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Entry in a Psychically Distant Market: Finnish Small and Medium-sized Software Firms in Japan

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Abstract

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.

Keywords: Psychic distance; Market entry; Entry mode choice; Uppsala model; Finland; Japan; SMEs

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 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 (Karppinen, 2006; Karppinen-Takada, 1994; Luostarinen, 1979; Peltokorpi, 2007; Ronen and Shenkar, 1985). For instance, the studies of Karppinen (2006) and Karppinen-Takada (1994) highlight the fact that the complexity of the Japanese language hinders Finnish expatriate access to relevant information in Japan. In addition, a recent study of Peltokorpi (2007) stresses the finding that differences in communication, language, and culture create barriers in interaction between Nordic expatriates and local employees in Japan. In their synthesis of country clustering, Ronen and Shenkar (1985) categorize Finland as belonging to the Nordic cluster whereas Japan is clustered with the "independent" group, which means that Japan is culturally different from other countries. Hence, in line with the Uppsala model, Finnish firms are assumed to operate first in the other Nordic countries by using indirect entry modes, and then start gradually developing direct investments to the Nordic countries and export activities to more distant markets. Thus, in the model, Japan is seen as the target country for Finnish firms in a very late phase of their internationalization process.

Psychic Distance in the Market Entry of Knowledge-intensive SMEs

Because the Uppsala model development is based on internationalization of large Swedish multinationals, several studies (Arenius, 2005; Bell, 1995; Crick and Spence, 2005; Coviello and Munro, 1997; Lindqvist, 1988; Moen et al., 2004) have tested its appropriateness to explain internationalization behavior of knowledge-intensive SMEs. These studies have found evidence that knowledge-intensive SMEs commonly enter first to geographically close countries, which gives some support to the concept of psychic distance in the Uppsala model. However, these studies have found some additional factors which explain internationalization of high-technology SMEs better than psychic distance between countries.

In his study, Bell (1995) investigated the internationalization of small software firms in Finland, Ireland, and Norway by validating the applicability of incremental internationalization models as regards the internationalization behavior of software firms. Findings in his study suggest that small software firms internationalize their operations first to countries with a low psychic distance, but that there are other factors with more explanatory power than the concept of psychic distance. For instance, Bell (1995) found that the firms' internationalization behavior is more related to customers' followership, niche markets, and industry-specific characteristics than to psychic distance between countries. This is also somewhat in line with the findings of Lindqvist (1988) emphasizing that the market entry of small technology firms is connected to small domestic markets and cooperation requirements with advanced customers in a target country. The study of Arenius (2005) also suggests that psychic distance has become less important for knowledge-intensive firms, because these are able to gain direct experiential knowledge from foreign markets. However, the findings of Arenius (2005) emphasize that greater psychic distance between countries slows down the internationalization process of knowledge-intensive firms, because these firms have difficulties in accessing relevant information.

The study of Coviello and Munro (1997) related to New Zealand-based small software firms imply that entry mode and market choice depend on firms' formal and informal network relationships rather than the psychic distance between home and host country. The firms' network relationships first give access to countries with a low psychic distance and, in time, these relationships enable market entry to countries with a greater psychic distance. This is generally in line with the Uppsala model, with the exception that the internationalization process of small software firms was found to be very rapid, included fewer stages, and the firms involved used a number of alternative entry modes simultaneously. In their study, Moen et al. (2004) found further support to the study of Coviello and Munro (1997) proposing that initial market selections were related to the psychic distance whereas in later choices the psychic distance was less visible. However, their findings suggest that firms prefer countries where English is commonly spoken, because it facilitates communication and networking. This finding gives some support to the concept of psychic distance.

Summarizing, earlier empirical studies (Arenius, 2005; Bell, 1995; Crick and Spence, 2005; Coviello and Munro, 1997; Lindqvist, 1988; Moen et al., 2004) have challenged the capability of the Uppsala model to explain internationalization behavior of knowledge-intensive SMEs and suggested other factors that may explain market and entry mode choice of these firms better than the psychic distance between countries. However, these studies have investigated firms' internationalization to several markets instead of focusing on any specific country. If firms enter first nearby or psychically close countries, as earlier studies suggest (Arenius, 2005; Bell, 1995;

Crick and Spence, 2005; Coviello and Munro, 1997; Moen et al., 2004), this does not give a reliable viewpoint to analyze the impact of psychic distance due to the fact that these countries commonly share similar cultural values, language, business practices, etc. Another weakness of the above mentioned studies is that they do not give an adequate description about how firms move from one entry mode to another in a particular country through various stages as described in the Uppsala model.

Research Method

A multiple case-study method was selected for this study due to the explanatory nature of the research questions. Eisenhardt (1989) suggests that multiple case-study enables studying patterns that are common to the cases and theory under investigation. In addition, the case-study method also makes it possible to explain the significance and cause-and-effect relationships of the examined phenomena (Yin, 1994).

The case firms were selected for this study for theoretical reasons as advised in the study of Eisenhardt (1989) instead of reasons related to random sampling. The selected firms complied with the following criteria: a) they have their headquarters in Finland, b) they have direct business operations in the Japanese market, c) they do business in the field of software, and d) they have a maximum of 500 employees worldwide. Software industry was selected as the target group for this study, because software firms are commonly used as a target group to analyze internationalization of knowledge-intensive SMEs (see e.g., Bell, 1995; Coviello and Munro, 1997; Moen et al., 2004; Ojala and Tyrväinen, 2007). The internationalization process of the case firms in this study was limited only to direct business operations in the target countries (excluding Japan) due to the fact that software products are easily delivered through Internet or firms' file transfer protocol (FTP) server, making traditional exporting activities less important than was the case previously. Although the case firms selected for this study covered firms up to 500 employees at the time of the interviews, all the firms had fever than 250 employees at the time of the market entry to the Japanese market. Thus, the case firms fit well to the Finnish government's and European Union's definition for SMEs (OECD, 2003).

In this study, Finland was chosen as the country of origin due to its small and open economy with a very limited domestic market. Due to its small domestic market, internationalization is generally a common growth strategy for Finnish software firms. Japan was chosen as the target country for the following reasons: firstly, due to language and cultural differences between Finland and Japan, Japan can be characterized as being a psychically distant country from Finland (Karppinen, 2006; Luostarinen, 1979; Ronen and Shenkar, 1985) Secondly, as recognized in several studies (see e.g., Czinkota and Kotabe, 2000), Japan is a very challenging country to enter and conduct successful business with. Thirdly, Japan has the second largest market for software products (EITO, 2006). Thus, it is a very attractive country for foreign software firms. Finally, choosing Finnish software firms in Japan enabled addressing the target group, to a large extent, by using a qualitative case-study method.

Suitable firms for this study were identified from the websites of the Finnish Chamber of Commerce in Japan and Finnish Software Business Clusters, as well as from a list of firms in the publication "Software Product Business Cluster in Finland 2005". By using these sources a total of nine suitable firms were identified. These firms were contacted with an e-mail request to attend the research. Eight of the nine firms answered and were willing to share their knowledge and their experience of the Japanese market.

Altogether 16 semi-structured open-ended interviews were conducted with managers in each firm's headquarters in Finland and their units in Japan. All the executives (with titles: CTO, Director, Executive Vice President, President, Managing Director, and Sales Administrator) who were interviewed had an in-depth knowledge of their firms' international operations and the entry to the Japanese market. The 60-90 minute long interviews were digitally recorded, carefully listened to, and transcribed verbatim with the help of a word processor. A second listening was arranged to ensure correspondence between the recorded and transcribed data. Complete case reports were sent back to the persons interviewed to ensure the validity and authenticity of the collected data. Whenever the interviewees in the case firms found inaccuracies in the text, these were corrected based on their comments. In addition, some telephone and email interviews were used to collect further information from the interviewees. The collected data was also compared with other sources, such as websites and annual reports of the case firms.

In the data analysis, the guidelines suggested by Eisenhardt (1989) and Yin (1994) were followed. All eight individual cases were written out as stand-alone case histories. After that, the unique patterns of each case were identified and similar patterns were categorized under common themes. This helped to organize and summarize the collected data. In addition, analytical tools were applied within and across the cases as proposed by Miles and Huberman (1994). For instance, checklists and event listings were used to identify critical events related to market entry process of each case firm.

Research Findings

All the case firms had been established between 1990 and 2000, except Firm C that had been established already in 1966. The number of overall employees varied from 12 to 300, the average being 127 employees. The firms had operated in the Japanese market from three to seven years at the time of the interviews. Table 1 summarizes the key information of these firms and demonstrates the case firms' target customers in Japan and the main reasons for the market entry.

Table 1 Key information on the case firms

	Number of employees	Year of establishment	Target customers in Japan	Main reason for the market entry
Firm A	30	1998	Mobile phone manufacturers, telecom operators, and companies in electronics industry	Size of the target industry in Japan
Firm B	90	1992	Mobile phone and semiconductor manufacturers	Important customer located in Japan
Firm C	300	1966	Building and construction companies	Size of the target industry in Japan
Firm D	240	1990	Banks, financial institutions, and Internet operators	Size of the target industry in Japan
Firm E	100	1995	Banks and financial institutions	Size of the target industry in Japan
Firm F	210	1991	Telecom operators and R&D companies related to mobile networks	Size of the target industry in Japan
Firm G	12	1998	Mobile game players	Sophisticated target industry
Firm H	35	2000	Video game players in broadband networks	Sophisticated target industry

Firm A became established as a spin-off from a large Finnish software corporation. They produced virtual designing and modeling tools for mobile phone manufacturers, telecom operators, and electronics industry. The large size of these industries in Japan made the market very important for Firm A. Firm B developed software components for handheld devices such as mobile phones. The market entry of Firm B was thought necessary, because they got an important customer from Japan. The negotiations with the customer and product specifications required so much time and traveling between Finland and Japan that Firm B decided to establish their own unit in the market. Other reasons for the market entry were attractive markets in Japan that might generate more sales later on to other mobile phone and semiconductor manufacturers. Firm C produced software for construction, energy distribution, and the public sector. Their business in Japan focused on modeling software for steel and concrete construction industries, which are large industries in Japan and offer good opportunities for selling products to the local construction firms. Firms D and E produced enterprise level security software solutions mainly for banks, financial institutions, and network operators. The Japanese market offered a large customer base for these highly specialized data security solutions. Firm F developed analyzers for telecom networks. In Japan, their main customers were telecom operators and research and development units which developed mobile networks. Firm G sold mobile phone games to consumers through telecom operators which distributed games to end users. Value added services in mobile networks in Japan were well developed and consumers were used to use these services. The reason for the market entry was based on the idea that sophisticated Japanese telecom markets might teach them something that would be useful later on in other markets. Firm H developed gaming-on-demand solutions and content for broadband networks. Use of their products requires highly developed broadband networks, and in this respect Japan offered the most sophisticated markets for their products.

Market Entry and Entry Mode Choice of the Case Firms

As can be observed from Figure 1, almost all the firms started their foreign direct business operations in countries with large markets for their products and only two in a country with a low psychic distance (Firms C and F). Four of the firms launched their foreign direct business operations by entering into the USA market, one selected the UK as the first target country, and one firm entered straight into the Japanese market. Firms C and F started their foreign direct operations by entering Sweden, which represents a psychically close market to Finland. However, pretty soon after entering the Swedish market, they started direct business operations in more distant markets such as Hong Kong and Malaysia. Firm C was the only firm that had direct business operations in more than two countries before entering the Japanese market. Four of the firms (B, D, E, and H) selected Japan as the second target country and Firm G launched their foreign operations first in Japan.

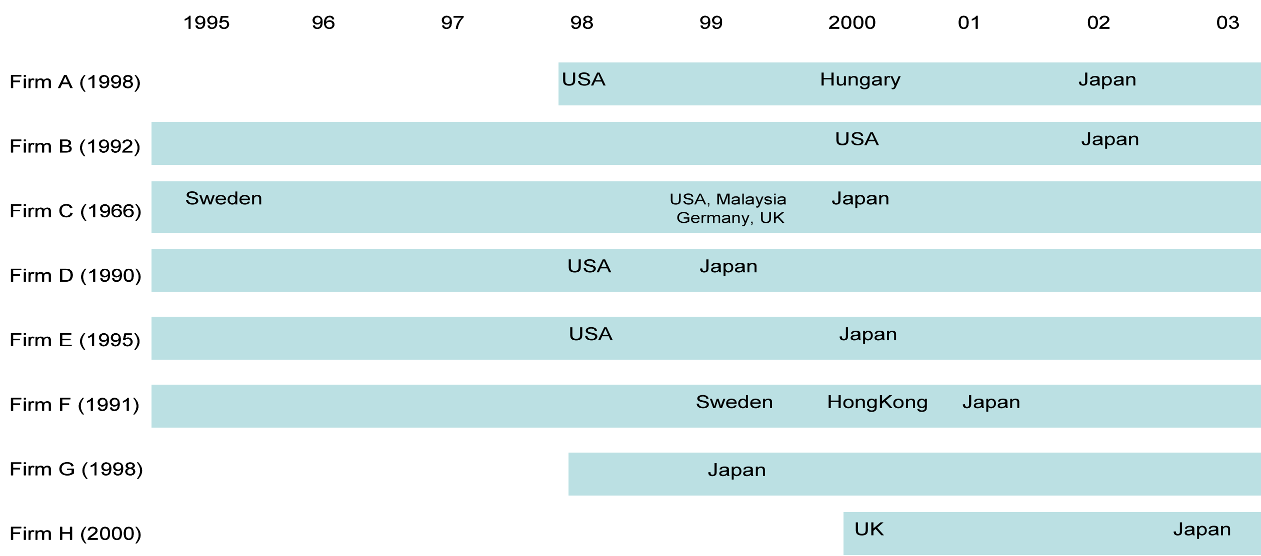

Figure 1 Direct business operations of the case firms until their market entry to Japan

Figure 2 demonstrates the evolution of these case firms entry modes in the Japanese market dividing them into indirect and direct entry modes according to stages 1-2 and 3-4 in the Uppsala model (Johanson and Wiedersheim-Paul, 1975). The arrows in the figure show the entry chain of the firms by starting from the year of the firms' establishment to the current operation mode in the market. Each crossed box demonstrates an earlier entry mode used with the year of the establishment of certain mode.

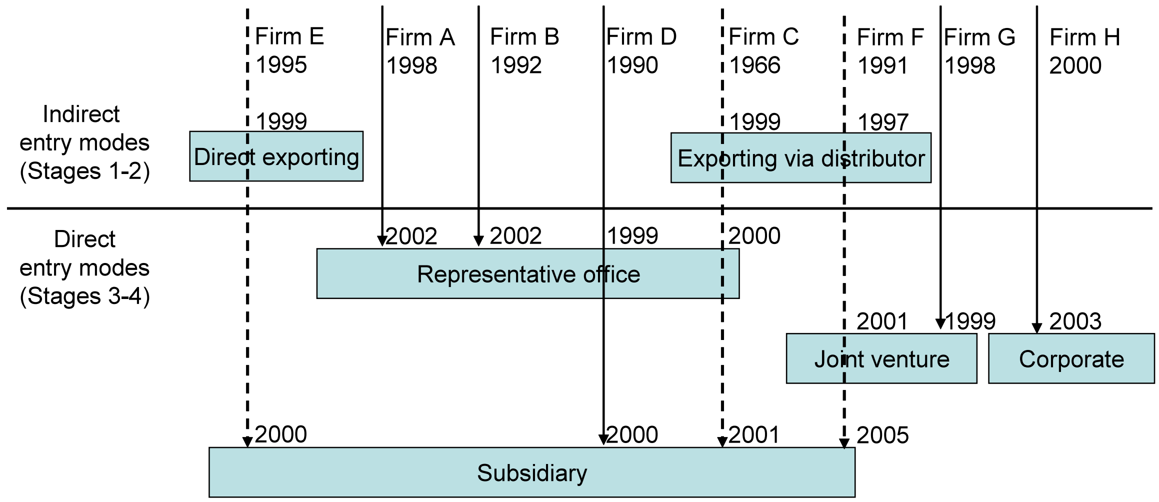

Figure 2 Case firm's entry modes in the Japanese market

Firms E, C, and F followed the Uppsala model entering the market by indirect entry modes (dotted arrows in Figure 2) without each establishing their own unit directly for the market. Firm E entered into the Japanese market in 1999 by using direct exporting from Finland to Japanese customers. However, after half of year they decided to establish a subsidiary. The subsidiary was needed for keeping regular contacts with the distributor and for technical support. Another reason for establishing the subsidiary was the requirement to hire an employee able to speak Japanese. One informant at Firm E explained this in the following manner:

> ”There were many potential customers in Japan, but the market was very difficult to handle without knowledge of the Japanese language. Those negotiations where I was involved were really difficult, because Japanese customers spoke only Japanese and we always needed an interpreter”.

Firm C started exporting to Japan via two Japanese distributors in 1999. However, quite soon the other of the distributors closed its business and Firm C found itself in a situation where they needed to find a new distributor or establish a unit for the Japanese market. They thought that handling the Japanese market with the help of a single distributor was too risky. In 2000 they established a representative office, and in 2001 changed it to a subsidiary mode. This enabled better marketing and after-sales support for their customers.

The market entry of the Firm F took place in 1997 when they started exporting via a Japanese distributor. That time they had only few customers in Japan due to the mobile network structure in Japan that was different from those elsewhere, and they were able to handle the market through the distributor. However, when Japanese launched the third generation (3G) mobile network, Firm F established a joint venture (in 2001) for the Japanese market, which now offered large market potential for 3G network analyzers. A joint venture with Japanese partners provides better opportunities to network with customers and to give better after-sales support. However, Firm F changed their operation mode to sales subsidiary in 2005 to achieve a better control of the market.

Five of the firms (A, B, D, G, and H) entered the market through direct entry modes which diverge from the Uppsala model. Firm A had a representative in Japan from 2002 onwards. Their initial thought was handling the market through a distribution channel, but due to the complex nature of the products using a sole distributor proved impractical. Their representative in Japan worked within the distribution channel in technical sales support. Firm B established a representative office in Japan in 2002 for two reasons. Firstly, a representative in the market enabled close cooperation with customers in both pre and after sales phases. One informant at Firm B commented on this in the following way:

> "Keeping regular contacts with our customer is much more difficult if we have to do it from here [Finland], it is the same with visits to potential customers [in

> Japan]. Regular appointments are required for these types of products… Anyway, physical presence is a must in our business".

They also contemplated the possibility of handling the market with the help of a distributor. However, product sales would have required such deep technical knowledge that it was thought going beyond the ability of a mere distributor. Secondly, a representative office enabled a cost-effective market entry and, compared to a subsidiary, required less bureaucracy in the establishment phase.

Firm D's market entry in Japan took place in 1999 when they established a representative office. The purpose of the representative office was to provide support to their distributor who started to sell their products in Japan at the same year. The representative office also created opportunities to find and recruit local employees for their subsidiary that was established one year later (in 2000). The subsidiary enabled better support services to local distributors who handled the sales of their products.

Firm G entered the Japanese market only one year after the start-up. They established a joint venture with their Japanese partners in 1999. Earlier, in their former jobs, the firm's employees had created personal relationships with their Japanese partners who were now interested in launching mobile games to the Japanese market. Helped by their local partners, the firm was able to get access to Japanese telecom operators. Their unit in Japan gave maintenance support for telecom operators, which delivered Firm G's mobile games to end users.

Firm H got access into the Japanese market by incorporating with a large Japanese corporation. They noticed that a successful market entry into the Japanese market required a great deal of financial resources and local knowledge. They decided to sell their shareholding to this Japanese corporation and incorporate with them in 2003. The firm still had headquarters in Finland operating as an independent unit of the corporation. This strategy facilitated a successful market entry, and one unit of the Japanese corporation started to sell and market their products in Japan and in other East and Southeast Asian markets.

Ways to Overcome Psychic Distance in the Japanese Market

According to the Uppsala model, experience of foreign markets and operations there lower the uncertainty to invest into more psychically distant markets (Johanson and Vahlne, 1977). However, all the firms expect Firm C, entered the Japanese market at a notably early phase in their life-cycle. Four of the firms (A, E, G, and H) entered into Japan within five years, and three of the firms (B, D, and F) within ten years after their establishment. In addition, the case firms' international experience before establishing direct entry modes in Japan were relative exiguous (from one year to five years). Furthermore, the case firms started to use entry modes which require high commitment (such as wholly owned subsidiary, joint venture, representative office) in the market quite soon after the establishment. However, all the case firms which had international experience in terms of direct business operations reported that those experiences helped them when they started their operations in Japan. The experience gained facilitated mainly in operational level activities such as cost estimations, choice of entry mode, and location choice in the target country, i.e. in issues to be dealt with in the market entry process. This knowledge was reported to be mainly in the headquarters and not facilitated in practical issues in Japan, which required more market-specific (tacit) knowledge related business environment. One informant at Firm E expressed this as follows:

> "In the headquarters, they knew how to evaluate cost and time [of establishment] to make everything work and what steps are required…but so far, the experience is still always personalized…the person who established our subsidiary in the USA, he knew how to do it, but he was not at all involved [in the establishment process of the subsidiary in Japan], he was managing our subsidiary in the USA…some parts of this process were known in the headquarters, but the knowledge about what we needed on the spot [Japan] was missing".

All the case firms, except Firm A, acquired local knowledge either by recruiting local employees for their unit in Japan and/or for the headquarters, or by partnering with a Japanese firm (Firms G and H). This facilitated fast market entry and commitment to the market. Because knowledge of both business practices and technology were critical for the case firms, most of their employees in Japan were recruited from competitors or customers. These employees already knew the products and players in the market. This decreased their training needs and enabled the use of their already existing business connections. In addition, Firms C, D, E, and F recruited a western manager with a long working experience in the Japanese market for their subsidiaries in Japan.

Discussion of the Research Results

The findings in this study show that six of the eight firms started their foreign direct operations by entering into a country that provides large markets for their niche products, namely the USA, Japan, and the UK. Furthermore, the firms started developing their foreign direct business operations relatively early on by establishing foreign units to the main market areas for their products. These findings support the conceptual model of Bell et al. (2003) and empirical findings of Ojala and Tyrväinen (2007) suggesting that high-technology intensive firms start to internationalize their operations to leading markets very early on in their internationalization process. This is also in line with Bell (1995) and Lindqvist (1988) in that due to niche product offering, firms in high-technology sectors are forced to internationalize into markets where their target customers are located. However, these findings give very little support to the internationalization process described in the Uppsala model (Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975). Due to the market size and sophisticated industry structure for the case firms' niche products, they entered Japan at an early stage of their internationalization; one of the firms even selected Japan as the location for their first direct operation abroad.

In their entry mode choice, only three firms out of eight followed the traditional stepwise entry route in the Japanese market by starting their operations using indirect entry modes. However, these firms established their own units in the market quite soon after starting these indirect operations. Other five firms started their operations using direct entry modes. Thus, the findings in this study do not fully support the entry route suggested in the Uppsala model (Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975), where a firm first acquires knowledge about the market by using indirect entry modes and then gradually starts to favour direct entry modes. The findings in this study indicate that the choice of the entry mode was based on the complexity of the firms' products, which required intensive cooperation with the customers in the sales process, implementation phase, and also made it possible to offer after-sales services near the customers. It may be also noted, that none of the firms moved their product development to Japan (as suggested in the Uppsala model's stage 4), although some of the firms had localization and customization activities in Japan.

Earlier international experiences helped the firms' market entry and entry mode selection in operational level activities, but not in practical issues that were needed in the Japanese market. This finding is in line with Johanson and Vahlne (2003) which indicate that, to a certain extent, a firm can resort to their experiences and knowledge from earlier foreign operations when entering into a new country. This also supports the concept of knowledge in the Uppsala model suggesting that general knowledge about markets is mainly objective and transferable from one country to another, whereas market-specific knowledge is tacit and based on experiences of individuals (Johanson and Vahlne, 1977, 2003). This tacitness makes it difficult to transfer market-specific knowledge between different countries as highlighted in the study of Lord and Ranft (2000).

Although all the case firms entered the Japanese market quite early on in their internationalization process and with limited international knowledge, they were able to overcome the psychic distance between Finland and Japan. For instance, almost all the case firms hired local employees to handle sales processes in Japan, where the Japanese language is an important skill. In addition, each firm with a subsidiary in the market recruited a western manager with a long working experience in the Japanese market to overcome the cultural differences there. These managers had experiential (tacit) knowledge about business practices in the Japanese market, which helped them to develop their firm's operations in the market and act as "cultural mediators" between the western culture and the Japanese culture. This is somewhat consistent with the findings of Karppinen-Takada (1994) and Karppinen (2006). This finding suggest also that the perception of cultural differences by the managers seems to be more important that the actual variation in cultures. In addition, this observation gives further support to the studies of Brewer (2007) and Sousa and Bradley (2006) emphasizing that psychic distance is based on a manager's experiences and feelings about how distant a country is rather than on cultural differences between countries.

Managerial Implications

From a practical perspective, findings in this study have several important managerial implications. Firstly, because managers conceptualize psychic distance between countries personally, depending on their earlier experiences, feelings, and awareness, a firm should perhaps recruit managers who are familiar with the target country, for their foreign operations. Familiarity with the environment of the target country helps a manager implement right marketing practices and build networks with customers and other important actors in the market. As another option, firms can establish joint operations with local firms in the target country and use their partners' market knowledge. Secondly, marketing of knowledge-intensive products requires understanding of both complex products and specific needs of the local customers. Thus, firms should recruit employees who have both of these capabilities. Managers should try to recruit these kinds of employees from customers or competitors, because they are usually familiar with the firm's products and/or customers needs in the target country, and can use the already existing relationships in the market. Thirdly, managers can also increase their awareness of the target country through culture and language training, participating international exhibitions, trade fairs, etc. (see e.g., Sousa and Bradley, 2006). However, knowledge-intensive SMEs are commonly forced to enter global markets soon after their establishment (due to increasing competition, niche markets etc.); thus, they do not have a time for this kind of training in the same scale as multinational corporations (c.f., Dowling and Welch, 2004). Finally, because the psychic distance towards a certain country is not equal between firms, managers can actively increase their awareness related to a target country and, hence, lower the psychic distance. Altogether, by implementing these above mentioned practices a firm can gain competitive advantages against competitors in foreign markets.

Summary and Conclusions

This paper investigated market entry in a psychically distant country by analyzing market entry and entry mode choice of eight small and medium-sized Finnish software firms in the Japanese market. In addition, this study analyzed how the case firms were able to overcome psychic distance between Finland and Japan.

The first contribution of this study is that it validates and extends earlier findings related to psychic distance and internationalization of knowledge-intensive SMEs. In line with these earlier studies (Arenius, 2005; Bell, 1995; Crick and Spence, 2005; Coviello and Munro, 1997; Lindqvist, 1988; Moen et al., 2004), the findings here suggest that knowledge-intensive SMEs select their target country for other reasons than those related to psychic distance. In this study, firms entered the Japanese market due to the market size and sophisticated industry structure. They also favored direct entry modes because of complex products, which required intensive liaison with the customers through the sales process. As distinct from earlier studies, this study validated these findings by using two countries having between them a wide psychic distance and many differences in language, cultural values, and business environment (Karppinen, 2006;

Karppinen-Takada, 1994; Luostarinen, 1979; Peltokorpi, 2007; Ronen and Shenkar, 1985). In addition, this study analyzed how the firms' entry modes evolve in the target country according to the Uppsala model that has been largely ignored in previous studies.

Another important contribution of this study is that it analyzes how the case firms have been able to overcome psychic distance between Finland and Japan. This is accomplished mainly at the individual level by hiring local employees for sales activities and managers with knowledge of both the home and the host country. This is very important for managers of knowledge-intensive SMEs who are planning to extend their business to countries with a greater psychic distance to them. This also answers to Sousa's and Bradley's (2006) call for more research on psychic distance as an individual level. When psychic distance is analyzed as an individual level, it helps managers to implement right practices to reduce psychic distance between the home and the target countries.

Altogether, although the concept of psychic distance in the Uppsala model seems to be valid, knowledge-intensive SMEs are forced to find ways to conduct business also in countries with a greater psychic distance to them. For this reason, their market entries and entry mode choices do not follow incremental routes or stages as suggested in traditional internationalization theories. This could be interpreted as a sign of the traditional internationalization theories being non-valid or outdated to explain market and entry mode choices in the present global business environment.

Limitations and Further Research

This study is not without its limitations. Firstly, it focuses on firms' market selection only by analyzing direct business operations (excluding the Japanese market, where all entry modes used are analyzed), thus its findings are not fully comparable to earlier studies related to internationalization of small and medium-sized software firms (Bell, 1995; Coviello and Munro, 1997; Moen et al., 2004). Secondly, the concept of psychic distance is multidimensional, and there are several alternative definitions for it. This study used the definition of psychic distance based mainly on the Uppsala model (Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975). However, further study is needed to investigate the psychic distance concept more deeply, especially on an individual level, because this seems to help firms overcome differences between home and target country. Thirdly, although network relationships had a less obvious role in this study compared to earlier findings (Bell, 1995; Coviello and Munro, 1997; Moen et al., 2004), the supportive role of these relationships in the internationalization process requires further study, especially when a firm is entering to a particular county. Finally, although the sample of this study covered almost all Finnish small and medium-sized software firms having direct business operations in the Japanese market, the sample can be generalized only to some extent and further study is needed to validate these findings.

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