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**Author(s):** Ojala, Arto; Oviatt, Benjamin

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# **A FRAMEWORK FOR EXPLAINING DISTANT FOREIGN MARKET ENTRY BY SMALL AND NEW VENTURES**

**Arto Ojala**

University of Jyväskylä  
Email: Arto.K.Ojala@jyu.fi

**Benjamin Oviatt**

University of New South Wales  
Email: Ben.Oviatt@unsw.edu.au

## **Abstract**

New and small ventures are increasingly observed to be selling and investing in foreign locations that are geographically and psychically quite distant. Such firms, however, are handicapped by several conditions. Their typically small size means they have relatively few resources with which to manage such distant commercial exchanges. They often have less legitimacy in foreign marketplaces than established competitors and their leaders may have less international business experience. Thus, every action they take in distant foreign locations may risk their survival because conducting business across distant national borders is most often more expensive and frequently more time-consuming than domestic commerce or commerce with proximate foreign countries.

This paper offers the first framework for studying distant foreign entry by new and small ventures. We employ international business theory, network theory, and concepts from entrepreneurship to build a framework that is at an operational level of abstraction. That is, academic scholars and practicing international entrepreneurs can both use the framework to advance theory, empirical research, and international business practice. The framework begins with the concept that foreign entry by new and small ventures is motivated primarily by large market opportunities. The attractiveness of such opportunities, however, is moderated significantly by geographic distance and secondarily by psychic distance. The framework proposes that three internal venture influences interact with geographic and psychic distance to determine which foreign markets are entered: Proactive opportunity seeking, international business experience, and the degree of product customization. Greater degrees of the first two and less of the last influence may overcome both geographic distance and psychic distance and lead ventures to enter larger, and therefore more attractive foreign markets, despite their distance. Distance bridging network relationships are proposed to have the greatest influence on distant foreign market entry when entrepreneurs are less proactive in their foreign opportunity seeking. All of these concepts motivate a set of nine propositions that are intended to lead scholarly research and to guide commercial actions by entrepreneurs in distant foreign lands.

# **A FRAMEWORK FOR EXPLAINING DISTANT FOREIGN MARKET ENTRY BY SMALL AND NEW VENTURES**

## **INTRODUCTION**

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 2008a). Some scholars have shown distance directly and powerfully inhibits 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 2008a). 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 entry into locations that are geographically and psychically quite distant, such as Ojala's (2008, 2009) studies of small Finnish software ventures' entries into Japan. Furthermore, Japan is not the only Asian market of interest to ventures headquartered in far-away countries (Lasserre and Probert 1998; Lieberthal and Lieberthal 2003), and Asian new ventures are, themselves, increasingly searching for business opportunities in distant Western countries (Lu and Beamish 2001; Zain and Ng 2006). Such globe-spanning activity among firms with modest means deserves additional investigation. What attractions draw them to distant lands? What forces inhibit them? How do the attractions and inhibitions interact?

To understand such issues we focus attention on the internationalization patterns of small and new ventures (Bell, McNaughton, Young, and Crick 2003; Coviello 2006; Jones and Coviello

2005; 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, distant entry is especially uncertain for such organizations. As a consequence, every action they take in distant locations has 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.

Although some recent frameworks focus on the internationalization of entrepreneurial firms (Bell et al. 2003; Coviello and Munro 1997; Jones and Coviello 2005), that research concerns broad patterns of internationalization. We believe our framework highlights a set of interesting ideas about a phenomenon that is currently evident and will be increasingly observed in a world where the centers of commercial gravity are shifting from West to East. The result is that buyers and sellers increasingly interact with each other across significant distances, according to multiple measures. Our framework shows first, understanding venture entry into distant markets is advanced not by relying on a single theoretical approach but by employing multiple viewpoints. Second, our explanation highlights complex yet tractable interactions among several factors: geographic distance, psychic distance, network relationships, characteristics of entrepreneurs, and degree of product customization. Third, the complexity of the framework and the measurement issues attached to its concepts suggest that well executed, theoretically rich, qualitative case research (Yin 2002) and policy capturing methods (Cooksey 1996; Shepherd and Zacharakis 1999) will be the most advantageous initial methods of testing the framework.

Because it is most puzzling, our interest is on market-seeking behavior in these firms, not on efficiency, resource, or asset seeking. We expect that the framework presented here will help develop theory and lead future empirical work. Because the framework is presented at a relatively low level of abstraction, we believe it will also aid practicing international managers and global entrepreneurs in their efforts to enter new distant foreign markets successfully.

## **RESEARCH ON DISTANCE**

In the academic literature on firm internationalization, inquiry into the influences of geographic and psychic distance has a long tradition.

### Geographic distance

It seems well established that, *ceteris paribus*, foreign markets geographically close to home are more likely to be entered or to be entered early by a firm (Ellis 2008a; Srivastava and Green 1986). Lower economic and managerial costs, rapid and effective information exchange, and environmental familiarity are all important reasons that geographically proximate countries attract mutual entry. Recent improvements in transportation systems and communication technologies have not eliminated the influence of geographic distance on trade intensity among countries (Ghemawat 2001, 2007; Leamer and Storper 2001). Indeed, the most influential single factor impacting trade between countries appears to be geographic distance (Dow and Karunaratna 2006). Geographic distance even impacts market selection by small software firms that trade completely intangible products over the Internet (Ojala and Tyrväinen 2007).

## Psychic distance

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 trade. Later, the scholars associated with the Uppsala model (Johanson and Vahlne 1977, 1990; Johanson and Wiedersheim-Paul 1975) showed that relationship empirically and established psychic distance as a centerpiece of their theory. Those studies define psychic distance as factors which impact the information flow between the firm and the host market. The factors are related to differences in language, culture, political systems, level of education, level of industrial development etc. (Johanson and Wiedersheim-Paul 1975). Thus, according to the model, firms tend to start their foreign operations in countries with low psychic distance and thereafter enter into countries with greater psychic distance as they learn more about foreign markets. However, empirical support for their theory has not been universal (Benito and Gripsrud 1992; McDougall, Shane, and Oviatt 1994; 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 (2008a) 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 (Rothaermel, Kotha, and Steensma 2006; Terpstra and Yu 1988), 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 2008a).

Ellis (2008a) also emphasized that scholars must be careful in defining what they mean by psychic distance. Many studies have used Hofstede's (1980) cultural dimensions and the composite index of Kogut and Singh (1988) when they evaluate psychic distance (Tihanyi, Griffith, and Russell 2005). However, there seems to be growing agreement that culture is only one part of psychic distance and dependence on Hofstede's dimensions may be misleading (Dow 2000; Dow and Karunaratna 2006; Evans and Mavondo 2002; Tihanyi et al. 2005). For that reason, several scholars (Brewer 2007; Dow and Karunaratna 2006; Ghemawat 2001) have developed macro-level indicators to estimate psychic distance among countries. Commonly used factors in these studies have been culture, language, religion, political and legal issues, economic conditions, and business practices.

Others believe subjective measures of perception about differences between foreign countries and a firm's home country may be key (Ellis 2008a). Thus, psychic distance per se is less important than a business person's reaction to it. Education, international experience, and age impact a decision maker's sensitivity to psychic distance (Dow and Karunaratna 2006), and individual perceptions impact a manager's or an entrepreneur's choices about which foreign markets to enter. Managers' perceptions about the differences between home and host country have been measured by expert panels and by Likert scales alone (Ellis 2008a; Nordström 1991) or together with macro-level indicators (Dow 2000; Evans and Mavondo 2002). Other authors (Ojala 2008; Petersen and Pedersen 1997; Sousa and Bradley 2006) have argued that perceptions about psychic distance should be measured at the individual level. Sousa and Bradley (2006, 61), for example, state "psychic distance captures the manager's individual perception of the differences between the home and the host country and is a highly subjective interpretation of reality". Thus, psychic distance does not impact employees within a firm equally.

A further complication is that buyers and sellers may have asymmetrical views of psychic distance. 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 (Shenkar 2001) because Ellis (2008a) found a majority of transactions in his study may have been initiated by someone other than the seller.

In summary and in contrast to geographic distance, there is uncertainty about the general influence of psychic distance on choices about foreign market entry. We do conclude it is less powerful than the Uppsala model holds it out to be, and there seems little doubt that psychic distance has multiple dimensions. We find it easy to agree with scholars who argue that subjective measures of psychic distance are most appropriate, especially among small and new ventures where routines are less established and where the opinions of an entrepreneur or a small group may overcome institutional and inertial forces. However, such conclusions make established countrywide measures of psychic distance inappropriate and, therefore, large-sample studies disappointingly difficult to conduct.

#### Compressing and bridging distance

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 perceptions. For example, some firms were drawn overseas to serve populations of expatriates from the home country and the foreign operations of home-headquartered firms. Thus, the wider market of the foreign country was largely irrelevant. 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 homogenization in life-styles, technologies, business practices, and institutions (Child et al. 2002). Some see this as an emergence of global cultures due to increasing interaction among individuals from different national cultures (Hannerz 1990). In these global cultures, people share similar values and behavior regardless of their geographic location (Alden, Steenkamp, and Batra 1999; Hannerz 1990). Andersson (2004) highlights global industries, such as the computer industry, that have their own worldwide culture and language despite national backgrounds of individuals. 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), along with other scholars, have also noted “distance bridging” actions by the firms themselves, and they all involve some form of networking. 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. That is consistent with Nordström and Vahlne’s (1994, 46) observation that “...distance can be bridged by factors such as knowledge dissemination...or trial and error processes”.

In addition, firms can use network relationships to obtain new knowledge by recruiting new employees or by acquiring new firms. These actions may bridge the distance between home and host country. Ranft and Lord (2000) asserted that access to embedded knowledge and to the network relationships of employees was the most important motivation for acquisitions in high-technology industries. Ojala (2008) revealed that some Finnish software firms recruited Western managers who had long working experiences in Japanese markets to manage their business operations in psychically distant Japan. These employees acted as cultural mediators between Finland and Japan and significantly decreased the perceived psychic distance between the markets. In addition, firms were able to use recruited managers' and employees' personal and business networks in the market to develop their business further.

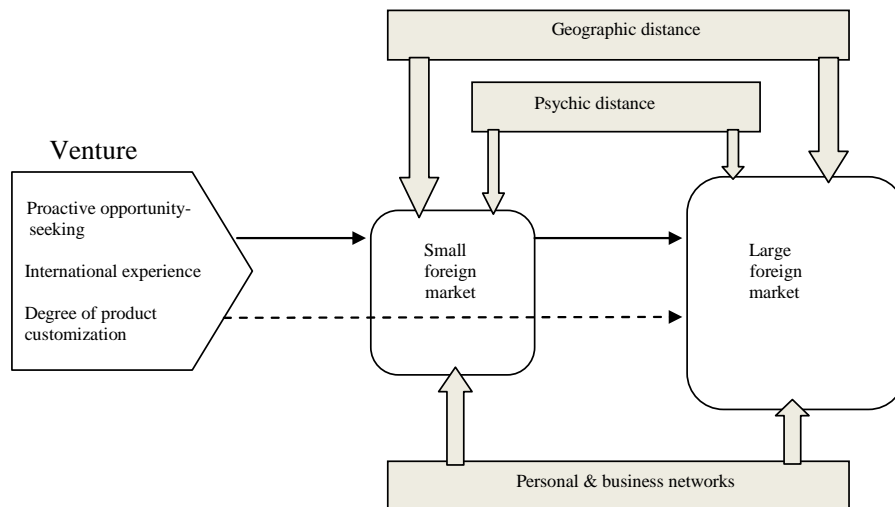
Several studies (Coviello 2006; Coviello and Martin 1999; Ellis 2008b; Sharma and Blomstermo 2003; Zain and Ng 2006) have focused on the personal and business networks of new and small ventures and it is clear that networks play an important role in the internationalization of firms (Coviello 2006), including the management of entry and operations in markets that are geographically and psychically distant from the firm's home (Ojala 2009). These authors have called for further exploration of the link between networking and the management of psychic distance in internationalizing firms.

## **A FRAMEWORK FOR DISTANT FOREIGN MARKET ENTRY**

Figure 1 is a framework that, we believe, depicts the primary influences affecting whether and how quickly small and new ventures seek growth in distant foreign markets. On the left under "Venture" are listed major influences on decisions about foreign markets that are within the

venture and to a significant degree under the venture leaders' control. To the right of the "Venture," the smaller square shape represents smaller foreign markets, and to its right the larger square represents 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 from the "Venture" to the foreign markets depict two different patterns of internationalization, which are described below. In Figure 1, the smaller foreign market is shown closer to the Venture than the larger one. That is often the empirical reality. Depicting the smaller market closer is also the more complex situation to analyze and is the one described in this paper. Depicting and describing the reverse just makes the analysis simpler without changing the conclusions materially.

**Figure 1: Framework for Entry into Geographically and Psychically Distant Foreign Markets**



The dominant foreign market-seeking motivation for firms, including small and new ventures is economic (Bell et al. 2003; Ellis 2008a; Ojala and Tyrväinen 2007). Firm leaders prefer large foreign market opportunities 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 moderates that preference.

As noted earlier, geographic distance seems well established, both theoretically and empirically, as a primary inhibitor of cross-border economic exchange (Ghemawat 2001, 2007; Leamer and Storper 2001). While psychic distance also appears to inhibit such exchange, its power would appear to be fragmented into multiple dimensions (Dow and Karunaratna 2006), and made uncertain by the fact that, especially among small and new ventures, its effect is subjective (Ellis 2008a) and, therefore, perhaps idiosyncratic. Therefore, we propose the inhibiting effects of geographic distance are stronger than those of psychic distance. We believe, as demonstrated in the discussion above, the direction and relative power of these effects can be established by reference to prior literature. However, that is not the case with other relationships in our framework.

**Proposition 1:** Large market size is the primary attraction for ventures to enter a foreign country.

**Proposition 2:** Geographic distance inhibits venture entry into attractive foreign markets more strongly than psychic distance.

**Proposition 3:** Subjective measures of psychic distance involving venture decision makers are the most relevant measures for understanding the foreign market entry actions of small and new ventures.

### Internal venture influences

Proactive opportunity-seeking by venture leaders may interact with the effects of distance. Persistence and determination sometimes enables entrepreneurs to overcome obstacles and to compensate for weaknesses (Timmons and Spinelli 2001). Thus, leaders with strong opportunity-seeking orientations may elect to pursue large markets, despite their great distance (Oviatt and McDougall 1994); whereas, other leaders might want to engage in a

restrained the internationalization process. Thus, the behavioral predispositions of firm leaders may interact with foreign market distance to influence market entry choices.

**Proposition 4:** Proactive opportunity-seeking interacts with foreign market distance to influence which foreign markets are entered.

Second, firm leaders with international experience may also reach for opportunities in the larger foreign markets soon after inception (Oviatt and McDougall 1995; Reuber and Fischer 1997); whereas, leaders without such experience may have to acquire it through learning or through employee recruitment, which naturally slows the internationalization process. It is difficult to estimate a priori whether proactive opportunity-seeking or international business experience affects distant foreign entry more because both could be multidimensional, vary along a continuum, and interact with each other. For example, 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.

**Proposition 5:** International experience interacts with foreign market distance to influence which foreign markets are entered.

The third internal influence on venture entry into foreign markets is the degree of product or service customization, or standardization at the opposite end of the same continuum. With standardized outputs that may suit a large number of buyer groups, ventures may quickly enter a relatively large number of countries (Hoch, Roeding, Purkert, Lindner, and Müller 2000; Kotha 1995; Pine II, Victor, and Boynton 1993). Psychic distance has little effect on standardized products because at that end of the continuum they encounter relatively few cultural obstacles in foreign countries. At the customized end, however, the need for tailored products, more liaison with customers, and perhaps more face-to-face meetings during the

sales process (Cornish 1996; Hoch et al. 2000) means that psychic distance may inhibit entry into foreign markets both large and small. Thus,

**Proposition 6:** The degree of output customization interacts with psychic distance to influence which foreign markets are entered.

#### External influence of network relationships

The business and personal networks of the venture and its leaders are an important external influence on distant foreign market entry. Some network associations begin forming prior to or during the conception of a new venture (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 venture ages. It has been observed that much of the structure and content of networks is idiosyncratic to each venture seeking to grow internationally (Coviello 2006).

Networks, however, certainly influence the pattern of international growth (Johanson and Mattsson 1988). 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 2009). When ventures were not proactively seeking entry, informal personal associations were essential for the firms to focus on the opportunity in the distant market even though it was large and attractive. In such circumstances, the opportunity to sell in the market was initiated by the buyer, 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 2008a). The implication is

that the interactions among these influences on the pattern of venture internationalization maybe quite complex.

**Proposition 7:** Where venture leaders are not proactive in the pursuit of distant foreign opportunities, network relationships significantly influence the choice of foreign markets to enter.

In contrast, Ojala (2009) found where venture leaders were proactively seeking new opportunities in large and distant foreign markets, business and personal networks had little influence on which countries were entered. The distance-bridging role of formal and mediated (e.g., export promotion organizations) network relationships, instead, was to actively develop and manage the foreign entry process. Network ties would introduce new customers, identify the most appropriate sources for distribution, and, where needed, help establish the most appropriate foreign subsidiary structures.

**Proposition 8:** Where venture leaders are proactive in the pursuit of distant foreign opportunities, network relationships have little influence on the choice of foreign markets to enter.

#### Speed of entry into distant foreign markets

In Figure 1, the solid and dashed arrows emerging to the right from the “Venture” toward the foreign markets depict two general patterns of entry into foreign markets by small and new ventures. The solid arrow summarizes what has been observed empirically as the most frequently travelled route. That is, the more proximate foreign market, which is sometimes also the smaller market (as in Figure 1), is the initial foreign entry (Bell 1995; Chetty and Campbell-Hunt 2004; Coviello and Munro 1997; Ojala and Tyrväinen 2007). Then, with learning about foreign markets and support from external network relationships reducing psychic distance, entry into the larger more distant foreign markets occurs. This incremental pattern resembles that of the Uppsala Model (Johansen and Vahlne 1977, 1990; Johanson and

Wiedersheim-Paul 1975), 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 2008).

Proactive opportunity-seeking leaders, venture entrepreneurs with substantial and relevant international experience (Oviatt and McDougall 2005), and ventures selling outputs on the standardized end of the product customization continuum are likely to engage in rapid foreign entry, as shown by the dashed arrow in Figure 1. That pattern, though increasingly observed, is 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. Nevertheless, the attractiveness of the large market size may be traded off against the risks of rapid internationalization (Shrader, Oviatt, and McDougall 2000).

**Proposition 9:** Proactive opportunity-seeking, international experience, and standardized outputs within new ventures are associated with rapid entry into distant foreign markets.

## CONCLUSIONS

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 2008, 2009). Thus, a framework to guide research has value.

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



propositions highlight issues especially ripe for empirical work. However, the framework is deliberately presented at a relatively low level of abstraction, which will permit simultaneous progress by those interested in applying the concepts described herein.

It can be seen that no one theory governs the pattern of distant internationalization in our framework. Indeed, we have used the Uppsala model, network concepts, and ideas about international new ventures. It is clear that in empirical work measurement will be difficult. For example, measurement of market size (Child et al. 2002; Ojala and Tyrväinen 2007), an essential influence in the framework, will not be easy for scholars wishing to test the framework. Furthermore, some 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. The influence of some of the variables in the framework might also vary depending on the country of origin and the industry involved. Thus, comparative case studies are needed to verify the framework by using firms originating from different countries and industries. In addition, comparative studies enable in-depth investigation into differences between entries into nearby and distant countries. Nevertheless, we have faith in the creativity of scholarly endeavor.

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