the United States, smaller firms account for an amazing 97 percent of the companies involved in direct merchandise exporting. Indeed, smaller firms are grabbing an ever-growing share of U.S. exports. American businesses without international subsidiaries accounted for 46 percent of sales abroad in 2005—up from 38 percent in 1999, according to the Commerce Department (Schlisserman 2007). Smaller firms thus represent the largest pool for potential growth in export sales. Microbreweries provide an excellent example. With production normally limited to fewer than 15,000 barrels a year, microbreweries would seem more local than global players. But the microbrewery industry is going through a transition in which exports make sense. With more than 33 regional specialty breweries and

424 microbreweries in the United States, the field has become too competitive. As a result, several of the most successful "craft" brewers are among a growing number of smaller U.S. companies looking to foreign markets to expand sales. Brewers have had the greatest successes in Sweden, Italy, and, to a lesser extent, Great Britain.

Corporations look abroad for the very same reasons they seek to expand their markets at home. Where economies of scale are feasible, a large market is essential. However, if a single market is not large enough to absorb the entire output, a firm may look to other markets. If production equipment is not fully utilized in meeting the demands of one market, additional markets may be tapped. Seasonal fluctuations in demand in a particular market may also be evened out by sales in another. During economic downturns in one market, corporations may turn to new markets to absorb excess output.

Firms may also find that a product's life cycle can be extended if the product is introduced in different markets—products already considered obsolete by one group may well be sold successfully to another. In addition to the reasons noted, significant changes in the United States and around the globe have helped fuel this phenomenal growth in international business.

SATURATED DOMESTIC MARKETS

As many markets reach saturation, firms look to foreign countries for new customers. Take the case of Starbucks. Starbucks began with 17 coffee shops in Seattle just two decades ago. Starbucks currently has over 11,500 stores in the United States alone. In Manhattan's 24 square miles, Starbucks has 124 cafes, which translates into 1 for every 12,000 New Yorkers. In coffee-crazed Seattle, there is a Starbucks outlet for every 9,400 people, and the company considers that the upper limit of coffee-shop saturation. Indeed, the crowding of so many stores so close together has become a national joke, eliciting quips such as the headline in *The Onion*, a satirical publication: "A New Starbucks Opens in Restroom of Existing Starbucks" (Holmes 2002, 101). The company had been blessed with extraordinary growth in both store traffic and same-store sales until quite recently, when this trend reversed itself. While the reversal may be attributable to the U.S. economic slowdown, some investors fear that weak growth figures could indicate saturation in the U.S. market. Indeed, Starbucks closed 600 under-performing locations in 2006—apparently an admission that cannibalization seems to be a major problem, To keep up the growth, Starbucks realized it had no choice but to export its concept aggressively. In 1999, Starbucks had just 281 stores abroad. Today it has about 5,000 outlets in more than 40 countries—and it is still in the early stages of a plan of globalization. Starbucks expects to eventually increase the number of its stores worldwide to 40,000. Canada and the United Kingdom are currently Starbucks's strongest markets abroad (some 69 percent of foreign revenues). However, India, Russia, and China represent key areas of focused future expansion.

HIGHER PROFIT MARGINS IN FOREIGN MARKETS

For the typical Fortune 500 company today, domestic revenues account for just 62.5 percent of total sales—a figure that is bound to shrink even further as globalization continues to advance. For an ever-growing number of firms, foreign revenues as a percentage of total revenues are well over 50 percent. Consider McDonald's, which gets almost two-thirds of its revenue from overseas. For the quarter that ended September 30, 2007, it reported that sales at restaurants open at least 13 months grew 5.1 percent in the United States, 6.5 percent in Europe, and 11.4 percent in Asia/Pacific, the Middle East, and Africa (Pender 2007). General Motors Chairman Rick Wagoner estimates that foreign markets will soon account for 75 percent of the auto maker's global sales, a testament to the booming growth in Asia, Russia, and far-Eastern Europe, as well as the fierce competition and market share erosion in the developed markets of the United States and Western Europe (Howes 2008). Examples of other firms that derive more than half of their revenues from abroad include: Hewlett-Packard (65 percent), Exxon Mobil (69 percent), Coca-Cola (72 percent), and Intel (79 percent). This trend toward higher profit margins in foreign markets is clearly not limited to U.S. firms. Nokia sells over 97 percent of its products outside the home market, and Toyota sells more vehicles in the United States than it does in Japan. Analysts figure that almost two-thirds of the company's operating profits come from the United States.

INCREASED FOREIGN COMPETITION IN DOMESTIC MARKETS

Over the past decades, foreign products have played an increasingly significant role in the United States. Classic examples include the phonograph, color television, video- and audiotape recorders, telephone, and integrated circuit. Although all were invented in the United States, domestic producers accounted for only a small percentage of the U.S. market for most of these products—and an even smaller share of the world market. For example, in 1970, U.S. producers' share of the domestic market for color televisions stood at nearly 90 percent. By 1990 it had dropped to little more than 10 percent. The decline in sales of United States-produced stereo components was even more serious—from 90 percent of domestic sales to little more than 1 percent during the same time span. Brand names such as Sony and Panasonic became household words for most American consumers.

Foreign companies continue to play a prominent part in the daily lives of Americans today, and domestic firms face competition in nearly every sector. While McDonald's, Burger King, KFC, and Subway dominate the fast food scene, they face competition from every corner of the globe. Pollo Campero reigns from Guatemala. The chain has 52 U.S. locations to date, but has plans for 200 by 2014. It offers chicken so good KFC couldn't beat it in Central America. Jollibee, from the Philippines, started out in California in 1998 and in 2009 added locations in New York and Las Vegas. The fast food restaurant serves everything from burgers with pineapple to spaghetti. Nando's, a South African firm, serves up Afro-Portuguese chicken with a spicy "peri-peri" sauce. Nando's has two locations in Washington, D.C. And British import Wagamama offers diners cheap ramen at three locations in Boston, with more coming to D.C. by 2010 (Demos 2009). When a U.S. consumer buys new tires, shops for the latest best-seller, or purchases a jar of mayonnaise, chances are increasingly good that the supplier will be a local subsidiary of a company based in Japan, Europe, or elsewhere outside the United States. For example, both Firestone Rubber and CBS Records were acquired by Japanese firms, and Macmillan Publishing and Pillsbury are owned by British firms (Shaughnessy and Lindquist 1993). Switzerland's Nestlé and the Anglo-Dutch giant Unilever moved into the U.S. market to grow their businesses. Unilever set the pace, paying $20.3 billion for Bestfoods, whose brands include Hellmann's Mayonnaise and Skippy Peanut Butter, as well as acquiring Slim-Fast, a diet-supplement firm, and Ben & Jerry's Ice Cream. Meanwhile, Nestlé acquired pet food manufacturer Ralston Purina, best known for its Purina Dog Chow brand. It was a logical move, as the pet food market is growing faster than Nestlé's traditional, matured businesses—particularly in the United States, where animal owners are buying higher margin products that promise both dietary and health benefits for their pets (Bernard 2001). This "selling of America" has caused a good deal of concern among the business community as well as the general public. The United Kingdom is the biggest investor in the United States by far, followed by Japan, Germany, and Canada. Increased foreign competition on domestic soil is not unique to the United States, but rather is occurring both in developed countries and in emerging economies. Regarding developed markets, the United States remains the largest recipient of FDI, followed by the United Kingdom, France, Canada, and Germany.

Worldwide, foreign direct investment (FDI) fell in 2008 to an estimated $1.4 trillion, down from an all-time high of $1.8 trillion in 2007. This was due largely to the economic and financial crisis that dampened investors' appetites to pour money abroad, including into the United States. Developed economies so far have been the hardest hit, as FDI was cut by an estimated one-third in 2008. Direct foreign investment flow to the United States slowed by just over 5 percent to $220 billion, while Japan captured 23 percent less FDI ($17.4 billion). FDI in Britain slumped from $224 billion in 2007 to an estimated $109.4 billion in 2008. Eastern and Central European economies suffered mixed