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## **THE ROLE OF PSYCHIC DISTANCE IN INTERNATIONALIZATION STRATEGY EVALUATIONS AND STRATEGIC CHOICES**

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### **ABSTRACT**

This analysis examines views of the term “psychic distance” and its application to the strategic choice process and managerial arrangements in international operations. It offers a background and conceptual framework of psychic distance, which stresses individual experience as part of the process. Individual experience is explored in terms of its components and through the use of information processing models that appear in the marketing literature. Next, applications to strategic management are made with regard to the choice to enter specific international markets, modes of entry selected, and the managerial structures that will be established.

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### **INTRODUCTION**

One major decision facing executives in many companies is in regard to conducting business with or in another country. Such a choice affects activities throughout the organization, while the actual judgements regarding whether to internationalize and how to do so boil down to the conclusions drawn by individual managers. The concept of psychic distance, which appears frequently in the international business literature, applies to a variety of theoretical models that relate to this strategic management concern, especially with regard to internationalization strategies and strategic choice processes.

The international business literature suggests that psychic distance influences strategic decision makers as they consider expansion into international markets. It may play a role in strategic decisions about whether or not to pursue international expansion, the choice of entry mode (exporting, licensing, franchising, joint ventures, strategic alliances, wholly owned subsidiaries, acquisitions (minority, majority, total), and greenfield ventures), as well as subsequent levels of international affiliate performance. Although the concept has been in use for many years (Beckermann,

1956) some complain that applications of the concept are unclear (see Shenkar 2001) and the construct has been criticized (Stottinger & Schlegelmilch, 1998).

This analysis examines views of the term “psychic distance” and its application to the strategic choice process and managerial arrangements in international operations. The first section provides a background explaining how the psychic distance concept emerged, primarily within the field of the international business, and to a lesser degree, international marketing. A conceptual framework of psychic distance is then offered. The framework stresses individual perceptual processing of psychic distance, both at the national and business levels, through individual experience. Individual experience is explored in terms of its components and through the use of information processing models that appear in the marketing literature. Next, applications to strategic management are made. The final section offers some basic conclusions.

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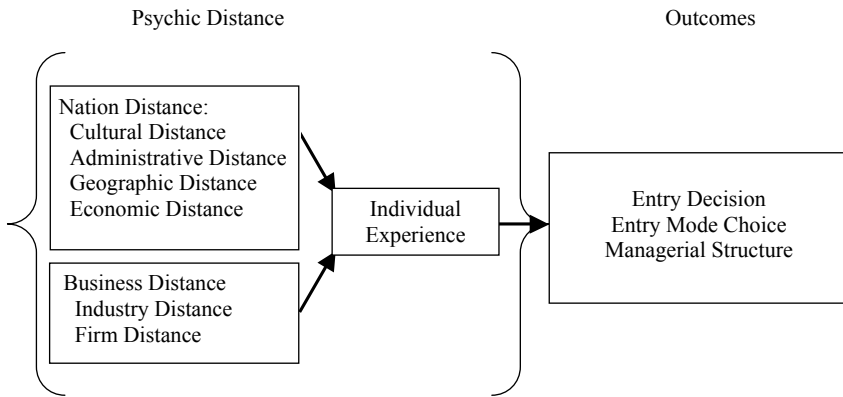
## **BACKGROUND AND CONCEPTUALIZATION OF PSYCHIC DISTANCE**

Welch and Luostarinen (1988) defined psychic distance “as the sum of factors preventing the flow of information from and to the market” (in Johanson & Vahlne, 1977, p. 23; revised 2009). Another definition of psychic distance suggests it represents “the mind’s processing, in terms of perception and understanding, of cultural and business differences” (Evans, Treadgold, & Mavondo, 2000, p.375). Conceptually, psychic distance may be divided into three components: cultural affinity, trust, and individual experience. Cultural affinity includes national level differences, including cultural differences, language, and the legal environment. Trust is a business level (rather than national level) consideration that represents the level of confidence between members of companies in an international business relationship. Personal experience is strongly linked to the initial discussions of psychic distance and becomes an individual, rather than national or business-level consideration. These components led Baack and Baack (2006) to describe the construct in the following manner:

*Psychic distance may be viewed as the aggregate of national distance and business distance being processed through individual experience.*

Figure 1 provides a model of this conceptualization as it would apply to strategic management.

**Figure 1**  
**A Psychic Distance Conceptual Framework**



This conceptualization essentially divides psychic distance into two components: psychic and distance. Distance, refers to differences between domestic and foreign markets, which differences occur at both the national and business levels. These factors create the knowledge deficiencies that individuals must overcome. Psychically, knowledge deficiencies are then processed through personal mental processes. Therefore, this definition and conceptual model suggest that the impact of distance will be interpreted through individual experience.

A review of the literature suggests that individual experience directly affects perceptions of psychic distance. Evans and Mavondo (2002) write that differences between countries result from an individual’s perceptions of another country’s general values and attitudes. The Johanson and Vahlne (1977; 2009) definition of psychic distance views it in terms of information flow from source to source, or from individual to individual. These individuals along with their experiences affect perceptions of psychic distance. Mitra and Golder (2002), using a model that includes both knowledge and distance, found that the distance between markets, when isolated, has no effect on the entry decision. Instead, it is only in the context of individual knowledge that distance plays a role.

Consequently, the framework displayed as Figure 1 represents a modification of the way in which psychic distance may be viewed. The construct moves beyond cultural distance to include additional national differences and business level differences. As noted, psychic distance only impacts managerial activities as it is interpreted through individual perceptions and experiences. A further elaboration of these components follows.

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***Nation Distance***

The first component of psychic distance, nation distance, includes dimensions of cultural, administrative, geographic, and economic distance, which comprise the CAGE distance framework (Ghemawat, 2001). These four dimensions emphasize the importance of relative distance rather than absolute metrics (e.g., cost structures, market access, market size, and markets' purchasing power). Each dimension plays a role in creating perceptions of psychic distance as interpreted through the individual experiences of organizational members.

Cultural distance has served as a surrogate for psychic distance. National culture consists of the systems of values and norms shared by nationals that in aggregate provide a design for living that are then reflected in the workplace (Hill, 2011). Differences in national cultures are expressed in language, ethnicity, religion, and social norms (Ghemawat, 2001). Shenkar (2001) noted that few constructs have gained as much acceptance in the international business literature as cultural distance. It appears in studies in the fields of management, marketing, finance, and accounting. The concept has also been used to investigate innovation patterns (Gomez-Mejia & Palich, 1997) and expatriate adjustment (Black & Mendenhall, 1991).

The cultural distance concept has been criticized (Shenkar, 2001). Problems may have taken place because it was used in isolation, a situation in which it fails to completely represent every component of psychic distance. Further, the measures used to operationalize cultural distance have been critiqued. One measure, the Kogut and Singh's (1988) assessment, has its basis in the research of Hofstede (1980), which itself has been called into question as being static, insensitive, and flawed (see Shenkar, 2001).

In spite of these conceptual problems, it seems apparent that differences between national cultures exist. The Kogut and Singh (1988) questionnaire provides one measure of these differences. Future studies may offer additional value if multiple measures of culture are included, possibly incorporating other research on culture utilizing such variables as dominant religions and language differences (Schwartz, 1990; Hall, 1959).

Administrative and political distance encompasses nations' historical and political association, shared monetary systems, and legal and financial institutions (Ghemawat, 2001; Hill, 2011; Rothaermel, Kotha, & Steemsa, 2006). Links between former colonies and their colonial power can increase trade considerably as in relations between the United Kingdom and its commonwealth nations and in Spain's relationship with the nations of Latin America. Shared monetary systems

also impact administrative distance, of which the Euro area is perhaps the most prominent example (Ghemawat, 2001). Key issues regarding similarity in legal systems include distinctions between common law and civil law, the nature of contract law, treatment of intellectual property, and product safety and liability. Differences in legal systems and institutions include conditions emanating from the host country such as tariffs, quotas, and restrictions on foreign direct investment (FDI) as well as protection of certain favored industries in the form of subsidies and regulations such as those extended by nations of the European Union to Airbus (Hill, 2011). Differences may also be manifest in practices by the home country. Domestic restrictions on bribery along with policies regarding health, safety, and the environment in the U.S. sometimes constrain development of trade relations in countries not sharing similar values (Ghemawat, 2001). Firms incorporating administrative differences and similarities into decision processes increase the likelihood of success in international trade.

Geographic distance, the third dimension of the CAGE framework, encompasses linear distance along with a range of geographic considerations that impact the attractiveness and, ultimately, the perceived psychic distance between one global market and another (Ghemawat, 2001). Differences in physical size, host country waterways and access to oceans, distances to other nations' borders, topography, and number of time zones (e.g., Russia has 16) are aspects of geographic distance beyond simple linear distances that can significantly influence perceptions of differences between nations. Infrastructure (e.g., roads, power, and telecommunications) clearly affects transportation but also impact flows of intangibles such as equity, knowledge, and information. Further, the types of products a potential trading partner offers can be heavily affected by geographic considerations (Ghemawat, 2001; Rothaermel et al., 2006). Low value to weight products (e.g., cement) and fragile or perishable products are sensitive to transportation issues. Overall, evidence suggests that geographic distance tends to constrain flow of investment and trade (Ghemawat, 2001).

Economic distance often plays a primary role. The conditions of a potential host country's consumer market as indicated by wealth and consumer per capita income are key characteristics affecting distance between countries. Further impacting distance is similarity across countries in the use of economies of experience, scale, and scope, and of standardization. Differences in supply chains and distribution channels can also affect trade. Firms in industries with key cost drivers whose prices vary widely across borders (e.g., garment and footwear) are often able to create value by exploiting these cross-border differences through economic arbitrage

(Ghemawat, 2001). Each of these economic features may separate and distance countries from one another.

Distance is a crucial consideration for managers attempting to expand beyond domestic markets. The CAGE framework offers a granular approach to identifying relative differences between global markets. It is a multi-dimensional concept intended to help managers assess the challenges of distance and the opportunities of similarity in determining the attractiveness of a foreign market.

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### ***Business Distance***

It seems likely that perceptions of psychic distance will be affected by differences in business practices between firms operating in two separate international markets. Therefore, including business distance in any conceptual representation of the psychic distance seems prudent. Business distance contains two levels: industry level differences and firm level differences.

Research by Evans and Movonda (2002) provides one measure of business distance. The authors note impact of industry structure, which is shaped by forms of competition (monopoly, oligopoly), growth rates, and concentration ratios, such as the number of competitors found in a nation or geographic region (Hennart & Larimo 1998; Trimeche 2002). Industry level differences are also manifest in the way industry value chains are organized, especially with respect to distribution channels such as what Procter & Gamble encountered in Japan. There the firm discovered a highly fragmented system involving an intricate series of intermediaries including general wholesalers, product wholesalers, product-specialty wholesalers, regional wholesalers, local wholesalers, and finally retailers adding costs and complexity (Kotler, 2003). The Evans and Movonda approach notes that in some industries, distance levels differ across international boundaries. Some industries remain highly standardized across national boundaries (low distance), while in others international differences become much more pronounced (higher distance). In international finance, one nation may not allow interest to be charged. This in turn affects a wide variety of investment evaluations and decision.

Another perspective regarding industry difference focuses on variances in consumer traits and behaviors (Davidson, 1980; Mitra & Golder, 2002). This industry level difference creates implications for a variety of strategic business activities ranging from product exporting choices to marketing strategies for those products.

Beyond industry differences, Evans and Mavondo (2002) describe firm level business distance in terms of business language, business practices, and marketing

infrastructures. Other researchers use similar measures (Klein & Roth, 1990; Vahlne & Wiedersheim-Paul, 1973). Also, corporate culture tends to be separate from national level cultural differences and often permeates every business activity (Erammilli & Rao, 1990; Weber, Shenkar, & Rayeh, 1996). When interpreted through the individual experiences of managers, these forces may exert greater or lesser influence on perceptions of psychic distance.

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## **INDIVIDUAL EXPERIENCE**

Individual experience constitutes the final component of psychic distance as conceptualized in Figure 1. The inclusion of individual experience constitutes an important component of the psychic distance construct. It may impact the process of strategy evaluation, strategic choice, and the type of managerial structure chosen to be established in a new foreign operation or entity.

Several attempts have been made to explain individual experience. Among them, within-country diversity, accumulated international experience, the similarity-attraction paradigm, attribution theory, social identity theory and in- or out-group status, self-categorization theory, cultural intelligence, and confirmation bias serve as indicators of individual experience (a more complete description of these factors appears in Baack and colleagues (2014). A brief review of these perspectives follows.

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### ***Individual Experience Models***

Within-country diversity implies that a variance exists within each nation in terms of language, religion, and ethnicity. For example, while substantial linguistic differences may be found between Mexico and the United States, a number of Mexican citizens are fluent in English and a number of Americans are fluent in Spanish. The same would hold true in the case of religion, most notably Catholicism. For these individuals, national-level indicators of psychic distance may be misleading, because in that situation psychic distance becomes lower due to the familiarity with the language spoken or religion practiced in the other country. Where cross-understanding or commonality does not exist, the individual experiences increase psychic distance as he or she considers expansion or entry into a more “foreign” country.

International experience constitutes a distance-bridging factor (Child, Ng, & Wong, 2002; Zhao, Luo & Suh, 2004). As an individual travels internationally, he or she may become more comfortable with other nations. This in turn may reduce perceptions of the degree of distance in those countries and also reduce the person’s

perceptions of distance with all foreign countries. Individuals with international experience contribute to a firm's stock of knowledge (Dierickx & Cool, 1989) particularly as it relates to international diversification. In this vein, international expansion to a particular market may be more a means than an end. Expansion to a particular foreign market, while certainly providing some opportunities and benefits for the firm's value creation, may also be a step in building the firm's store of knowledge in order to create greater opportunities in subsequent international market expansion thereby providing a context for additional learning (Verbeke, 2003).

A firm's store of knowledge may benefit from an individual's international experience in at least two ways. First, with long organizational tenure at the focal firm, the individual's international experience may combine with a deep understanding of the firm's codified systems and tacit routines (Capron, Dussauge & Mitchell, 1998; Dyer & Singh, 1998; Nelson & Winter, 1982; Vermeulen & Barkema, 2001) enhancing the firm's capabilities to create additional value through international diversification.

Second, an individual may have gained international experience through work experience with a variety of firms. Recent upper echelons scholarship suggests that although many strategic leaders still rise through the organizational ranks in a single firm or single industry (Kotter, 1982), career variety is increasing among CEOs and executives (Crossland, Zyung, Hiller, & Hambrick, 2014). The increasing cognitive breadth resulting from this career variety tends to increase a manager's tendency toward experimentation and change. Consequently, individual international experience can bring with it considerable knowledge depth and breadth that decreases the perception of psychic distance and increases the likelihood of expansion into a foreign market thereby affecting the decision to enter a foreign market. This knowledge breadth and depth of individual international experience tends to result in reduction of uncertainty concerning the firm's future international prospects making it more likely that the firm will pursue international investments entailing greater risk such as the high resource commitments associated with foreign direct investment (FDI) (Hill, Hwang, & Kim, 1990).

The similarity-attraction paradigm identifies the ways in which people become attracted to things they view as similar while they also find things viewed as different to be unattractive. In terms of individual experience, such differences may lead to reduced interactions with people in other countries or situations. This in turn lessens the frequency of communication (Lincoln & Miller, 1979) and eventually results in diminished trust and weaker intentions to associate (Thomas & Ravlin,



1995). As managers consider international expansion, differences such as these may cause serious concerns. High psychic distance based on differences and lack of attraction between managers in foreign subsidiaries may make it harder for these individuals to understand one another and reduce their willingness to interact and cooperate with each other.

Attribution theory (Heider, 1958) conceptualizes the methods by which a person assigns or attributes responsibility for an action resulting from various contextual factors, one of which is perceptions of similarities between actors. In a case of high psychic distance resulting from individual experience, a manager would be more likely to place responsibility for an adverse outcome in an international operation on the foreign partner. When low psychic distance is present, the responsibility would more likely be attributed to situational influences that are external to the trading partner. The attribution of the manager, then, filters other factors including nation distance, but more importantly, business distance.

Social identity theory examines how people view themselves, how others view them, how they operate in groups, and how they view out-groups. These perceptions affect many fundamental aspects of life including self-concept, self-esteem, and group identification (Ashforth & Mael, 1989). When constructing a perception of the differences between oneself and others; the “other” may become categorized as being part of an out-group. Most people express a preference for an in-group (Billig and Tajfel, 1973). Viewing others as an out-group may result in discrimination along with the tendency to consider members of that out-group in more extreme ways (Ahmed, 2007; Linville & Jones, 1980). Once again, in-group and out-group status will be reflected as individual experience as it alters views of nation and business distance. Consider, for example, the impact of religious affiliation. Current American attitudes often reflect the assignment of out-group status to Islamic citizens, both foreign and domestic. These attitudes would in turn influence the perceived degree of psychic distance when conducting business or considering expansion into some Middle Eastern and African countries.

Self-categorization processes is another key area of study. “Self-categorization theory” and the related concept of cognitive complexity suggest that individuals assign schemas or associative networks in long-term memory (Zarate & Smith, 1990; Turner et al., 1987). Each category consists of nodes or bundles of semantic meaning that form the basis of the overall meaning of the category. The categories vary across individuals based on different life experiences and cognitive abilities.

As cognitive complexity increases, individuals become less likely to rely on simple heuristics, such as stereotypes, and more likely to employ in-depth decision-making thought processes (Park & Lessig, 1981). Self-category theory and the concept of cognitive complexity cannot make unidirectional predictions about perceptions of psychic distance. Instead, greater cognitive complexity may cause one to view a country as closer or more distant, depending on the nature of the heuristic it replaces. This perspective offers implications for the number of underlying dimensions that constitute individual experience. In perceptions of religion, for example, some individuals hold simple schemas that make no distinction between Sunni and Shia, which means they view all forms of Islam as being the same. Others, in contrast, possess more complex schemas and regard the two branches of Islam as being different. In essence, the individual's experience of Islam varies, thereby leading to a subsequent difference in perceptions of psychic distance.

Cultural intelligence concepts originated within the international business domain. It notes that some individuals may more readily adapt to and learn about difference aspects of foreign cultures. Such increased intelligence leads to more effective functioning when interacting with people in those cultures and a swifter acclimation to unique cultural situations (Thomas et al., 2008). Logically, higher levels of cultural intelligence would result in lower perceptions of psychic distance and serve as an individual experience influence on perceptions of other factors.

Finally, confirmation bias explains how an individual's existing attitudes or beliefs influence the process by which he or she seeks out and processes new information. The overarching premise, that when an individual has a hypothesis or belief about a particular issue, that hypothesis or belief then influences the inferences or conclusions he or she draws about any new information (Jussim, 1991). When considering entry into new markets, managers tend to rely on low involvement sources (Reid, 1984). Consequently, the potential for a manager to discount or disregard information that contradicts his or her existing perceptions occurs. Thus, if a manager does exhibit a tendency to focus heavily on information that confirms his or her existing perceptions of psychic distance while avoiding or doubting information contrary to that perception, then the individual considers that information using a strong bias for or against expansion into a new country. Through the use of an experimental design, Baack et al. (2014) demonstrated that, even with a relatively modest intervention, the impact of confirmation bias on perceptions of distance and risk as well as managerial choices was detected.

In summary, the factors associated with nation distance including cultural, administrative, geographic, and economic factors and the factors associated with

business distance such as industry and firm distance are all going to be examined in the light of individual experience. A manager's perception of psychic distance, as it is affected by personal experiences, may constitute an important influence on decisions to enter a country, the mode of entry selected, and the managerial structure to be implemented. The manner in which a manager considers these issues may further impact such decisions and actions.

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### ***Information Processing Models***

Consumer buying decision-making processes have been studied for many years. The result has been a set of models which may be applied to the ways in which individuals consider product purchases. These same models appear to have implications for strategy evaluations and choice processes as they are influenced by individual experiences and subsequent perceptions of psychic distance. Four such models include cognitive mapping, the multi-attribute approach, the evoked set method, and affect referral.

Cognitive maps are used to represent the knowledge structures and memories embodied in an individual's brain (Kearny & Kaplan, 1997). These internal mental structures contain a person's assumptions feelings, beliefs, interpretation of reality, and attitudes regarding the world. Within this framework, when a manager encounters information about a country, it can be processed in several ways. If the new information appears to be consistent with current information the individual holds, then an internal linkage becomes stronger. In other words, the concept that Australia has a great deal in common with the United States may be strengthened by any new information that suggests similarities between the two countries, much in the manner suggested by confirmation bias. If, on the other hand, new information does not have a linkage to any knowledge in the individual's brain, a new linkage will be established. Thus, a person who does not know that cars are driven on the left side of the road, rather than the right as is the case in the U.S. will need to establish a new linkage. The same person may be aware that drivers in England also use the left hand side of the road. The corresponding linkage may be that the United Kingdom and Australia have something in common and that, in spite of driving patterns, other similarities remain with the U.S., such as language. Psychic distance would be lessened as a consequence.

Cognitive mapping also explains how short term processing of information moves into longer term memory (Kaplan & Kaplan, 1982). Repetition represents the process by which a message is processed more than once using the person's

mental linkages, and over time the information becomes stored into the person's knowledge structure. This structure, normally conceptualized as an associative network, serves as the foundation of memory. Consequently, repeated information suggesting that a country "is not all that different from us" would lead to lessened perceptions of psychic distance. Such an approach features messages designed to accentuate similarity-attraction, positive attributions, and suggest an in-group status to recipients.

As cognitive complexity increases, the number of linkages present in a mental "web" rises. An individual with higher levels of cognitive complexity would likely find more similarities but also differences among nations. Subsequent conclusions regarding the perceived degree of psychic distance would then be affected. Cognitive mapping explains such processes much in the same way that cognitive complexity appears to operate. That is, the individual may draw differing conclusions about the degree of psychic difference present by the manner in which he or she considers the perceived or experienced similarities and differences between countries.

The multi-attribute approach applies to high-involvement purchases, and by inference, high-involvement strategic decisions (Wilkie & Pessemier, 1983). A consumer considers products in terms of performance over a series of attributes along with the importance of each attribute. For example, when buying a car, the consumer thinks about gas mileage, comfort, reliability, and the looks of the vehicle. A purchaser ranks the attributes from most important to least important and then rates each individual attribute. Someone who values comfort over every other feature gives that factor the greatest weight, with the most comfortable car gaining the highest ranking on that factor (Bettman, 1979). The sum of the evaluations of the total set of factors, each weighted in terms of importance, then influences the final purchasing choice.

In terms of psychic distance, a manager considers the components displayed in Figure 1, or nation distance in terms of cultural, administrative, geographic, and economic factors along with business distance in terms of industry and firm factors. Each nation under consideration receives a mental rating for all of the factors which are have been ranked in terms of importance to the manager. These assessments will be influenced by the manager's individual experience. A person who values similarity or in-group status may rank a common language or religion as the most important factor and economic distance as the least, for example. The net result would be a cumulative evaluation of the nation in terms of psychic distance as interpreted

across various attributes with varying levels of importance to the manager making the assessment.

The evoked set conceptualization suggests that individuals make purchases by considering a set of products or companies that first come to mind when the person experiences a need (Zeithaml, 1981). For example, if asked, "Where do you go for a good steak at a restaurant?" the respondent will recall a set of dining establishments that immediately enters his or her thoughts. That group is the evoked set. In strategic terms, the question, "Which country do you think would be best for entry?" would lead to a response naming the nations that come to mind, or the respondent's evoked set.

Two additional factors are present. An inept set contains the products, brands, or companies that individuals will not consider because they elicit negative feelings. Someone with a negative attitude toward a specific restaurant would not consider going to that establishment to dine. In psychic distance/individual experience terms, those in the out-group stay in the out-group and those that are dissimilar remain dissimilar, which further reflects the presence of a confirmation bias. In terms of strategic decision-making, individual experience would dictate that a nation will not be considered as a target for expansion as a result. Any nation which has been engaged in a war with the home company's country may be quickly placed into an inept set due to individual experience perceptions and its corresponding confirmation bias tendency.

The inert set contains brands the consumer knows about but has neither positive nor negative feelings regarding them. In cognitive mapping terms, no linkage is present. The consequence will be that the brand may be eliminated simply due to lack of knowledge. Often, marketers seek to change that outcome through advertising and other marketing messages. Many nations may be found in the inert sets of managers considering international expansion. The goal for leaders in those countries would be to help their nations move into a decision-maker's evoked set by creating positive emotions and increasing memories of those countries and emotions.

Affect referral posits that consumers select the brands they like or the ones with which they hold emotional connections (Sneider, 2004). This eliminates thoughts about other brands or products. Most of the time, affect referral applies to low involvement purchases.

In terms of strategic choice, affect referral would imply that managers will only consider expansion into countries with which they hold positive emotions and those that they perceive would be relatively easy to enter. Once again, similarity, in-group status, and confirmation bias might become part of a response modeled by

affect referral. For example, a Canadian manager asked to choose the next country to expand into might quickly respond “the United States,” due to positive feelings and the perceived ease of entry.

Affect referral requires the least amount of mental energy. It also explains how a previous choice (sending one product into a new country), which has been made using a more complex information processing model such as the multi-attribute approach, will simply be confirmed in a subsequent choice. Nations belonging to the European Union may contain managers who only consider other member nations when making strategic internationalization choices.

These information processing models imply that the individual experience components can be combined with models of how individuals make purchasing decisions to further explain the ways in which managers considering internationalization think about their choices. Subsequent decisions to enter or not enter a specific country, to utilize a certain mode of entry, and to establish a form of managerial structure may be more clearly understood through such an analysis. Previous international experiences, perceptions of similarity, confirmation bias, in-group status, and various attributions may influence such choices.

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### ***Operationalization of Individual Experience***

Very few marketing studies include measures of individual experience in any model or methodology regarding psychic distance. The studies that include experience serve as the foundation for operationalizing this component of psychic distance. Dichtl, Keoglmayr, and Mueller (1990) studied individual manager variables including education level, proficiency in foreign languages, degree of foreign travel, and foreign market orientations. Other measures of individual experience might include a manager’s knowledge of the foreign market and actual experience and comfort level with this market.

Additional research could incorporate the personal variables noted here, including perceptions of similarity and difference, the degree or amount of international experience, reflections on in- or out-group status with a particular country in mind, the presence of confirmation bias (as explored in the Baack et al. 2014 study), and measures of cultural intelligence. Individual experience is open to investigation using qualitative methods, such as in-depth interviews combined with observations of the decision-maker’s activities. Post hoc analyses of decisions to enter foreign markets, choices of entry modes, and the types of managerial structures

implemented might also provide valuable insights into strategic decision-making processes in international settings.

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## **PSYCHIC DISTANCE AND STRATEGIC MANAGEMENT**

The psychic distance concept has been applied to strategic marketing management studies. The foreign direct investment (FDI) process serves as an example. The three main FDI outcomes connected to psychic distance in the marketing literature include: foreign market investment location decisions and the sequence of the investments, the choice of entry mode into a foreign market, and the performance levels of multinational firm affiliates (Shenkar, 2001). Two of these outcomes apply to strategic management. That is, psychic distance may affect decisions to engage in international operations, choices of country to enter, and modes of entry selected. Psychic distance may further explain the managerial structure that will be put into place.

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### ***Choices of Countries to Enter***

Psychic distance has been strongly linked to the decision to begin international activity in the first place (Johanson and Vahlne, 1977; 2009). Then, deciding where to compete constitutes an integral part of a firm's corporate level strategy. The role psychic distance plays in such decisions may be an important factor in a strategic manager's (or management team's) decision to enter a specific foreign market, because the impact of psychic distance may be context specific and vary in importance by industry and by certain firm characteristics. Such evaluations can be modeled using the multi-attribute approach or through assessments of a manager's evoked set.

As a general rule, perceptions of low degrees of psychic distance would seemingly be associated with greater propensities to enter specific countries. If another nation is viewed as "not all that much different," the decision to select that country as a place to enter becomes easier. In contrast, high perceived psychic distance between a home country and a potential host country would logically result in increased concern regarding the difficulty of entering that specific nation.

As an example, industries producing highly consumable products such as food and entertainment may be greatly impacted by cultural factors, thereby influencing perceptions of psychic distance. Industries enmeshed tightly with a country's reputation or national security, such as aerospace, would also affect the degree of psychic distance experienced by a top level manager. Further, low value-



to-weight ratios in the cement industry constrain potential international market options, and the demand for automobiles is income dependent, thereby constraining the potential for development of international markets. Consequently, the industry in which a firm operates affects perceptions of psychic distance as part of the decision to enter a specific foreign market (Ghemawat, 2001), and these factors may be assessed in the manner suggested by the various decision-making modes, such as the multi-attribute approach or confirmation bias.

With regard to the actual choices of countries, some research suggests that firms are more likely to enter geographically-close countries (Davidson 1980, Johanson and Wiedersheim-Paul, 1975; Denis and Depelteau, 1985; Welch and Luostarinen, 1988). Logically, a nearby country may influence individual strategic decision-makers because their perceptions include the view that those nations are culturally similar and may have a greater number of economic, industry-level and business-level similarities, thereby reducing perceived psychic distance.

At the same time, the primary impact of psychic distance in the decision to expand into another country has not always been clearly supported by past research. It is possible that a more complex conceptualization, such as the one provided in Figure 1, may lead to more in-depth analyses of these relationships in the future. As an example, consider the differences between perceptions of Canada and Mexico by managers in the United States. Factors such as similarity-attraction based on language and/or religion may come into play.

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### ***Modes of Entry***

Psychic distance may be a factor that affects the choice of entry mode. Standard entry modes include exporting, licensing, franchising, joint ventures, strategic alliances, acquisitions (minority, majority, or total), and greenfield (startup) ventures (Agarwal, 1994; Hill et al., 1990). Costs, levels of risk, and the degree of control constitute three factors influencing such choices (Anderson & Gatignon, 1986).

In general terms, the more involved the modes of entry, in terms of a company's investment of time and other resources, the greater degree of control that company will seek to hold. At the same time, greater involvement creates increased costs and higher levels of risk. Psychic distance, then, may play a key role in the selection of entry mode. The lower the degree of perceived psychic distance, the more likely it becomes that entry will include a more complex and involved entry strategy.



Conversely, greater psychic distance would be associated with increased reticence with regard to making an involved, higher cost, more complex entry choice.

In some cases, exports may be the only mode available due to a lack of knowledge and/or risk aversion. When considering exporting, structural arrangements for such an approach typically depend on either arm's length relationships with intermediaries specializing in foreign trade including traveling sales representatives and foreign-based distributors or agents or on internally coordinated organizational subunits such as domestic-based export departments or overseas sales branches.

The choice of exporting as a mode of entry may be impacted by psychic distance in a number of ways. The uncertainty of local market acceptance of the entering firm's product offering increases that firm's risk in entering the market. A firm may lack understanding of local business practices and may only with difficulty be able to reach local potential customers without the assistance of local partners. The entering firm may also lack sufficient knowledge to recruit, hire, and manage local personnel. These attributes reflect both nation distance, as demonstrated by the CAGE framework, and business distance in terms of a lack of knowledge by the firm of local practices.

Exporting avoids the investment costs of establishing operations in the host country and may allow an exporting firm pursuing a cost leadership strategy to benefit from potential cost advantages from production in its home market (Hill et al., 1990; Hitt, Ireland, & Hoskisson, 2009), which in turn may lower perceptions of psychic distance.

On the other hand, exporting entails transportation costs and regulatory constraints including potential tariffs and other import duties. Reliance on third party intermediaries for marketing, distribution, and sales means higher transaction costs will be associated with contract specification, monitoring, and enforcement (Hill et al., 1990; Williamson, 1996), thereby producing heightened feelings regarding the degree of distance present.

The size of the potential market can require the firm to seek more effective ways of reaching local customers while still recognizing the impact of constraints of distance driving a firm to pursue licensing as a mode of entry. In a licensing arrangement, the licensee assumes the business risks and fixed and variable costs associated with manufacturing and marketing the product (Hill et al., 1990), because the home firm sells the rights to a host country firm to manufacture and market the home firm's products in the host country in exchange for royalties.

Licensing may allow the firm to make use of host country expertise, for example, in product development or distribution systems and also allow a local

firm access to the foreign firm's knowledge base allowing both firms to share in the revenue. Consequently, perceptions of the degree of psychic distance may decrease, due to the conclusion that lower levels of risk and cost are present. Factors that might heighten the perceived degree of psychic distance would include the other costs associated with contracting (searching for an agent, negotiating, monitoring, and enforcement) and the risks that the licensee may learn how to develop the product on its own (dissemination risk) (Hill et al., 1990). The multi-attribute model may be used to assess the relative importance of each of these factors (in the mind of the decision-maker/s) affecting the choice of entry mode.

With franchising, the franchisee bears the bulk of the investment risk as the franchisor bears the costs of enforcing quality control in addition to the larger issues of contract specification, monitoring, and enforcement which are exacerbated by distance (Hill et al., 1990) and, in some cases, differences in the institutional environments of the two countries. Business level factors constitute the primary force affecting psychic distance in such deliberations, and these in turn would be influenced by factors such as similarity-attraction or out-group status.

Multi-firm equity strategic alliances include European Aeronautic Defense and Space (EADS), an alliance of aerospace firms from the U.K., Spain, Germany, and France, a collaborative arrangement between Microsoft and Toshiba to develop embedded processors for running on-board entertainment functions in automobiles, and Nestlé's 16% stake in L'Oreal. In these arrangements, the credible commitment implied by the equity investment may offer partial security against opportunism by the foreign partner (Williamson, 1990) which would reduce perceptions of psychic distance. Conversely, the same arrangements entail clear long-term agreements with the foreign partners, which create high exit costs. Strategic decision-makers would likely be influenced by such factors, which would be associated with the perceived degree of distance present.

High-profile examples of international joint ventures exist. General Motors is involved in a three party joint venture in China with Shanghai Automotive Industrial corporation (SAIC) and Wuling, a Chinese manufacturer, to produce the Wuling Sunshine, a mini-commercial vehicle for use within China (Muller, 2010). In the petroleum industry, Chevron and Phillips have combined subunits to create Chevron Phillips Chemical Company to develop petrochemicals (Stynes, 2014). Managers assessing economic and business level factors would filter such considerations through the lens of individual experience, when considering potential mergers. Strategic alliances including both equity strategic alliances and joint ventures are

dependent on a certain level of trust that is likely only with a relatively low degree of distance (Dyer and Singh, 1998).

In the case of wholly owned subsidiaries either as acquisitions or as greenfield ventures, the firm shoulders 100% of the risk but also maintains 100% of control. The expanding firm must be capable of understanding and controlling local operations suggesting that only in situations of low distance should firms engage in wholly owned subsidiaries as a mode of entry. Cross-border acquisitions, such as Kraft's 2009 purchase of Cadbury, are on the increase (Jarrone, 2011). These provide a rapid means for large scale initial international expansion and afford the acquirer full control over operations. Cross-border acquisitions entail several difficulties. They often involve large amounts of debt financing, are typically more complex than domestic deals (Weitzel & Berns, 2006), and may involve legal and regulatory considerations of both the acquirer's home country and the host country of the target firm (Hitt, Ireland, & Hoskisson, 2009). Evaluations of such complexity would likely increase perceptions of psychic distance as interpreted through individual experience. Factors such as within-country diversity in the company to be acquired along with the accumulated international experience and level of cultural intelligence of the decision-maker may influence such deliberations.

Acquisitions should typically occur only when there is low distance because the existence in the host market of businesses ripe for acquisition implies an established market for the firm's product and existing know-how in terms of production, marketing, and distribution. When such attributes are not present but market conditions have demonstrated strong existing and growing demand, greenfield ventures become more likely.

Greenfield ventures are the establishment of a wholly owned subsidiary built from the ground up. Greenfield ventures may allow protection of intangible capabilities (Barney, 1991; Conner, 1991; Dierickx and Cool, 1989; Kor and Mahoney, 2000). In its U.S. market, Toyota shifted from exporting to wholly owned subsidiaries bypassing collaborative strategies to protect its knowledge base from appropriation from potential U.S. partners. Firms generally use acquisition and greenfield ventures in later stages of development of international strategies. At the same time, when wholly owned subsidiaries are warranted from a business standpoint and under conditions of low psychic distance, local regulations may require a certain level of local ownership suggesting the need for joint ventures instead. In such cases, most of the components of psychic distance are low, but administrative distance in the form of local regulations becomes a rather stubborn driver of distance. McDonald's faced similar conditions during its early expansion into Europe, forcing the firm to

create a number of joint ventures when it might otherwise have chosen to operate wholly owned subsidiaries. Advantages of greenfield ventures include maintaining control over technology, production, marketing, and distribution. Disadvantages include high fixed costs and employment of host nationals.

Psychic distance may play differing roles in the determination of whether to pursue a greenfield venture. A foreign firm pursuing a wholly owned subsidiary entry mode may construct its own facility rather than acquire existing operations. Toyota was quite familiar with the U.S. automobile market by the time the company was ready to manufacture cars in the U.S., and the Japanese firm was generating considerable revenues from U.S. operations. The firm's leaders did choose to build company-designed plants (moving from exporting to greenfield ventures) conforming to its rather unique business practices that would likely not have fit well with U.S. automotive plant layouts. In that case, the impact of psychic distance was reduced through the individual, group, and enterprise levels of experience with the U.S. market, but the firm chose greenfield ventures in order to maintain and protect many of its unique capabilities.

Kikkoman's construction of a soy sauce production facility may also have been driven by factors other than psychic distance. The firm was also familiar with the U.S. market, having sold its products for nearly two decades through exporting, licensing, and joint ventures. Company managers concluded, however, that the complexities of soy sauce production, the need for deep expertise in those processes, and the lack of existing soy sauce plants in the U.S. created the need for a greenfield venture (Tanaka, Taylor, and Claterbos, 2001).

In both the Kikkoman and Toyota cases, nation distance may have been reduced through long periods of individual experience, while business distance may have continued to play a role. Ultimately, it was the demands of the product and processes that were largely the determinants of the choice of greenfield ventures.

The final choice of mode of entry is somewhat dependent on internal firm processes, and the dynamics of the various modes of entry mean that the choice of mode is highly situation-dependent (Hitt et al., 2009). Firms whose creation of value is knowledge intensive are more likely to gravitate toward modes of entry associated with greater levels of control. Although such a choice increases the level of investment risk, it tends to reduce the level of dissemination risk, the risk that the firm's knowledge base may be appropriated by an opportunistic foreign partner and used by the foreign firm to develop its own market for the focal firm's products (Hill et al., 1990). Therefore, it seems plausible that when individual experience factors

reduce perceptions of psychic distance, the likelihood of entering a foreign market would increase, assuming all things remain equal.

Some studies have investigated the impact of psychic distance on entry mode choice, with mixed results (Brouthers & Brouthers, 2001). Eclectic theory suggests that location familiarity (an individual experience component of psychic distance) affects several managerial decisions including the choice of entry mode (Hill et al., 1990; Brouthers & Brouthers, 2000). Although a relationship between psychic distance and the choice of entry mode may be present, the form that relationship takes has not been consistent. For instance, high levels of cultural distance are associated with modes in which greater control is present, such as wholly-owned subsidiaries in Anand and Delios (1997). In other research, high levels of psychic distance were associated with shared or low control modes (Kogut & Singh, 1988; Erramilli & Rao, 1990; Kim & Hwang, 1992). In other research, no relationship was found (Erramilli, 1996; Gatignon & Anderson, 1988; Larimo, 1993). Again, future research utilizing a more complex conceptualization of psychic distance might yield more precise and informative results.

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### ***Managerial Structure***

The choice of managerial structure accompanies the selection of an entry mode. The assignment of general managers of foreign markets (managerial structure) typically centers around three choices: whether to assign a home country national, a host country national, or a third country national. As with the decision to enter a foreign market and which mode of entry to use, all things being equal, individual experience may also influence these managerial decisions.

Numerous factors might affect the choice of managerial structure (Agarwal & Ramaswami, 1992; Barkema, Shenkar, & Vermeulen, 1997). Culture, religion, and language affect perceptions of nation distance. Industry and firm distance represent business level factors that also influence the degree of psychic distance. A mechanism by which such decisions are made or influenced would be to incorporate components in individual experience into the degree of psychic distance perceived and subsequent choices. In other words, considering managerial structure choices in terms of similarity-attraction, in-group/out-group status, attribution considerations, the degree of foreign experience, and confirmation bias might provide quality insights into such selections.

As a component of individual experience, within-country diversity may impact international choices facing organizational decision makers with regard

to managerial structure. Also, exposure to a variety of differences within one's own country (e.g., language, religion, and ethnicity) may make one more readily adaptable and accepting of cultural differences, thereby reducing psychic distance. The example provided earlier of diversity in the U.S. of Anglo and Hispanic cultural diversity may also extend to other countries. Switzerland has three official national languages, Belgium two, and Spain has several unofficial languages although Spanish is the official language in most areas of the country. People raised in such diverse cultures in their own countries may view other cultures as less psychically distant. Furthermore, this tendency may be magnified by certain geographical factors such as size and population. A densely populated, diverse country may result in more pronounced experiences of diversity among its populace. In addition, a relatively small country geographically will have less distance to its borders and may border many more countries than would a geographically larger country. Further, a small population may drive local firms to seek overseas markets sooner than would firms in countries with larger domestic markets (Ghemawat, 2001). Thus, within-country diversity might result in individual experiences that reduce perceptions of psychic distance.

Cognitive maps, the multi-attribute model, evoked sets, and the affect referral model could be also used to explain the processes by which managers consider and analyze the type of individual who would be suited to an international expansion operation. For example, the combination of international knowledge and reduction of uncertainty may lead the firm to consider other managerial structures by examining the range of managerial talent. This suggests that third country expatriates would become candidates as country subsidiary managers.

Low psychic distance, or similarity, would likely lead a firm entering a foreign market to assign general management responsibilities to a host country national. Low psychic distance implies a high degree of mutual understanding by firm managers and host country nationals regarding host country culture, administrative infrastructure, geography, and economic system. As psychic distance increases, it becomes more likely for the firm to prefer a home country national as general manager in order to maintain control over the foreign division and maintain consistency in communications within the division and between the division and corporate offices.

Cases of highest psychic distance may lead the firm to assign general management responsibilities to a third country national. This individual may be one with firm experience in another foreign division or an outsider with a certain level of international experience who understands the firm and its home country as well as understanding the host country.

In general, the greater the degree of perceived psychic distance, the less likely a host country national is to assume general management responsibilities of the foreign division. Further, as psychic distance increases it becomes more likely for the firm to rely heavily first on intrafirm experience in the host country, then on intrafirm experience abroad, and then on experience outside the firm but with strong international experience.

The experience of Kikkoman, the soy sauce producer, expanding into the U.S. market illustrates some of these processes (Tanaka et al., 2001). The firm first entered the market as an exporter relying on such specializing intermediaries as domestic-based export agents and U.S. distributors knowledgeable about the U.S. and perhaps with some knowledge of Kikkoman's products and their consumer applications. As the market grew, the firm grew to rely on more involved modes of entry until it built its own production facility in Walworth, Wisconsin. Although Kikkoman had had a U.S. presence for nearly twenty-five years, this was the first Japanese owned manufacturing plant to be built in the U.S. The plant manager, the finance manager, and the laboratory manager were considered the three key senior management positions and were held by Japanese employees of Kikkoman. This was due to the rather complex production processes, the associated technologies, and the century long involvement of Kikkoman in soy sauce production and distribution. This management structure allowed the U.S. division of Kikkoman to operate as an American firm in the Japanese style. As the firm's U.S. market developed further, the management became more American in character, and the plant manager position eventually went to an American. Hence, upon entering the U.S. market, Kikkoman relied on home country nationals as general managers but became sufficiently assimilated to U.S. styles that a host country national eventually took the position.

The knowledge breadth and depth of individual international experience (as may be modeled with cognitive maps) will likely result in less cognitive simplification typical of management when confronted with cognitive complexity leading to less reliance on simplifying heuristics such as stereotypes and leading to greater cultural intelligence. The result is that attributes and characteristics encountered in the realms of international expansion will be seen as more similar than to individuals with more narrow and more shallow knowledge bases, and those attributes and characteristics may seem more attractive resulting in greater attraction thereby reducing psychic distance. In addition, there might be fewer tendencies to categorize differences based on in-group/out-group distinctions.



## CONCLUSIONS AND IMPLICATIONS

This investigation seeks to explore relationships between psychic distance and strategic international considerations as reflected in strategy evaluations, strategic choices, and the choice of managerial structure to be deployed in an international expansion. Figure 2 summarizes these proposed relationships. The assertion being made is that individual experience plays an important role in such deliberations. Individual experience can be viewed as the various components involved or through the use of consumer purchasing decision models.

**Figure 2**  
**Proposed relationships of psychic distance and involvement**  
**in international expansion**

1.	Greater nation distance as interpreted through individual experience results in greater perceived psychic distance.
2.	Greater business distance as interpreted through individual experience results in greater perceived psychic distance.
3.	Greater perceived psychic distance as interpreted through individual experience reduces managerial intentions to expand across national borders.
4.	Greater perceived psychic distance as interpreted through individual experience results in less complex modes of entry involving lower levels of investment risk and lower levels of control by the focal firm.
5.	Greater perceived psychic distance as interpreted through individual experience results in a higher likelihood of employing a foreign national either from the host country or from a third country.

In general, greater psychic distance would be viewed as likely to reduce the inclination to enter any new country or pursue an internationalization strategy. Greater psychic distance would logically influence leaders (through processes interpreted by individual experience) to avoid or be less inclined to enter certain countries, while low psychic distance would make a nation appear to be more inviting. Psychic distance influences the degree of complexity and control associated with various modes of entry. And finally, psychic distance has an impact on the choice of home country, host country, or third party nationals as managers in international subsidiaries.



Two arguments have been made for including individual experience in the psychic distance construct. One is that that individual experiences were part of the initial development of the construct (Johanson & Vahlne, 1977; Hallen and Wiedersheim-Paul, 1984). Second, removing individual experience would take away the psychic aspect, leaving only “distance.”

It may be that the actual relationships are more complex and multi-dimensional. Interactions between the three components within the domain of the construct (nation distance, business distance, and individual experience) are likely to be complex and interact with one another. These relationships may become more complicated in strategic decision-making processes, especially those in which groups of individuals voice views reflecting each person’s perception of the degree of psychic distance present with regard to any given potential target nation.

Some international business experts believe that, for the concept of psychic distance to remain useful, greater clarity regarding terms will be necessary (Shenkar, 2001; Dow, 2000; Evans et al., 2000; Brouthers & Brouthers, 2001; Barkema, Bell, & Pennings, 1996). Brouthers and Brouthers (2001) argue that business practice differences and perceptual components of psychic distance are key facets of the construct that have not been included in various studies. Instead, the majority of empirical studies substitute cultural distance for psychic distance (Shenkar, 2001). This approach limits psychic distance to one facet. Such an approach may explain some of the conflicting findings present in studies of psychic distance and subsequent outcomes. Therefore, the complete conceptualization of the psychic distance construct as presented here may be of some use.

In the end, the goal of this paper is to change the way the psychic distance construct is viewed and used. In addition, the suggestion being offered is that the psychic distance construct provides an insightful lens into studies of the ways in which top managers make strategic internationalization decisions as well as influence the forms of entry strategies and managerial arrangements that result.

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