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Foreign market selection of online retailers — A path-dependent perspective on influence factors

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ABSTRACT

Internationalization is a critical task for online retailers, yet the question of how and in which order online retailers choose foreign markets has not been investigated. Based on dynamic capabilities and institutional theory, the authors identify, test and explain factors influencing the foreign market selection behavior of European online retailers. Following a dynamic, path-dependent view of the market selection process over time, the hypotheses are tested using a longitudinal database containing observations of the foreign market selection behavior of 140 online retailers in Europe, accounting for 825 market entries over 15 years. The use of a rank-ordered logistic regression model allows the observation of how different attributes contribute to overall evaluations of the attractiveness of chosen markets, assuming that online retailers attempt to maximize the utility of markets for their specific interests, in dependence of the observed factors.

The results indicate that market size, rule of law, and local market knowledge, as well as a common language and the logistics performance of a target country have a positive effect on the likelihood of selecting a target country. Although the internet is said to reduce the impact of distance, both cultural and geographic distance as well as added geographic distance still show a negative impact on the selection of foreign markets by online retailers.

1. Introduction

The emergence and quick rise of online shops has dramatically changed the retail industry over the last decade (Gartner Industry Research, 2012). E-commerce already accounts for 2.45 % (EUR 423 bn) of European GDP (E-Commerce Europe, 2015). At the same time, internationalization of retailers is an ongoing trend. Both the convergence of markets and the limited possibilities for sustainable growth in home markets have caused more and more retailers to internationalize their operations. Being present in and managing a diverse set of country markets has become a critical task (Assaf, Josiassen, Ratchford, & Barros, 2012). Whereas this trend has been discussed in the retail literature for store-based retailers, it has rarely been investigated for online retailers, even though online retailers appear to internationalize more rapidly than and differently from brick-and-mortar retailers (Dawson & Mukoyama, 2014; Schu, Morschett, & Swoboda, 2016). One arguable reason for this is that the internet significantly reduces psychic barriers and makes internationalization a cost-effective and more viable option (Buckley, 2011; Sinkovics & Penz, 2005; Wen, Chen, & Hwang, 2001).

Foreign market selection, which refers to the choice of which country or countries to enter, is a strategic decision for a firm and needs to be made with meaningful deliberation and care (Douglas & Craig, 2011). It can affect the appropriateness and applicability of firm-specific advantages and transaction costs as well as the ability of firms to effectively transfer knowledge (Brouthers, Mukhopadhyay, Wilkinson, & Brouthers, 2009). Hence, many scholars have emphasized that foreign market selection decisions are a critical success factor in international market expansion (Papadopoulos & Martín, 2011). Despite this recognized importance of foreign market selection in IB literature, little is known about how foreign market selection decisions are made and the majority of foreign market selection research focuses on manufacturing companies (Andersen & Buvik, 2002; Brouthers et al., 2009; Buckley et al., 2007; Musso & Francioni, 2014).

Several scholars stress that this research area is characterized by two main problems: first, a high level of fragmentation and

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second, a relative lack of representative empirical studies, resulting in the impediment of both, the reduction of fragmentation as well as the development of theory and in particular the combination of existing theories to explain the choice of international markets by a firm (Brouthers & Nakos, 2005; Brouthers et al., 2009; Leonidou, Katsikeas, & Samiee, 2002; Papadopoulos & Martín, 2011; Ragland, Brouthers, & Widmier, 2015).

To date, the different streams of foreign market selection research are not closely connected, neither in retail research nor in the field of IB research (Swoboda, Zentes, & Elsner, 2009). Papadopoulos, Chen, and Thomas (2002, p. 166) note that in this context the literature is "limited to either general qualitative frameworks or operational models that have not been tested sufficiently, offer little or no evidence that they can in fact predict market attractiveness and/or are in fact too complex to apply in practice". This statement also holds true for foreign market selection in the retail sector (Elsner, 2014; Gripsrud & Benito, 2005; Swoboda et al., 2009): the selection of international markets by retailers is neither well researched nor well supported by theoretical explanations. Furthermore, the abovementioned scholars list studies on retailers' foreign market selection and from these, it becomes evident that none of them investigate the specific case of online retailers.

Anecdotal evidence shows that the internationalization of online retailers over time may be described with the help of 'internationalization paths', resulting in a hierarchy of countries ranked in the order of entry. The underlying assumption is that preferences of the online retailers, developed over time, determine the order of their market selections, i.e. that previous market selections (and thereby the existing country portfolio of the retailer) play a role for future decisions and that decision makers combine attributes of countries into overall evaluations of the attractiveness of these countries while maximizing their utility (Weesie, 2003).

Using the example of Zooplus, a German pet supply online retailer, this path-dependent behavior can be illustrated. Zooplus' first foreign market was Austria, a country with the same language as Germany and low cultural and low geographical distance. Switzerland was Zooplus' fourth foreign market; it also has low cultural distance and the same language in major parts of the country but it has higher institutional distance because it is not a member of the EU. Country no. 2 was the UK, country no. 3 France, country no. 5 Denmark. All of these countries have a similar rule of law as the home country and the previously entered countries, all have similar incomes per capita, all are geographically close to the home country and can be served by logistics from the home country. As a consequence, these markets represent a high volume for Zooplus and are seen as focus markets. In France, a logistics center was established by Zooplus in order to serve the French market more efficiently but also to use this logistics center as a basis for further expansion: Spain (country no. 10, with a rather large market size) and Portugal (country no. 26, with a smaller market size and further geographical distance) are served from the logistics hub in France. Poland was entered as country no. 6. It is geographically close to the home country but has different market characteristics than the previously entered countries. However, with Zooplus' experience, gained from its portfolio of previously entered countries, this was manageable. Poland was first served logistically from Germany; then, a logistics hub was established in Poland itself from which Zooplus also serves other Eastern European countries that it entered later (e.g., Slovak Republic, no. 12; Czech Republic, no. 14; Romania and Bulgaria, no. 16 and 18, respectively). Further steps into Scandinavia, South-Eastern Europe and even Russia and Turkey followed. As of 2015, Zooplus has entered 31 foreign markets, with Cyprus and Malta being the latest ones (Zooplus, 2008a, 2008b, 2015, 2016).

From a theoretical perspective, there are contradictory considerations in the literature – tension fields between literature streams – with regard to the role of distance for market selection and with regard to the internationalization process. Our study may contribute to investigate for the specific case of online retailing which perspective explains foreign market selection better. As a first tension field, it is argued with regard to distance, on the one side, that psychic distance and other institutional distances get less relevant in the case of e-commerce, and that the world is flat (Friedman, 2005; Ragnan & Adner, 2001); on the other side, a core assumption in international management is that "distance matters" (Eden & Miller, 2004), i.e. that country differences play a role. Whether the presumable decline of relevance of country differences is reflected in the foreign market selection behavior of online retailers is to be investigated. Furthermore, as a second tension field, while the internationalization process model argues that companies follow a psychic distance chain and dynamically learn from each new country market which influences their further market selections (Helfat et al., 2007; Johanson & Vahlne, 1977, 2009; Vahlne & Johanson, 2013), the born global literature considers the time span so short that learning before an next entry is not feasible (Barkema & Vermeulen, 1998; Vermeulen & Barkema, 2002; Yamin & Sinkovics, 2006). In that case, path-dependency would not be relevant. Whether online retailers display a path-dependent behavior in their market selection is investigated in this study.

To contribute to current foreign market selection research, our paper aims to combine the descriptive approach of foreign market selection research and the specific approach of the internationalization process models (Swoboda et al., 2009) to investigate market selection in a particular internationalization step. Following Johanson and Vahlne (1977), an internationalization step refers to entering a new foreign market. With a focus on the foreign market selection behavior of online retailers, we also aim to contribute to the relatively young discipline of research on online retailing that is emerging within international retail research. The objective of this paper is to investigate and empirically test, with a sufficiently large dataset, influence factors on the market selection in the European online retail sector, based on dynamic, firm-specific capabilities and on an institutional view of foreign market selection, considering also the distance between countries. We examine the effects of economic factors, the role of cultural and geographic distance in an online retail context, institutional effects in the respective target countries as well as the effects of experience and local market knowledge in the respective target countries. In doing so, we statistically reproduce the dynamic process of firm's foreign market selection over time as a path-dependent sequence of its internationalization steps. This allows us to observe how different attributes contribute to overall evaluations of the attractiveness of chosen markets, assuming that online retailers attempt to maximize the utility of markets for their specific interests.

The remainder of this paper is organized as follows: first, the theoretical background of our study is presented and the hypotheses are developed, followed by details regarding the research design and method. Our results section contains the hypotheses testing with a rank-ordered logistic regression model using data from the market selection behavior of 140 European online retailers from a geographically diversified country sample (all EU countries plus Norway, Russia, Switzerland, and Turkey), containing 825 market entries. Finally, we draw conclusions, discuss limitations of the study and provide implications and suggestions for further research.