

# Drivers of Success for Market Entry into China and India

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## Abstract

China and India are the fastest growing major markets in the world and the most popular markets for foreign entrants. Yet no study has examined the success or failure of these entries. Using a new definition of success and a uniquely compiled archival database, the authors analyze whether and why firms that entered China and India succeeded or failed. The most important findings are rather counter-intuitive: smaller firms are more successful than larger firms, and greater openness of the emerging market have lower success. Other findings are that success is higher with earlier entry, greater control of entry mode, and shorter cultural and economic distance between the home and host nations. Importantly, with or without control for these drivers, success in India is lower than that in China. The authors discuss the reasons for and implications of these findings.

# Introduction

China and India have become major players in the world economy. For example, China and India have led all world economies with GDP growth rates of over 9% in recent years (Vietor 2007). Because of this rapid growth, China and India are currently the 3<sup>rd</sup> and 5<sup>th</sup> largest economies in purchasing power parity (Wilson and Purushothaman 2003). Some forecasts suggests that by 2020, China and India will pass Japan in GDP in purchasing power parity, and that by 2050 China will be the leading economy of the world followed by the US and India (Hawksworth 2006).

This remarkable economic resurgence and future promise of China and India has made entering these markets critical to the survival and success of many firms (Wilson and Purushothaman 2003). 400 of the Fortune 500 firms now operate in China (Fishman 2005) while 220 of the top 500 operate in India (India Brand Equity Foundation 2005). In 2005, China alone attracted about \$1 billion per week in foreign direct investment. While firms in the earlier years primarily rushed into these countries for reasons such as acquiring resources, securing key supplies, accessing low-cost factors, and diversifying sources of supply (Vernon, Wells and Rangan 1996) the rising incomes of the local populace is now resulting in market-seeking behavior.

Yet how have foreign entrants performed in these emerging markets? What factors have led to their success or failure? The reluctance of firms to divulge specific information on performance and the neglect of researchers to study this issue has left it largely unexamined. As a result, despite two to three decades of history, it is unclear how firms should enter such emerging markets. Examples of unexplained success and failure abound. Unilever launched 14

joint ventures in China from 1986 to 1999 (Dasgupta and Dutta, 2004) and was in the red for most of the time. On the contrary, P&G ended up as the market leader in almost all categories they introduced in China (Tunistra, 2000).

The few empirical studies on entry success (e.g. Gielens and Dekimpe 2007; Pan, Li and Tse 1999; Luo 1998) while making important contributions to the topic suffer from at least one of the following limitations: First, the studies focus on a single country – China in most cases. Second, the studies use a restrictive definition of success such as market share, which does not encapsulate degrees of success and failure. Third, the studies often focus on one particular industry. Fourth, the studies do not cover success or failure over time from the beginning of the liberalization of the Chinese and Indian economies. Against this setting, it is unclear whether these findings will generalize across industries and emerging markets.

The current study attempts to analyze the success and failure of firms entering the major emerging markets of China and India. It addresses the following research questions: What factors drive the success of entry into China and India? Is entry into China more or less successful than that into India? How do entry timing, mode, and size and country openness, risk, economic distance, cultural distance affect success?

Relative to the literature our contributions are the following. First, we propose a richer measure for success and failure, which encapsulates longitudinal historical accounts. Second, we relate our measure of success to underlying causal factors, which emerge from a vast body of inter-disciplinary research over decades. Third, we focus on both the major emerging markets: China and India. Fourth, because of the paucity of systematic or syndicated data, we use the historical method (Golder and Tellis 1993) to collect data to answer these questions.

The rest of the paper has three sections. The first discusses the factors that may lead to success or failure and poses specific research questions. The second section, describes the method and results of historical analysis. The third section discusses the findings, implications, and limitations of the current study.

## The Drivers of Entry Success

Researchers have not yet developed a single coherent theory of the drivers of success or failure of entry in emerging markets. This section reviews the prior literature on international market entry to identify the drivers of success or failure to market entry. The interdisciplinary literature spans marketing, strategy, and international business (Root and Ahmed 1979, Dunning 1988, Zhao, Luo and Suh 2004). We use the terms **firm** to describe the entrant, **host nation** to describe China or India, **home nation** to describe the firm's country of origin, and **foreign nation** to describe any other country that may be involved. Our literature search shows that the factors that affect the success or failure of market entry can be grouped as follows:

- Firm-level factors such as the mode of entry, entry timing, and firm size.
- Country-level factors of the host nation and home nation, such as economic distance, cultural distance, country risk, and country openness.

We next discuss how these factors might affect success or failure.

### Modes of Entry

The mode of entry is a fundamental decision a firm makes when it enters a new market because the choice of entry automatically constrains the marketing and production strategy of the firm. The mode of entry also affects how a firm faces the challenges of entering a new country and deploying new skills to successfully market its product (Gillespie, Jeannet and Hennessy, 2007). A firm entering foreign markets faces an array of choices to serve the market. In an

exhaustive survey of the different modes of market entry, Root (1994) identified 15 different forms of market entry. Following Root we categorize them into the following five main classes, listed in order of increasing control:

**Export** – a firm’s sales of goods/services produced in the home market and sold in the host nation through an entity in the host nation.

**License and Franchise** – A formal permission or right offered to a firm or agent located in a host nation to use a home firm’s proprietary technology or other knowledge resources in return for payment.

**Alliance** – Agreement and collaboration between a firm in the home market with a firm located in a host nation to share activities in the host nation.

**Joint Venture** – Shared ownership of an entity located in a host nation by two partners-one located in the home nation and the other located in the host nation.

**Wholly Owned Subsidiary** – Complete ownership of an entity located in a host nation by a firm located in the home nation to manufacture or perform value addition or sell goods/services in the host nation.

A firm can choose any of the above entry modes or some combination of them to enter a host nation. The key attribute that distinguishes the different modes of entry is the degree of control it gives a firm over its key marketing resources (Anderson and Gatignon 1986). At one end of the spectrum is export of goods, which has the lowest degree of control. Licenses, franchises, and various forms of joint venture provide progressively increasing degree of control for the firm till we reach the other end of the spectrum with highest control: ownership based entries such as wholly owned subsidiaries.

Two opposing theories suggest alternate outcomes for as control increases: the resource based view and the transactions cost view. The resource based view holds that as the degree of control increases, the firm’s chances of success increases because the firm is able to deploy key resources essential to success (Isobe, Makino and Montgomery 2000; Gatignon and Anderson 1988). These resources could be intangible properties such as brand equity and marketing

knowledge (Arnold 2004) or tangible properties such as a patent or a process blueprint. Control over such properties allows a firm freedom to deploy resources flexibly thus enhancing its chances of success. In the context of emerging markets control provides two key benefits. First, it safeguards key resources from leakage, such as patent theft. Second, it allows internal operational control essential to a firm's success in emerging markets (Luo 2001). In addition a firm could control key complementary resources such as access to local distribution channels which can be important to its success in any country.

In contrast, the transaction cost view holds that transaction costs increase with increasing control of the mode of entry. Control and commitment are inextricably linked factors in mode of entry (Luo 2001). High control in entry strategies entails high commitment. Transaction cost theory suggests that the higher the resource commitment and desired control of an entry mode, the higher the cost. Wholly owned subsidiaries and joint ventures are high-cost entry modes because of the level of resource commitment needed to set up operations (Pan and Chi 1999). These higher costs imply higher levels of investments needed to break-even and make a profit. Taken together these arguments suggest our first specific research question:

*Q<sub>1</sub>: Does success in entering emerging markets increase or decrease with the degree of control?*

## **Entry Timing**

Besides the entry mode, timing of market entry plays a critical role in emerging markets (Pan and Chi 1999). However, the direction of the effect is not clear. The literature suggests reasons for why early entry into international markets could favor or hurt success.

On the one hand, early entry has many advantages. First, the early entrant can lock-up access to key resources such as distribution channels and suppliers. Second, early entrants also have the opportunity to set the pattern of consumer preference (Carpenter and Nakamoto 1989;

Mitchell 1999) that may disadvantage later entrants. Third, early entrants can benefit from being the first to exploit governmental concessions and incentives which governments often offer to attract such entrants (Pan and Chi 1999). In addition, early entrants can also time their entry to exploit the “strategic window” of an expanding market and observe and learn market attributes for a longer time. Pan and Chi (1999) report that “MNCs that started their production in China in an earlier year had a higher level of profit than those that began in a later year (page 360)”.

On the other hand, Golder and Tellis (1993) find that pioneers are often not the long run winners in a market. Using US data they show that in several categories “best” beats “first” (Tellis, Golder and Christensen 2001). In the international context, pioneers may fail for several reasons. First, firms that rush in first may not be aware of the pitfalls of the newly opened emerging market. Second, returns to the early entrants might be too low compared to their investments, especially because infrastructure is not yet fully developed. Third, latter entrants also have a flatter learning curve as they can learn from the errors of the early entrants (Fujikawa and Quelch 1998). These three factors may be responsible for the failure of many early entrants in some markets (Arnold 2004). These arguments lead to our second research question:

*Q<sub>2</sub>: Does success in entering emerging markets increase or decrease with early entry?*

## **Firm Size**

New trade theories developed by Krugman (1980) and Porter (1990) suggest that firm specific advantages play an important role in international trade. Although small firms (with less than 500 employees) today account for 30% of US exports (Cateora and Graham 2006), larger US firms have been generally able to participate more in global markets than smaller firms due to their financial and managerial resources (Terpstra, Sarathy and Russow 2006). The literature

is not unanimous about the role of size in the success of firms, with some researchers asserting that large size helps whereas others asserting that it hurts success.

There are several reasons why large firms might have greater success than smaller firms. First, larger firms have recourse to greater resources or can commandeer greater resources than smaller firms (Bonaccorsi 1992). For example, Coke was able to purchase the leading Cola brand in India, Thums Up, to open its entry into India (Ramaswami and Namakumari 2004). Second, larger firms are also more likely to possess greater wealth of product-specific and marketing specific knowledge than smaller firms. For example, Nestle has a portfolio of 7,695 brands to choose from and a huge organizational history of international expansion to help it exploit any new market that it enters (Parsons 1996). Third, larger firms are also more capable of sustaining periods of negative performance upon entry into a host nation, than smaller firms. Luo (1997) finds that size favors performance even after controlling for mode of entry.

On the other hand, the experience of many large firms shows that size is no guarantee for success. The recent withdrawal of Wal-Mart first from Korea and later from Germany is a case in point (*Economist* 2006). Researchers have unearthed some explanations for this result. Large size diminishes organizational flexibility because of increasing bureaucracy (Hitt, Ireland and Hoskisson 2003). This bureaucratic effect also impairs innovative ability (Chandy and Tellis 2000). In line with this finding, Cooper and Kleinschmidt (1985) show that export success is negatively correlated to firm size in the high-tech electronic industry. These arguments lead to our third research question:

*Q<sub>3</sub>: Are smaller or larger firms more successful in entering merging markets?*

## **Economic Distance**

Economic distance is a measure of economic disparity between two nations. Firms find it easy to deal with host countries that are close in economic distance from their home country for several reasons. First, countries close in economic development have similar market segments that can afford to consume similar types of goods and services. Thus knowledge about market demand transfers easily from home to host country. Second, countries close in economic development have similar physical infrastructure, such as airports, roadways, railways, and sea ports. Thus, firms serving a host country with very similar infrastructure as its home nation will enjoy efficiencies in its operations thereby lowering its costs. Third, firms develop competencies or knowledge-based resources which are related to the markets they serve (Madhok 1997). These resources can be best leveraged in nations that are similar in economic development because the skills learnt in one market can be replicated or adapted to the new markets. Firms entering nations that are widely different economically from their home nation will need to adjust to the new market conditions thus reducing their likelihood of success (Dunning 1998). These arguments suggest our fourth research question:

*Q<sub>4</sub>: Does entry success decrease with greater economic distance?*

## **Cultural Distance**

Consumers are not driven by economic considerations alone. The underlying cultural dimensions of a society affect its consumption pattern beyond what economic laws predict (Marieke de Mooij, 2004). Culture is usually defined as shared values and meanings of the members of a society. It not only affects underlying behavior of customers in a market but also the execution and implementation of marketing and management strategies (Kogut and Singh 1988). For example cultural distance affects how well partners in a joint venture interact over the cultural divide. Thus, cultural distance directly impacts the effectiveness of the entry.

Evidence of failures caused by insensitivity to cultural differences abound. The much discussed troubles of Euro Disney is a classic example of how Disney executives failed to adjust for the cultural differences between America and Europe. Cultural differences affect several aspects of consumer behavior as well as a firm's marketing mix. It not only affects the attribute levels of products (Leclerc, Schmitt and Dube 1994) and the efficiency of the marketing programs (Tse, Vetinsky and Wehrung 1988) but also how customers derive meanings about the brand or product. Mistakes arising from misunderstandings of brand names are legion.

The tendency of firms to start their international marketing activities in countries similar to their own is another example of how culture influences market entry. Several studies have shown that the sequential path of internationalization is determined by cultural distance to enhance the chances of successful entry (Czinkota 1982). Firms usually start internationalizing by entering countries culturally close to them. For example, Toyota started exports by first selling to the South East Asian countries (Terpstra, Sarathy and Russow 2006). In addition to geographic proximity, cultural similarities may also lead Americans to trade with Canada, the European countries to trade with one another, and the Japanese to focus on Asia (Johansson 2006). Recently Frankel and Rose (2002) show that linguistic similarity is a far more powerful determinant of the volume of trade between countries than economic factors such as a common currency. Barkema, Bell and Pennings (1996) also show that cultural barriers "punctuate" organizational learning lowering their longevity in countries with greater cultural distance. These arguments suggest our fifth research question:

*Q<sub>5</sub>: Does success into emerging markets decrease with greater cultural distance?*

## Country Risk

Erb, Harvey and Viskanta (1995) define country risk as uncertainty about the environment which has three sources: political, financial, and economic. Political risk is the risk that laws and regulations in the host nation are changed adversely against a foreign firm. These could be of a regulatory nature such as the imposition of tariffs or political in nature such as unrest caused by pressure groups (Spar 1997). At its severest, political risks may cause confiscation of assets without adequate compensation (Hawkins, Mintz and Provissiero 1976).

Financial and economic risks manifest themselves in several ways. They could take the form of: a) recessions or market downturns, b) currency crises or c) sudden bursts of inflation. Most of these factors arise from imbalances in the underlying economic fundamentals of the host nation such as a balance of payment crisis. Recessions result from business cycles inherent in any economy (Lucas 1987). The origins of currency crises could be a progressively deteriorating trade imbalance (e.g., India in the late 1980s) or loss of faith by the international financial system on the nation's ability to meet its international debt obligations (e.g., Argentina in 2001). Whatever the source of the problem, a fall in the currency rate leads to a fall in revenues and profits (Shapiro 1985). Differential inflationary pressures between the home and host nation could also pose a risk. Inflation directly affects the price-demand structure of a firm. It can also affect the firm indirectly through its adverse effects on exchange rates (Erb, Harvey and Viskanta 1995, Frankel and Mussa 1980).

Country risk can reduce entry success in emerging markets in two ways. First, it can cause firms to suddenly lose money precipitating a financial crisis. Consider P&G in Russia. P&G's "optimistic projections of Russia were shattered on a single day in the summer of 1998" (Dyer, Dalzell and Olegario 2004 pp 336). The sudden devaluation of the ruble on 17<sup>th</sup> August

1998 triggered a deep financial crisis as the annual projected dollar revenues shrank to half—far below P&G’s ability to service debts. A more serious problem was the uncertainty over how long the crisis would last. Second, high country risk and past experiences of risk can lead firms to underinvest or delay investments resulting in lower success over time. Unilever was cautious and delayed entry into China “especially in view of the past difficult experiences with the Soviet Union” (Jones 2005, pp 160) – another high risk country. These arguments suggest our sixth research question:

*Q<sub>6</sub>: Does success of entry into emerging markets decrease with country risk?*

## **Openness**

The term openness refers to the lack of regulatory and other obstacles to entry of foreign firms. Openness could either increase or decrease entry success.

On the one hand, openness could increase success for three reasons. First, it stimulates demand by increasing the variety of products offered for sale in the market. Second, it increases competition on quality and thus improves the level of quality supplied. Third, as the economy opens up, competition increases efficiency and lowers prices, resulting in further increases in demand. Consider the Indian automotive industry. Until the early 1980s, the protected local market was dominated by two highly inefficient players: Hindustan Motors (HM) and Premier Auto Limited (PAL), which offered just 2 basic car models, priced at around \$20,000. The government allowed Suzuki to set up a joint venture in 1983. This increased the number car models in the Indian market to 3 and the quality of all cars on the market, including those from HM and PAL, improved dramatically. In 1992, the remaining barriers for foreign firms were lifted. Since then, 30 car models have been sold in India. Prices in all segments have steadily declined by 8 to 10 percent a year and the industry tripled in size. The liberalization of the Indian

telecom industry with the resulting boom in sales of cell-phones is another example of how openness spurred growth in demand (Ramaswamy and Namakumari 2004). Evidence from China also shows that “growth acceleration has been associated with the opening of markets” (Naughton 2007, pp 7).

However, an open economy is a double-edged sword. While openness makes entry easier for a target firm, it also increases competition from other new foreign entrants. Increasing competition affects market success in several ways. First, even a small degree of competition is enough to pull down prices significantly (Wallace 1998). Thus, competition keeps margins low permitting only the most efficient to survive. Second, competition increases costs of purchases, hiring talent, or marketing products and services. Competitive pressures are one reason why firm profitability has been shown to be lower for international markets compared to domestic markets (Gestrin, Knight and Rugman 2001). Third, competition also causes firms to lose leadership if they make any strategic mistake such as targeting the wrong segment or pricing the product too high – common mistakes while entering emerging markets. Competitors are quick to pounce on any mistake and prevent firms from recovering lost ground. Thus, increasing openness increases competition and decreases success. These arguments suggest our seventh research question:

*Q<sub>7</sub>: Does success of entry into emerging markets increase or decrease with openness.*

### **Summary**

The prior section shows how three firm level variables (mode of entry, timing of entry and size) and four country level variables (economic distance, cultural distance, country risk and openness) can affect the success or failure of a firm entering an emerging market. We next try to answer these questions through a historical analysis of entry Into China and India.

## Empirical Evidence

We carry out a historical analysis of market entry in two of the largest emerging markets to answer the research questions. We consider only the entry of those firms that were not there in the years immediately prior to 1978 for China and 1991 for India. Historical analysis involves carefully assembling, critically examining, and summarizing the records of the past (Golder and Tellis 1993). This method is well suited for our purpose because it is based on neutral observers and factual data recorded at the time the success or failure of a firm's entry occurs. Historical analysis provides a powerful means of understanding marketing phenomena by recreating markets as they evolved (Golder 2000). It also responds to the call for historical research in this area (e.g., Jones and Khanna 2006). In particular, Mitra and Golder (2002) recommend "longitudinal, archival-based studies of relative success of companies in multiple markets" (pp 382). This section presents the measures, procedure, sampling, and model of the empirics.

### Measures

This sub-section discusses the measures for the dependent variable and the seven independent variables: entry mode, timing of entry, firm size, economic distance, cultural distance, country risk, and openness.

#### *Dependent Variable: Success (or Failure)*

Perhaps the most contentious issue in studying success and failure of international market entry is to define and measure it. This is so because firms do not divulge the internal parameters and measurements of success. Attempts to ascertain this by the survey method leads to the well known self-reporting bias (Golder and Tellis 1993). Additionally, success is a time dependent phenomena and at any given time it may only be partial (Luo 1998). To circumvent this problem

researchers have used multiple measures of success such as market share and profitability (Pan, Li and Tse 1995), hazard rates (Li 1995) and timing (Luo 1998).

To arrive at an objective and comprehensive measure which can discriminate degrees of success we used a content analysis of articles from several sources reporting on the performance of firms entering into China and India and arrived at numerical ratings. For the content analysis we first developed a set of terms that reviewers use to describe success or failure of market entry. We then grouped these terms into five levels expressing increasing success, on a 5-point scale ranging from 1 to 5 (see Appendix 1). This graded measure of success allows us to measure degrees of success.

### ***Entry Mode***

Anderson and Gatignon (1986) show how we can categorize entry strategies based on the degree of control it allows a firm in its entry into foreign markets. They categorize entry strategies as possessing low, medium and high control over the firm's strategy. To calibrate the varying degrees of control we use a 6-point ordinal scale ranging from one for low control to five for high control entry modes, as follows: exports (1), alliances (2), franchise (3), joint ventures (4), equity joint ventures (4.5) and wholly owned subsidiaries (5).

Mixed entry modes such as contract manufacturing can be handled as a hybrid of existing modes. Idiosyncratic variations of the traditional entry modes such as wet or dry licenses (see Luo 2000, pg 284) can also be defined within the scope of our scale. Firms with two entry modes for different products are handled as two separate entries.

### ***Timing***

Our measure of timing is the number of years between a firm's market entry and the year of first deregulation by the host country. For China we took 1978 as the first year of deregulation and for India we took 1991.

### ***Firm Size***

To measure size of the firm, we use the year-end sales of the firm in the year of entry into the host nation.

### ***Economic Distance***

To measure economic distance, we follow Mitra and Golder (2002). Thus,

$$(1) \quad ED_{smt} = |GNP_{st} - GNP_{mt}| + |\hat{GNP}_{st} - \hat{GNP}_{mt}| + |Infra_{st} - Infra_{mt}| + |Popdensity_{st} - Popdensity_{mt}|$$

where  $ED_{smt}$  is the economic distance between the host country  $s$  and the home country  $m$  in year  $t$ ;  $GNP_{st, mt}$ ;  $\hat{GNP}_{st, mt}$  are the log of aggregate and per capita GNP for host country  $s$  and home country  $m$  respectively in year  $t$ ;  $Infra_{st, mt}$  are the kilometers of road per square kilometer for host country  $s$  and home country  $m$  respectively in year  $t$ ; and  $Popdensity_{st, mt}$  are the population densities for host country  $s$  and home country  $m$  respectively in year  $t$ .

To capture the size of demand for a firm's goods in a host nation we use per capita GNP (Loree and Guisinger 1995). However, while per capita GNP provides a suitable measure for consumer goods it does not give us a good measure for industrial products. To correct for this limitation, we use the aggregate GNP of the host nation (Terpstra, Sarathy and Russow 2006). We measure these variables in the year of entry and convert to their dollar values based on year-end dollar exchange rates.

### ***Cultural Distance***

We employ the measure of cultural distance between the host and home nations from Hofstede's four cultural dimensions: power distance, individualism-collectivism, masculinity-femininity, and uncertainty avoidance (Hofstede 1991). Following Kogut and Singh (1988) we collapse the individual scores into a single number by taking the Euclidian distance of the four dimensions as follows:

$$(2) \quad CD_{smt} = \sum_{j=1}^4 \sqrt{(D_{jst} - D_{jmt})^2}$$

where  $CD_{smt}$  is the country distance score between host country  $s$  and home country  $m$  in year  $t$ ;  $D_{jst}$  is the score on dimension  $j$  for host country  $s$  and  $D_{jmt}$  is score on dimension  $j$  for home country  $m$  both measured in year  $t$ . This measure of cultural distance has a long history of use in both the international marketing and strategy literature (Mitra and Golder 2002).

### ***Country Risk***

Our measure of country risk needs to capture political, regulatory, and economic sources of risk (Simon 1984; Erb, Harvey and Viskanta 1996). While several commercial agencies measure each of the above components of country risk using proprietary methods, researchers in finance have shown that the ones used by the International Country Risk Guide (ICRG) possesses the greatest forecast accuracy (Erb, Harvey and Viskanta 1997). This measure of country risk is based on a multi-dimensional measure for each component of country risk viz. political, financial, and economic risk (See Appendix 1 for details). Country risk is reverse coded relative to the US, which has the highest score and the lowest risk.

## ***Openness***

Our measure of openness is based on the fraction of FDI as a function of the host country's GDP. We compile this measure from the annual Statistical Surveys of China and India.

## **Procedure**

The data for this study are a unique compilation from several sources. The primary source for information about market entry and market success is from electronic sources such as Lexis-Nexis and ABI Inform. Golder & Tellis (1993) show that archival data must meet the following criteria to ensure validity:

1. **Competence:** The capability of the informant to report correctly.
2. **Neutrality:** the lack of vested interest by the informant of the report.
3. **Reliability:** a long record for undisputed good reporting by the informant.
4. **Corroboration:** confirmatory evidence from a similar source.
5. **Contemporaneity:** proximity of the time of report to that of the event.

The competence criterion is met as the reports are by well known sources and are from the time-frame when the firms entered the host nation. The objectivity criterion is satisfied as neutral commentators wrote the stories. The reliability criterion is satisfied, as the sources are all reputable sources that have been respected for a long time. The corroboration criterion is satisfied as at least two data sources are used to complete the details for each firm.

Contemporaneity is satisfied as the electronic search engines used sorted the articles with the oldest first to ensure that the reports closest to the event are included in the sample. We collect additional articles where necessary so that the data on success and failure meet the above criteria.

Hard copy sources such as books and country reports (e.g. International Monetary Fund Country Reports) are used to supplement the electronic sources. The period of the data coincides with the time period in Study 1. A step-by-step elaboration of this technique follows:

- 1) Locate articles on entry into China and India using key words.
- 2) Extract and save articles from step 1 or where applicable obtain hard copies. Extract information on firm names and enter into a spreadsheet.

- 3) Extract phrases about the success or failure of the entry and record in the same spreadsheet as 2.
- 4) Compile additional information on the mode of entry, performance of the firm in the host nation, and year of entry by focusing the search on the firm and expanding the key words.

We study the information collected to arrive at the 5-point scale for success and failure (see Appendix 2). We recruited and trained two MBA students as research assistants for the study. The research assistants evaluated the language of each review with the scale shown in Appendix 2. They then converted the review into a numerical rating of success. We instructed them to treat the scale as continuous from 1 to 5. The assistants were allowed to consult the authors for any interpretive difficulties. The average rating from the two assistants was used for the analysis. The correlation coefficient of the coding between the two research assistants is 0.78. The inter-rater reliability as measured by Cronbach's alpha is 0.88. The research assistants are within one count of each other for 88% of the cases. All these statistics compare very favorably with those of Chandy et al (2001).

We retrieve and code data on entry mode from the archival data. Data on sales at the time of entry was collected and recorded in millions of local currency from primarily three sources: COMPUSTAT tapes from the Wharton Research Data Services (WRDS) for US firms and from firms' websites and Mergent Online database for non-US firms. We convert all sales data into USD for analysis. We collect data on cultural dimensions from Hofstede (1991 and 2001). We obtain economic measures from the International Financial Statistics Yearbook - a compilation of annual national statistics prepared by the International Monetary Fund. This was also the source of foreign-exchange rates needed to convert sales figures and GNP data denominated in local currency into USD. We use the year-end market exchange rates wherever available and government nominated rates elsewhere. We acquire data on country risk for each year of interest

from the International Country Risk Guide which is available online from the website maintained by the PRS group (<http://www.prsgroup.com>).

## Sample

Starting with a total of 192 entries of firms into China and India that met with the criteria outlined above, we found that 128 entries were into China while 64 were into India. The number of entries found for India is substantially less given that India's major economic reforms took place thirteen years after China started its reforms. In nine cases we cannot obtain information on the mode of entry of the firms and in another 11 cases the exact nature of success or failure is not clear. There are another nine cases where sales data was missing. These are non-US firms that entered in the 1980s and early 1990s for which we can not obtain any records in the public domain. Missing sales values are replaced with the mean dollar sales value of the entire sample. Thus the usable sample is 168 cases.

## Model

To answer the research questions, we estimate the following regression model:

$$(3) \text{ Success}_{ismt} = \beta_1 * \text{Entry Mode}_{ism} + \beta_2 * \text{Timing}_{ismt} + \beta_3 * \text{Size}_{it} + \beta_4 * \text{Cultural distance}_{smt} + \beta_5 * \text{Economic distance}_{smt} + \beta_6 * \text{Country Risk}_{st} + \beta_7 * \text{Openness}_{st} + \beta_8 * \text{India} + \beta_9 * \text{Entry Mode}_{ism} * \text{India} + \beta_{10} * \text{Timing}_{ismt} * \text{India} + \beta_{11} * \text{Size}_{it} * \text{India} + \beta_{12} * \text{Economic distance}_{smt} * \text{India} + \beta_{13} * \text{Cultural distance}_{smt} * \text{India} + \beta_{14} * \text{Country Risk}_{st} * \text{India} + \beta_{15} * \text{Openness}_{st} * \text{India} + \varepsilon_{ismt}$$

Where,  $i$  is a subscript for firm,  $s$  for host country,  $m$  for home country, and  $t$  for time.

Success is the success rating from 1 to 5; Entry mode is the categorical variable specifying the mode of entry chosen by the firm; Timing is the number of years between the year of a firm's entry and the start of economic reforms in the host country; Size is the logarithm of dollar value of sales (in million) in year of entry; Economic distance is given by equation (1); Cultural distance is the difference between the host and home countries in the composite measure

calculate from Hofstede's individual dimensions( equation 2); Country Risk is the overall country risk of the host country; Openness is a measure of the degree of participation of foreign firms in the host nation; India is a dummy variable,  $\beta_1$  to  $\beta_{15}$  are coefficients to be estimated and  $\varepsilon_{ismt}$  error term initially assumed to be I.I.D Normal.

To ascertain the heterogeneity of coefficients over China and India, we include a dummy variable for India and interaction terms of India with each of the key independent variables.

## Results

This sub-section discusses the descriptive statistics, estimates of the model, and answers to the specific research questions.

### Descriptive Statistics

Table 1 provides the descriptive statistics for our sample of firms.

#### Insert Table 1 here

The table shows that the dominant mode of new entry into China (1978 to 2005) and India (1991 to 2005) is joint venture (41%) followed by wholly-owned subsidiaries (33%) and equity joint ventures (10%). Exports, licensing and franchising make up 4%, 7% and 5% respectively. 56% of the entering firms were from North America (USA and Canada), 23% of the firms were from Europe and 21% of the firms were from S.E. Asia which included Australia and New Zealand.

### Model Estimates

Table 2 reports the results of estimating the model in Equation (3). To ascertain the effect of multicollinearity, if any, the table shows estimates of running a simple regression with each independent variable alone (Columns 3 & 4), a full model with all important interaction terms,

(Columns 5 & 6), and a reduced model after dropping insignificant terms (Columns 7 & 8). Note that all of the main effects are significantly different from 0. In addition, the main effect of India and three of the interaction terms with India (timing, economic distance and cultural distance) are significantly different from 0, suggesting that these three factors hold differently for India and China. On the other hand, four of the interaction effects with India (entry mode, size, risk, and openness) are not significantly different from 0, suggesting that these four factors hold equally well for China and India. The main effect for India is negative and significant, suggesting that in general, entry into India has been less successful than entry into China. Moreover, this effect is quite robust, holding equally strongly across all three specifications. The  $R^2$  is about 29%, which compares very well with other studies (Gatignon and Anderson 1988; Pan, Li and Tse 1999).

### **Drivers of Success or Failure**

With reference to our first research question,  $Q_1$ , the positive and highly significant coefficient for the mode of entry shows that entry modes that have higher control tends to be more successful. The effect is robust and holds for all three model specifications (Columns 3 to 8) and holds equally strongly for China and India.

With reference to our second research question,  $Q_2$ , the negative and highly significant coefficient for entry timing (Columns 3 & 4) shows that firms that entered earlier are more successful. However, this effect seems to hold only for India as indicated by the negative and significant interaction term for India (Columns 5 & 6).

With reference to our third research question,  $Q_3$ , the negative and significant coefficient for size shows that smaller firms have higher success in emerging markets. The effect is robust

as it holds across all three specifications (Columns 3 to 8) and is equally strong for China and India (Columns 5 & 6).

**Insert Table 2 here**

With reference to our fourth research question,  $Q_4$ , the negative and significant coefficient for economic distance shows that firms that enter host nations that are economically similar to the home nation enjoy greater success. This effect is robust as it holds across all three specifications (Columns 3 to 8). However, it is significantly weaker for India than for China (Columns 5 & 6).

With reference to our fifth research question,  $Q_5$ , the negative and significant coefficient for cultural distance shows that firms that enter host nations that are culturally closer to the home nation enjoy greater rates of success (Columns 3 and 4). However, this effect is not robust and does not hold in the presence of other variables. The effect does hold in the expected direction only for India as evidenced by the significant interaction effect with India (Columns 5 & 6).

With reference to our sixth research question  $Q_6$ , the positive and significant coefficient for country risk shows that higher risk of the host nation lowers success (Columns 3 and 4, 7 and 8). Note that country risk is reverse coded signifying higher scores for lower risk countries. Moreover, this effect holds equally strongly for China and India.

With reference to our seventh research question,  $Q_7$ , the negative and significant coefficient for openness shows that greater openness lowers success (Columns 3 and 4, 7 and 8). This effect holds equally strongly for China and India.

## Conclusion

This section outlines our contribution, discusses main results, draws implications, and points to limitations of our study.

### Contribution

China and India are two of the largest emerging markets which are growing very fast and destined to rank among the top economies of the world in the next two or three decades. Firms are in a rush to enter these markets. Yet, the literature contains insufficient analysis of the drivers of success and failure of entry in these markets. Our study is an attempt to make a contribution in this area. Relative to the literature, it makes four distinct contributions. First, we have a richer definition of success and failure than prior studies. Second, we relate our measure of success to important causal factors, which emerge from a vast body of inter-disciplinary research over decades. Results show which of these drivers are most important and whether the importance is generalizable or works for only one country. Third, we focus on both the major emerging markets: China and India. Fourth, we use a new research method, rarely used in this domain: historical analysis. The main conclusions from our study are the following.

- Success is higher for entry into China than into India
- Success is higher for smaller firms than larger firms
- Success is higher for entry into emerging markets with lower openness, lowers risk, and economically close to the home market.
- Success is higher for firms that use a mode of entry with greater control,
- Joint ventures are the most popular mode of entry accounting for 41% of entry modes

## Discussion

Perhaps the most surprising finding is that success is substantially and significantly lower in India than in China. One possible reason is the immense diversity of India relative to China, characterized by inconsistent policy across Indian states and pockets of varying demand across the India market. A second possible reason is that India had an early history of capitalism with many entrenched private firms and brand names. Thus, entrants had greater native competition in India than in China. A third reason could be that China's infrastructure has been substantially superior to India's, making operations much easier for new entrants.

Another surprising finding is that smaller firms tend to be more successful than larger firms in entering emerging markets. This result is contrary to research findings which show that higher firm size correlates with higher success (e.g., Anderson and Gatignon 1986; Luo 1997). Examples may clarify the result. GM, the largest auto maker in sales and Toyota, the largest in market capital, have struggled in India while smaller rivals like Hyundai have been quite successful. One explanation for this result is that the mere size of resources by itself may not be the chief factor behind success. Control of resources along with how they are deployed may lie at the heart of success in China and India, because these are markets characterized by rapid environmental changes requiring continuous adaptability and learning (Yan 1998). Small firms with a less bureaucratic burden may thus be able to adapt much faster (Hitt, Ireland and Hoskisson 2003). Indeed, researchers in international marketing have found that smaller firms, given their smaller budgets, tend to collect first hand information rather than sponsor third party data collection (Hollensen 2004). Another explanation is that larger firms may be more confident or even arrogant about their resources, strengths, and prior successes, and may not try as hard to succeed as smaller firms do (Chandy and Tellis 1998).

A third surprising result is that openness of markets reduces success in both China and India. Intuitively, openness suggests easier entry and thus easier success. However, what is often overlooked is that what is true for the entrant is also true for other entrants. Greater openness results in more firms from the same industries from multiple countries to enter the fray. This competition puts downward pressure on margins making it increasingly difficult for all firms to succeed. Thus, increasing openness increases competition and decreases success.

Consistent with the above result, we find that earlier entrants enjoy greater success than later entrants, at least in India. This finding is consistent with earlier studies (Pan and Chi 1999). Indeed, content analysis of archival reports of the reasons for success and failure shows that the speed of entry was mentioned 25 times in the reports. For example P&G, which entered India much after Unilever, does not have the market success of Unilever.

A strong finding of our study is that entry strategies that involve high control (e.g., wholly owned subsidiaries) are more successful than those that involve low control (e.g., licensing). For example in China, FedEx, which operates as a wholly owned subsidiary is more successful than UPS, which operates as a joint venture. Our results hold despite the possible entry restrictions on mode of entry that China and India have imposed. Restriction to entry usually forces firms to take low control entry modes. However, we still have a large proportion of observations for high control modes and find this variable to be highly significant.

Economic and cultural proximity between the home nation and host nation favor successful entry into emerging markets. For example, the South East Asian agri-business conglomerate from Thailand, Charoen Pokphand Group, is more successful in China than the agri-based firm of North America, Seagram. The effect of cultural distance is far stronger in India than in China. Our content analysis of the archival reports indicates that one of the most

frequently cited reasons (34 times) for success or failure in India is how well or poorly (respectively) the entrant adapts the product to the local culture. Surprisingly even after several decades of international experience many western firms tend to impose western consumption habits and production methods in emerging markets. For example, Kellogg's initially failed to market cold breakfast cereal in India because of the strong Indian taste for hot breakfast foods.

## **Implications**

This research has some important implications for entry into emerging markets.

First, firms should not only consider the growth of emerging markets but also the success rates of prior entrants. In the case of the two giants under study, China seems to have a much higher success rate than India.

Second, the progressive opening of the economies of China and India does not mean that firms should wait to enter when entry gets easier. Easier entry applies to all firms, increasing competition. As China and India liberalize and deregulate even further, the increased competition will reduce success. Our data suggests earlier entrants do enjoy greater success. Thus, firms that enter later should be prepared for stiffer competition and probably lower success.

Third, counter to widely held priors, small size itself should not deter firms from entering emerging markets. In contrast, large firms should not assume that past success and deep resources will necessarily guarantee success.

Fourth, firms should choose the entry mode that affords them the highest degree of control while entering emerging markets. Doing so implies not taking on partners and alliances in the host nation and may add to the cost and difficulty of entry. However, the greater control

provides the entrant an opportunity to compete on its own unique strengths, monitor success and failure closely, and makes changes in strategy as soon as necessary.

Fifth, when entering emerging markets, firms should consider those targets that are close to their home nation in terms of economic and cultural distance. In particular, firms from developing nations may be more successful in entering emerging markets than those from developed nations, if the emerging markets are close to them in cultural or economic distance. An example is the inroads made by Chinese and South Korean firms into emerging markets like India and Brazil.

## **Limitations and Future Research**

Our study has several limitations, which could benefit from future research. First, analysis of disaggregate firm level variables like the level of investment in manufacturing and marketing can further enlighten the issues. Second, research on whether and which firms learn from their mistakes would be helpful. Third, more precise measures of culture are in order. The standard country level measures, like Hofstede's cultural distance, are at too aggregate a level and static in nature and may not reflect the regional differences and temporal changes in large nations like China and India. Fourth, the evolution of the firm's fortunes over time could lead to greater insights on how a firm adjusts its strategies to exploit the opportunities presented by emerging markets. Fourth, while economic and cultural distances measure are proxies of firm knowledge, other factors like experience in similar markets may be important proxies of firm knowledge. Fifth, entering firms may have faced regulatory restrictions over their choice of entry mode, which may have restricted the full set of options normally available.

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## *Appendix 1*

### *Details of Country Risk Calculation (from International Country Risk Guide)*

Political risk is calculated by assigning points to each of the following components: government Stability, socioeconomic Conditions, investment profile, internal Conflict, external conflict, corruption, military in politics, religious tensions, law and order, ethnic tensions, democratic accountability, and bureaucracy quality. Each of the

Financial risk is calculated by assigning points to each of the following components: total foreign debt as % GDP, debt service as % exports of goods & services, current account as % exports of goods & services, international liquidity as months of import cover, and exchange rate stability as % of change.

Economic risk is calculated by assigning points to each of the following components: real annual GDP growth, annual inflation rate, budget balance as % GDP, and current account as % GDP.

A composite country risk is produced by combining the three measures outline above according to the following formula:

$$(1) \quad CPFER = 0.5 (PR + FR + ER)$$

where *CPFER* is Composite political, financial and economic risk ratings; *PR* is the total of political risk indicators; *FR* is the total of financial risk indicators and *ER* is the total economic risk indicators.

The highest overall rating (theoretically 100) indicates the lowest risk, and the lowest rating (theoretically zero) indicates the highest risk.

## *Appendix 2*

### *Content Analysis Outline*

The outline for evaluating success or failure of entry is given as follows:

**1) Successful Entry– 5:**

- Making more margins than their global margins
- Market Share leader
- Well functioning partnership
- Above average industry leadership
- Top three in industry profitability
- Top three in market share
- Exceeded investment criteria

**2) Good Entry -4**

- Successfully selling
- Met investment criteria
- Increasing investments
- Growing shipments
- Rapidly evolved into a major force in the Industry

**3) Acceptable Entry–3**

- Hope to recover investment in time
- Entry awaiting removal of market restrictions
- Establish a beachhead
- Continuing operations

**4) Poor Entry– 2**

- No initial lead buyers
- Conflicting expectations
- Fail in system integration and optimization
- Struggled to make headway
- Underperformance
- Priced out
- Stiff competition
- Market restrictions
- Executives frustrated with entry

**5) Failed Entry– 1**

- Quit or withdrawal from market
- Break up with cessation of venture

### *Appendix 3*

#### *Sources*

| <i>India</i>                  | <i>China</i>                          |
|-------------------------------|---------------------------------------|
| American Chamber of Commerce  | AmCham News                           |
| Asian Wall Street Journal     | Asia Week                             |
| Asia Week                     | China Business Insight                |
| BBC                           | China Wire                            |
| Business India Intelligence   | China Bulletin                        |
| Business Week                 | Asian Wall Street Journal             |
| Economic Times of India       | South China Morning Post              |
| Economist                     | McKinsey                              |
| Harvard Business Review       | American Chamber of Commerce          |
| India Brand Equity Foundation | Harvard Business Review               |
| India Today                   | Bain Consulting Company               |
| McKinsey                      | BBC                                   |
| The Telegraph                 | Business times                        |
| Times of India                | Business China                        |
| New York Times                | AmCham News – China Briefs            |
| Wall Street Journal           | American Chamber of Commerce          |
|                               | Asian Wall Street Journal             |
|                               | Bain Consulting Company               |
|                               | BBC                                   |
|                               | Business China                        |
|                               | Business times                        |
|                               | China Bulletin                        |
|                               | China Business Insight                |
|                               | China Wire                            |
|                               | Economist                             |
|                               | Fortune                               |
|                               | Global News Wire                      |
|                               | Harvard Business Review               |
|                               | McKinsey                              |
|                               | Mintel's Global New Products Database |
|                               | People's Daily                        |
|                               | South China Morning Post              |
|                               | The China Business Review             |
|                               | Xinhua News Agency                    |

**Table 1: Descriptive Statistics**

| <b>Variable</b>                       | <b>No.</b> | <b>Percentage</b> |
|---------------------------------------|------------|-------------------|
| <b>1) Mode of Entry</b>               |            |                   |
| a) Exports and branch subsidiaries    | 7          | 4%                |
| b) Licenses                           | 12         | 7%                |
| c) Franchises and agreements          | 10         | 5%                |
| d) Joint ventures                     | 75         | 41%               |
| e) Equity joint ventures              | 18         | 10%               |
| e) Wholly owned subsidiaries          | 61         | 33%               |
| <b>2) Country of Origin of Firms</b>  |            |                   |
| a) North America                      | 108        | 56%               |
| b) Europe                             | 43         | 23%               |
| c) S.E. Asia, Australia & New Zealand | 41         | 21%               |
| <b>3) Type of Industry</b>            |            |                   |
| a) Consumer Non-Durable               | 54         | 28%               |
| b) Consumer Durable                   | 86         | 46%               |
| c) Service                            | 29         | 15%               |
| c) Industrial                         | 23         | 11%               |

**Table 2: Regression of Success on its Determinants**  
Dependent Variables: Success

| (1)                     | (2)                  | (3)                         | (4)      | (5)                  | (6)      | (7)                     | (8)      |
|-------------------------|----------------------|-----------------------------|----------|----------------------|----------|-------------------------|----------|
| Dependent Variable      |                      | Simple Regression Estimates |          | Full Model Estimates |          | Reduced Model Estimates |          |
| Variable                | Question             | Estimate                    | t        | Estimate             | t        | Estimate                | t        |
| Intercept               |                      |                             |          | 23.981               | 2.767**  | 20.040                  | 3.031**  |
| Entry Mode              | <i>Q<sub>1</sub></i> | 0.261                       | 2.946**  | 0.273                | 2.396**  | 0.288                   | 3.521**  |
| Timing                  | <i>Q<sub>2</sub></i> | -0.043                      | -2.662** | 0.236                | 1.531    | 0.212                   | 1.620    |
| Size                    | <i>Q<sub>3</sub></i> | -0.121                      | -2.041** | -0.141               | -1.965*  | -0.146                  | -2.740** |
| Economic Distance       | <i>Q<sub>4</sub></i> | -0.002                      | -1.991** | -0.008               | -2.725** | -0.007                  | -3.063** |
| Cultural Distance       | <i>Q<sub>5</sub></i> | -0.017                      | -2.168** | 0.008                | 0.696    | 0.006                   | 0.634    |
| Country Risk            | <i>Q<sub>6</sub></i> | 0.042                       | 3.003**  | 0.029                | 0.848    | 0.048                   | 2.029**  |
| Openness                | <i>Q<sub>7</sub></i> | -0.038                      | -2.134** | 0.155                | 0.164    | -0.085                  | -2.27**  |
| India                   |                      | -0.630                      | -2.752** | -34.765              | -3.165** | -32.295                 | -3.489** |
| Entry Mode*India        |                      |                             |          | 0.123                | 0.680    |                         |          |
| Timing*India            |                      |                             |          | -0.351               | -1.999*  | -0.334                  | -2.193** |
| Size*India              |                      |                             |          | 0.002                | 0.016    |                         |          |
| Economic Distance*India |                      |                             |          | 0.011                | 2.620**  | 0.011                   | 3.110    |
| Cultural Distance*India |                      |                             |          | -0.076               | -2.457** | -0.076                  | -2.670** |
| Country Risk*India      |                      |                             |          | 0.042                | 0.816    |                         |          |
| Openness*India          |                      |                             |          | -0.256               | -0.271   |                         |          |
| <i>Adj R-square</i>     |                      |                             |          | <b>29.02%</b>        |          | <b>28.43%</b>           |          |
| <i>F</i>                |                      |                             |          | <b>4.279***</b>      |          | <b>5.814***</b>         |          |
| <i>N</i>                |                      |                             |          | <b>168</b>           |          | <b>168</b>              |          |

\*\*\* $p < 0.001$ , \*\* $p < 0.05$ , \* $p < 0.1$