Testing the Waters: How Firms Enter New Markets

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Abstract:

Using firm-level data on production and trade from Denmark, we document that firms frequently employ a strategy of entering new export markets exclusively with Carry-Along Trade (CAT), i.e., with products manufactured by other firms. To rationalize this new stylized fact, we propose a model where CAT plays a pivotal role in enabling firms to learn about market conditions and assess market viability. In our framework, exporting requires upfront entry investments that create a benefit of knowing the exact market conditions. When the potential losses incurred from making investment decisions for own-goods based on expected market characteristics are significant, beginning to export with CAT becomes the optimal strategy. We provide empirical evidence in support of our mechanism by showing that entering with CAT is particularly prevalent among small firms, in distant markets, and among firms with no prior exporting experience.

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