Heterogeneity and Uncertainty in the Dynamics of Firm Selection into Foreign Markets

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Abstract

The data from Turkish manufacturing firms shows a positive relationship between revenues of a firm from a market and the number of markets penetrated by that firm, and previous presence in that market. Also, firms do not export to a common set of destination markets which violates a common entry cost assumption. Unlike the general equilibrium studies of trade, I study a partial equilibrium analysis to explain an entry-cost-reducing effect of previous presence in a market, and increasing returns to being in more markets. Then, I undertake an empirical analysis and find significant benefits to being in a market in the previous period on continued selection into the same market, and synergetic benefits to being in more market on entry costs and demand across different markets. Quantifying these impacts in a model which accounts for other possible shocks to productivity, demand and entry costs is important because they can provide a rationale for the existing export subsidies by showing why a firm's status in a market can be persistent after the first entry into that market. Also, my empirical strategy allows me to separate firm-specific and market-specific heterogeneity from idiosyncratic uncertainty in firms' selection problem, and I find that 1) firm-specific heterogeneity explains more of the total residual variation in revenues from foreign markets as opposed to idiosyncratic variation in technology intensive industries than less technology intensive ones, 2) the relative importance of idiosyncratic components diminishes as the level of per capita income of a destination market increases. Last, as a counterfactual experiment, I measure the impact of Turkey's participation in the EU Customs Union on firms' selection behavior.