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## The logic behind foreign market selection: Objective distance dimensions vs. strategic objectives and psychic distance

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### ABSTRACT

The aim of this paper is to highlight the importance of the firm's strategic objectives regarding the choice of countries for foreign expansion, complementing the existing literature on the internationalisation process. Through a multiple case study methodology, we conduct a comparative analysis of three Brazilian ventures that have internationalised in Italy, and three Italian firms that have internationalised in Brazil, seeking to investigate the firms' decisions on the selection of foreign markets. We consider jointly the objective aspects of distance, the overall perceptions of the decision-makers in relation to the differences between the domestic and (potential) host countries, and the firm's strategic objectives. This research contributes to International Business studies by revealing the role of firm-specific strategic objectives as determinants of foreign market selection, in addition to, or even on top of, the dimensions of objective distance and psychic distance.

### 1. Introduction

The choice of foreign markets is a key issue in the International Business (IB) literature, which has traditionally approached it through the lens of what Hymer terms the “liability of foreignness” (Hymer, 1976). From this perspective, the so-called Uppsala model of international growth posits that due to risk aversion and a lack of knowledge about foreign markets, the choice of a foreign country depends on psychic distance (Johanson & Vahlne, 1977). This approach has been criticised in the following years for its determinism (Andersen, 1997; Melin, 1992; Petersen, Pedersen, & Sharma, 2003). The International Entrepreneurship (IE) stream of research states that firms can target “distant” markets from their beginning, mostly leveraging the experience and network of their key decision makers (e.g. Oviatt & McDougall, 1994; Zahra, Matherne, & Carleton, 2003). Both streams suffer determinism and path dependence to some extent, which seems also confirmed in the recent version of the Uppsala model (Johanson & Vahlne, 2009). Autio (2017, p. 38) recently argued: “The network perspective to internationalization originally built upon the Uppsala portrayal and shares many ontological features and elements of theoretical logic [...]. In the network ontology, similar to the process ontology, there appear to be few shortcuts to overcome the liabilities of foreignness and outsidership.”

What leads a firm to choose to enter a distant market, without any prior experience in the organization or decision-makers of that market,

and without any existing partnership? We still have no adequate answer to this question, which refers to the actual behaviour of a number of firms that are internationalising. We believe that managerial discretion (Petersen et al., 2003) and the strategies decision makers implement in their organizations can shed light on this question, and that the “strategic objectives explanation” can fruitfully complement the existing knowledge about foreign market selection. In adopting this perspective, we respond to a call for contributions dating back to Melin (1992), who asked researchers to include strategy among the key variables in their multinational enterprises (MNEs) studies, and Bell, Crick, and Young (2004), who invited researchers to include strategy as a determinant in the international growth of small and medium enterprises (SMEs). Chetty and Campbell-Hunt (2004) discussed strategy as a strong motivator for international growth, both for born globals and for established firms. These calls for studies are also recently supported by Terjesen, Hessels, and Li (2016), Love and Roper (2015) and Benito (2015), who highlights that a firms' internationalisation is purposeful and goal-oriented: “Without an explicit and clear notion of motives, conceptualizations of firms' internationalisation are bound to be imprecise [...] which [...] has been the case for the well-known internationalisation process model.” (ibid, p. 16).

Strategic objectives may lead a firm to enter markets characterised by high distance, thus bridging the known with the unknown, and can provide a motive to face the liability of foreignness.

But what exactly is distance? This construct is at the heart of IB

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studies, and has received much attention from scholars in the field. Distance encompasses many different dimensions, including geographical, cultural, administrative, and economic distance (Ghemawat, 2001). It can be approached (and measured) as an objective variable, but it can also be viewed as a matter of decision makers' perceptions (psychic distance, Johanson & Vahlne, 1977), affected by their knowledge and previous experience in foreign markets. Moreover, distance can be viewed as either symmetrical or asymmetrical (Beugelsdijk & Mudambi, 2013; Håkanson & Ambos, 2010; Håkanson, Ambos, Schuster, & Leicht-Deobald, 2016; Shenkar, Luo, & Yeheskel, 2008; Tung & Verbeke, 2010; Zaheer, Schomaker, & Nachum, 2012), as either absolute or relative (Beugelsdijk & Mudambi, 2013; Goerzen, Asmussen, & Nielsen, 2013; Håkanson & Ambos, 2010).

Asymmetry occurs when the distance between A and B is different (or is perceived differently) from the distance between B and A. It explains why, when it comes to the distance between country A and country B, decision-makers in country A perceive the distance between themselves and B differently from the way decisions-makers in country B perceive the distance between themselves and A.

Relativity, on the other hand, occurs when different decision-makers in country A experience and perceive the distance from country B differently, due to industry and product-specific motivations, for example (Ghemawat, 2001).

We contend that strategic objectives represent an important determinant of both distance asymmetry and distance relativity, in addition to objective and perceptual causes.

Our empirical context encompasses the internationalisation decisions of Brazilian and Italian firms that have internationalised in Italy and Brazil, respectively. We chose to study firms from a pair of countries, as recommended in the most recent literature (Puthusserry, Child & Rodrigues, 2014) and, in order to extend the understanding of the mechanisms behind internationalisation decisions, we analysed the different dimensions of distance in conjunction (Ambos & Håkanson 2014; Ojala, 2015; Williams & Grégoire, 2014). By studying firms from a pair of countries, we also can better explore the asymmetry and relativity issues related to distance. This study therefore contributes to understanding the internationalisation process of firms in a globalized era, in which distances are increasingly showing traits of relativity and asymmetry in an "intercontextual business" (Knight & Liesch, 2016) environment. This work contributes to IB and IE studies by highlighting the critical role of strategic objectives in foreign market selection, in addition to the already acknowledged roles of objective distance dimensions, and how they are perceived by decision-makers (i.e. psychic distance).

The remainder of the paper is structured as follows. After describing our theoretical framework, we present the methodological component, which includes a comparison of Brazil and Italy in terms of classical IB objective dimensions of distance, and international business activity between the two. Subsequently, building on evidence from the case studies, we illustrate and discuss these findings, offering a set of propositions and a model. Finally, we highlight our contributions to the literature on IB and IE, and provide some insights for management practice.

## 2. Theoretical framework

### 2.1. Dimensions of distance, perceptions of distance, and strategic objectives in foreign market selection

The construct of distance has multiple dimensions (geographic, cultural and institutional, economic), which can be approached and measured adopting an objective perspective (how distant is country A from country B in terms of kilometres, institutions, markets, etc.) or through the subjective point of view of decision makers (psychic distance).

*Economic distance* refers to country differences in consumer wealth

or income (Ghemawat, 2001), but also encompasses differences in customer preferences and purchasing power (Hutzschenreuter, Kleindienst, & Lange, 2016), which, taken together, provide insights into the country's market potential. Economic distance is usually measured using objective indicators such as income (GDP per capita); inflation (GDP deflator); exports of goods and services, and imports of goods and services (as% of GDP) (see Ellis, 2008, for example). At present, only a few studies have investigated in-depth the effects of economic distance with respect to foreign market selection (Hutzschenreuter et al., 2016).

*Geographic distance* is often measured as the spatial distance between the centres of a pair of countries (Berry, Guillén, & Zhou, 2010) or as the distance between their capital cities (Campbell, Eden, & Miller, 2012; Slangen & Beugelsdijk, 2010). It has been argued that geographic distance is a barrier to international trade (Frankel & Rose, 2002; Hummels, 2001; Leamer, 1974; Limao & Venables, 2001), on the basis that a greater distance, will result in higher transportation costs (Clark, Dollar & Micco, 2004; Combes & Lafourcade, 2005; Hummels, 2001; Leamer, 1974), more difficulties monitoring markets and the firm's activities abroad (Grant, 1987), and barriers to interactions (Bell & Kozlowski, 2002; Hinds & Bailey, 2003), ultimately inhibiting the decision to enter a geographically distant target country. For instance, Hummels (2001) quantified transport costs by estimating that every additional day of ocean transit reduces the probability of trade between two countries by 1.5% for manufactured goods.

*Institutional distance* refers to the extent to which the institutional profiles of two countries differ (Ferner, Almond, & Colling, 2005). It has been shown to influence bilateral business relationships (Eden & Miller, 2004; Puthusserry et al., 2014; Verwaal & Donkers, 2003), performance (Chao & Kumar, 2010), and entry mode decisions (Meyer, Estrin, Bhaumik, & Peng, 2009). Institutional distance may also include aspects of *administrative distance* (Ghemawat, 2001) i.e. the extent to which local governments raise barriers to foreign competition (ibid), the legal framework and its enforcement, property rights, information systems, and regulatory regimes. These aspects also affect decisions on the mode of entry (Meyer et al., 2009), as they impact on the attractiveness of a given location. Kaufmann, Kraay, and Mastruzzi (2009) offer a set of "objective" indicators to measure institutional distance according to six different dimensions of governance: control of corruption; rule of law; voice and accountability; government effectiveness; political stability; and regulatory quality.

*Cultural distance* refers to differences in the "system of collectively held values" (Hofstede, 1980, p. 9), as well as communication styles, and stereotypes (Ojala, 2015). The four cultural attributes proposed by Hofstede (1980) are used extensively in the literature. Cultural distance is also often understood at the country level of analysis (see Ghemawat, 2001 and Hofstede, 1980, for example) and discussion focuses mainly on how country-specific cultural traits affect the ability of the business to penetrate a culturally diverse context (Yamin & Sinkovics 2006; Zaheer, 1995). Culture is often measured using the Kogut and Singh (1988) index. According to Ellis (2008), although it is acknowledged that the Kogut & Singh index has some flaws (Dow & Karunaratna 2006; Shenkar, 2001), it is still widely used by many studies on cultural distance (Dow, 2000; Sousa & Bradley, 2006).

Overall, studies have reported mixed results in relation to the effects of cultural distance. Some found that the cultural environment of a target country was the least important factor affecting a firm's decision-making (e.g. Robertson & Wood, 2001), while others concluded that it was the most important one (e.g. Edwards & Buckley, 1998). As far as geographic distance is concerned, the findings of Ellis (2007) on the perceived effects of geography are mixed. Neither it is clear whether, and to what extent firm-specific characteristics (Ojala, 2015) can influence geographic distance.

These controversial findings are attributable – among other factors – to the fact that distance can be asymmetric and relative (Beugelsdijk & Mudambi, 2013). For example, the objective measures of

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