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Geographic, cultural, and psychic distance to foreign markets in the context of small and new ventures

Arto Ojala *

University of Jyväskylä, Department of Computer Science and Information Systems, P.O. Box 35, FI-40014 University of Jyväskylä, Finland

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ABSTRACT

More often than one might expect, small and new ventures, which already suffer from few resources and a lack of industry legitimacy, take on the additional uncertainties of entry into foreign markets. Some of these foreign entries involve countries that are geographically distant and culturally different from the firm's home country, making foreign market entry all the more difficult and uncertain. Recent studies have criticized prior academic approaches to understanding these difficulties. Insights may be limited if one uses merely the concept of distance and looks primarily for main effects. Entry by new and small ventures into distant foreign markets is complex, and the factors influencing it are interactive. The aim of this conceptual paper is to contribute to an understanding of the stability of the distance factors, and also the interactive effects between distance factors, market attractiveness, and network relationships, with particular attention to small and new ventures.

1. Introduction

More than a decade ago Shenkar (2001) highlighted a variety of problems with "cultural distance" as a useful metaphor in research on international business. Among other remedies he proposed "friction" between cultures as a better metaphor than "distance" on the grounds that it emphasizes the contact between cultures and the possibility of conflict. Later, Shenkar, Luo, and Yeheskel (2008) argued more strongly for friction as a metaphor, noting that conflicts are likely when distinctive cultures interact, and also that large corporations often use power to manage these conflicts. Similar questions have been raised regarding psychic distance, its validity, and its usage in international business. Some scholars have argued that psychic distance is a concept that is past its due date (Stöttinger & Schlegelmilch, 2000) or concluded that it is not a valid concept for small and new ventures (Autio, 2005; Bell, McNaughton, & Young, 2001). Nonetheless, the concepts of cultural and psychic distance continue to be used metaphorically by international business scholars (Ambos & Håkanson, 2014; Dow & Karunaratna, 2006; Håkanson & Ambos, 2010; Mezias et al., 2002). Thus, it can be argued that international business research on distance should not be abandoned, but rather refined.

Despite criticisms and disagreements, several scholars have contributed to our understanding of cultural distance, and of other types of distance – specifically, geographical and psychic distance. These studies have mainly focused on how distances impact on firms' international expansion. Recently, scholars have also deepened our understanding on the nature of the distances themselves (Nebus & Chai, 2014), and distinguished differences between the distances in question (Håkanson & Ambos, 2010). Indeed, research has indicated that many common assumptions regarding distance are incorrect and require further investigation (Avloniti & Filippaios, 2014; Ellis, 2008; Håkanson & Ambos, 2010; Nebus & Chai, 2014; Shenkar, 2001). Despite this, all studies on the topic agree that when the distance between a home and a target country becomes greater, this increases the uncertainty of doing business.

Especially for small and new ventures, this uncertainty is critical. Unlike large established corporations, small organizations have relatively few resources to devote to internationalization (Oviatt & McDougall, 1994) or to transform competitive advantages in such a way as to overcome the difficulties created by distance dimensions (Nebus & Chai, 2014). Small and new ventures have relatively weak legitimacy in their industries and among potential customers, in both their home markets and foreign markets. The managers of these small and new ventures are often inexperienced at international business. Securing entry into distant foreign countries is particularly uncertain for such organizations; consequently, every action they take in a distant

* Tel.: +358 14 260 4622.
E-mail address: Arto.K.Ojala@jyu.fi

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location has significance for their survival (Bell, McNaughton, Young, & Crick, 2003; Coviello, 2006; Oviatt & McDougall, 1994). It should also be noted that these firms have received less research attention than large multinational corporations (MNCs), and that their typically weak power to dictate terms in host-country cultures may contrast in interesting ways with the power that Shenkar et al. (2008) depict in their discussion of established multinationals. Thus, studying geographic, cultural, and psychic distance in the context of small and new ventures may yield evidence that is more interesting than would be the case if the research focused on established MNCs.

With these considerations in view, the aim of this paper is to contribute to a theoretical understanding of the dimensions termed geographical, cultural, and psychic distance, looking at how they affect small and new ventures. The focus of the paper is on the stability of the distance factors and on the interactive effects between distance factors, market attractiveness, and network relationships. It is true that distance factors have received considerable attention among international business scholars; nevertheless, the stability of these factors has been largely neglected. Thus, we adhere to Shenkar's (2001) argument concerning the illusion of stability. A second aspect to note is that the roles of market attractiveness and network relationships have been seen as having an impact on distance factors (Johanson & Vahlne, 2009; Ojala, 2009). However, important questions remain as to precisely how distance factors interact with market attractiveness (cf. Ellis, 2008) and network relationships (cf. Johanson & Vahlne, 2009).

We begin with a focus on the three dimensions of distance mentioned above and their impact on the foreign market entry of small and new ventures. This is followed by discussion on the factors that make a foreign market attractive, and how the attractiveness of a foreign market interacts with distance. Thereafter, we address the interactive role of distance dimensions with foreign market size, considering also the stability of distance, and the interactive role of network relationships. Our approach makes it possible to delineate testable propositions for further studies on distance. At the end of the paper, we discuss the measurement of different distance dimensions.

2. Three dimensions of distance

In the context of this study, distance dimensions can be divided into geographic, cultural, and psychic distance. These are in fact the three concepts most commonly used in the literature on international business (e.g. Brewer, 2007; Child, Rodrigues, & Frynas, 2009; Dow, 2000; Dow & Karunaratna, 2006; Ellis, 2008; Ojala & Tyrväinen, 2007, 2008; Ragozzino, 2009). However, we also acknowledge certain distance concepts that have received attention more recently. For instance, Xu and Shenkar (2002) focused on how institutional distance affects foreign direct investment by multinational enterprises, while Peretto and Smulders (2002) investigated how technological distance reduces the spillovers between firms. Estrin, Baghdasaryan, and Meyer (2009) examined how human resource distance impacts on the entry mode choices of multinational enterprises. Some scholars have stressed the existence of multiple distance dimensions, referring to important simultaneous influences on international firm behavior. Ghemawat (2001) highlighted the commercial effects of cultural, administrative, geographic, and economic distance among countries. Shenkar (2001) identified many additional dimensions, including for example linguistic, religious, educational, and political factors. All in all, there would seem to be quite a number of factors that can impact on the international activities of firms, especially small and new ventures. Nevertheless, for the sake of conciseness and clarity, we shall concentrate here on the most commonly used distance dimensions: geographic, cultural, and psychic distance. It should be noted that several studies have used psychic distance as a first order construct that includes several of the dimensions listed above (see e.g. Brewer, 2007; Dow & Karunaratna, 2006; Håkanson & Ambos, 2010).

An examination of foreign distance in terms of three dimensions – physical space, socio-cultural norms, and perceptual issues – makes it possible to achieve extensive coverage of the main foreign distance concepts that interest scholars of international business. It also addresses some of the problems brought about by restricting oneself to a single "distance" metaphor (Shenkar, 2001). It should be noted that none of the points made above denies the importance of "cultural friction," bearing in mind that the latter concept, although related to and affected by distance, is of a different nature (Luo & Shenkar, 2011; Shenkar et al., 2008). Cultural distance is an "ambient condition" that may or may not result in friction, depending on a variety of other influences, such as the quality of communication between foreign firms and the people in a host country (Luo & Shenkar, 2011). Most importantly, defining and distinguishing between geographic, cultural, and psychic distance highlights for scholars the necessity of having fully worked out theoretical development if one is to understand how the dimensions of international distance operate. We believe that attention to the precise distinctions in question provides the best chance of yielding significant and meaningful empirical results.

2.1. Geographic distance

Geographic distance is the physical separation between one location and another, typically involving the space between the home of a firm and the foreign location in which it is selling, or exploring possible sales. Increasing the physical space, as measured in kilometers or miles between countries or cities, or between a firm and its market, adds time and costs to commercial transactions, thus making the market less attractive in terms of efforts to increase sales (Dunning, 2001).

Lower economic and managerial costs, rapid and effective information exchange, and environmental familiarity are all important reasons why geographically proximate countries attract mutual entry. Recent improvements in transportation systems and communication technologies, including the Internet, have not eliminated the influence of geographic distance on trade intensity between countries (Dow, 2000; Dow & Karunaratna, 2006; Ghemawat, 2001; Gooris & Peeters, 2014; Leamer & Storper, 2001) or its impact for small and new ventures (Brock, Johnson, & Zhou, 2011; Dow, 2000). Geographic distance even impacts on the trade of digital goods sold over the Internet (Blum & Goldfarb, 2006), affecting the market selection of small software firms that trade completely intangible products (Ojala & Tyrväinen, 2007, 2008).

It seems that the impact of geographic distance on the foreign market selected decreases after initial market entry (Clark & Pugh, 2001; Ojala & Tyrväinen, 2007). Clark and Pugh (2001) found that the first three countries entered by British firms were geographically closer than the last three countries. Ojala and Tyrväinen (2007) found that the entry priority of small software firms tended to shift from geographically close countries (first and second entries) to geographically more distant countries (third entry). There are several reasons why small and new ventures tend to enter nearby markets first. In addition to the likelihood that these firms will have relatively fewer resources than MNCs (Oviatt & McDougall, 1994), nearby markets may offer quick access to funding opportunities (Freeman, Giroud, Kalfadellis, & Ghauri, 2012), and better possibilities to build networks for further business opportunities (cf. Coviello, 2006; Freeman et al., 2012; Johanson & Vahlne, 2009).