

# Rule of law *vis-à-vis* foreign market entry modes: exploratory interviews of a few experts

Rule of law

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## Abstract

**Purpose** – The purpose of this qualitative paper is to identify and amplify the voice of those experts who advise practitioners faced with foreign market entry decisions. This paper reports the importance that experts place on the rule of law, a positive ethical climate in host nations and the experts' knowledge of investment financial performance after five years of the initial foreign market entry.

**Design/methodology/approach** – The sample included 12 experienced expert professional interviewees who spent careers with publicly held multinational corporations, attorneys who advised multinational corporation officers, arbitrators with significant international dispute resolution experience, corporate ethics compliance experts, small global entrepreneurial business owners and an academic specializing in international commercial law and dispute resolution.

**Findings** – The rule of law and ethical climate significantly influence private market entry mode, dispute resolution choices and the likelihood of financial success. Finally, the findings illuminate the importance of the rule of law and a positive ethical climate in private foreign market entry decisions and their managerial and policy implications.

**Originality/value** – This study lays the foundation for the development of propositions to understand better the significant role of the rule of law in the private foreign investment decision-making process and the financial performance of the foreign investment.

**Keywords** Rule of law, Legal environment, Private foreign market entry, Financial performance, Ethical values, Investment and risk, Law and development

**Paper type** Research paper

## Introduction

The rule of law is being threatened globally. Over the past several years, it has retreated in many countries and advanced in fewer countries (World Justice Project, 2021). The rule of law is a host country asset that is a significant factor upon which private foreign market entrants rely on making various decisions (Roy and Oliver, 2009). For example, it is a factor in determining foreign market entry mode, the value of resources to place at risk and profit potential. In addition, it may influence a firm's level of political engagement in a host nation (Pang and Wang, 2021).

Firms entering a foreign market may be disadvantaged because their managers are often less familiar with the market than managers of native firms. Zaheer (1995) discovered that a foreign investor's lack of firsthand knowledge of the foreign market might result in higher costs and increased business risk. He described his findings as the liability of foreignness (LOF). The rule of law mitigates the LOF because it introduces stability, predictability (Roy and Oliver, 2009) and impartial dispute resolution. Consequently, the rule of law can level the playing field for a foreign investor.



This study explores the impact of the rule of law. In particular, it aims to examine how the rule of law along with ethical climate influence private firms' foreign market selection, entry mode, dispute resolution methods and eventually, financial performance. This research makes three contributions. First, it focuses on individuals who have advised foreign investment decision-makers and agreed to reveal the substance of their advice. Second, it verifies the importance of the rule of law and a positive ethical climate to foreign investors. Third, it explains the vital role those advisors played and why their advice is critical to decision-makers.

The experience of one author of this study made the study feasible. For example, following the collapse of the Soviet Union, this author served as the commercial law advisor to the government of the newly independent Republic of Uzbekistan. That experience piqued his interest in how the rule of law and ethical climate influenced foreign investment decisions. The same author has also served as an advisor to a member of the U.S. House of Representatives and counsel to two public corporations. He is currently an arbitrator, entrepreneur and educator.

This study benefits management, policymakers and educators because it illuminates the link between the rule of law and a positive ethical climate, foreign private market entry decisions and the opportunity for an investor to make a profit. Managers learn the importance of the rule of law to their investment decisions. Public policymakers benefit as they understand the importance of the rule of law to private foreign investors. In addition, educators realize how the rule of law influences private foreign investment decisions.

### **Literature review**

There is no universal definition of the rule of law. Prominent British jurist Tom Bingham credits Oxford law scholar A. V. Dicey for coining the term in the 1880s but traces the idea back to Aristotle (Bingham, 2011, p. 3). It has been argued that a legal system is a mechanism that is both a component and a regulator of society's behavior (Breuker, 1997). Accordingly, it may be argued that the legal system is an important national institution consisting of various subcomponent institutions. The presence or absence of the rule of law reflects the extent to which the legal system regulates societal behavior. A comprehensive and concise definition of the rule of law is "the degree to which the citizens of a country are willing to accept the established institutions to make and implement laws and adjudicate disputes" (Knack and Keefer, 1995, p. 225; Li and Resnick, 2003).

Several academic disciplines including economics, finance, political science and law have focused on the influence of the rule of law and the related fields of international trade, investment and development. Economists have argued that countries with poor investor protection laws and enforcement mechanisms have weaker capital markets (La Porta *et al.*, 1997). Political scientists have maintained that government respect for property and contract rights represent the central feature of the rule of law. National institutions establish societal structure through restraints and boundaries for the acceptable conduct of individuals and organizations (North, 1990). Further, formal and informal (social, educational, religious, political, economic) institutions serve as a precursor to the rule of law and the latter relies on public trust (Haggard *et al.*, 2008). Government acceptance to fulfil its contractual obligations signals its willingness to enforce private contracts (Knack and Keefer, 1995). The establishment and funding of an independent judiciary bolster governmental commitment to the rule of law (Biglaiser and Staats, 2010). In a study by Biglaiser and Staats (2012a), the authors surveyed chief executive officers of foreign firms who invested in Latin America. They found that those decision-makers were more likely to invest in countries with a strong judiciary and the rule of law. In a separate study, they

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found that rule of law, an independent judiciary and protection of property rights have a positive effect on a country's bond ratings (Biglaiser and Staats, 2012b).

Legal scholars have found that the rule of law plays a significant role in economic development (Dam, 2006). Respect for the rule of law influences the ethical climate through legislation and other efforts to curb bribery. For example, beginning in the 1970s, the USA enacted antibribery statutes. Eventually, like-minded government officials in other nations negotiated the OECD Anti-bribery Convention. Some researchers have argued that an unintended consequence of antibribery statutes was that firms in countries that took a stand against bribery tended to avoid investments in countries that tolerated bribery (Blundell-Wignall and Roulet, 2017; Spalding, 2010; Cuervo-Cazurra, 2008; Hines, 1995).

The management discipline has shown less direct interest in the influence of legal and public policy on managerial decision-making concerning private foreign market entry (Czinkota and Ronkainen, 2000; Schlegelmilch, 2003). Unsurprisingly, legal and public policy scholars have shown a similar lack of interest in management decision-making (Spratt and Miyazaki, 2002). Those who have researched the influence of the rule of law have focused on its specific aspects. For example, a few researchers argued that the rule of law is a significant factor in an emerging market's economic value creation. For instance, if the rule of law is weak in the host country, foreign investors are likely reluctant to share proprietary assets crucial to value creation (Li *et al.*, 2012). Another research group projected that strengthening the rule of law may significantly increase the quantity of inbound outsourced work to specific emerging markets (Liu *et al.*, 2011). In addition, two other authors used the term "policy environment" to consolidate laws with regulations, administrative procedures and government-sanctioned policies to test several staged market entry hypotheses using data from Japanese firms (Delios and Heinsz, 2003, p. 229).

This study has focused directly on the importance of the rule of law and ethical climate to those who influenced or made foreign investment decisions and the subsequent financial performance of the investment. While senior managers play a vital role in a firm's central decision-making process, few would undertake an investment in isolation. Instead, they rely on accountants, attorneys, engineers and other specialists to supplement their decisions. Such reliance not only enables prudent decision-making but also serves as evidence of having performed due diligence and the exercise of the duty of care to the business and its shareholders. Exercise of the duty of care is one significant component of the business judgment doctrine intended to shield decision-makers from liability if a business decision later fails to achieve expectations (Manning, 1984).

### Methodology

This study mimics but does not duplicate the Delphi technique. The Delphi research method encourages a small but diverse group of experts on a topic to engage in up to three rounds of debate, commentary and feedback to forge a consensus. Group size is typically 30 or less because of findings that larger groups generate few additional ideas and limit in-depth examination of those ideas (Delbeq *et al.*, 1975). In this study, the data was gathered through a single interaction between the investigator and the 12 participants. In addition, each participant was asked to respond to ten research guide questions found below in the Findings and discussion section and the left column of Appendix 1. Finally, the author recorded their responses during an oral interview or the respondent typed them in an email response to the author.

Management scholars have avoided researching how the rule of law influences significant firm management decisions such as market selection and entry mode. While conducting a literature search for this article, the authors used the applicable words and

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phrases in the above Keywords section but with limited success. However, economics, political science and international relations journals offered on-point articles. In the management discipline, articles were limited and specific to countries or included the rule of law as one of the several factors for analysis. Several decades have passed since management researchers have focused significant attention on the vital link between the rule of law and the private foreign investment decision process. It is hoped that this article will encourage future research into this crucial area.

Most interviewees had 20 or more years of experience in the private foreign market entry decision-making process. Their expertise ranged from being the final decision-maker to advising decision-makers. Interviewees were global corporation executives, entrepreneurs, attorneys, dispute resolution experts, project managers and international legal scholars. The annual revenues of the associated businesses ranged from several million dollars to multibillion dollars. Their experience ranged from South America, Guinea, Tanzania, the Middle East, Russia, the former Soviet Union, China, Japan, Malaysia, the Philippines to Thailand. Most interviewees were based in the USA and the remainder were in the UK and Italy. Their industries ranged from mineral extraction to metal product production. Services included language translation and software localization, strategic marketing, financial and professional services, see [Appendix 2](#).

### **Findings and discussion**

*To what extent does the presence of the rule of law impact the decision to enter a foreign market?*

Eight interviewees considered the rule of law a very important factor in a foreign market entry decision. Four interviewees indicated that the rule of law was an important factor but would consider entering a weak rule of law market. All interviewees agreed that it is necessary to perform due diligence before entering a foreign market. Understanding the prospective host nation's legal system is critical in foreign market entry decisions. Investor risk tolerance, financial strength, firm ethical standards and negotiating power significantly determine how much weight to assign to the rule of law in the decision-making process. For example, one interviewee, an attorney and a decision-maker for a global firm, asserted that while the rule of law was necessary, a consistent set of rules is paramount. The statement reflected the bargaining power of the investor and indicated a willingness to invest in countries where the rule of law was weak. Finally, the interviewee explained that even corrupt governments often agree to a set of rules ([Haggard et al., 2008](#)) when a large corporation promises to make significant investments in the host country because of the potential of job creation, an inflow of tax revenue and associated prestige of foreign investment.

The same interviewee thought that it is possible for a firm with a robust ethical culture to positively influence host government officials who initially had little regard for the rule of law. For example, the interviewee's firm made a significant investment in Russia and imported its corporate culture into the host nation's location. That culture included periodic legal and regulatory self-audits and self-reporting of any violations. For example, one audit revealed 40 violations of laws and regulations – the firm self-reported each breach with a correction plan and reserved budget. While local officials initially questioned why management would self-report, the interviewee observed that they eventually developed a greater respect for their laws, regulations and enforcement responsibilities.

In contrast, another interviewee who earlier was an advisor to businesses entering foreign markets and is currently a regional ethics officer for a large financial services firm indicated that a firm's home country culture usually determines the importance of the rule

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of law. Firms rooted in western culture care about the rule of law and written agreements much more than ones rooted in eastern culture. For example, the interviewee cited transactions where Chinese investors in Uzbekistan relied merely on handshake agreements valued in millions of dollars. This interviewee indicated that negotiating power is critical, especially for small businesses. A small business that offers a unique or vital product or service is likely to have greater negotiating control with a government entity or well-connected local company and may avoid ethical challenges in markets where the rule of law is weak. In contrast, small businesses whose survival depends on completing transactions may place less importance on the rule of law when entering that same foreign market. For example, a third interviewee, based in the USA and a small service sector business owner, indicated that the rule of law is essential to foreign market entry. Therefore, this owner would not enter a foreign market without the rule of law.

Another interviewee emphasized the importance of preinvestment planning, especially when entering a weak rule of law market. Three preinvestment planning tools include the existence of investment treaties between the home and host nations, an exit strategy and a search for any counterparty assets located in other countries that are subject to attachment should a future dispute result in a judgment or arbitration award in the investor's favor. An investment treaty may be a prominent planning tool, but in the interviewee's experience, only large, sophisticated firms have referred to investment treaties when planning foreign market entry. Similarly, decision-makers expect a positive outcome but seldom prepare for failure. At the outset, regardless of how attractive an investment appears, it is just as critical to plan for favorable and unfavorable outcomes. A vital component of an investor's exit planning includes identifying assets that may be seized in the event of a dispute and favorable judgment or arbitration award. A host nation with a weak rule of law is unlikely to enforce a favorable award or judgment. Therefore, it is critical to identify any assets in a jurisdiction where enforcement is likely to be successful. Finally, the mere threat of seizure of offshore assets may encourage the host nation counterparty to avoid disputes or be more amenable to dispute resolution without third-party intervention.

Another interviewee indicated that government foreign aid programs that encourage the rule of law are essential in raising the profile of countries seeking foreign investment. For example, the interviewee cited a United States Agency for International Development program designed to encourage contract enforcement in Kosovo. The program taught senior government leaders that a foreign investor's perception of a potential investment market quickly becomes a reality. Senior Kosovo government leaders learned that they must demonstrate a genuine commitment to contract enforcement through their actions to attract foreign investors (Knack and Keefer, 1995). Failure to present this assurance to prospective foreign investors would diminish foreign investment opportunities.

*Is there a preferred legal system: common law or civil law when entering a foreign market?*

As known commonly, most world legal systems may be divided into two large groups. Civil law attempts to find a general rule through legislation to address a legal problem with its origins in Roman law and the Napoleonic Code. In other words, civil law focuses on substance. In contrast, common law, with its roots in England, is oriented toward problem-solving and finding general rules. The common law approach enables judges to solve legal problems. Consequently, there is an additional focus on the procedure and substance in the common law countries (David and Brierley, 1985). The common law permits broad discovery of documents as part of the litigation process, whereas civil law is much less likely to involve sharing of relevant documents. For example, an expert indicated that a firm familiar with civil law might need to alter its document retention policy when doing

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business in a common law jurisdiction because of broad document and evidence discovery rules. Conversely, a firm familiar with common law might erroneously expect certain key documents to enjoy attorney–client privilege in a civil law jurisdiction.

All interviewees preferred their home country’s legal system but agreed that the type of system was not a significant factor when entering a foreign market, provided there was a set of predictable rules. One interviewee addressed the differences in legal education and judges’ experience level in the two systems. Civil law judges are often recent law school graduates with limited commercial and legal experience. They are often underpaid compared to peers with similar training. In contrast, common law judges typically have significant legal experience before becoming judges and are well paid. This disparity in experience often affects the quality of judicial decisions. It also increases the likelihood that civil law judges will accept bribes to supplement meager compensation. This distinction in systemic judicial quality may well influence the selection of applicable law, dispute resolution method or even host country.

One interviewee expressed the importance of using English in commercial and investment contracts. In the interviewee’s experience, firms from civil law countries often agreed to apply English and common law to transactions because clients perceived common law dispute resolution and enforcement of judgments superior to civil law. The interviewee also cited that translating documentation from another language into English entailed translation expenses and the possibility of inaccurate translation of critical terms. Selecting English as the governing language avoided these issues and translation expenses.

*Which approach to private foreign market entry is preferred: transactional or relational?  
Does it depend on the type of investment?*

In this study, transactional exchanges are treated as one-time or infrequent dealings and without the intention of forming a long-term relationship. Relational exchanges are developed over several years and reflect a commitment toward entering a trusted relationship.

The interviewee responses varied depending on the interviewee’s risk tolerance and foreign market entry mode. All interviewees preferred a relational approach in high-risk foreign market entries such as joint ventures or direct investments. Several interviewees emphasized the necessity of developing trust and confidence in the counterparty through a long-term relationship. In low-risk entry modes such as exporting, all preferred the transactional approach. One interviewee indicated that elements of both approaches are typically part of any foreign market entry. For example, discovering a potentially profitable export market may increase the desire to transition from transactional to relational. This is especially true when foreign market associates could facilitate or identify opportunities for additional forms of investment in the host or neighboring markets. For example, a service sector interviewee considered the distinction between the two approaches to be superficial because service business favors relational, whereas manufacturing tends toward transactional. Another interviewee indicated that a firm’s approach is dependent on size. A small firm is likely to rely on developing a local market relationship than a larger firm.

According to one interviewee, the amount of control the investor wished to retain was significant in selecting the approach. This interviewee’s firm outsourced a service function to India. While the outsourcing agreement was transactional, the service being purchased required implementation to be relational because the work to be performed was expected to appear to third parties as an extension of the investor’s home country workforce. In addition, the investor established clear standards for host nation service – provider employees to use and monitor them as if they were a part of the home country workforce.

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One interviewee warned of the danger of the relational approach with government officials. If a governmental official is replaced, the relationship might prove temporary. Conversely, the interviewee indicated that to enter some industries, it may be necessary to develop a relationship with a government official. For example, in the interviewee's experience, access to Azerbaijan's oil and gas industry was only possible through a minister or higher-level official. In the interviewee's opinion, reputable firms avoid unethical officials because the latter can entangle a firm in legal and ethical problems.

*Is the rule of law more or less important depending on the chosen market entry approach?*

Six interviewees considered the rule of law important depending upon the entry mode; five did not consider the rule of law important and one was not sure. For example, the rule of law was considered important when investors chose high-risk entry modes such as joint ventures or made direct investments because each of these entry modes was likely to favor a relational approach. The rule of law was considered less important if the entry mode was low risk, such as exporting. Another interviewee indicated that the importance of the rule of law was dependent upon the scale of the investment, firm bargaining power and firm size. The interviewee compared the rule of law to insurance – the stronger the legal system, the lower the risk. The rule of law also increased the likelihood of equal treatment between local and foreign firms.

Another interviewee indicated that while the rule of law is unnecessary for either a transactional or relational approach, it could exacerbate cultural barriers. For example, an investor from a country with a strong rule of law tradition entering a host nation without this heritage could encounter or even create misunderstandings with their host nation counterparty. For example, a joint venture with a host nation counterparty accustomed to bribing government officials may not understand why the home nation investor demands adherence to zero tolerance for bribery.

*Is the foreign market ethical climate a relevant factor when entering a foreign market?*

Nine interviewees considered the ethical climate a crucial factor in foreign market entry decision-making. The other three interviewees who represented large public multinational corporations indicated that the real issue was the strength of their firm's ethical standards. Because of their large size, a strong capacity for risk tolerance and a high expectation for financial returns, these firms considered entering markets with poor ethical standards. Consequently, they were confident that their firm employees would ethically conduct business in a market with a poor ethical climate. The findings from these three interviewees contradict the findings of earlier studies (Blundell-Wignall and Roulet, 2017; Spalding, 2010; Cuervo-Cazurra, 2008; Hines, 1995) that indicated that firms located in countries that enacted strong antibribery statutes were reluctant to invest in countries that tolerated bribery.

One of the remaining three interviewees indicated that firm size and reputation for ethical conduct influenced the behavior of government officials in markets rife with bribery. Their firm was often one of the largest foreign investors in the market. However, once government officials learned of the firm's strict policy on bribery, they were less willing to pose ethical challenges to firm employees. This was particularly relevant when monitoring the firm's supply chain because the movement of goods presented multiple opportunities for bribe seekers. In addition, the firm's culture served as an ethical shield for local employees to avoid bribery demands. For example, when asked for a bribe, employees responded that their employer did not engage in bribery, resulting in their termination. This response ended bribery conversations, eased the employee's future relations with officials and reduced employee stress.

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Another interviewee suggested that the ethical climate was more important than the rule of law, especially in a relational investment such as a joint venture. If both parties desired to avoid the hazards of an unethical climate, they were more likely to plan for managing future conflicts. For example, both parties might choose to apply the law and resolve disputes in the courts of a third nation with a rule of law tradition. Alternatively, they might choose to resolve disputes through international arbitration and select award enforcement in a nation known for adherence to the rule of law.

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*Does the extent of the rule of law influence foreign market entry mode?*

Ten interviewees agreed that the rule of law was a factor in selecting a foreign market entry mode. Two interviewees indicated that it did not. All interviewees indicated a direct relationship between the value at risk, foreign market entry mode and the rule of law. However, some interviewees considered the rule of law less important for exporting, especially if the value at risk and intellectual property exposed were small relative to firm size and revenue. For example, one interviewee indicated that it was critical to understand customs rules, tariffs and dispute resolution when importing goods into a foreign market.

Another interviewee responded that as the value and scope of activity rises to the level of direct investment and joint venture, the presence of the rule of law increases in importance. Firm leadership must assess the importance of entering the market through one of these two entry modes against firm strategy, operational methods and profitability targets. For example, a capital-intensive firm in a mature industry that has adopted a growth strategy may be inclined to risk a direct investment in a market known for an unethical climate that promises significant growth and profitability opportunities to implement its strategy. Therefore, a firm in this situation would need to ensure that training in anticorruption policies is required regularly.

*Is the dispute resolution method, including choice of law, determined before foreign market entry?*

All interviewees indicated that failure to include a choice of law and a dispute resolution method in an agreement is malpractice. One interviewee expressed that a foreign investor would always be at a disadvantage, especially in gray areas of the law such as taxation. Large firms regularly select the desired applicable law and dispute resolution venues in advance. The foreign investor's level of trust in the host nation's legal system is a crucial factor. For example, without some level of trust in the host nation's judicial system, a prospective investor will choose to apply the law of a nation with a trustworthy judicial system and where the host has assets available for attachment located outside the host nation to enforce any foreign judgments or arbitral awards.

One interviewee highlighted the importance of geographic location for dispute resolution. For example, parties may select a primary dispute resolution or arbitration center in London or Singapore halfway between their respective locations. Previous experience may influence a choice of law and venue selection and may control the cost of dispute resolution. Another interviewee indicated that a search for a bilateral investment treaty should be part of due diligence prior to market entry. These treaties often specify dispute resolution methods, including valuation techniques.

Including a dispute resolution process in an investment agreement is particularly important when a government entity is a party. For example, one interviewee explained that a foreign investor might negotiate a law, official decree or rules applicable to its specific investment from the appropriate government officials. In another example, a prospective investor with significant bargaining power contemplating an investment in a location with

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unpredictable tax laws may demand special tax treatment as a condition of entering the market. This represents an alternative dispute resolution approach, especially when anticipating a dispute with government officials. Another interviewee indicated that involving a third party with a prior relationship with the domestic and foreign contracting parties served as a proactive planning step that minimized the risk of a dispute. For example, suppose both parties to an agreement had a previous relationship with a financial institution that funded the transaction. In that case, the presence of the financial institution may encourage both parties, particularly government-affiliated parties, to be more amenable to resolving disputes without third-party intervention.

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*Does the foreign market entry mode influence the dispute resolution method?*

All interviewees agreed that transaction value and market entry mode influenced the dispute resolution method. For example, a dispute that arises from a low-value transaction may be resolved locally, whereas a high-value transaction may be resolved at a neutral location. For example, one interviewee indicated that a dispute between joint venture participants, particularly with a government-affiliated firm, may be resolved in a foreign location to avoid a local court favoring host parties over foreign investors. In contrast, a dispute involving a foreign wholly owned subsidiary might be resolved locally because of the host nation's perception that the firm is local because it provides jobs, pays local taxes and may have established strong local relationships.

Another interviewee who advised on large capital investment decisions indicated that the dispute resolution method was always specified. Local law will apply universally if land use is involved in the entry mode. Another interviewee highlighted the distinction between an investment that included a host country government counterparty rather than a private investor. In that case, the foreign investor should negotiate an explicit waiver of sovereign immunity to overcome a possible sovereign immunity defense.

*How is the conflict resolved that does not rise to the level of third-party dispute resolution?*

Nearly all interviewees (one was unsure) agreed that the parties would usually attempt to resolve disputes among themselves, which typically ends most disputes. One common approach among private parties is to include in a negotiated agreement a provision that specifies the steps the parties will use to resolve the dispute internally. For example, if the parties directly involved fail to resolve a dispute, it ascends to more senior or executive leadership. Higher-level managers are likely to bring a different, more strategic and objective perspective toward resolving the dispute. Third parties are consulted only if this process fails. For example, one interviewee suggested that it is advisable to maintain open communications with home country diplomats depending on the transaction value. In the event of a dispute, particularly with a foreign government-affiliated firm, political channels may provide an informal means to successful dispute resolution.

*Does the rule of law increase the likelihood of positive financial performance after five years?*

The interviewees agreed that the rule of law, or a consistent set of rules, provides a better environment and opportunity for profitability because it reduces risk and offers stability and predictability. Five interviewees *believed* that the rule of law was likely to enhance financial performance over five years because firm managers may formulate and execute plans that require a long-term investment view. The absence of the rule of law does not foreclose profitability but does increase risk. For example, one interviewee mentioned the interaction between the risk/reward ratio and a firm's risk tolerance. For example, the rule of law might increase the probability of profit, but such profit might be lower than in a

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country with a weak rule of law. Another interviewee thought that the rule of law would increase the probability of profit through expense reduction. It was likely to result in greater productivity and cost savings stemming from the need for less management supervision, employee ethics training and audit oversight.

Most surprising was the interviewees' general lack of knowledge about the profitability of their firm's foreign investments. Eleven interviewees were unaware of whether their firm had ever developed empirical data to determine the profitability of its foreign investments. Interviewee firms deployed more resources to analyze pre- rather than postentry investments. Consequently, they avoided accountability for the accuracy of pretransaction assumptions and analysis.

One interviewee's firm developed a process for evaluating major investments at several postinvestment time intervals but found that the firm seldom, if ever, used the process. Another interviewee's firm had an active acquisition accountability process. The firm made projections prior to an investment or acquisition and then compared results with projections. In addition, the firm selectively held some managers accountable for overpaying for acquisitions that underperformed. Finally, the interviewee was unaware of how uniformly the firm applied the evaluation system and suggested that organizational politics played a major role in assigning accountability.

Another interviewee indicated that it is essential to remember that a five-year-old business will differ from the original. Initial expectations may change in response to the dynamic economic and political environment of the market as well as the strategic direction of the investor. For example, an interviewee recalled that a foreign investor might be subject to occasional harassment from local government officials seeking to fund a favored project. These officials may enlist local law enforcement to "find" petty violations that are intended less to enforce local regulations and more to raise revenue to fund the favored project. A change in government or policies also may alter the business and ethical climate in either direction. Finally, firm management changes or external pressure on incumbent management may result in a new strategic direction that either deemphasizes the investment or results in an exit.

### **Conclusion and implications**

This study made three significant contributions. First, it focused on experts who advise foreign investment decision-makers. Second, it reported the importance of the rule of law and the ethical climate in selecting a foreign market, entry mode and dispute resolution method. Third, it explained the importance of the ethical climate. Accordingly, foreign investment decision-makers act because the failure to do so could expose the decision-maker to personal legal liability should the investment fail to meet expectations.

The interviewees made clear that a prospective host nation with a robust rule of law was attractive because it included a set of predictable and stable rules. Most interviewees considered the rule of law a critical factor in the prospective foreign market selection process. Those interviewees whose firms had developed a robust corporate culture that emphasized ethical conduct displayed a greater tolerance for entering riskier markets, but they still expected to find a clear set of rules for conducting business. The interviewees indicated that firm risk tolerance and desired level of control were critical factors in determining the firm strategy for foreign market selection and entry mode. Small firm interviewees avoided markets perceived to be risky where control of assets such as intellectual property could be jeopardized or they used a low-risk entry mode such as exporting. Larger firms, especially those seeking new growth opportunities and risk tolerance, were willing to enter a risky foreign market through a high-risk entry mode such

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as a joint venture or direct investment. In both instances, control over the investment remained a recurrent theme and the rule of law enhanced the firm's degree of control over foreign investment. The interviewees believed that the rule of law and quality of the ethical climate directly affected the investment's financial performance.

### *Implications*

This study has identified three practical benefits for managers. The first is to assess the business firm and counterparty strengths and weaknesses. This knowledge will enable management to determine the desired market entry objectives, develop a negotiation strategy and enter negotiations with the prospective host in a clear-eyed manner. Second is the necessity to examine the prospective foreign market legal environment. This requires managers to identify, understand and address the differences between a familiar legal system and that of the target foreign market. Failure to recognize and address differences could threaten implementation, financial performance or the investment itself. The third is to encourage managers to develop financial performance and profitability measurements before foreign market entry and use them afterward. This would provide empirical evidence of profitability and determine the success of the investment. These measures would also enhance executive performance review and compensation systems and assist the firm in identifying similar potential host market opportunities.

This study emphasizes to policymakers the critical role the rule of law plays in private firms' foreign market selection. All interviewees indicated that the rule of law was either a very important or an important factor in the foreign market entry selection process. Policymakers who recognize the significance of the rule of law to foreign investors provide their nation with a competitive advantage to attract foreign investors and associated revenue and employment opportunities. Closely related to the rule of law is the importance of a nation's ethical climate. Most interviewees considered the ethical climate an important factor in foreign market selection. To attract foreign investors, policymakers must conduct themselves ethically and create and enforce laws and regulations that encourage ethical business conduct.

This study reinforces to educators the value of the firm and counterparty self-assessment and goal setting prior to embarking on foreign market entry. The study also illuminates the vital role of the rule of law and ethical climate in the foreign market entry process. Educators will have a firm foundation to explain why the rule of law and ethical climate are significant factors in foreign market entry. Finally, students will understand the value businesses place on stable, predictable laws and regulations and a positive ethical climate.

### **Future issues**

A shortcoming of this research is the small number of interviewees because of our resource constraints. While it is advantageous that all the interviewees are highly experienced, future researchers would benefit from expanding the population of interviewees. For example, it would be beneficial to include individuals from additional management disciplines. Eleven interviewees were from western culture. The remaining one interviewee earned an undergraduate degree in eastern culture and a graduate degree in western culture. Thus, western culture and firms shaped the interviewee's professional and business experience. It would be advantageous to include interviewees whose training and expertise were grounded in eastern culture to determine their understanding of the rule of law concept and their perception of its importance. Future research also might include empirical data and analysis. Finally, future researchers might consider examining the experience of firms that

chose to rely on a strong corporate culture of ethical conduct as a prophylactic measure when investing in risky foreign markets.

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Research guide questions	Majority response	Minority response
To what extent does the presence of the rule of law impact the decision to enter a foreign market?	Eight interviewees indicated that the rule of law was a very important factor in the market entry process.	Four interviewees indicated that the rule of law was an important factor in the market entry process.
Is there a preferred legal system – common or civil law – entering a foreign market?	Twelve interviewees indicated that the legal system was not a principal factor in the market entry process	
Which approach to private foreign market entry is preferred: transactional or relational? Does it depend on the type of investment?	Twelve interviewees considered the two approaches critical depending upon entry mode. However, the relational approach was critical when engaging in higher-risk market entries such as joint ventures. In contrast, the transactional approach was critical when engaging in lower-risk entries such as exporting	
Is the rule of law more or less important depending on the chosen approach?	Six interviewees considered the rule of law more important depending upon the chosen approach	Five interviewees did not consider the rule of law important depending upon the chosen approach, and one interviewee was unsure
Is the foreign market ethical climate a relevant factor when entering a foreign market?	Eight interviewees considered the ethical climate a particularly important factor in the market entry decision	Four interviewees indicated that employee adherence to the firm's code of conduct was the primary reason the interviewees did not consider the ethical climate a key factor in the market entry decision
Does the extent of the rule of law influence foreign market entry mode?	Ten interviewees indicated that the extent of the presence of the rule of law was a factor in their firm's entry decision	Two interviewees indicated that the extent of the presence of the rule of law was not a factor in their firm's entry decision
Is the dispute resolution method, including choice of law, determined before foreign market entry?	Twelve interviewees indicated that the dispute resolution method must be determined before market entry	
Does the foreign market entry mode influence the dispute resolution method?	Twelve interviewees indicated that the market entry mode influenced the dispute resolution method	
How is the conflict resolved that does not rise to the level of third-party dispute resolution?	Eleven interviewees indicated that conflict that does not involve third parties is resolved among the conflicting parties	One interviewee was unsure how conflicts between the parties would be resolved if a third party was not involved
Does the rule of law increase the likelihood of positive financial performance after five years?	Seven interviewees did not know if the rule of law contributed to positive financial performance after five years	Five interviewees believed that the rule of law contributed to positive financial performance after five years

Table A1.

Title	Affiliation	Interviewee profiles	
		Expertise	Experience (years)
Global corporation subsidiary president and attorney	The largest foreign subsidiary of a large global public firm	Management, legal and corporate ethics expert and author	Global (30)
Chief financial officer	A large public global firm	Accounting and finance expert	Global (25)
Vice president and general counsel	A large global public firm	Legal and ethical expert	Global (30)
Risk manager	A large global public firm	Legal and risk management expert	Global (23)
Chief executive officer	A small private firm in a service industry	Management and marketing	Global (40)
Chief executive officer	A small private firm in a service industry	Management and marketing	Western Europe and the USA (25)
Regional ethics compliance officer	Large public firm	Legal and ethics	Former Soviet Union, Central Europe and Asia (20)
Expert witness	Private legal dispute resolution consultant	Legal and dispute resolution	Former Soviet Union (25)
Marketing and project manager	Software firm	Marketing and project implementation	Global (13)
International arbitrator	Global law firm	International commercial law and arbitration	Global (20)
International arbitrator	Global law firm	International commercial law and arbitration	Global (30)
University law professor	A major research university, legal commentator and legal consultant	International commercial law, enforcement of judgments, arbitration and commercial treaty negotiation	Global (35)

Table A2.

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