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# **Is globalization reducing distances between countries? Some empirical evidence from foreign software firms operating in Japan**

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## **Introduction**

Nowadays, one of the most discussed topics is globalization and how it reduces cultural differences and distances between countries. This has been seen as a consequence of the development of communication technologies, improvement of transportation connections between countries, establishment of free trade areas, and emergence of global cultures. It is also a commonly held view that, with the help of information technology, business can be conducted regardless of time or place. In addition, travel connections between and within countries have increased becoming faster and cheaper. From all of this, it is easy to conclude that internationalization of firms has also become easier and that geographical or cultural distances do not matter anymore. However, globalization is a complex phenomenon and its impact to the international trade is not self-evident.

Although international trade should today be easier than ever, some scholars have argued that so-called “distance factors” such as geographical distance, cultural distance, and psychic distance are still valid in the contemporary business. These factors can be shortly defined as follows: 1) geographic distance refers to geographical distance in kilometers or miles between countries, 2) cultural distance is commonly defined as differences in cultural values between nations, and 3) psychic distance refers to managers’ individual perceptions and awareness of the distance between the home and the host country. For instance, the study by Leamer and Storper (2001) reveals that current improvement in transportation systems and communication technologies has not eliminated the importance of geographical distance in trade intensity between countries. This is in line with the findings of Dow and Karunaratna (2006) indicating that geographic distance was the most influential single factor impacting the trade between countries. In his study, Hofstede (2001) argues that cultural values and norms are very deep-rooted and not changing as fast as commonly predicted. The recent study by Ellis (2008) also indicates that although managers tend to prefer large markets instead of small ones, the relationship weakens if the psychic distance between the markets becomes greater. In addition, some scholars have proposed that globalization has made the world a more fragmented and challenging place for international trade (Florida, 2005; Ghemawat, 2001). As a consequence, firms’ now have to establish themselves in the major cities where industrial clusters locate and where most of innovations are accomplished.

As the discussion above indicates, the impact of globalization on international trade seems to be somewhat vague. The aim of this study is present some empirical findings about how distance factors impact on foreign software firms’ operations in the Japanese market. Software industry can serve as a fine example of a global industry and the internationalization of the firms in this sector has commonly been characterized as being somewhat irrespective of distance factors.

## Research related to market selection of software firms

We have made several studies to find out how software firms select their target countries (see e.g., Ojala and Tyrväinen, 2007a, 2008a). As the findings in these studies indicate, software firms still seem to primarily favor psychically and geographically close countries in their market selection. Psychical closeness refers here (as defined by Johanson and Wiedersheim-Paul (1975)) to countries where it is easy for a firm to conduct business due to the similarities in culture, business practices, and language. For instance, the studies of Ojala and Tyrväinen (2007a, 2008a) revealed that US software firms tend to favor the UK market as the main target for their foreign direct investments and that Sweden presents the most favored target for Finnish software firms. The study of Ojala and Tyrväinen (2007a) also indicates that Finnish software firms favor geographically nearby countries in their first market entries. Figure 1 presents the findings related to market entries of one hundred most successful US small and medium-sized software firms based on their annual revenue. As it can be observed from the figure, the countries which attract more investments than indicated by their market size are historically linked to the British Empire. In other words, these countries are former British's colonies, sharing some similarities related to psychic distance factors. In addition, English is the official language in all of these countries.

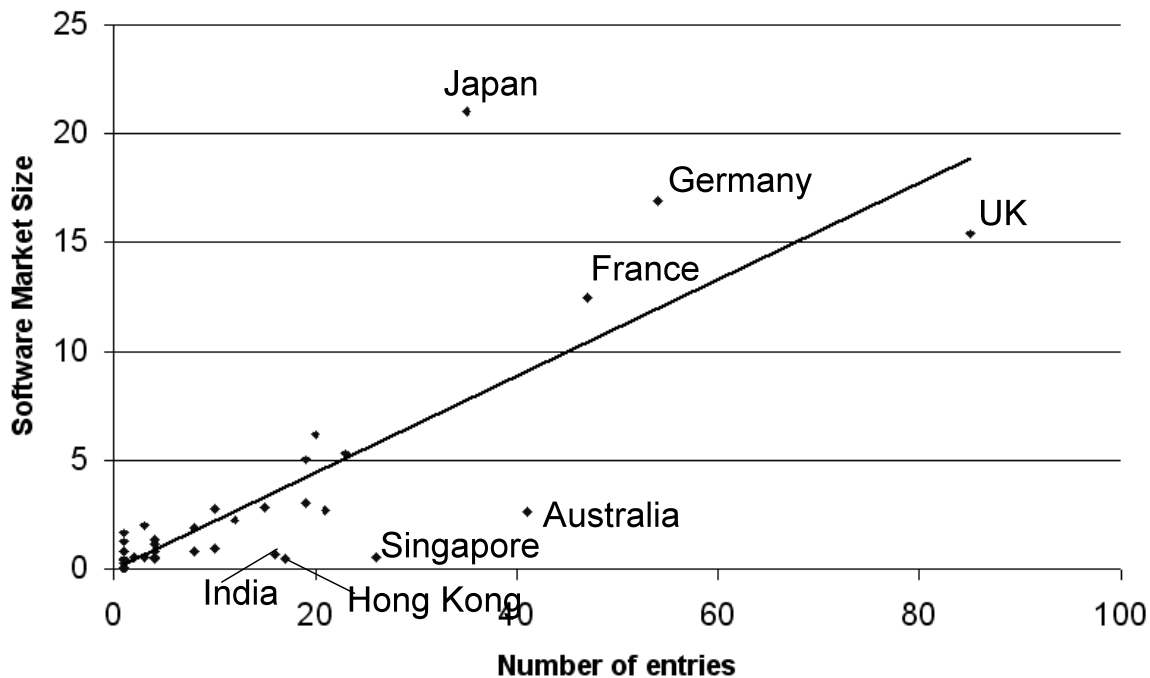


Figure 1. Software market size and number of entries (adapted from Ojala & Tyrväinen, 2008a)

So if distances do not matter, why do software firms still favor psychically close countries instead of the markets which have the greatest market potential? If we think about Japan, it can be conceptualized as a psychically distant country from most of the other countries (see e.g., Karppinen, 2006; Ojala, 2008; Ronen & Shenkar, 1985), but it is also a country with the world's second largest software market (EITO, 2007). As it can be observed from Table 1, Japan is only the fifth among the most favored targets for US software firms, likewise, very few Finnish software firms have entered the Japanese market (Ojala & Tyrväinen, 2007a, 2008a). This is the

case despite the fact that, based on the software market size in Japan, it should be the first target country for US software firms and the second target country for Finnish software firms after the US market. Thus, do the distances still matter in the globalized world, even affecting those “global” industries that the software industry represents?

	Largest software markets	U.S. software firms top targets	Finnish software firms top targets
1.	USA	UK	Sweden
2.	Japan	Germany	USA
3.	Germany	France	Germany
4.	UK	Australia	Norway
5.	France	Japan	UK

Table 1. The five largest software markets and the top target countries for US and Finnish small and medium-sized software firms.

One may also ask why software firms should enter distant markets such as that in Japan? The Japanese markets are commonly characterized as very difficult for foreign firms to conduct successful business (see e.g., Czinkota & Kotabe, 2000; Mason, 1992; Namiki, 1989). This has been mainly due to the Japanese government restrictions for foreign firms (Czinkota & Woronoff, 1993; Dunning, 1996; Mason, 1992), weak intellectual property protection (Anchordoguy, 2000), and cultural issues (Maguire, 2001). However, recent studies of Ojala and Tyrväinen (2007b, 2007c) have revealed that most of the current entry barriers in the Japanese market are more related to foreign firms’ business execution capabilities and resources to operate in the market than to regulatory barriers set by the Japanese government. This is the case at least with the software industry. The study of Ojala (2008) also indicates that foreign firms are able to overcome most of the barriers related distances by implementing appropriate market entry strategies.

There are many reasons one can think of why foreign software firms should enter the Japanese market. In addition to that Japan has the world second largest software market, Japanese are the world class producers of electronic devices, and these hardware devices commonly need software products. However, the local production of software is relatively low in Japan. Thus, Japanese are highly dependent on imported software products (Enterprise Ireland, 2005) and consequently there is a high demand for those products. In addition, Japan is a very small country by its geographical area. Most of Japan’s 127 millions people live on the east coast where the biggest cities – Tokyo, Yokohama, Osaka, and Nagoya - are located. Thus, a large number of customers are easily reachable within a limited geographical area.

### **Research related to foreign software firms’ operations in Japan**

Because Japan is a very attractive market but, at the same time, also distant and challenging (see e.g., Karppinen, 2006; Ojala, 2008; Ronen & Shenkar, 1985), we conducted several studies (Ojala & Tyrväinen, 2007b, 2007c, 2008b; Ojala 2007, 2008) related to Finnish software firms

operating in the Japanese market. The selected Finnish small and medium-sized software firms had their own subsidiary, a joint venture, or a representative in the Japanese market. Thus, they were using direct business operations in the market, which requires more understanding and knowledge about the environment of the target country compared to indirect entry modes such as exporting (Luostarinen & Welch, 1993). Investigating these firms' internationalization, especially as regards Japan, helps increase our understanding about why these firms selected Japan as the target country despite the fact that Japan is commonly regarded as a very difficult country to enter and conduct successful business. We also tried to investigate how these firms had been able to enter Japan and what kinds of strategies they had implemented to reduce the impact of psychic distance between Finland and Japan.

### **Reasons for the market entry to Japan**

As the findings of these studies (Ojala & Tyrväinen, 2007b, 2007c, 2008b; Ojala, 2007, 2008) indicate, the firms studied internationalized their operations to the Japanese market at a very early phase of their life-cycle. This was mainly due to the narrow product strategies that drove these firms to search customers from Japan from among several large target customers for their products. The reason for their narrow product strategies was mainly to avoid competition with larger firms. It is due to that competition that they do not find enough customers in their home country or even in the nearby markets. This increases the need to enter the leading software markets very early on, in this case, the Japanese market. Thus, the main reasons to enter the Japanese market were: large size of the target industry, the location of the key customers in Japan, sophisticated markets where consumers were used to use advanced products, and developed infrastructure that facilitated product development through broadband and wireless networks.

### **How to overcome distance factors in Japan?**

For the market entry, the software firms used several 'distance-bridging' factors. As an example, the firms took benefit from three kinds of network relationships. These relationships consisted of formal networks with other firms, informal networks with friends, and mediated relationships through so-called 'mediating organizations' such as Finpro in Finland and JETRO in Japan. These mediating organizations played a central role for the firms which did not have other network relationships to utilize for the market entry. So, by actively creating new relationships and utilizing their existing relationships the firms got access into knowledge that helped them to enter the market and further network with customers and distributors in Japan (Ojala, 2007). The firms also decreased the impact of psychic distance between Finland and Japan by recruiting Western managers who already had working experience in the Japanese market (Ojala, 2008). These managers already knew the local practices and culture, and they spoke Japanese. Thus, they were able to act as a bridge between different cultures and helped in communication between the units of the firm. In addition, most of the firms recruited Japanese employees for tasks which require close interaction with customers or distributors and where cultural knowledge and language proficiency are critical. Employees for their units in Japan were commonly recruited from distributors, customers, or competitors. These recruited employees had already a basic knowledge of the products and competitors in the market. This also decreased the needs for training and enabled utilizing the existing network relationships of the new employees. Some of the firms also established joint ventures with Japanese, which helped in utilizing the local knowledge (Ojala & Tyrväinen, 2008b). The firms favored direct investments to Japan, because their products

required close cooperation with customers and/or distribution channels during the sales process (Ojala, 2008). Thus, physical interaction with customers was not solely replaced by communication technologies.

## **Conclusions**

Finally, can we still say that distances do not matter in the globalized world? If all the markets are equally distant, why don't firms internationalize their operations to those markets that offer the greatest market potential for their products? As the findings in our studies indicate, despite of developed communication technologies and increased transportation connections, distances still matter in the contemporary business. This seems to be true even in global industries such as the software industry. We can say that Japan is very attractive but at the same time distant country for Western firms. This is mainly due to linguistic and cultural differences. However, our studies indicate that by implementing the right strategies firms can successfully enter the market there. This is inline with the recent study by Ellis (2008) revealing that market entries are always a trade-off between the attractiveness of a market and the distance-creating factors. Hence, we can say that distances still matter, but firms are also capable to employing different distance-bridging factors to overcome distance-creating factors in the market. The differences between countries in their international operations should not be underestimated, nor should they be seen as a barrier to business. If a firm avoids distant countries and enters only nearby markets, it might lose significant market potential that is available in countries like Japan. In other words, a firm that is capable of entering distant markets by conducting right strategies can attain significant market advantages against firms who are not able to do likewise.

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