

# The Entry Strategy of Retail Firms into Transition Economies

International entries into transition economies occur infrequently and involve considerable uncertainty. This raises the question whether managers, who have limited own experience, take their competitors' prior decisions into account when deciding on their own entry timing and size and whether there is value in doing so. To address these questions, the authors estimate a sequential hazard/Poisson regression model on the top 75 European grocery retailers' decisions to enter the Eastern European market. Indeed, firms pay close attention to prevailing practices in their industry. Prior entries first serve as legitimation but eventually become a deterring factor. Moreover, rather than just imitating the most popular or modal decision when determining the own entry timing and size, managers pay closer attention to the actions of their home competitors, react to prior entries of same-format competitors differently from those of different-format competitors, and adjust the observed industry practice for the specificity of their own resources. The authors show that managers are justified in taking the combined industry wisdom into account; deviations from prevailing industry practice, in terms of both timing and size, hurt the efficiency of their operations in subsequent years. Thus, attempts to develop own, distinct entry rules tend to be dysfunctional. Moreover, corrective actions are easier to implement along the size than along the time dimension; the detrimental effects of entering at a different time from the industry norm persist and even become amplified over time, whereas the negative impact of size deviations is temporary.

**C**ross-country capacity expansion is a fundamental option of strategic diversification, but it is still little understood (Martin, Swaminathan, and Mitchell 1998). On the one hand, many firms are reluctant to commit substantial resources to a new host market quickly, especially in light of the considerable uncertainty that often accompanies foreign-market entry and the realization that investments are largely sunk when initial expectations fail to materialize. On the other hand, firms in many industries tend to be confronted with a saturated market demand in their home country, and they often fear being left out of interesting growth opportunities abroad as a result of investing too little, too late. Because of this ambiguity, there is a wide variety of entry strategies, even within the same industry. Some players follow a cautious expansion strategy and enter late on a limited scale, and others try to establish a substantial presence as quickly as possible.

In this article, we provide a conceptual framework to understand the variability in firms' entry timing and size, and we argue that these decisions are influenced not only by

the firm's own international experience (as Mitra and Golder [2002] demonstrate) but also by the internationalization activities a company observes with its competitors. Although it could be argued that markets with less direct competition are more attractive, firms may actually orient their own international expansion decisions toward the actions of or toward a subset of their competitors. Especially in the light of limited own experience and considerable demand uncertainty, firms may need to resort to inter- rather than intraorganizational learning to evaluate and legitimize alternative expansion options. If such inter-organizational learning takes place, relevant questions become which competitors constitute the reference group, whether the presence of more competitors always offers a legitimization effect, and whether there is a critical number beyond which a deterrence effect dominates. These issues ultimately lead to the questions whether and to what extent it pays to adhere to "industry wisdom."

Using a sequential hazard/Poisson regression model, we test the proposed conceptual framework on a data set that covers all the top 75 European grocery retailers' decisions to expand into Central and Eastern Europe (CEE). The grocery retailing industry has only recently begun to explore the opportunities that foreign expansion offers. As recently as the early 1990s, foreign sales accounted for less than 5% of the turnover of the world's top retailers, thus lagging most of their suppliers. However, this pattern is rapidly changing. For example, the 15 leading international grocery retailers already realized more than 25% of their 2003 sales through their international operations (M+M Planet Retail 2005) and are known to grow faster abroad than domestically. Still, despite this growing international activity, many grocery retailers appear to be struggling to develop the competencies needed to compete and survive in this more global arena (Kumar 1997). Few succeed in obtaining com-

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parable margins and returns through their foreign operations compared with their home markets, and many do not break even. Some of these disappointing results have been attributed to the notion that retailers often appear to be motivated less by the chance of creating value in a new market than by the fear of being left out by their competitors (*The Economist* 1999), suggesting that interfirm imitation is indeed an issue.

## Contribution

So far, the academic literature on foreign entry and expansion decisions has focused mostly on performance consequences. For example, Luo (1998) studies the short-term performance consequences of the timing, entry mode, and degree of diversification of foreign entries in the light industry, and Mascarenhas (1997) investigates the impact of entry size and order of entry in the oil rig market. In the retailing industry, Gielens and Dekimpe (2001) study the long-term performance consequences of standardization, mode, timing, and size of entry.

Another stream of literature focuses on which firm and market factors drive initial entry decisions. As such, questions about the extent to which rivals' actions are followed and imitated, the match between home- and host-market profile, and which firm characteristics tend to be associated with foreign entry become relevant. Answering these questions helps managers not only select entry strategies given the host-market situation and their own firm profile but also predict the type of competitors they are likely to face at the time of entry (Fuentelsaz, Gomez, and Polo 2002).

We extend this latter research stream in four ways. First, although recent research has considered the timing of foreign entry (Mitra and Golder 2002), the size decision has been largely ignored. Still, international entries can be considered "lumpy" investments of firm resources in an environment characterized by uncertainty about future performance, which necessitates attention to two key dimensions: when investments in foreign operations are made and how much resources are invested (Bar-Ilan and Strange 1999). Ayal and Zif (1979) argue that firms can choose between two expansion alternatives. To overcome resource and information constraints, they can act cautiously and postpone major investments. In contrast, to make sure not to forgo opportunities, firms may enter quickly and at full force. Both options have different timing and size implications. If retailers have different firm-specific resources and/or if managers differ in their interpretation of various market signals, the timing and extent of their entry may vary considerably. We develop a framework that helps explain this variability.

Second, we focus on the impact of interfirm learning from observing rival foreign activities. After controlling for the intraorganizational learning effects identified in prior research (Mitra and Golder 2002), we assess whether interorganizational learning has any further explanatory power. Moreover, in line with Debruyne and Reibstein's (2005) recent work, we argue that firms do not treat their competitive landscape as homogeneous but react more to some moves than to others. Firms may compose their competitive

reference group in various ways, and we assess the impact of two reference schemes. First, we consider whether firms react differently to home than to foreign competitors. Second, we consider whether retailers with a similar store format constitute the reference group that is imitated or avoided.

Third, we reflect on the costs of deviating from industry practice. If competitive entry decisions are monitored closely, to what extent does it actually pay to adhere to this "combined industry wisdom"? Can managers turn to prevailing practices in the industry to learn which decisions are good or even best (Anderson 1988; Geletkanycz and Hambrick 1997)? We study whether firms whose entry timing and size conform to the pattern of decision making in the industry (as captured in our descriptive models) perform better than firms that deviate from these rules. Moreover, we evaluate whether these performance premiums are temporary or permanent and for which decision, timing or size, is adherence to industry practice more critical.

Fourth, we consider all entries made by the top 75 Western European grocery retailers in 11 CEE transition economies. Entries into these economies provide an ideal setting in which to assess potential imitation and competition effects. Transition economies constitute a major growth opportunity in today's world order (Arnold and Quelch 1998). They are also characterized by a substantial amount of environmental uncertainty, making organizational learning both more difficult and essential (Luo and Peng 1999). Moreover, all CEE markets opened up and became an investment opportunity to all retailers at the same time. However, instead of witnessing an undifferentiated rush into all these markets, entry patterns differed substantially across both retailers and host markets.

Research on emerging markets has been relatively neglected in the marketing literature. Still, "these countries represent the growth and future of [U.S.] companies" (Steenkamp 2005, p. 7), and there is increasing evidence that multinational corporations should rethink their traditionally deployed marketing strategies when dealing with emerging markets (Arnold and Quelch 1998); that is, they should not necessarily use their "developed-world" decision rules as a default option.

## Conceptual Framework

In every entry-timing and -size decision, firms must consider market uncertainty and the potential irreversibility of investments (Ghemawat 1991). Because of the perceived opportunity costs or because firms do not want to commit themselves (yet) in the midst of high uncertainty, they may be reluctant to enter a specific market. Indeed, early and extensive commitments tend to reduce flexibility and increase risk exposure (Miller and Folta 2002). This applies to every foreign investment, but it is especially relevant in our setting. Export opportunities tend to be missing in the retail industry (Erramilli and Rao 1993). To reach potential customers, retailers must set up stores, which requires forging logistic networks, developing relationships with new suppliers, and managing assortments of thousands of products. This constitutes a considerable investment that is

largely sunk after it is made. Moreover, there is considerable uncertainty on the demand side. Local consumer tastes may differ from those in the home country, and the concept of modern retail distribution tends to be unfamiliar in most emerging economies (Dries, Reardon, and Swinnen 2004). In addition, Western retailers initially did not have any experience operating in such markets, and the extent to which macroeconomic and institutional factors would change was unclear.

To explain the timing and size decision when firms enter transition economies, we consider how firms may obtain information about the attractiveness of these markets. Specifically, we study the extent to which the presence of other retailers may legitimize or deter entry. Apart from this interorganizational knowledge transfer, we also acknowledge the value of intrafirm knowledge derived from a given retailer's own experience in similar markets, and we control for other firm resources and various host-market characteristics (for a graphic representation of our conceptual framework, see Figure 1).

### Interretailer Information

Lack of accurate information about the retail opportunities in a new market increases uncertainty and may delay entry (Martin, Swaminathan, and Mitchell 1998). However, prior decisions by other retailers may provide crucial information

about the success potential of a foreign venture (see, e.g., Henisz and Delios 2001). Following what seems to be the industry norm reduces uncertainty and enhances legitimacy because a given practice is often viewed as appropriate. Thus, a firm's initial urge to remain cautious is expected to decrease when rival players enter the host market.

In contrast, other researchers have emphasized the view that rival players tend to decrease host-market opportunities. With every rival that enters, market competition becomes tougher, raising a barrier to further entry. Cotterill and Haller (1992) point out that especially in the context of grocery retailing, aggressive responses to subsequent entries are common.

The ecology literature (Hannan and Freeman 1977) reconciles both views, arguing that the presence of rivals initially facilitates a process of social recognition or legitimization and therefore attracts new entrants into the host market. Still, as competitive investments in the host country increase, the best geographical locations become preempted, and some interesting market opportunities become depleted, creating a deterring effect that eventually dominates the legitimization effect. Following this line of reasoning, we expect that there are two opposing forces at work: rival imitation and deterrence. Although these forces are not directly measurable, we use them to derive a testable hypothesis about the dependence between the entry rate in a

**FIGURE 1**  
Conceptual Framework

