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Entry in a psychically distant market: Finnish small and medium-sized software firms in Japan

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Summary This paper investigates the market entry and entry mode choice of eight small and medium-sized Finnish software firms in the Japanese market. The findings in this study reveal that, despite of the psychic distance between Finland and Japan, most of the firms entered Japan at a very early stage of their internationalization process by using direct entry modes. This was mainly due to the market size, sophisticated industry structure, and requirements for intensive cooperation with the customers during the sales process. The firms were able to overcome psychic distance by hiring local employees and western managers who already had working experience in the Japanese market. This finding indicates that psychic distance is based on a manager's personal experiences and feelings about how distant a country is rather than on cultural differences between the countries.

Introduction

Several studies have brought to light the increasing involvement of SMEs in global markets in the past decades. Especially among fast growing high-technology industries, internationalization of SMEs has been particularly fast. The drivers for increasing involvement of knowledge-intensive SMEs in the world markets, to name a few, have been the increasing competition in both domestic and international markets and the fast development of information and communication technologies. As a consequence of this rapid internationalization, managers of SMEs are facing challenges regarding how to enter countries which are, in many ways, different from the home country.

In traditional internationalization theories (Bilkey and Tesar, 1977; Cavusgil, 1980; Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975), differences between countries are conceptualized as 'psychic distance'. The Uppsala internationalization model (Johanson and Wiedersheim-Paul, 1975) defines psychic distance between countries as differences in language, culture, political

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system, level of education, level of industrial development etc. The model proposes that firms enter first to nearby countries within a low psychic distance, because knowledge about these countries is available easier and thus makes the business practices in these countries easier to understand. In his study, Brewer (2007, 44) explains this as follows: ''The connection between psychic distance and knowledge is that a firm's managers tend toward the country markets that they can get to know most easily, and they avoid markets that are difficult to get to know, at least early on in the firm's internationalization process''. Thus, the concept of psychic distance should be studied at the individual level. This distinguishes it from cultural distance, which examines differences in cultural values between countries (Sousa and Bradley, 2006).

Because knowledge-intensive SMEs are forced to operate globally to find customers for their niche products (Bell, 1995; Bell *et al.*, 2003; Lindqvist, 1988; Ojala and Tyrväinen, 2007), they also have to enter and conduct business in countries with a greater psychic distance. For this reason, the aim of this study is contribute to the literature by investigating the market entry and entry mode choice of knowledge-intensive SMEs in a psychically distant country. Although this topic has been studied to a certain extent, earlier studies (see e.g., Bell, 1995; Coviello and Munro, 1997; Moen *et al.*, 2004) have investigated firms' internationalization to several countries without focusing on any particular country. In addition, these studies have mainly investigated initial market entries where firms commonly enter nearby, 'psychically close' countries. This kind of research setting can be argued to skew the results related to psychic distance if the nearby countries share a similar business environment, cultural values, language, etc. As distinct from the earlier literature, this study investigates the market entry and entry mode choice in a psychically distant country by analyzing eight Finnish software firms' market entries in Japan. Based on the concept of psychic distance, Japan can be ranked as a country relatively distant from Finland (Karppinen, 2006; Karppinen-Takada, 1994; Luostarinen, 1979; Peltokorpi, 2007; Ronen and Shenkar, 1985). Thus, Finnish firms are supposed to establish direct entry modes in Japan only after operating directly in several less distant countries. This helps to validate the applicability of the traditional internationalization theories regarding the present global business environment. Therefore, the following two questions are of particular interest in this study: 1) To what extent does psychic distance influence market entry and entry mode choice in the Japanese market? and 2) How are firms able to overcome the psychic distance in the Japanese market?

Psychic distance and internationalization

The concept of psychic distance has been present in several internationalization models (Bilkey and Tesar, 1977; Cavusgil, 1980; Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975). The concept became popular after Nordic studies by Johanson and Vahlne (1977) and Johanson and Wiedersheim-Paul (1975) resulted in what is now known as the Uppsala internationalization model. It describes internationalization as a gradually evolving process, in which a firm goes through various stages when it internationalizes its operations. In the model, market selection is explained so that firms are expected to enter first into nearby markets with a low psychic distance, because these countries commonly share a similar language, culture, political system, level of education, level of industrial development etc. Thereafter, once a firm has acquired more knowledge about how to operate internationally it may enter countries with a greater psychic distance.

According to the Uppsala model (Johanson and Wiedersheim-Paul, 1975, 307), in their entry mode choice, firms are expected to use the following ''stages'':

1. no regular export activities
2. export via independent representatives (agent)
3. sales subsidiary, and
4. production/manufacturing

Thus, the operations in a foreign country are supposed to start by indirect entry modes (stages 1—2), which do not require such extensive knowledge about the environment of the target country. Both, indirect or direct exporting can be considered. These kinds of exporting activities require less commitment to the market and can be conducted without extensive knowledge about the target country (Ekeledo and Sivakumar, 1998; Luostarinen and Welch, 1990). According to the model, indirect entry modes increase a firm's knowledge about the target country and allow it to learn about how to deal with the customers in that country. Once the country has become more familiar for a firm, direct operations can start there (stages 3-4). A firm might establish a sales subsidiary (stage 3), which requires more knowledge and commitment to the target country compared to indirect entry modes. During stage 4, a firm may start production or manufacturing activities in the market. The model does not include joint venture operations or partnering, which also requires intermediate level of knowledge and commitment (Ekeledo and Sivakumar, 1998; Luostarinen and Welch, 1990).

In the Uppsala model, knowledge of the foreign markets has a central role. The model divides knowledge into general knowledge and market-specific knowledge. General knowledge includes knowledge about marketing methods of a product, operation modes, and typical customers in a global scale. This knowledge is mainly objective and transferable from previous countries entered to the target country (Johanson and Vahlne, 1977). Market-specific knowledge is experiential knowledge about the target country environment, including its culture, the market structure, customers in the market etc. This knowledge is mainly acquired through operating in the target country (Johanson and Vahlne, 1977) and it is highly tacit. Due to this tacitness, that kind of knowledge is difficult to acquire and transfer from country to country (Lord and Ranft, 2000). However, a firm can, to a certain extent, use their experiences and knowledge from earlier foreign operations when entering into a new country (Johanson and Vahlne, 2003). Thus, the knowledge is highly personalized and depends on managers' earlier experiences about similar operations. If a manager is familiar with a certain country, it makes a firm's market entry easier and increases its possibilities to conduct successful operations there (Brewer, 2007; Sousa and Bradley, 2006).

Cultural and language differences between Finland and Japan are especially wide, as emphasized in several studies