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Defensive strategy framework in global markets

A mental models approach

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Abstract

Purpose – The purpose of this study is to develop a conceptual framework for defensive strategy by integrating market entry modes and the typology of firms suggested by Day and Nedungandi, and to attempt to propose how local incumbent firms utilize their mental models in order to react against market entry of new competition in global markets.

Design/methodology/approach – The theoretical perspective adopted in the study is how mental models used by incumbent firms influence their reaction to market entry of new competition in developing defensive strategies to defend their markets.

Findings – Mental models of incumbent firms, categorized as self-centered, competitor-centered, customer-oriented, and market-driven firms, impact their reaction and the development of defensive marketing strategies against market entrants using a variety of market entry modes in global markets.

Originality/value – The paper presents an extensive review of the defensive marketing and mental models literature and shows how the way in which incumbent firms react to market entry of new competition contributes to understanding of incumbent reaction to market entry of new competition in global markets. Research directions for future research and managerial implications are also provided.

Keywords Marketing strategy, Market entry, International marketing

Paper type Conceptual paper

Introduction

As a result of increased competition from both domestic and global competitors, shrinking market size, and declining market growth rates, companies seek opportunities in global markets. However, the success of entry into global markets often depends on the reaction of incumbent firms already in the markets. Many research studies have primarily focused on the export behavior of US and Western European businesses (see for example: Cavusgil and Zou, 1994; Moen and Servais, 2002; Zou and Cavusgil, 2002). The strategic management and marketing literature show that incumbent firms employ defensive strategies to discourage market entry of

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new competition or defend their markets once a new competitor enters their markets (Calantone and di Benedetto, 1990; Calantone *et al.*, 1991; Gruca *et al.*, 1992; Gruca and Sudharshan, 1995; Hauser and Shugan, 1983; Yeung *et al.*, 2003). However, there is also evidence that not all firms engage in defensive marketing (Gatignon *et al.*, 1989; Kuester *et al.*, 1999; Robinson, 1988; Smiley, 1988).

The literature review presented in the next section indicates that studies using mental models in foreign market entry deterrence and defense settings are limited. A study conducted by Maignan and Lukas (1997) considered offensive marketing strategies; how firms use mental models and choose market entry modes when entering international markets. Their findings indicate that managers are highly likely to use the same mental models that they developed in domestic market entry situations when they make choices of market entry modes in international markets. Our study is similarly structured to the study conducted by Maignan and Lukas (1997), but we focus on defensive marketing strategies used by incumbent firms instead of offensive marketing strategies used by market entrant. With this in mind, we consider incumbent firm reaction to foreign market entry of competitors and how the incumbent firms utilize their mental models in defending their markets. There is a growing body of research using mental models to explain competitive behavior and strategy development of managers (see Day and Nedungandi, 1994; Song *et al.*, 2002; Song *et al.*, 1999; Varadarajan and Jayachandran, 1999; White *et al.*, 2003).

In light of the importance of mental models in the analysis of competition, Hodgkinson and Johnson (1994) argue that there is a need for researchers to develop models of competition and techniques that include mental models along with managers' causal logics and analytical techniques. The literature review in the next section reveals a paucity of research taking the cognitive approach to the study of defensive actions in global markets. The lack of cognitive research in the domain of cognitive defensive strategies may be due to the lack of a conceptual cognitive framework for researchers to use in empirical studies. The purpose of our paper is to provide such a framework by examining how managers utilize mental models in responding to market entry of new competition in global markets in a variety of market entry settings. We consider the defensive actions of incumbents from managerial mental models perspective (Day and Nedungandi, 1994), and the choice of foreign market entry modes (Buckley and Casson, 1998; Gemser *et al.*, 2004; Malhotra *et al.*, 2003; Sarkar and Cavusgil, 1996) to develop a conceptual framework for defensive marketing. The current marketing strategy literature lacks research using mental models for defending markets. Consideration of mental models in making managerial decisions will help understand and improve the decision making processes used by managers in today's especially information rich business environment. This paper attempts to contribute to marketing strategy literature by including the managerial mental models concept when reacting to market entry of new competition that use a variety of market entry modes in global markets. With this in mind, this paper is organized as follows:

(1) review of defensive marketing literature;

(2) discuss mental the models concept and decision making;

(3) discuss market entry modes in global markets;

(4) develop a conceptual framework of incumbent reaction to foreign market entry;

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(5) discuss how mental models are utilized in responding to market entry and develop propositions;
(6) present discussion and conclusions;
(7) provide managerial implications; and
(8) discuss the limitations and future research.

Defensive marketing strategy literature review

Incumbent firms attempt to deter entry of new competition into their markets long before new competition even considers market entry. Similarly, incumbent firms defend their markets by retaliating once new competition enters their markets (Chen and Miller, 1994). In competitive situations where multiple incumbents exist, some incumbents wait for others to act first, and then follow or do nothing. Also, some incumbents who are unable to compete against the new market entrants choose to exit the market (Nargundkar *et al.*, 1996). In general, however, incumbent firms try to block or slow down the entry of new competition by engaging in entry deterrence strategies or decide to wait until after new competition enters the market to take action.

Firms engaged in competition find that their actions are mutually dependent, that is, the outcome of marketing actions of one firm depends to some degree on the response of its rivals. Failing to consider competitor reaction may cause a firm to draw the wrong conclusions about the outcome of such actions (Porter, 1980; Putsis and Dhar, 1998). Therefore, successful firms look onward by taking a dynamic view of competition as a series of moves and countermoves. However, despite its importance, many firms often pay little attention to the reaction of competitors in their decision-making and usually think, at best, in terms of only one move instead of multiple moves (Reibstein and Chussil, 1997). Research suggests that firm performance increases when companies perceive competitive reactions accurately (Clark and Montgomery, 1996; Day, 1994). Successful firms assess the possible reaction of competitors to their proposed marketing initiatives before initiating them. They achieve this by learning about competitors and then building their marketing strategy on the basis of what they have learned.

Researchers have attempted to develop and test models for examining defensive strategies. Hauser and Shugan (1983) developed the well known "defender model" which included a framework in using the marketing mix to optimize incumbent response to market entry of competition. They concluded that as a response to market entrants, incumbents lower advertising and distribution expenditures, decrease their price in general, but increase price in market segments with differentiated products to maximize profits. The strategy of increasing price is also supported by an empirical study conducted in the US pharmaceutical industry for name brand prescription drugs (see Frank and Salkever, 1997). Kumar and Sudharshan (1988) tested the defender model and found similar results to those suggested by Hauser and Shugan (1983). Another test of the defender model was conducted by Calantone and di Benedetto (1990) in an industrial marketing setting, suggesting that the defender model could be utilized to assess the effect of competitive attacks as well as the effects of a range of defensive maneuvers. In another test of the defender model, Gruca *et al.* (1992) found that defenders use marketing mix elements to respond to competition, but the incumbent's market share also has an impact on the type of defensive strategy used.

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Although the defender model has been widely used and has contributed to the defensive marketing literature, it does not consider the mental models concept.

Research studies present in the marketing literature deal with defensive actions by incumbent firms in post-market-entry situations and ignore the pre-market-entry conditions where some of the strategies used actually differ. Defensive strategies discussed here could be firm or industry specific strategies. A strategy that could be used by a firm in the pre-market entry condition in one industry could be used in post-market entry condition by another firm in another industry. In pre-market entry conditions, incumbent firms lower their prices, increase promotional expenditures, hide profits, and provide incentives for distribution channels. They also send signals of retaliatory actions or bluff their potential competitors that they will use their most effective marketing mix elements to retaliate (Heil and Walters, 1993), In addition, some incumbent firms threaten their competitors that they would attack their strategically important markets.

Incumbent firms plan for long-term and utilize pre-market-entry defensive strategies that will keep competitors out of their markets. These strategies include building barriers to entry (Karakaya and Kerin, 2007; Karakaya and Stahl, 1989, 1991; Porter, 1980), such as customer switching costs, product differentiation, cost advantages, government policy, and access to distribution channels. In building barriers, they reduce operating costs and improve product quality. Developing and implementing customer retention programs aimed at maintaining relationships and retaining customers are also considered as a part of a long-term defensive strategy. Firms attempting to avoid confrontation reposition their products, do nothing or simply exit the market. Also some firms announce new product introductions or introduce new products. For example, Microsoft uses new product announcements and introductions to successfully deter entry of new competition in both domestic and global markets.

Although the types most pre and post market entry defensive strategies are similar in nature, they can vary in magnitude between pre and post entry situations. In general, most common post-market entry defensive actions include price cutting, cost reduction, advertising, sales promotions, improving product or service, and introducing new products to combat the market entrants. For example, Korea Tobacco & Ginseng Corp. improved its cigarettes to better serve its customers shortly after the entry of foreign tobacco companies into its market. In addition, the company accelerated its exports to regain the market share it lost to foreign competitors (Joo-Young, 2001).

Some defensive strategies may include the use of only a single element of the marketing mix or the use of corporate-level strategies (Gruca and Sudharshan, 1995). In fact, competitors retaliate with their most effective marketing mix elements and retreat with their most ineffective ones (Gatignon *et al.*, 1989). However, the impact of a marketing mix element may depend on the effect of another marketing mix element (Gruca *et al.*, 1992). There is empirical evidence that, when facing new competition, incumbent firms reduce prices (Bengtsson and Marell, 2006; Simon, 2005; Gruca *et al.*, 1992; Calantone *et al.*, 1991; Robinson, 1988), increase advertising expenditures (Robinson, 1988; Cubbin and Domberger, 1988), and introduce new products (Bengtsson and Marell, 2006). Empirical evidence also suggests that an incumbent's price reduction is mitigated by the incumbent's age, incumbent corporate scope, and

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market concentration (Simon, 2005). It is also important to note that some incumbents do not lower prices as a response to entry (Yamawacki, 2002).

Actions such as changes in marketing expenditures (e.g. advertising and distribution) depend on whether the product is a dominant or a non-dominant brand on the market. Gruca *et al.* (1992) suggest that dominant brands should increase advertising spending, but non-dominant brands should reduce advertising and distribution spending. It is important to note that not all incumbent firms react in the same manner. Some firms increase advertising spending while others decrease it.

Previous research indicates that the success of entry deterrence strategies is related to the speed and magnitude of reaction by incumbents. Faster reactions to new market entry (Gatignon *et al.*, 1997) and more intensive competitive responses (Chen and Hambrick, 1995) have a positive impact on the success of deterrence strategies. Similarly, early responders and attackers gain market share at the expense of late responders (Chen and MacMillan, 1992).

In addition to the defensive and sometimes offensive actions undertaken by incumbent firms to retain market share, they also have the option of exiting markets, accommodating the new entrants, or cooperating with them. Once competitors signal entry or actually enter a market, some incumbent firms consider exiting the market. This decision often depends on the incumbents' marketing mix capabilities, marketing resources to preserve their market position (Robertson and Gatignon, 1991), and barriers to exit (Karakaya, 2000; Nargundkar *et al.*, 1996; Porter, 1980, 1985). Large investments and sunk costs incurred by incumbents often force them to remain in the market even if they suffer losses.

There are also incumbent firms that do not react at all because they do not know what the appropriate defensive reactions against new market entrants are (Gatignon *et al.*, 1989). A study conducted by Smiley (1988) showed that most incumbent firms are not involved in entry deterrence. This is especially true when incumbent firms accommodate market entrants to avoid confrontation that could lead to destructive price wars (Simon, 2005) by repositioning their products (Calantone *et al.*, 1991; Smiley, 1988). Incumbent firms also accommodate when they feel that the entrant will only take an insignificant percentage of their business or if the market will expand with the increase in the number of competitors (Gatignon and Reibstein, 1997). This is especially true if the new competitors enter the market with improved products. For example, the compact size automobile market in the USA grew because of market entry of fuel-efficient and high-quality foreign automobiles.

Entry deterrence strategies are not always effective in preventing entry. Also, once the new competitors enter the market, it may be difficult to force them to exit, but it is possible to defend against further entry by obtaining the cooperation of the new competitors (Heil and Walters, 1993; Porter, 1985). For example, if the entrant enters with a new technology, incumbents may allow the entrant to further develop the new technology and take a stake in it with venture capital (D'Aveni, 2002). This is likely to happen in global markets where product adaptation may be necessary.

Mental models and decision making

In the previous section we discussed the factors that shape a firm's response to entry of new competition These factors represent a rational and deliberate approach to the formulation of defensive strategies by incumbent firms against entry by other firms.

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However, the business world has become increasingly complex and imposes excessive cognitive demands on managers rendering the rational model of decision-making inadequate to capture market realities. As a result, managers use mental representations of reality to interpret external environmental information (Feeney and Handley, 2006; March, 1994; Mezias *et al.*, 2001; Porac and Thomas, 1990; Qudrat-Ullah, 2007; Song *et al.*, 1999; Walsh, 1995). Such mental representations mirror reality as perceived through the senses – making the external world accessible to the mind. In fact, mental models are predefined representations or schemata that are used by managers to interpret complex business phenomena (Barnes, 1984; March and Simon, 1958; Simon, 1955; Walsh, 1988).

A major finding of cognitive science is that cognition mediates between the external environment and individual response to environmental stimuli (Moors and De Houver, 2006). Another important finding of cognitive science is that people have limited information capacity (Simon, 1955). Organizational theorists have used these ideas to propose a model of managerial cognition in order to explain how managers make decisions in the face of ambiguous and ill-defined events (Daft and Weick, 1984). In the mental models approach, managers receive, process, and disseminate information about their external environment. But managers often have to sift through an enormous amount of information to develop strategies and respond to environmental challenges. According to the mental models approach, before managers act on information received, they interpret the information within the framework of their mental models. Mental models contain decision rules for filtering information (selective perception) and help simplify decision-making by considering only the relevant or important information (Day, 1994; Walsh, 1995).

It is important to note that mental models are not always static, so when managers receive new information they may be modified to accommodate the new information (Barr *et al.*, 1992; Mason and Mitroff, 1981; North, 2005; Prahalad and Bettis, 1986 Walsh, 1995; Vandenbosch and Higgins, 1996). However, there is evidence that mental models may change very little even in the face of rapid environmental change (Reger and Palmer, 1996). Hodgkinson (1997) also found that individual and shared mental models of the competitive landscape of UK residential real estate agents remained highly stable even after their industry underwent a rapid change. In a longitudinal study conducted at a large Swedish university hospital between 1990 and 1994, researchers found that mental models of strategist's (MD's) way of thinking was stable (Lindell *et al.*, 1998). The study further determined that, beliefs and opinions related to specific business issues change more easily than the core beliefs or opinions.

The mental models concept differs from the traditional view that managerial decision-making is a rational, intentional, and deliberate decision-making process (Denzan and North, 1994; Stubbart, 1989). Instead it is consistent with the view that managerial decision making lacks rationality (March and Simon, 1958; Mintzberg, 1973; Simon, 1955). The mental models perspective is also consistent with the bounded rationality theory proposed by Simon (1957). The bounded rationality theory views managers as having limited cognitive abilities that hinder their capacity to deal with the cognitive demands of the real world by relying on heuristics or rules of thumb to solve managerial problems.

Much like individuals, organizations develop shared mental models over time through education, experience, the nature of the industry, and past strategic choices

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(Gebhardt *et al.*, 2006; North, 2005; Reger and Palmer, 1996). Managers use shared mental models to make sense of industry trends, competitors' actions, customer requirements and help avoid narrow interpretation from special interest groups or departments. But to lead to appropriate actions, shared beliefs about the consequences of organizational action need to be valid, given the environment in which they are made. But strongly held shared beliefs often act as blinkers leading managers to reject environmental information that is contrary to their accepted views. Also shared mental models can be significant barriers to change (Mezias *et al.*, 2001). It must be noted that shared models may not be widely shared throughout an organization. Researchers have found the existence of similarities and differences in the mental models of managers within individual firms due to differences in managerial experiences, environment and other factors (Hodgkinson and Johnson, 1994).

Mental models are visible in the organization's culture, routines, actions, and rules of behavior (Mezias *et al.*, 2001; Bettis and Prahalad, 1995; Markides, 1997). They also form the framework of organizational belief system on which policies are based. Belief systems are the basis for initiating and organizing managerial action (Weick, 1995; Senge, 2006). They define what is important and unimportant based on underlying values, shared interests, and common understanding in an organization. Mental models also impose order on seemingly chaotic competitive environments and reduce environmental uncertainty to manageable proportions (Pfeffer and Salancik, 1978; Day, 1999).

Market entry modes in global markets

The entry strategy is the starting-point of all future activities in the host market and one of the most important strategic decisions made by managers of companies seeking to expand into global markets (Sarkar and Cavusgil, 1996). The choice of entry strategy significantly affects the performance and survival of the foreign subsidiary (Li, 1995). Firms entering global markets usually pursue one or more of the following entry modes or their variants: exporting, licensing, joint venture, and foreign direct investment (Buckley and Casson, 1998). Firms choose the entry mode that maximizes the chances of establishing a successful operation in the foreign country. The political, economic, cultural, technological, and competitive environments and other local market conditions, entry barriers, amount of control required, incumbents' resources and potential reaction, and market entrant's global experience, resources, and managerial commitment are key factors that affect the choice of entry mode (see Osland *et al.*, 2001; Florin and Ogbuehi, 2004). For example, a joint venture with a local firm is often necessary as a mode of entry if local laws prohibit foreign control (Gatignon and Anderson, 1988). Similarly, a company that has superior manufacturing and technological capabilities may find a local partner who has an extensive distribution network or excellent marketing capabilities. Some firms also use acquisition to access specific capabilities to strengthen themselves and improve the chance of success of market entry (Claude-Gaudillat and Quelin, 2006). Other firms find a wholly owned subsidiary attractive because this mode enables them to exert the most control in decision-making (Osland *et al.*, 2001).

The choice of entry mode employed by market entrants' influences the nature of the incumbent's response. For example, entering through acquisition elicits a different response because it allows new entrants to overcome existing barriers to entry and

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make it easier to enter a market (Root, 1994). Other things being equal, incumbent response should be more vigorous when the new entrant's entry involves a large investment, such as foreign direct investment or joint venture. This is because incumbents perceive direct investment or joint venture as a greater threat than an entrant, which adopts a less aggressive strategy (Venkataraman *et al.*, 1997). Large firms typically use foreign direct investment as mode of entry because they have the necessary resources and they are perceived more threatening to the incumbent firms. In addition, foreign direct investment and joint venture are more visible entry modes. Thus, they elicit a more rigorous reaction by incumbents than other forms of entry (Chen and Miller, 1994). Also, these entry modes represent a greater threat because they demonstrate a greater commitment by the foreign firm in the host country. On the other hand, export or licensing strategies are low-level involvement entry modes usually pursued by smaller firms and represent a lesser threat to local firms.

Framework of incumbent reaction to foreign market entry

In general, the decision to deter market entry and the choice of entry deterrence strategy by incumbent firms in global markets depends on a variety of factors. As discussed in the previous sections, we include market entry modes and mental models as two of the major components of deterrence or defensive strategy framework. In order to focus on the defensive strategy framework, we discuss the mental models here very briefly, but expand on the use of mental models as applies to incumbent reaction to market entry of new competition in the next section. The market entry modes and mental models, and other factors as they relate to defensive marketing strategy framework are presented in Figure 1.

Companies learn from their past experience of dealing with competitors and use their accumulated knowledge and experience in planning and implementing strategies against competitors. Of course, the knowledge of what was successful and what was unsuccessful is utilized in designing strategies to combat new competition. Incumbent firms' past experience impacts how managers perceive and interpret threats presented by new competition in both pre-and-post-market entry situations. In addition, past experience of incumbent firms help determine management attitudes, which in turn influences the selective perception process in filtering the information managers receive about competitive threats and their environment. Therefore, past experience, management attitudes and selective perception assist in forming the four types of incumbent firm mental models, self-centered, competitor centered, customer oriented, and market driven, as shown in Figure 1. The four types of mental models are explained in detail in the next section.

Once foreign market entry occurs, managers' response is shaped by their mental models, which take the form of some decision rules (e.g. do if, or else, etc.). Managers of incumbent firms continuously receive information on the existing competitive environment, potential or current market entrants, and on the performance of their own strategies. Based on the filtered information, managers then prepare to respond or not to respond (incumbent reaction) in defending their markets in both pre-and-post-market entry conditions utilizing their mental models. The type of reaction depends on the mental models of the incumbent firms in that a competitor centered firm may have a different reaction than a self-centered, customer oriented or a market driven firm or vice versa. Mental models affect managers' response, but the

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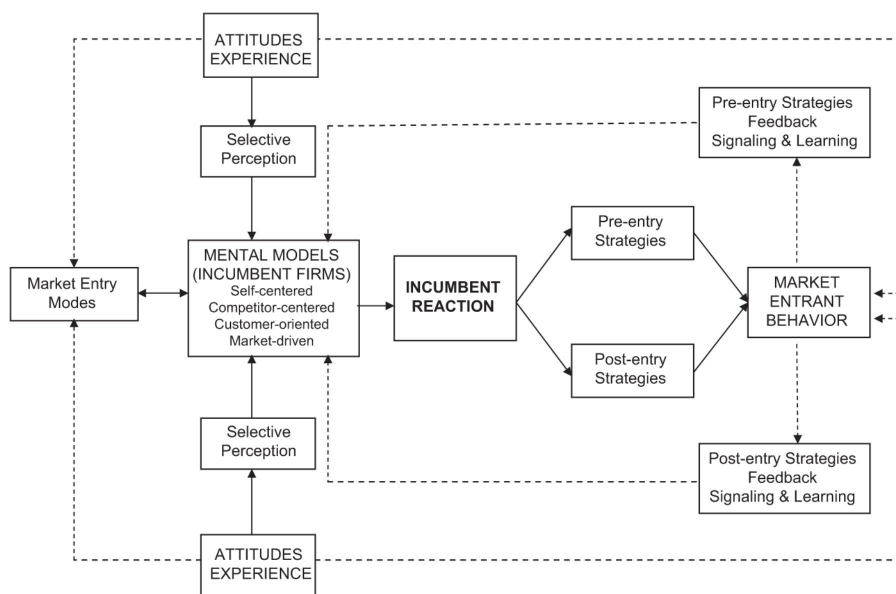

Figure 1.
Market entry and defensive strategy framework

outcome of the incumbent's reaction can also lead to a modification of their mental model. Also, as shown in Figure 1, potential or current market entrants send signals or bluff the incumbent firms to learn the potential reaction of the incumbent firms. Managers interpret the information contained in the signals or bluff through their mental models and then decide to act or not to act. Similarly, the mode of market entry used by market entrants also affects the reaction of incumbent firms. The mental models of the incumbent firms determine their reaction to different types of market entry modes.

The framework in Figure 1 distinguishes between pre-entry and post-entry defensive strategies. Incumbent firms may send signals or bluff potential entrants of impending retaliatory actions during the pre-market entry period. They may also hide profits, lower prices, or introduce new or improved products into the market to deter entry of new competition. The feedbacks received by the incumbent firms are also filtered through the mental models. As a result, the incumbent firms may modify their mental models and react accordingly. In post-market entry situations, however, incumbents often adopt more aggressive measures in order to drive out the new competition. Thus, competitive actions in post-market entry situations can be more active in nature and may involve changes or adjustments in one or more of the marketing-mix variables.

The use of mental models also applies to market entrants. The market entrants' experience, management attitudes, and the selective perception process impact market their mental models. Consequently, market entrants' mental models determine the choice of market entry mode and the course of action to pursue. Market entrants receive feedback from their competitive actions or threats. For example, pre-market entry announcements are primarily designed to gather information about the reaction of incumbent firms. Similarly, as indicated earlier, in order to receive feedback and

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learn the reactions of existing firms, new or potential market entrants often send signals or enter a small portion of the market and then expand or withdraw from the market depending on the incumbent reaction.

Incumbent firms use the information they receive about the new competition in both pre-and post-market-entry conditions by utilizing their mental models. The nature of the threat is associated with market entry modes and serves as a trigger for the incumbent firms' actions. For example, news about a new market entrant using direct investment or joint venture will influence the incumbent firms in line with their mental models. As indicated in the earlier section some market entry modes such as direct investment, acquisition and joint ventures pose stronger threats than others, and may influence incumbent firm reactions differently. Therefore, in this research, we focus our attention on the role of market entry modes and managerial mental models in shaping the incumbent firm reaction. In the following section, we expand on the use of mental models in competition with a focus on developing and implementing defensive strategies and then present specific propositions about incumbent reaction to market entry of new competition.

Using mental models in responding to market entry in global markets

Past research has assumed that managers follow structured decision-making procedures when they develop defensive strategies. However, there is evidence that few firms make comprehensive analysis of their choices (Barnes, 1984; Daft and Weick, 1984; Miller and Starr, 1967; March, 1994; Porac and Thomas, 1990; Simon, 1955). A structured deliberate approach to determine defensive actions against new competitors requires information on all major factors that affect incumbent response. The information required to make such structured, rational decisions is seldom available and an attempt to obtain it would delay the decision making process. This makes it very difficult for managers to make fully informed decisions (Zahra and Chaples, 1993) and leads managers to make decisions on the basis of perceptions and mental models rather than following a structured and comprehensive analysis of their options (Janis and Mann, 1977; March, 1994; Miller and Starr, 1967; Prahalad and Bettis, 1986; Simon, 1955, 1976). For example, a study of how firms make foreign market entry decisions indicates that most companies are not involved in a systematic decision-making process, but they rely instead on managers' mental models of their firm's domestic experience (Maignan and Lukas, 1997). Similarly, Thomas *et al.* (2007) provide evidence that managers use existing mental models and are subject to cognitive biases when they enter foreign markets. In their survival analysis, they found that entry decisions by emerging market firms based on alliance experience with developed market firms led to failure because they incorrectly assumed that knowledge gained in emerging markets could be transferred to a developed market (Thomas *et al.*, 2007).

A firm's strategic orientation shapes the strategic direction followed by a firm to create the proper behavior that ensures superior profitability (Armstrong, 1996; Han *et al.*, 1998; Narver and Slater, 1990). Market-driven firms, through superior market sensing and sense making abilities, are better equipped to anticipate how markets will evolve and respond to competitive entry (Day, 1994; Narver and Slater, 1990). Such firms continually learn about their markets and disseminate the information generated about markets and competitors into their collective mental models (Day, 2002;

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Gebhardt *et al.*, 2006; Nonaka, 1994). These mental models enable members of the organization to work together and communicate effectively in responding to market challenges ensuring the coherence and timeliness of their strategies (Gebhardt *et al.*, 2006). Therefore, mental models are fundamental to learning organizations, as they are vital in collecting and acting on market knowledge.

Research indicates that managers across nations with different cultures use different mental models to select a competitive strategy (Song *et al.*, 2002). More specifically, these researchers found that there are indeed differences between managers in the USA and Japan in terms of importance placed on the competitive forces. For example, managers in Japan prefer a cost-leadership strategy compared to managers in the US when selecting market entry strategies. These researchers also point out that managers use mental models when defending their markets against competitors, but do not provide any explanation of such actions. In another study, Song *et al.* (1999) found that managers in the Asia-Pacific Rim perceive product differentiation advantages of pioneering to be more important than managers in Western nations. Therefore, managers in the Asia Pacific Rim are likely to strengthen their own product differentiation advantages as a defensive mechanism to become more competitive. Also, Shaw (2001) found that French and German subsidiaries located in the UK use different marketing strategies. German companies follow market-focused strategies based on product quality, but their French counterparts utilize a more short-term oriented strategy related to cost.

Mental models imply that managers' form cognitive representations of their complex competitive environment that help them interpret information to make decisions. These representations result from managers' interaction and experience with their external environment (Mezias *et al.*, 2001; Song *et al.*, 2002). Managers use their understanding and experience of their competitive environment to focus on certain information that they consider important for decision-making and then measure their performance on the basis of their decision (Porac and Thomas, 1990).

As we discussed earlier, mental models permeate the entire organization and influence managerial decision making. Given their dominance throughout the organization, we expect mental models to be employed in strategic decision-making including the formulation of defensive strategies against foreign market entry. Therefore, by acting as a mediating mechanism and filtering incoming information about competitive factors, mental models shape managers' thinking processes in determining their response to foreign entry.

Instead of conducting a thorough and systematic analysis of all factors that influence the defensive strategy against foreign entry, we propose that managers defend their markets on the basis of their mental models of their competitive advantage. Research on mental models shows that organizations differ widely in the way they deal with their competitors, customers, and the marketing environment (Day and Nedungandi, 1994). These researchers examined empirically how managers use mental models to interpret their competitive advantage in their chosen markets. They considered customers and competitors as two salient dimensions of a competitive market and studied the degree to which these two factors shape managers' mental models of competitive advantage. Based on the empirical results, Day and Nedungandi (1994) classified managerial mental models of competitive advantage into four types:

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(1) self-centered;
(2) competitor-centered;
(3) customer-oriented; and
(4) market-driven.

They also found that the managerial representations of competitive advantage are associated with restricted search for and use of information.

Self-centered firms

Self-centered firms operate in stable competitive environments – low in both customer bargaining power and competitive rivalry (Day and Nedungandi, 1994). These conditions influence them to form mental models characterized by a limited responsiveness to customer needs and competitive moves (Day, 1994; Maignan and Lukas, 1997). Because they fail to actively search their competitive environment for threats, self-centered firms often respond only when there is a crisis. Day (1999) characterizes the self-centered firms with internal orientation and as blind to the market. As a result of this orientation, self-centered firms lack awareness of their competitive environment, fail to capture threatening signals from competitors, and pay little attention to customer needs or wants (Day and Nedungandi, 1994).

Self-centered firms suffer from marketing myopia, as they are narrowly focused on selling a specific product or service to the market (Levitt, 1960). Most self-centered firms accommodate their rivals rather than actively compete with them. Their mental models assume that if a competitor takes a certain action, there must be a good reason for it, and it should be emulated (Day, 1999). Failure to properly monitor the market place may cause self-centered firms to miss new technologies or the market entry of new competitors and lose market share. For example, Motorola lost its leadership in the mobile telecommunications market because it was more inward looking in developing new technologies than its competitors (He *et al.*, 2006). Also, government owned and/or subsidized industries in Eastern Europe, Asia, South America and other parts of the world consisted of self-centered firms that dominated the marketplace until new competition from foreign countries arrived (e.g. automobile, farming, tobacco, and liquor industries).

In light of their particular managerial representation, self-centered firms are not expected to react to foreign entry at least in the short-run before entry takes place. Therefore, the entry mode is inconsequential to self-centered firms. That is, the reaction of incumbent firms will be the same regardless of the mode of entry. Furthermore, since mental models reflect existing competitive conditions (Song *et al.*, 2002), we expect the entry of new competition to cause a change in the incumbent's competitive orientation after entry has occurred. More specifically, we expect that, in the long-run, the entry of foreign competition and the resulting loss of market share and heightened competitive conditions will lead this type of firms to become customer-oriented, competitor-centered, or market-driven depending on the particular market and competitive circumstances. For example, IBM underwent a major cultural transformation from a self-centered, inward-looking organization to a customer-focused provider of computing solutions (Gestner, 2002). On the basis of this discussion, we offer the following propositions:

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P1. In the short-run, the probability of self-centered host country incumbent firms' reaction to foreign entry in pre-market or post-market entry situations is lower than that of competitor centered, customer oriented, and market driven firms.

P1. In the long-run, after successful market entry of new competition, self-centered host country incumbent firms will react to new competition altering their mental models and becoming competitor centered, customer-oriented or market-driven.

Competitor-centered firms

A competitor orientation reflects a commitment to incorporate competitor information into decision making (Voss and Voss, 2000). Competitor-centered firms engage in direct comparison with target competitors (Day and Wensley, 1988) and continuously search their external environment for information about competitors (Day and Nedungandi, 1994). Such organizations are concerned mostly with how they compare to their competitors on specific product attributes or features and cost performance because they operate in highly intensive competitive environments. Overall, this type of firm is characterized by an excellent ability to identify, analyze, and respond to competitors' actions (Narver and Slater, 1990). In fact, competitor-centered firms formulate their strategies in response to competitors' actions (Day, 1994; Day and Nedungandi, 1994) and react quickly to threatening competitors. These firms usually operate in capital-intensive, mature industries and are very sensitive to capacity utilization. They often use price as one of their most important weapons. Therefore, when competition intensifies, they focus on cost cutting (Song *et al.*, 2002). However, it must be noted that companies often employ Mutually Assured Destruction (MAD) retaliation strategies, a deterrent strategy according to which the deployment of strong weapons is essential to threaten the opponent in order to prevent him from using the same weapons. Each company has enough resources and in the event of serious escalation, each company has the capability to inflict maximum damage on its opponents. MAD is a doctrine of military strategy in which a full-scale use of nuclear weapons by two opponents will and in the event of an escalation each country has the capability to endure the destruction of both the attacker and the defender (Gardner, 2003).

In view of their particular orientation, competitor-centered host country incumbents are expected to send signals intended to discourage potential foreign entrants from entering their market. Such signals may take the form of new product announcements, investment in additional capacity, or other initiatives such as Mutual Assured Destruction threats. On the other hand, when competitor-centered incumbent firms receive signals of threats from potential entrants, they are likely to engage in actions designed to deter entry such as building capacity, lowering prices, cutting costs, or improving their products.

Once entry occurs, a competitor-centered host country incumbent firm is expected to immediately engage in defensive action to defend its market. Since entry modes such as joint venture and direct foreign investment involve large foreign firms and are much more visible than exporting or licensing, market entrants using these entry modes represent a greater threat to incumbent firms in the host country. Therefore, we would expect a more immediate defensive action against such entrants by host country

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companies, other things being equal. This reasoning leads us to the following propositions:

P3. Competitor-centered host country incumbent firms scan their marketing environment continuously to gather competitive information and if they detect any competitive threat of market entry of potential foreign firms, they send signals to discourage market entry.

P4. When competitive-centered host country incumbent firms receive signals of entry from potential entrants, they engage in entry deterrence actions prior to entry of new competition.

P5. The likelihood of immediate reaction by competitor-centered host country incumbent firms to foreign competitors' entering their markets through foreign direct investment and joint venture is greater compared to other entry modes in post market entry situations.

Customer-oriented firms

Customer-oriented companies adopt mental models that call for detailed analysis of customer needs and satisfaction because they operate in markets highly characterized by a high degree of customer bargaining power (Day and Nedungandi, 1994). Managers of customer-oriented companies focus on market segment differences, differentiation advantages, and emphasize gathering of customer-related information. The perceived basis of their competitive advantage is the knowledge of customer needs and behaviors (Day, 1994; Deshpandé *et al.*, 1993). This helps them incorporate customer preferences into their marketing decisions (Voss and Voss, 2000). The customer information also enables them to create superior value for customers (Narver and Slater, 1990). Overall, customer-oriented firms emphasize customer retention, superior customer service, innovative product features, and focus on narrow market segments. They indirectly compare themselves to competitors on the basis of comparisons made by customers rather than by managers (Day and Wensley, 1988). In addition, because these firms know their customers well, they have the ability to anticipate their customers' reactions to new market entrants.

Given their mental models, customer-oriented host country incumbent firms are not expected to signal to their competitors that they will retaliate against them. In fact, as indicated earlier, they anticipate their customers' reaction to new market entrants and utilize the information gathered from customers to develop defensive strategies. Some of their most important strategies are product differentiation, customer satisfaction, and customer retention. These strategies are expected to be more intensive in the case of foreign direct investment or joint venture compared to other entry modes because firms employing such entry modes are likely to be larger and represent a greater threat for incumbents. Based on the above discussion, we provide the following propositions:

P6. Customer-oriented host country incumbent firms engage in customer retention strategies including differentiation to discourage foreign competitors from entering their markets in pre-market entry conditions.

P7. Upon receiving signals of potential foreign market entry, customer-oriented host country incumbent firms rely more on customer retention strategies than sending signals back to competitors that they will retaliate against them.

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P8. Market entry of foreign competitors is likely to intensify customer-oriented host country incumbent firms' customer retention strategies by focusing on one or more of the following: differentiation, customer service, innovative product features, product quality, and breadth of product choice.

P9. If the mode of entry is foreign direct investment or joint venture, the intensity of customer retention strategies employed by customer-oriented host country incumbent firms will be much higher compared to other entry modes in post market entry situations.

Market-driven firms

Market-driven firms are concerned with both customers and competition when making strategic decisions (Day and Nedungandi, 1994; Kohli *et al.*, 1993; Narver and Slater, 1990; Deshpandé *et al.*, 1993; Gatignon and Xuereb, 1997). These firms are focused on sensing the needs of customers and anticipating the moves of competitors. Such an orientation provides them with superior understanding of customer preferences and competitor strategies (Gatignon and Xuereb, 1997; Kohli *et al.*, 1993). Thus, market-driven firms have a sense of balance between customer and competitive orientation (Day and Wensley, 1988). Because of the greater breadth of their mental models, they are open to both customer and competitor related information. They have information processing mechanisms capable of detecting trends, events, competitors, and technological developments to ensure their success (Daft and Weick, 1984). In addition, they have superior strategic thinking capabilities that allow them to better respond to market conditions and anticipate changing competitive conditions (Day, 1999). By focusing on both customers and competitors, these firms avoid the problem of oversimplification that afflicts other mental models and perform better than other firms (Day and Nedungandi, 1994).

Market-driven organizations place a great deal of importance on their customers (Deshpandé *et al.*, 1993), and use their expertise to create and retain customers (Day, 1994). These companies know the factors that influence customer buying decisions and use this knowledge to create superior customer value and satisfaction (Noble *et al.*, 2002) while keeping costs under control (Day and Nedungandi, 1994). Their capabilities enable them to anticipate rather than react to changes in their competitive environment. They also act on competitive information quickly because their orientation is widely shared throughout the organization (Day, 1994). However, in order for a market orientation to take hold, information about customers and competitors must permeate the organization by formal and informal means (Kohli and Jaworski, 1990; Kennedy *et al.*, 2003).

In market-driven firms, the information gathered about competitors and customers are widely distributed within the organization at all levels (Day, 1994) and managers spend a lot of time analyzing competitors' strategies (Day, 1990). These practices allow them to be familiar with their competitors' actions, resources, capabilities, objectives, and strategies (Day, 1999). Also, market-driven companies focus on both cost containment and customer satisfaction and service (Day and Nedungandi, 1994). But market-driven firms that adopt primarily customer satisfaction strategies tend to perform better than firms that emphasize both cost containment and customer satisfaction (Rust *et al.*, 2002). They send signals to potential market entrants to discourage them from entering their markets and engage in customer retention

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strategies. When foreign market entry occurs, market-driven host country incumbents react more aggressively in the case of joint venture and direct foreign investment compared to other entry modes because such entry modes are more visible and more threatening to them. Given this discussion, we propose the following:

P10. Market-driven host country incumbent firms send signals to discourage entry of foreign competitors and engage in customer retention strategies to maintain their market position in pre-market entry situations.

P11. Market-driven host country incumbent firms' reaction to entry of foreign competition via foreign direct investment and joint venture will be more aggressive compared to other entry modes in post-market entry situations.

Discussion and conclusions

Research on defensive strategies has identified numerous variables influencing a firm's decision to respond to competitive entry. This research has focused on a normative defensive decision-making process and not on how managers actually decide to defend their markets. As indicated earlier, there is a growing body of research suggesting that managers do not adopt a systematic analysis of the situation but instead rely on mental models that greatly simplify decision making and lead to quick decisions (Barnes, 1984; Day and Nedungandi, 1994; Song *et al.*, 1999; Song *et al.*, 2002).

Mental models of competitive advantage utilized by managers help firms simplify decision-making by dictating the kind of information to be selected and how it is screened and interpreted (Day, 1990). However, this simplification may lead to a partial and likely biased view of the marketing environment (Barr *et al.*, 1992). Consequently, self-centered, competitor-centered, and customer-oriented mental models may be deficient as they offer a partial view of market reality. Self-centered firms completely overlook customers and competitors. Competitor-centered firms overlook important customer information. Similarly, customer-oriented firms miss important competitive information because they focus only on customer-related information (Day, 1999). Only market-driven firms combine a customer and a competitor focus (Day and Wensley, 1988).

On the basis of our review and synthesis of the research on defensive strategies and mental models, we conclude that when faced with new competition, host country incumbent firm managers use their mental models of their competitive advantage to deal with foreign entry. We claim and provide support from extant literature that there are systematic differences in the ways managers make decisions (see Day and Nedungandi, 1994; Song *et al.*, 1999; Shaw, 2001; Maignan and Lukas, 1997). In addition, mental models act as filters that help interpret incoming information in accordance with managers' perceptions of their firm's competitive advantage. Therefore, depending on mental models and market entry modes, managers react to new competition differently. In our study, we modified the mental models competitive advantage framework suggested by Day and Nedungandi (1994) to develop a decision-making typology of incumbents' reaction to foreign market entry and apply it to international market entry and defensive marketing. Any explanation of an incumbent company response to competitive challenges must consider the mental models of organizational strategists or marketing executives formulating defensive strategies. Given the pervasiveness of mental models in organizations, one can expect

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that their mental models or cognitive representations of their business environment will shape managers' defensive actions against foreign entry. Organizations develop and alter their mental models based on previous experience and new information received from the business environment and the activities of competitors. Therefore, developing anticipatory mental models of incumbent reaction and market entrant strategies is important to both market entrant and host country incumbent firms so they can promptly take planned actions.

Managerial implications

As firms become more global and expand into markets around the world, it is important for expanding firms to understand how managers of host country firms formulate and implement defensive strategies. Knowledge of the competitive environment and the mental models used by managers in assessing and responding to competitive threats will help managers develop effective strategies for entering foreign markets (Song *et al.*, 1999). Similarly, knowledge of market entrants' mental models can be useful to incumbents in formulating their defensive strategies.

Firms planning entry into a foreign country could predict the reaction of local firms on the basis of the entry mode, knowledge about the types of incumbents firms (e.g. market driven firms vs competitor centered firms) and competitive conditions prevailing in the country. Based on such predictions, managers of entering firms may be able to adjust their entry strategies in line with the expected foreign company reaction. For example, as we indicated earlier, Song *et al.* (2002) found that, on average, managers in Japan were more likely to choose cost leadership strategies than US managers, other things being equal. However, when bargaining power of customers was high, managers in Japan were more likely to choose differentiation or focus strategies compared to their US counterparts. Also, Hitt *et al.* (1997) found that managers in the USA attribute more importance on ROI and cash flow when making strategic decisions whereas managers in Korea emphasize market share and sales. Therefore, one can assume that the reaction of managers in Korea would be strong if they were likely to lose market share and sales to new competition.

Using the Day and Nedungandi (1994) framework of managers' mental models of competitive advantage, we can derive the following managerial implications. If markets are characterized by intensive competitive conditions or threatened by highly substitute products, we would expect competitor-centered firms to dominate the market. Such orientation would elicit an aggressive competitive retaliation if the entry mode were foreign direct investment or joint venture. Also, if the market consists of buyers with high bargaining power, we would expect more customer- oriented firms and a less direct reaction against foreign entrants. If the market were stable and mature with very little environmental turbulence, we would expect to find a number of self-centered companies who would be largely oblivious to any form of foreign entry at least in the short-run. Therefore, studying the competitive history of incumbents will provide strategic guidelines for market entrants because they serve as mental models for incumbent firms. Similarly, study of market entrants' mental models will also provide insights and directions for formulating defensive strategies by host country incumbent firms. It is important to note that managers' mental models are likely to be different in various regions of the world or countries necessitating using a different market entry strategy in each region or country.

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Limitations and future research

This paper discussed the defensive strategy framework and strategies in global markets and provided some explanations of how managers use mental models for defending their markets in accordance with the modes of market entry. The same framework can apply to domestic markets with some modifications. Consideration of mental models by market entrants is equally important. In fact, host country incumbents and market entrants simultaneously try to predict how they will react given certain competitive conditions. This may lead researchers to employ a game theory approach to understand market entry and entry deterrence decisions as suggested by Varadarajan and Jayachandran (1999). In addition, there are other factors that influence managers' mental models that could not be included in the conceptual framework developed for parsimonious reasons. These factors, while not exhaustive, include barriers to entry, market entrant and incumbent characteristics (e.g. company size, reputation, available resources, etc.), the nature and likely consequences of entry into incumbent firms' markets, and industry structure. Future research may include testing of the conceptual framework through case scenario, content analysis, or historical data of market entry and deterrence situations. It is also important to understand whether managers use compensatory (e.g. conjunctive, disjunctive, and lexicographic) or non-compensatory decision rules in developing their mental models to make strategic decisions to deter market entry or defend their markets. Such knowledge would help managers understand their decision-making process and provide useful information for effective strategy development.

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