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Does distance matter for internationally-oriented small firms?

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ABSTRACT

This paper assesses the contemporary relevance of distance and its key components in international business for young, internationally-oriented small firms. In doing so, it reconceptualizes the distance concept and investigates its relevance in American, British, and German firms' early foreign market selection. Economic, geographic, and cultural distance (based on Hofstede's and Schwartz's frameworks) for the three countries, along with psychic distance for the German firms, are considered. The results show that some components of distance still matter for internationally-oriented small firms and that cultural distance is sample source and concept sensitive. In addition, psychic distance acts as a mediator construct to the more objective, external distance measures of economic, geographic, and cultural distance, confirming the proposed distance framework.

1. Introduction

Distance and its intrinsic notion of a location-sensitivity in business transactions is one of the key theoretical underpinnings of the international business literature. Explicitly introduced by Beckermann (1956), further conceptualized by Linder (1961), and then popularized by the psychic distance concept (Hallén & Wiedersheim-Paul, 1979; Johanson & Vahlne, 1977; Vahlne & Wiedersheim-Paul, 1973), distance in international business remains an integral part of empirical studies and theoretical discussions (e.g., Dow & Karunaratna, 2006; Evans, Treadgold, & Mavondo, 2000; Fletcher & Bohn, 1998; Johanson & Vahlne, 2003; Ojala & Tyrväinen, 2007; Shenkar, 2001; Sousa & Bradley, 2006; Stöttinger & Schlegelmilch, 2000).

However, developments in transportation technology and information and communication technology, as well as various political, economic and social factors, have led to an increasingly integrated, less distant world. This ongoing process, often referred to as globalization, has facilitated the emergence of small international entrepreneurial firms and has led some authors to question the relevance of the distance concept in international business. Hamill (1997) argued, for example, that due to the emergence of the location-insensitive Internet the traditional distance sensitive internationalization process no longer makes sense. Cairncross (1997) went even further than that and simply proclaimed the overall death of distance. In addition, as reported below, empirical findings regarding the importance of distance and its various elements are mixed.

This increasing gap between the theoretical importance attributed to the distance concept on the one hand and decreasing importance of distance in a globalizing world on the other hand gives rise to an interesting research question: Does distance still matter for internationally-oriented small firms in today's globalized world? And if so, which components of distance matter and which do not?

This paper addresses these research questions by assessing the role of distance in the contemporary internationalization dynamics of firms' early foreign market selection. The paper begins with a review and discussion of relevant international entrepreneurship and distance literature including empirical evidence, leading to a proposed framework of the distance concept. Next, a description of the study's research methods are provided, subsequently leading to the delineation and discussion of its empirical results. This is followed by an articulation of the study's key findings along with a discussion of their implications for theory and practice, as well as the recognition of important research limitations that should be taken into consideration.

2. Synthesis of the literature

The concept of distance in international business and its importance in the internationalization process of firms has been researched and debated for many years. Beckermann (1956) was one of the first to explicitly relate this intrinsic notion of location-sensitivity in international business transactions through assessing its role empirically. Ever since, various aspects of distance – usually

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conceptualized as differences between the host and home countries of interest – have been conceptualized and assessed, such as: spatial or geographic distance, economic distance, technological distance, language dissimilarities, cultural and religious distance, time zones differences, colonial links, distribution channel differences, industry structure differences, and psychic distance (e.g., Dow & Karunaratna, 2006; Ganesan, Malter, & Rindfleisch, 2005; Ghemawat, 2001; Hallén & Wiedersheim-Paul, 1979; Linder, 1961; Luostarinen, 1980; O'Grady & Lane, 1996; Posner, 1961; Ronen & Shenkar, 1985; Vahlne & Wiedersheim-Paul, 1973; Vernon, 1966). Of this long list, spatial, economic, cultural, and psychic distance are the most commonly measured distance determinants.

The findings regarding their respective influence in firms' internationalization processes are mixed. While spatial distance matters in some studies (e.g., Chetty, 1999; Dow, 2000; Dow & Karunaratna, 2006; Ghemawat, 2001; Luostarinen, 1980), the “born global literature” in particular finds it to be of little to no relevance (e.g., Bell, McNaughton, & Young, 2001; Knight & Cavusgil, 1996; Rennie, 1993). Mixed findings are also noted with cultural and psychic distance, with some studies finding its role to be substantial (e.g., Chetty, 1999; Chetty & Campbell-Hunt, 2004; Evans & Mavondo, 2002; Fletcher & Bohn, 1998; Kogut & Singh, 1988; Luostarinen, 1980; Mutinelli & Piscitello, 1998), while in others finding it to be of little or no relevance (e.g., Benito & Gripstud, 1992; Czinkota & Ursic, 1987; Dow & Karunaratna, 2006; Granstrand, 1999). One study even found that psychic closeness might increase distance (O'Grady & Lane, 1996), while Ellis (2008) found that psychic distance moderates the relationship between foreign market size and entry sequence. Our review only identified economic distance to be unequivocally influential (e.g., Dow & Karunaratna, 2006; Ghemawat, 2001; Luostarinen, 1980).

Luostarinen (1979) conceptualized business distance as geographic, economic and cultural distance (the latter being measured by differences in the levels of economic development and education, as well as language and difficulties in understanding messages) and found that it helped explain the foreign market decision-making behavior of the Finnish firms in his study. More recently, Ojala and Tyrväinen (2007) conducted a similarly structured study to the one presented in this paper. They examined the impact of cultural distance, geographic distance and market size on the foreign market selection process of Finnish software SMEs, finding that geographic distance and software market size explained up to 70% of country selection in their target population.

In addition to the mixed empirical findings, some authors have questioned the relevance of the classical distance concept in the modern, Internet-enabled international business world (e.g., Bennett, 1997; Cairncross, 1997; Hamill, 1997; Zaheer & Manrakhan, 2001). If the Internet essentially superimposes a location-independent marketplace on the location-dependent physical markets, why should distance matter for many firms' internationalization since the inception of the Internet's World Wide Web in the mid-1990s?

With regard to the mixed findings, we believe that they are mainly due to three factors: contextual differences, level of analysis incongruence and country assessment range restrictions. Contextual differences in existing empirical work can lead to inconsistent findings. Industry factors coupled with the potential for a virtual marketspace, as well as varying motives for internationalization, can impact foreign market selection and hence findings related to distance.

Level of analysis incongruence refers to mixing country-level distance and individual-level distance constructs. The application of aggregate national distance indicators to market entry decisions made by individual firms leads to inconsistent findings. For example, the common use of national cultural distance aggregates as a proxy for psychic distance (Sousa & Bradley, 2006), which operates at the level of the firm's decision-maker(s), is a source of error (cf. Brewer, 2007; Evans & Mavondo, 2002; Evans et al., 2000; Nordström, 1991; O'Farrell, Moffat, & Wood, 1995; Petersen & Pedersen, 1997; Sousa & Bradley, 2006). The few studies that view psychic distance as distinct from cultural distance and operationalize it at the cognitive level of the decision-maker(s), consistently find it to be of key relevance (e.g., Andersen & Strandskov, 1998; Dow, 2000; Holzmüller & Kasper, 1990; Nordström, 1991). However, how this level of distance relates to the aggregate distance indicators of spatial, economic, and cultural distance is unclear.

Country assessment range restrictions relate to the limited country coverage of the cultural distance indicators and the impact on the other distance indicators via the common application of the listwise deletion procedure during statistical analysis. In most cases, the Hofstede framework (Hofstede, 1980) is used to operationalize cultural distance (Kirkmann, Lowe, & Gibson, 2006; Sivakumar & Nakata, 2001), usually applying the Kogut and Singh distance formula (Kogut & Singh, 1988). The Hofstede framework provides distance indicators for 50 countries, based on data collected in the 1960s and 1970s. Countries not covered cannot be assessed with the framework. When applying the listwise deletion procedure, other distance indicators of interest are also taken out of the analysis, resulting in potentially misleading findings. Only the empirical comparison of culture frameworks covering different countries can shed light on this potential source of error.

With regard to internationalization in the Internet era, some evidence exists that this global communication and information infrastructure does indeed impact the internationalization process of firms by influencing the foreign market selection process (e.g., Brock, Ibeh, & Zhou, 2005; Kotha, Rindova, & Rothaermel, 2001; Zaheer & Manrakhan, 2001). Still, recent evidence suggests that distance is not rendered obsolete per se. The distance perception at the level of decision-makers is altered but continues to exist (Berry & Brock, 2004; Lim, Leung, Sia, & Lee, 2004).

3. Toward a new distance framework

From the discussion above it is evident that distance can be viewed from two different levels, independent of Internet effects. One level focuses on distance at an external, aggregate, objective level between countries. The other focuses on the internal, individual and subjective level of managers involved in internationalization decisions. The two levels are not necessarily congruent (for empirical evidence see Holzmüller & Kasper, 1990). A tenable argument could be made that the levels do not operate in parallel, but in sequence. External distance such as spatial or economic distance influences internal distance perceptions, which depending on the decision-makers' individual experiences with or expectations for a given host country market leads to a subjective perceived distance assessment, psychic distance. In other words, psychic distance operates as a mediator between external distance and the selected foreign market.

Based on this logic we propose a distance framework (see Fig. 1) encapsulating both external and internal dimensions of distance. External distance involves the rather objective assessment of spatial, economic, and cultural distance, while internal distance encompasses the subjective individual assessment of psychic distance by the decision-maker in the firm, both of which are influenced by legal, political, economic, technological, and social globalization forces. In addition, the ensuing international business behavior of the firm stems from its distance perception along with its perspective regarding the likely costs, risks, and benefits associated with the activity. The outcome of this behavior (e.g., an increase or decrease in profitability) then feeds back into this process, both at the aggregate and firm levels. Over time this ongoing process can lead to shifts, increases or decreases, in both distance dimensions, adding to the influencing general globalization forces. Converging economies and industries (Makhija, Kim, & Williamson, 1997; Schulze & Ursprung,