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**Entry into Geographically and Psychically Distant Foreign Markets by  
Small and New Ventures**

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## **Entry into Geographically and Psychically Distant Foreign Markets by Small and New Ventures**

### **Abstract**

More often than we would expect, small and new ventures, which already suffer from few slack resources and lack of industry legitimacy take on the additional uncertainties of entry into foreign markets and foreign direct investment. Some of these foreign entries involve countries that are geographically distant and culturally quite different from the firm's home country. Yet we have no established model of distant foreign entry to guide research. This paper presents such a model. It highlights such influential factors as business and personal networks, international business experience, product strategy, and the speed of foreign entry.

Keywords: distant foreign market entry, new ventures, small firms

## **Entry into Geographically and Psychically Distant Foreign Markets by Small and New Ventures**

The process of firm internationalization has been a topic of interest among academic scholars for decades. Many studies have focused on the effects of geographic and psychic distance on the internationalization process, but results are often conflicting (Child, Ng, and Wong, 2002; Ellis, 2008). Some scholars have shown distance directly and powerfully slows entry by firms into foreign markets (Johanson and Wiedersheim-Paul, 1975), while more recently others have revealed interactive relationships among the size of the foreign market, psychic distance, and the sequence of market entries (Ellis, 2008). Even more complex relationships with additional influences have been explored (Ojala and Tyrväinen, 2007). Several scholars have called for the inclusion of personal and business networks and more nuanced measures of economic opportunities into models (Child, *et al.*, 2002). Most relevant for this paper, empirical work is emerging that focuses on locations that are geographically and psychically quite distant, such as Ojala's (forthcoming) studies of Finnish software ventures' entries into Japan.

To understand such actions it is to focus attention on the internationalization patterns of small and new ventures (Bell, McNaughton, Young, and Crick, 2003; Coviello, 2006; Oviatt and McDougall, 1994). Their typically small size means they have relatively few resources. They have less legitimacy than established firms in their industries and among potential customers. They and their leaders usually also have less international business experience. Thus, every action they take in distant locations has great significance for their survival, and because they are simple organizations relative to large established multinational enterprises, it is easier to isolate the primary influences on those actions.

We know of no framework or model of entry by small and new ventures into distant foreign markets. It is the goal of this paper to fill that void. These sorts of firms are often knowledge-intensive, technology-based firms (Bell, *et al.*, 2003) and are believed to be growing in number (OECD, 1997). Therefore, studying them is valuable. Furthermore, we expect that the framework presented here will help develop theory and lead future empirical work. Our focus is on market-seeking behavior in these firms, not on efficiency, resource, or asset seeking. Because the framework presented here is at an operational level of abstraction, we believe it will aid practicing international managers and global entrepreneurs in their efforts to enter new distant foreign markets successfully.

### **Prior Research**

In the academic literature on firm internationalization, inquiry into the influences of geographic and psychic distance has a long tradition. It seems well established that, *ceteris paribus*, foreign markets that are geographically close to home are more likely to be entered or to be entered early by a firm (Ojala and

Tyrväinen, 2007; Ellis, 2008). The relationship between psychic distance and foreign market entry, however, is not clear at all. More than 50 years ago, Beckerman (1956) identified psychic distance as an important impediment to foreign entry. Later, the scholars associated with Uppsala Theory (Johanson and Vahlne, 1977, 1990; Johanson and Wiedersheim-Paul, 1975) showed that relationship empirically and established psychic distance as a centerpiece of their theory. However, empirical support for their theory has not been universal (Benito and Gripsrud, 1992; Oviatt and McDougall, 1994; Sullivan and Bauerschmidt, 1990), and important criticisms of the theory itself have appeared (Andersen, 1993).

In a sample of 302 Chinese manufacturers-exporters, Ellis (2008) demonstrated psychic distance did not have a direct influence on the order of foreign entries. Instead, it moderated the otherwise negative relationship between foreign market size and the order of foreign market entry. Specifically, although large markets will normally attract early foreign entry, that association weakens as psychic distance becomes greater, presumably because the cost of doing business increases and offsets the benefits of large market size.

Ellis (2008) also highlighted two additional problems in understanding the relationship among foreign market size, foreign market entry, and psychic distance. First, perhaps the transaction costs of psychic distance are more relevant for exporters than for firms involved in foreign direct investments. The reason is that the costs to exporters of adjusting to psychic distance may be more in proportion to their overall costs of export than it is to the overall costs of foreign direct investment, which are assumed to be less. Thus, psychic distance may be more relevant for firms engaged in export than for those engaged in foreign direct investment.

Second and perhaps more important, scholars must be careful in defining what they mean by psychic distance. Some define it using Hofstede's (1980) traditional measures of cultural differences among countries. Others use subjective measures of perception about differences between foreign countries and a firm's home country, and it is these measures that may be more correctly identified as psychic distance (Ellis, 2008). Furthermore, buyers and sellers may have asymmetrical views of psychic distance about each other. For example, Japanese buyers may have more business experience in the United States than American sellers have in Japan. When a sales transaction is initiated by such a buyer, it is the Japanese perception of psychic distance—which is closer than the American--that is most relevant to the exchange and to the scholar's measure of it. Such asymmetries may be important to consider, as Ellis (2008) found a majority of transactions in his study may have been initiated by someone other than the seller.

A study by Child *et al.* (2002) revealed additional problems in studying the effects of psychic distance. First, because their evidence was gathered using 25 in-depth interviews of executives in only five firms, it was possible to observe decision making about foreign entry in greater detail than is possible in large

samples. Thus, decisions about foreign entry were very often seen to be motivated, not by macroeconomic measures of country market size as used by many scholars, but by more specific measures of an immigrant population that was most relevant to production and/or sales. The effect was judged to be important and highlighted as “distance compressing.”

A second distance compressing effect, as others have noted, was a degree of international homogenation in life-styles, technologies, business practices, and institutions. Such distance compression has made foreign markets less culturally distinct over time and, therefore, easier for firms from other countries to enter (Child *et al.* (2002).

Child *et al.* (2002) also noted “distance bridging” actions by the firms themselves. Selecting countries for entry that contained or to which they could send trusted people meant organizational leaders could use their personal networks to help enter and to manage any operational problems that emerged in the foreign country. The authors called for further exploration of the link between networking and the management of psychic distance in internationalizing firms.

Several studies have focused on the personal and business networks of new and small ventures, and it is clear that networks play an important role in the internationalization of firms (Coviello, 2006), including the management of entry and operations in markets that are geographically and psychically distant from the firm’s home (Ojala, 2007).

### **A Framework for Distant Foreign Market Entry**

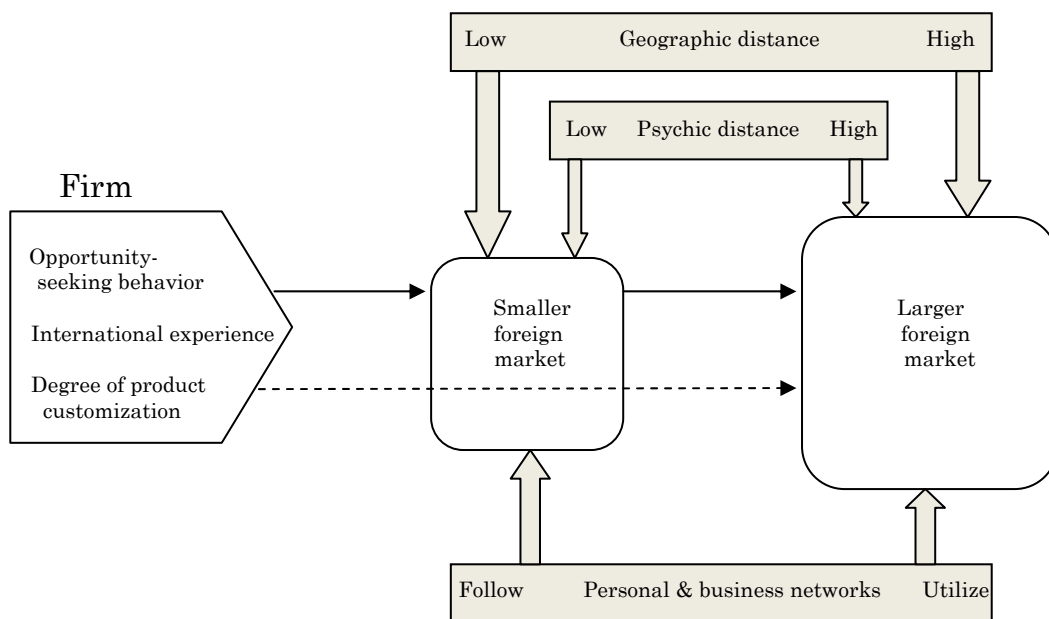
Figure 1 is a framework that, we believe, depicts the primary influences affecting how small and new ventures seek growth in distant foreign markets. On the left under “Firm” are listed the influences on decisions about foreign markets that are within the firm and largely under the firm leaders’ control. To the right of the “Firm,” the smaller square shape represents smaller foreign markets, and to its right the larger square represents leading, large markets. The shaded areas represent influences of geographic distance, psychic distance, and networks on the pattern of foreign entry and operation. The solid and dashed arrows emerging right from the “Firm” to the foreign markets depict two different patterns of internationalization, which are described below.

The dominant motivation for small and new ventures to seek new foreign markets is economic (Ellis, 2008). Firm leaders prefer large foreign markets to small ones, but, as shown by the shaded influences above the markets, great geographic distance to the market and to a lesser extent great psychic distance dampens that preference.

Nonetheless, two influences within the firm have the potential to overcome the affects of distance. First, firm leaders with strongly entrepreneurial opportunity-seeking orientations may elect to pursue the larger markets rapidly

(Oviatt and McDougall, 1994). Second, firm leaders with international experience may do the same (Reuber and Fischer, 1997). It is difficult to estimate a priori which of these two is most influential because both could be multidimensional and vary along a continuum. Some entrepreneurs have greater risk aversion than others, and international experience may be anything from direct business experience in a foreign country to an education about a culturally similar foreign country.

**Figure 1: Framework for Knowledge-Intensive Firm Entry into Geographically and Psychically Distant Foreign Markets**



The solid and dashed arrows emerging to the right from the “Firm” toward the foreign markets depict two possible patterns of entry into large foreign markets by small and new ventures. Aggressive entrepreneurial leaders and leaders with substantial and relevant international experience are most likely to engage in rapid foreign entry directly into large distant markets, as shown by the dashed arrow (Oviatt and McDougall, 2005). It represents the less travelled entry route. Direct entry from the home market into a large, geographically and psychically distant foreign market offers the greatest opportunity but perhaps has the greatest risks. But the attractiveness of the large market size may be traded off against the risks of rapid internationalization (Shrader, Oviatt, and McDougall, 2000).

The solid arrow represents what has been observed empirically as the most frequently travelled route. That is, the smaller and often more proximate market is the initial entry. Then the degree of learning and success with that experience, the degree of entrepreneurial aggressiveness, and the amount of prior international experience determines the speed with which the following entry into the larger more distant market occurs. The staged pattern resembles that of the Uppsala Model (Johansen and Vahlne, 1977, 1990), but movement from the initial foreign entry to the subsequent ones is often less incremental than traditionally depicted, even when geographically and psychically distant markets are involved (Ojala, forthcoming).

One influence in the framework that is internal to the firm and one external to it remains to be considered. The external influence is the personal and business network of the firm and its leaders. Some of these associations begin forming prior to or during the conception of a firm (Coviello, 2006). New ties are suggested by prior personal associations as well as by new business associates. Ties tend to grow in number, to become more populated by business, as opposed to personal, associations (cf, Ellis, 2000), and to become less densely interconnected as the firm ages. Much of the structure and content of networks is idiosyncratic to each firm seeking to grow internationally (Coviello, 2006).

Networks, however, certainly influence the pattern of international growth. In some studies it is evident that business and personal associations are important influences in the selection of countries to be entered by small firms and new ventures (Coviello and Munro, 1995). In other studies that focused especially on large distant markets, the role of networks was observed to be more complex (Ojala, 2007). When firms were not actively seeking entry, informal personal associations were essential for the firms to notice the opportunity in the distant market even though it was large. In such circumstances, the opportunity to sell in the market was initiated by the buyer or by an intermediary, and as noted earlier, that means the relevant psychic distance is that from the buyer’s culture to the seller’s, which may be significantly different than the reverse (Ellis, 2008). The implication is that the interactions among these influences on the pattern of small-firm internationalization maybe quite complex.



Returning again to Ojala (2007), in firms that had made a prior strategic decision to enter a large foreign market, formal business relationships were simply utilized to manage the entry, but had nothing to do with identifying the country entered (Ojala, 2007). Whatever the case, it is clear that networks serve a distance-bridging function for international small and new ventures (Child *et al.*, 2002). Firms may follow networks into nearby markets and strongly utilize networks in a variety of ways when entering distant markets. Future research is needed to understand the complex nuances.

The final influence to be considered by the framework in Figure 1 is the degree of product customization. For example, some software firms design custom programs for business clients while others design mass-market software sold without modification (except language and marketing methods) in a variety of countries. The degree of customization is an internal strategic issue in the firm. Ojala and Tyrväinen (2006) found that product customization in Finnish software firms is closely related to mode of entry and operation. They observed small firms that sold completely customized solutions in the geographically and psychically distant market of Japan utilized their own sales representatives who sold into niche markets. Firms with semi-customized products that required local adjustments established sales subsidiaries with local sales and marketing people who could make those adjustments. Firms with mass-market products requiring no adjustments used cooperative entry and operational modes that emphasized localized marketing. Future research on additional samples is needed to investigate this pattern further.

## **Conclusion**

This paper has presented a framework for understanding market seeking behavior by small and new ventures entering geographically and psychically distant markets. As noted in the introduction, we believe there is a growing number of ventures entering such markets, and studies of foreign market entries as distant as Finnish software firms entering Japanese markets are emerging (Ojala, forthcoming; Ojala and Tyräinen, 2007). Thus, a framework to guide research has value.

Although this paper written for the PBFEM Conference 2008 is but an initial draft that requires much more work, it provides a beginning. We believe we have identified the key influences, and our discussion has shown their relationships are likely to be complex, often interactive, but amenable to study. The framework can be treated as a collection of propositions about the issues involved in firm entry into distant markets. Furthermore, the framework is deliberately presented at a low level of abstraction, which will permit simultaneous progress by scholars interested in theory and by business people interested in commerce.

It can be seen that no one theory governs the pattern of distant internationalization. Indeed, we have cited Uppsala theory, network concepts,

and ideas about international new ventures. Evidence and our initial thinking about the role of each approach is described above. It is clear, however, that in empirical work measurement will be difficult. For example, measurement of market size, an essential influence in the framework, will not be easy for scholars wishing to test the framework (Child *et al.* 2002). Furthermore, some of the relationships are likely to be so complex as to require the in-depth analysis of case studies, which means progress will be slow and our ability to generalize from any one study will be limited. Nevertheless, we have faith in the creativity of scholarly endeavors.

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