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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

**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



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](#); [Spaldia7](#)

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



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

One interviewee warned of the danger of the relational approach with government  
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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



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.

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

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

as a joint venture or direct investment. In both instances, control over the investment

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

Tab A1.

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