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Overcoming the Liability of Foreignness in International Retailing: A Consumer Perspective

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ABSTRACT

Foreign firms usually suffer the liability of foreignness (LOF), which refers to additional costs incurred by a firm when conducting business overseas that local firms do not incur. In this paper, we focus on one type of consumer bias, namely the perceived importance of supporting domestic retailers (PISD), and investigate whether foreign retailers are able to overcome this disadvantage by obtaining pragmatic legitimacy, which is achieved by providing superior retail mix attributes, and improving moral legitimacy, which is attained by conducting corporate social responsibility (CSR) activities. Our results show that to overcome the LOF, at least in Chinese market, foreign retailers should emphasize value-for-money retail mix attributes such as increasing product quality and running effective promotional campaigns. Interestingly, CSR is not effective in mitigating the disadvantage of PISD.

1. Introduction

Foreign firms often bear additional costs when conducting business abroad (Hymer, 1976), later referred to as the liability of foreignness (LOF), which is described as "all additional costs a firm operating in a market overseas incurs that a local firm would not incur" (Zaheer, 1995, pp. 342–343). The LOF can arise from various sources such as spatial distance, unfamiliarity with the local environment or the discriminatory behavior of local stakeholders (Zaheer, 1995). Eden and Miller (2001) categorize the LOF into three kinds of hazards: unfamiliarity hazards caused by lack of international experience and unfamiliarity with local business; relational hazards caused by lack of trust; and discrimination hazards caused by nationalistic tendencies and the host government's, suppliers' or consumers' perception that a foreign firm lacks local legitimacy (Eden and Miller, 2001; Denk et al., 2012), because they view powerful foreign firms as threats to their country's technological and industrial development (Vernon, 1977).

Prior studies have suggested that the additional costs of foreign firms can be overcome by the advantages they possess (Zaheer, 1995; Nachum, 2003). Several studies have examined how foreign firms respond to the challenge of the LOF and have suggested ways of overcoming it, such as entry mode choices (Eden and Miller, 2001; Chen, 2006; Chen et al., 2006), incorporating local executives in decision making (Mezias, 2002), learning about and adapting to the local environment (Petersen and Pedersen, 2002), providing greater product variety and being affiliated to a business group (Elango, 2009), and acquiring market-based resources in the host location such as skilled employees and a better supplier base (Barnard, 2010). In general, these studies are mainly concerned with the unfamiliarity and relational hazards that appear to decline over time as a foreign firm acquires local market knowledge and gains experience in a particular location (Miller and Parkhe, 2002). However, discrimination hazards accrued as a result of discriminatory behavior by local stakeholders are argued to persist and become a major concern for multinational corporations

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(Hymer, 1976; Miller and Parkhe, 2002). In this study, we focus on discrimination hazards that foreign firms may suffer and examine possible ways to overcome this kind of LOF.

Valuable references for studying discrimination hazards of LOF are provided by some prior studies. Newburry et al. (2006, 2014) examined the impact of firms' foreignness on attracting local employees. Yildiz and Fey (2012) reconsidered the relationships between legitimacy, local isomorphism, and overcoming the LOF, suggesting that there are alternatives to local isomorphism for multinational corporations to gain legitimacy from local institutional actors. More recently, Moeller et al. (2013) offered a framework with which to examine the impact of country of origin on acceptance into a host's country environment by constituents such as vendors, suppliers, and distributors.

The present study differs from previous studies that focused on employees, suppliers, or vendors by focusing on the LOF discrimination hazard caused by consumers. We base on Maruyama and Wu (2014)'s definition of a new concept, the perceived importance of supporting domestic firms (PISD), which expresses consumers' willingness or desire to support domestic firms. They found that PISD has a negative effect on consumers' choice of foreign retailers. In this study, we perceive PISD as a discrimination hazard of the LOF, and attempt to investigate how to overcome this LOF in the international retailing context. Using institutional theory as a theoretical setting, we focus on two mechanisms: obtaining pragmatic legitimacy and improving moral legitimacy. Pragmatic legitimacy is linked to the organization's ability to satisfy needs which, in the international retailing context, can be achieved by providing superior retail mix attributes (e.g., lower price, better service). On the other hand, moral legitimacy demands that a company's actions are consistent with societal welfare. In this study, we focus on the effect of executing corporate social responsibility, which involves firms' actions toward giving back to the society. We propose that by conducting CSR activities, international retailers can enhance their acceptance by the host consumers. We empirically test whether the negative effect of PISD on consumer store choice of foreign retailers interacts with consumers' perceived importance of retail mix attributes and CSR.

We report the empirical results in the international retailing context, which to our knowledge has not attracted much attention in the LOF literature. The power of choosing the international retailing setting for studying LOF comes from the fact that the assessment of the legitimacy of the firm is made by individuals, and therefore provides the opportunity to obtain a fine-grained perspective on the functioning of LOF. We focus on the Chinese retailing industry, specifically, grocery and food retailing, because China's rapid economic growth and increasing consumption power has made it one of the most attractive markets for international grocery and food retailers. Retailers, for example, Wal-Mart and Carrefour are increasingly seeking international expansion and competing in the Chinese retail market. Thus, investigating whether consumers' PISD is reflected in actual store patronage behavior, and how to cope with it, will be both theoretically and practically significant.

Our study adds to the LOF literature in three ways. To our knowledge, this is the first study that attempts to examine LOF within an international retailing context. Second, previous studies on the determinants of LOF used performance measures (Zaheer, 1995; Sethi and Guisinger, 2002; Elango, 2009), survival and exit rates of multinational corporations (Zaheer, 1995; Zaheer and Mosakowski, 1997) or the probability of lawsuits (Mezias, 2002) as dependent variables. In contrast, the unit of analysis in our study is individual consumers and we use consumers' patronage behavior to measure outcomes. In comparison to many previous studies that adopted firm-level data, focusing on consumers' behavior will provide a fine-grained perspective of the functioning of the LOF, and help open its 'black box'. Third, based on empirical evidence, our study proposes a possible way of overcoming the discrimination hazard of LOF in the Chinese market. In particular, we have examined the effect of CSR in overcoming the LOF which, to the best of our knowledge, has been little investigated.

2. Institutional theory and construct development

Institutional theory is increasingly common in LOF studies (Yildiz and Fey, 2012). A key proposition of the theory is that within a given socially constructed value or belief system, a firm will seek legitimacy in order to gain the support of social actors such as suppliers, consumers, citizens, and charities (Suchman, 1995). Based on its resources and profit-generating activities, the firm achieves pragmatic legitimacy, which emphasizes the firm's skill in manufacturing and delivering the product or service. For example, in the retailing context, supermarkets need to improve retail mix attributes (e.g., product quality, lower price, and better service) in order to gain pragmatic legitimacy (Zarkada-Fraser and Fraser, 2002).

Moreover, an organization must also aspire to moral legitimacy, which rests not on judgments about whether the evaluator can benefit from a given activity, but rather whether the activity is "the right thing to do" (Suchman, 1995). Therefore, moral legitimacy usually reflects whether the activity effectively promotes societal welfare (Suchman, 1995). Moral legitimacy is usually associated with societal norms such as family, community, religion, and nation.

The process of legitimation is especially complex in the case of foreign firms as they often face the challenge of establishing and maintaining legitimacy in the host environment (Kostova and Zaheer, 1999). One important reason for the challenge is associated with their country of origin, which is one of the critical dimensions of moral legitimacy (Zarkada-Fraser and Fraser, 2002). In the marketing literature, the country of origin (COO) effect has been an important research issue for a long time (e.g., Bilkey and Nes, 1982; Diamantopoulos et al., 2011; Josiassen et al., 2013). A key research interest of these studies is whether and how the country of origin of products and services influence consumers' attitude or purchase intention. Earlier studies concluded that the country of origin of products and services is typically used as an extrinsic cue by consumers to evaluate product quality or other product attributes (Bilkey and Nes, 1982). In particular, it has been found that products from more developed countries generally enjoy a more positive image than those from less developed countries (Bilkey and Nes, 1982; Ahmed et al., 2004).

However, although in some cases, foreign brands benefit from their foreign identity and tend to use it in a direct way with positive consumer reactions, especially in developing countries, consumers in host countries sometimes perceive foreign firms' lack of