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How Do Managerial Biases Affect Foreign Market Entry Decisions?

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In this practitioner-focused study, we discuss how cognitive biases impair foreign market entry decisions. Focusing on three factors that are central to the evaluation of foreign markets: cost, control, and uncertainty, we explain how decision-making biases undermine their assessment and the ways in which the biases can be mitigated. Specifically, overconfidence bias and the sunk cost fallacy negatively affect the estimation of entry costs which can be mitigated by a strong governance structure and independent reviews; anchoring and confirmation biases undermine the assessment of an appropriate level of control requiring the use of systematic decision frameworks and decision extension tools; and representativeness and availability biases limit the comprehension of environmental uncertainty suggesting mitigation strategies such as the challenging of internal assumptions and devil's advocacy. By explicating how managerial biases turn into flawed assessments of foreign markets, our study uncovers the mechanisms that explain and potentially remedy cognitive pitfalls during internationalization.

THE DECISION TO ENTER A FOREIGN MARKET

Within the first seven years of entering Australia, a U.S. coffee café chain accumulated \$143 million in losses. It forced the company to close 61 of its 84 stores and dramatically reduce its presence. A global technology company's acquisition of a local counterpart in China did not go as expected. Within five years, the company curtailed its Chinese operations and left the market soon after, incurring hundreds of millions of dollars in losses. Similarly, within six years of entering the U.S., a U.K. supermarket chain discontinued its U.S. operations. During this period, the company accumulated almost \$1.8 billion in losses. All three examples point to market entry failures by otherwise successful firms. They raise an obvious question: Why do highly successful firms sometimes fail to understand a foreign market?

In this practitioner-focused study, we address the question by explicating the role of managerial biases in foreign entry decisions and identify some approaches that mitigate the biases. The decision to enter a foreign market typically emanates from a structured process - objective considerations such as the gathering of information on a target market's size and household income, building of computational models to predict future trends such as market growth and uncertainty, and timely decisions that capitalize on first mover advantage, technological superiority, and economies of scale. These considerations represent areas where successful firms have extensive experience. Having entered a number of markets, these firms are in a strong position to gather and process objective information.

Unfortunately, past experience is not always beneficial. More often, past experience leads to the development of cognitive heuristics - shortcuts - that serve as unconscious

decision rules. The rules emerge in the absence of sufficient information, as a means for simplification when decision choices are complex or ill-defined, when there are significant time pressures, and when decision makers are physically or emotionally exhausted. In effect, heuristics informed by past experiences become 'fillers' that replace missing, ambiguous, incomplete, or complex information. They overcome the need to address informational and interpretational gaps by replacing objective evaluations with subjective inferences. This happens without the conscious awareness of decision makers. Given the acute informational and interpretational challenges posed by new markets, it is no surprise that foreign entry decisions are highly vulnerable to cognitive biases.

When a new market is deemed feasible, the decision to enter requires the selection of an entry mode such as exports, licensing, cross-border alliance or joint venture, or a wholly owned subsidiary. It takes into account three key factors: cost, control (or ownership), and environmental uncertainty (Agarwal & Ramaswami, 1992; Brouthers, 2002; Zhao, Luo, & Suh, 2004). *Cost* assessment involves evaluating the mode of entry that minimizes the monetary value of initial and ongoing transactions after incorporating market imperfections such as information asymmetry, opportunism, and institutional voids (Buckley & Casson, 1998). A wholly owned subsidiary is far more costly than a foreign agent or third-party importer. In evaluating *control*, the focus is on the level of influence a firm desires to maintain over foreign operations (Forsgren & Holm, 2022). It determines access to local knowledge, the protection of proprietary assets, and the maintenance of operational and quality standards. The level of control varies from complete control in a wholly owned subsidiary to shared control in a

strategic alliance, and even less so with licensing and exports (Morschett, Schramm-Klein, & Swoboda, 2010). Accounting for *environmental uncertainty* means taking stock of current and potential changes in the political, economic, cultural, and regulatory environments, and increasingly, the ecological environment (Mithani, Narula, Surdu, & Verbeke, 2022). Stable, culturally similar, and ecologically stable environments favor higher commitment in terms of cost and control as in a wholly owned subsidiary, and turbulent environments discourage direct entry in favor of arm's length approaches such as exports or licensing.

COGNITIVE BIAS AND FOREIGN MARKET ENTRY

The research in behavioral economics suggests that six cognitive biases are more readily accessible, and therefore, most likely to surface in managerial decisions (Guercini & Milanesi, 2022). They include representativeness bias, availability bias, overconfidence bias, anchoring bias, confirmation bias, and the sunk cost fallacy. When pressed for a decision, managers unconsciously invoke one or more of these readily available biases as decision-making heuristics. The appearance of these biases leads to an overestimation of knowledge and firm capabilities, and a preference for information that conforms to pre-existing beliefs and expectations. Below we discuss how these six cognitive biases affect the three key factors central to foreign market entry, i.e., cost, control, and uncertainty, and in particular, how the biases lead to evaluations that make it difficult to develop an effective understanding of a foreign market. For each bias, we identify one or more mitigation strategies. Although the biases do not operate in isolation and an executive decision may be affected by more than one bias, we discuss each bias and mitigation strategy independently to simplify the explanation. The enclosed table summarizes the discussion.

FOREIGN MARKET COSTS: OVERCONFIDENCE AND SUNK COST FALLACY

Managerial overconfidence and sunk cost fallacy play a critical role in the evaluation of cost of entry and operation in a foreign market. *Overconfidence bias* increases the odds that decision makers overestimate firm capabilities, underestimate the engagement necessary for facilities, operations, and compliance, and ignore market imperfections such as information asymmetries, opportunistic behaviors, and institutional voids (Malhotra, Zhu, & Reus, 2023). They lead to unduly positive estimates of the benefits of a foreign market that either ignore or undervalue the accompanying challenges. Allocation of resources based on unduly optimistic projections risk budgetary overruns as the actual cost of establishing and sustaining a foreign presence exceeds projections. Worst, managers may end up choosing more costly entry modes such as a wholly owned subsidiary, leading to undue commitment and financial risk.

Overconfidence bias can be mitigated by promoting group decision processes that encourage differing viewpoints. Diverse perspectives acknowledge the limits of per-

sonal knowledge, and in turn, the applicability of subjective estimates. They are expedited by a *strong governance structure*, like a powerful CEO and board, committed to the hiring of individuals from varied backgrounds and experiences. Diversity in staff and senior executives ensures more inclusive views in decision-making processes. The implications of overconfidence are closely associated with another costly bias: the sunk cost fallacy.

Sunk cost fallacy impairs a firm's reevaluation strategy wherein managers continue to invest in a foreign market beyond the point of viability to justify resources already expended even when the indicators suggest additional investments are unlikely to yield a favorable outcome. It causes managers to ignore diminishing returns for resources that could be optimally deployed elsewhere (Kahneman & Tversky, 1977). Instead of considering future benefits and the likely costs, decisions are based on accumulated investments. Rather than exploring alternative and potentially more rewarding strategies, the focus is on salvaging a failing entry mode. Sunk cost fallacy delays investment reassessments, and a reluctance to cut losses in time and pivot continues to drain more resources and raises opportunity costs.

A sunk cost fallacy can be avoided when prior investments are viewed as a learning tool to leverage past successes and to critically assess the practices responsible for past failures. Learning can be achieved by bringing in third-party consultants or through the building of internal review teams not tied to a project's past to evaluate its viability. *Independent reviews* provide objective insights that encourage decision makers to consider current and future benefits and costs instead of limiting the focus on past outcomes. Resulting changes may include the establishment of "stop-loss" orders where firms predefine criteria that, when not met, automatically trigger project reassessment. It prevents excessive losses by establishing limits on the magnitude and period of investments based on a firm's risk tolerance.

Returning to the example of the U.S. café chain, its entry in Australia illustrates both overconfidence bias and the sunk cost fallacy. The company entered the Australian market in 2000, opening its first café in Sydney. Its expansion strategy was aggressive, with plans to open numerous outlets quickly across the country. It followed the strategy for a while, but the results did not pan out as expected due to stiff competition from local cafes that were deeply embedded in the community and strongly aligned with local tastes. Unfortunately, the company's success in other markets contributed to an unwarranted belief in the universality of its business model. It resulted in underestimation of the need for local adaptation despite significant shortfalls in projected revenues, highlighting overconfidence. The company continued to invest in the Australian market for several more years. Additional investments in stores and operations increased losses, which made it difficult to reevaluate the appropriate footprint or to close underperforming stores, exemplifying the sunk cost fallacy. A powerful governance structure in the form of an influential board could have mitigated overconfidence by encouraging diverse views on the brand's appeal before entry into Aus-

Table 1. Cognitive biases and their mitigation for foreign market entry

	Factors	Bias	Mechanism	Implication	Mitigation
1	Cost	Overconfidence	Overestimation of knowledge, abilities, or accuracy of predictions	Failure to account for accurate costs or capability gaps	Strong governance structure
		Sunk cost	Continuation of commitment past the point of optimality	Failure to exit a market when an entry decision is incorrect or not appropriate anymore	Independent reviews
2	Control	Anchoring	The use of unrelated reference information or experiences	Failure to use effective benchmarks	Challenging of initial assumptions
		Confirmation	Reliance on information that confirms pre-existing beliefs	Failure to incorporate cues that are inconsistent with existing beliefs	Devil's advocacy
3	Environmental uncertainty	Representativeness	Overemphasis on similarities between new decisions and past experiences	Failure to discern unique structure and patterns of an environment	Structured decision frameworks
		Availability	Undue preference for readily available (recent or salient) information	Failure to ignore recent or memorable experiences that do not fully characterize a context	Decision extension tools

tralia or during the launch, and an independent review team would have curtailed expansion much sooner, limiting the momentum that exacerbated the sunk cost fallacy.

FOREIGN MARKET CONTROL: ANCHORING AND CONFIRMATION

Anchoring and confirmation biases have a disproportionate effect on the extent to which control and ownership are considered critical in a foreign market. *Anchoring bias* causes managers to add meaning to initial information about a market in the light of past market experiences (Malhotra et al., 2023). It leads managers to identify a reference point for future decisions regardless of whether that reference is adequate. For example, if a firm's entry in a foreign market using a wholly owned subsidiary was successful but not with a strategic alliance, past success becomes an anchor that leads the firm to prefer a wholly owned subsidiary even when an alliance or a joint venture may be more suitable. The anchor locks managers into an unqualified benchmark that distracts from superior alternatives.

Managers can counter the effect of anchoring bias by *challenging initial assumptions* (Mitra & Golder, 2002). Individuals with extensive background knowledge related to a decision are less likely to be anchored to initial assumptions, suggesting the need to improve managerial understanding of potential international challenges. Explicit evaluation of underlying assumptions encourages the closing of gaps and adjusts the initial estimates. An important source of relevant information is near-market knowledge, i.e., knowledge that pertains to a geographically proximate market that is institutionally similar to the target market. Assumptions pertaining to a target market can be evaluated or adjusted by considering near-market knowledge. It re-

fines the assumptions and grounds expansion decisions on concrete data that incorporate contextual information to overcome the influence of arbitrary anchors.

Confirmation bias leads decision makers to view ownership and control not in terms of the likely implications but as a means to support existing beliefs (Kahneman & Tversky, 1977). It is driven by selective information where the evidence sought and prioritized is conditioned by expected outcomes instead of a proper understanding of the pertinent knowledge, resources, and risks (Buckley, Devinney, & Louviere, 2007). For example, a manager who is convinced that complete control of their products is crucial for success may overlook or undervalue any information that highlights regulatory and market benefits of host market partnerships. It leads them to ignore non-confirmatory or contradictory evidence.

Confirmation bias is potentially mitigated when managers are asked to substantiate their decision. Strategies such as 'consider-the-opposite' and structured analytic techniques like 'red teaming', where decisions are challenged by designated contrary teams, help reassess available information and reduce the risk of reinforcing existing beliefs (Buckley et al., 2007). It requires a culture that encourages *devil's advocates* who provide opposing or disconfirming data and boldly confront decision makers. These approaches foster an environment that values information over beliefs.

In the example of the global technology company, its foray into China highlights the operation of anchoring and confirmation biases. The company entered China in early 2000s with an expectation to replicate the success of its online business model in the U.S. and other western markets. While the company acquired a local Chinese counterpart instead of starting from scratch, it replaced the Chi-

nese founders with senior executives from other parts of the world. Anchored to its strategy, the company exercised complete control over operations based on the belief that success in any market required full operational ownership. Its anchoring bias could have been mitigated if the senior leadership in China included locals that had the understanding and authority to challenge the assumptions brought in from the west. The effect of anchoring was compounded by the company's confirmation bias that led it to overlook the evidence that strategic alliances and joint ventures were, and continue to be, more common in China. Strong local partners can be effective as devil's advocates. By capitalizing on their nuanced understanding of the culture and market, locals provide information that is critical to overcome uncorroborated beliefs.

FOREIGN MARKET UNCERTAINTY: REPRESENTATIVENESS AND AVAILABILITY

A foreign market exposes firms to heightened levels of uncertainty due to the distinct political, economic, cultural, and ecological environments. While an objective assessment of these uncertainties is already complex, representativeness and availability biases compound the problem by minimizing potential contrasts. *Representativeness bias* leads decision makers to overgeneralize similarities between new and existing markets (Elia, Larsen, & Piscitello, 2019). Exaggeration of similarities breeds misjudgments about economic, cultural, and regulatory challenges by attuning firm preferences to those enacted in the previous markets rather than developing locally appropriate choices. This lends to inadequate risk mitigation for uncertainties specific to the new market. Unlike anchoring bias where past experiences are a reference for aspects of a decision, representativeness bias relays past experiences in terms of overarching similarity. For example, a firm used to strategic alliances when entering developed economies may deem that entry mode equally effective for all other economies including newly developed economies without accounting for the latter's weak intellectual property protection regime or underdeveloped regulations, both of which undermine the effectiveness of cross-border alliances.

Structured decision frameworks are helpful in overcoming representativeness bias. They avoid overgeneralization of past experiences by separating the decisions into sub-components. In case of a foreign market, an entry decision can be broken into two distinct reflections: (a) identification of the geographical, institutional, and temporal context of past and new markets, and (b) evaluation of the extent to which each of these facets are similar across markets. These reflections shift managerial attention from unconscious replication of past choices to an objective assessment of the new and more relevant information (AlKhars, Evangelopoulos, Pavur, & Kulkarni, 2019).

Availability bias leads managers to view foreign markets in the light of readily recallable (i.e., recent) or emotionally impactful (i.e., salient) information (Elia et al., 2019). They overlook subtle cues not connected to those in memory even when those cues are critical to manage the situation at hand. The bias results in skewed risk assessments and ana-

lytical missteps that mischaracterize uncertainties. For example, a manager witnessing a violent political rally while traveling through a foreign country may overestimate the political risk for that market due to personal feelings and fears.

To mitigate availability bias, *decision extension tools* that prompt managers to consider a wider array of information and market scenarios, are invaluable. They assist in the use of objective market insights than an overreliance on memory; gathering of market data from diverse sources to build interconnections; and capitalize on the idea that market knowledge from institutionally and geographically proximate markets is likely to be more relevant than from experiences salient to the decision maker. This controls for the disproportionate influence of emotional and recallable information (Mithani & Kocoglu, 2024).

Recall the example of the U.K. supermarket chain. The British retailer entered the U.S. in 2007 thinking that American consumers would be attracted to the idea of freshness and ease of shopping similar to shoppers in the U.K. and other European countries. Representativeness bias made it difficult to account for the U.S. consumers' tendency to shop in large supermarkets, in bulk, and for a wider variety of products in conjunction with local regulations. The use of structured decision framework could have highlighted the contrasts. Moreover, the vividness of home country decisions made them more "available" to executives, materializing into a failure to account for the strength of existing players such as Walmart and Kroger they did not face elsewhere. Decision extension tools, offering a range of market scenarios, would have mitigated the availability bias by highlighting the need to account for new competitors.

In addition to the strategies discussed above, technological advances offer new ways to mitigate managerial biases. For instance, AI-driven analytics are able to process vast datasets that identify patterns, trends, and anomalies not apparent to human analysts. The models generated for interpretation, through analysis of past decisions where optimistic projections failed to align with market realities, detect the signs of overconfidence. The insights from these models can be used to calibrate expectations and strategies for newer conditions, ensuring that foreign entry plans are grounded in data rather than in subjective views of capabilities or opportunities (Watson, Weaven, Perkins, Sardana, & Palmatier, 2018). Similarly, crowdsourcing platforms gather an array of perspectives on foreign entry strategies. By presenting market entry challenges to a diverse global community, firms may gather insights from individuals of varied backgrounds, experiences, and cultural understandings. This not only counters the risk of narrow viewpoints central to cognitive biases but also enriches decision processes by incorporating diverse and possibly more creative solutions. Moreover, visualization design advancements have made it possible to adjust how information is presented to decision makers. By easing the processing of relevant information, they suppress heuristic activation (Wall, Stasko, & Endert, 2019). Although a nascent area, more work is underway to ensure that new technologies do

not introduce their own, machine-induced biases, such as AI hallucinations.

DISCUSSION

In this study, we identified how managerial instincts can at times undermine well developed decisions. More specifically, we highlighted the role of cognitive biases in international market entry decisions. We explained how overconfidence, sunk cost, anchoring, confirmation, representativeness, and availability biases can distort the assessment of foreign market cost, control, and environmental uncertainty. They incline the firm to investments and relationships that are inappropriate for a market, ineffective at the chosen time, or simply not right for the firm. Not only do we suggest the need to be cognizant of the common biases when making foreign entry decisions, we also propose the use of a strong governance structure, independent reviews, systematic decision frameworks, decision extension tools, mechanisms to challenge initial assumptions, and a culture that celebrates devil's advocacy. Mitigation strategies improve the accuracy of foreign market assessments, and they are particularly effective for established firms whose vast experiences at some point turn into deeply ingrained heuristics.

Foreign entry biases do not just harm a firm, they have much larger implications. Biased decisions undermine foreign investments by local entrepreneurs. Their failure to scale in foreign markets harms local interests. In conjunction, entry challenges experienced by foreign investors can disrupt investments in the host market. In the long run, incorrect assessments of cost, control, and uncertainty cast a negative light on the local investment climate. It is therefore important for policymakers to take the lead in instituting policies that encourage bias mitigation strategies for firms going abroad or entering the local market. This can take the form of incentives, say preferential tariffs for firms with diverse executive teams or for those with independent reviews of strategic decisions. Such policies also have the potential to create an ecosystem of consultants, decision analysts, and devil's advocates helping managers make

more effective entry decisions. It is equally timely for policymakers to look into funding R&D initiatives for AI and other technological solutions that offer promising avenues to address cognitive biases.

With an increasingly connected world, we believe the awareness of managerial biases, how they harm foreign entry decisions, and the mitigation strategies are ever more critical for internationalization.

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