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Internationalization in retailing: modeling the pattern of foreign market entry

Geir Gripsrud[a], Gabriel R.G. Benito[b,c,*]

[a]Department of Marketing, BI Norwegian School of Management, Oslo, Norway
[b]Department of International Economics and Management, Copenhagen Business School, Frederiksberg, Denmark
[c]Department of Strategy and Logistics, BI Norwegian School of Management, Oslo, Norway

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Abstract

This article investigates retailers' choice of foreign markets using a spatial-interaction model that takes into account factors related to the attractiveness of a given market as well as distance to that market. While gravity and spatial-interaction models have a long tradition in retailing research, such models have not been applied to foreign market entry before. Data on UK retailers' cross-border operations provide good support for the model. Its explanatory power is particularly strong for the initial set of entries made by the retailers, which suggests that experience effects as well as firm-specific internationalization strategies eventually override the common effects of distance and market attractiveness on the choice of which foreign markets to enter.

Keywords: Foreign market entry; Spatial-interaction model; UK companies; International retailing

1. Introduction

Foreign market entry has been a popular topic in international business research during the last couple of decades. Entry modes as well as choice of foreign markets are analyzed in a large number of empirical studies (Datta et al., 2002; Mitra and Golder, 2002). Manufacturing industries initially attracted the main interest in foreign market entry studies (see, e.g. Benito and Gripsrud, 1992; Davidson, 1980), but the international expansion of service industries has recently gained increasing attention (Buckley et al., 1992; Contractor et al., 2003; Gielens and Dekimpe, 2001). Retailing is a service industry where international expansion and cross-border activities have become much more pronounced in recent years (Akehurst and Alexander, 1996; Petersen and Welch, 2000). Relatively little is in fact known about retailers' choice of foreign markets, but it is generally assumed that while manufacturing companies typically enter a foreign market to exploit location advantages in production costs and access to resources, an entry into a foreign market by a retailer is more likely to be motivated by demand factors.

The present article deals with the choice of foreign markets when retail operations are to be internationalized. Which countries are being selected when a retailer goes abroad? What factors explain the pattern of foreign expansion pursued by retailers? Previous literature on foreign market entry has tended to look at such decisions from either economics (Dunning, 2000; Hennart, 1982) or internationalization process models (Andersen, 1993; Johanson and Vahlne, 1977; Leonidou and Katsikeas, 1996; Luostarinen, 1979) based on the behavioral theory of the firm (Cyert and March, 1963), and treating them as

* Corresponding author. Department of Strategy and Logistics, BI Norwegian School of Management, Oslo, Norway. Tel.: +47 67557000; fax: +47 67557670.
E-mail addresses: geir.gripsrud@bi.no (G. Gripsrud), gabriel.r.g.benito@bi.no (G.R.G. Benito).

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essentially competing approaches (Datta et al., 2002). Despite the emerging recognition that the theoretical perspectives complement each other (Benito and Welch, 1994), few attempts have been made to bring their strong points together; possibly due to a perceived lack of modeling tools that could adequately integrate the main attributes of the various approaches. Our aim is to develop a model of foreign market choice with a micro-foundation concerning human choice behavior. In this article we argue that a spatial-interaction model may be highly relevant for analyzing the impact of various factors on the choice of foreign markets to enter. That model can accommodate both factors drawn from economics approaches–e.g. the purchasing power and size of markets–and factors drawn from the internationalization process approach, such as the distance to a market. The proposed probability model summarizes the impact of various factors on the outcome of the location choices and makes it possible to estimate the effect of each factor. To the best of our knowledge, the model has not been applied to the choice of foreign markets before. The remainder of this article is organized as follows: In the next section, we briefly review literature dealing with retailers' choice of foreign markets. Following that, we present our model and describe the data and measures used in the study. Then, we present our results and conclude with a discussion of key findings, limitations of the study and possible directions for future research.

2. The choice of foreign markets

The classical approach to the analysis of international expansion in retailing has been to discuss "push" and "pull" factors (Kacker, 1985). Typical examples of factors that "push" the retailers abroad are a limited home market and regulatory constraints, which both may contribute to rapid saturation at home. The owner of a particular retail offering may therefore be forced to look abroad if expansion is to be continued. The "pull" factors include all the attributes that make a particular foreign country attractive (Mitra and Golder, 2002). The attractiveness of the US market to European retailers during the 1970s has for instance been discussed in terms of its size and spending power, limited interference from government agencies, and low growth in wages (Alexander, 1990). Initially, the internationalization process tended to be interpreted as the result of "push" factors and this is usually referred to as the "reactive school" of thought. By the late 1980s and early 1990s, the tendency was to regard retailer internationalization in a more positive light–it was acknowledged that foreign markets could be attractive opportunities–and the "proactive school" of thought emerged (Alexander and Myers, 2000). A survey among UK retailers with international operations indicated that the proactive factors were the most prominent in their decision to internationalize, but the relative importance of "reactive" and "proactive" factors may be influenced by the business conditions at different points in time (Quinn, 1999). However, the internationalization of retailing literature does not focus on the choice process itself.

Concerning the choice of foreign markets, two general theories developed in international business are particularly relevant. First, the eclectic framework of foreign direct investment (see, e.g. Dunning, 2000) may be a starting point for developing a model in retailing (Pellegrini, 1994; Sternquist, 1997). In the original eclectic model, location advantages are analyzed in terms of the factors that make it profitable to locate a given business activity, say manufacturing, in a particular country, e.g. a low wage level. The products manufactured in the plant may then be exported to other countries. In retailing, the attractiveness of a country for starting operations is more closely related to the size of the market and the income level (de Mooij and Hofstede, 2002). Several market characteristics may have an impact upon the perceived attractiveness of the market. For example, Mitra and Golder (2002) point to prosperity, size, infrastructure and accessibility as indicators of economic attractiveness, whereas Sternquist (1997) mentions market size, competitors' moves, and low cost labor as economic factors that make a foreign market attractive.

Second, based upon the behavioral theory of the firm, models of a gradual internationalization process were proposed by Johanson and Vahlne (1977) and Luostarinen (1979) and further developed by Hedlund (1994), and Vermeulen and Barkema (2002), among others. Their research underlines the importance of experiential knowledge and suggests an expansion pattern where the firm is gradually moving into (1) higher commitment entry modes and (2) more distant countries in cultural or psychic terms. A number of studies support the notion of internationalization as a gradual learning process; Leonidou and Katsikeas (1996) provide a good overview. Yet, despite the intuitive and commonsensical appeal of the basic ideas, the empirical support for the model is not conclusive. In particular, empirical tests have not uniformly supported the gradual move into culturally more distant countries (Benito and Gripsrud, 1992; Mitra and Golder, 2002). A possible explanation is that many investments, especially in manufacturing, are mainly motivated by low production costs, proximity to suppliers, and/or agglomeration benefits, and not by demand characteristics of the chosen market. In contrast, retailing has traditionally been a business oriented towards local customers, and one would therefore expect that the attractiveness of a particular market is closely related to the demand it represents in terms of size and wealth. For example, a recent study of foreign direct investment in UK retailing concludes that the main predictor of foreign entry into UK retailing over the last 150 years was purchasing power in the UK (Godley and Fletcher, 2000).

The impact of cultural distance is likely to be particular strong in retailing (de Mooij and Hofstede, 2002). Evans et