

**THE ROLE OF CULTURE IN THE INTERNATIONAL MARKET  
SELECTION DECISIONS OF AUSTRALIAN FIRMS.**

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**ABSTRACT**

Underlying much of the research into how and why firms choose which international market to enter is the concept of psychic distance. The broad argument states that the closer the culture of the host country to that of a potential country market, the more likely that that country will be seen as “easier” and therefore will be entered first. When this concept is operationalised in academic research, it is usually done through the application of adaptations of Hofstede’s (1980) model of national culture (Fletcher and Bohne 1998; Kogut and Singh 1988). The research discussed in this paper explores psychic distance through the use of qualitative in-depth interviews with the senior executives responsible for selection of international markets in six purposefully sampled firms. The findings of the research indicate that psychic distance, as frequently operationalised at a national level is not an important influence on market selection decisions of Australian firms. However, the cases do show some support for the influence of psychic distance at the firm level, at least in respect of first country markets. Based on an examination of key demographic and socio-cultural statistics, we suggest reasons why psychic distance in the Australian context needs to be operationalised at the firm level.

*Keywords:* Culture, psychic distance, Australia, market entry, internationalisation

# **THE EFFECT OF CULTURE ON THE INTERNATIONAL MARKET SELECTION DECISIONS OF AUSTRALIAN FIRMS.**

## **Introduction**

One of the central features of international business is the international market selection (IMS) process employed by firms in establishing their geographic target markets. IMS is an element of operations that firms need to get right (Kay 1993; O'Farrell & Wood 1994; Papadopoulos & Denis 1988). It is not a simple process, as the “best” markets may not necessarily be the obviously attractive or geographically convenient countries but also may be newly emerging, exotic markets or indeed countries “in decline”. According to Douglas, Craig and Keegan (1982, p.27): “the major problem (in IMS) is the bewildering array of countries and markets throughout the world...”

Within the international market selection literature, the theory most widely accepted is that of internationalisation via psychic distance, developed by Johanson and Wiedersheim-Paul (1975) and Johanson and Vahlne (1977). Some researchers (Fletcher & Bohn 1998; Kogut & Singh 1988) in turn attribute psychic distance to cultural differences between firms as measured by the national cultural determinants identified by Hofstede (1980). Others emphasise the importance of the idiosyncrasies of different firms and advocate study of psychic distance via the minds of individual firm managers (Petersen and Pedersen 1996).

This paper is based on recent research into the IMS practices of Australian firms which throws considerable doubt, in the Australian context, on the validity of the connection between culture as measured at a national level by Hofstede's (1980)

determinants and overseas markets. It does however provide support for the psychic distance concept at the firm level for the first markets and for some later ones.

## **Research Issues**

Psychic distance conceptualises the idea that firms tend to internationalise via country markets from which information flows are relatively unimpeded, because those countries can more easily be understood by managers (Cavusgil & Godiwalla 1982; Johanson & Wiedersheim-Paul 1975). The “easy” countries are targeted first and the more difficult ones later. Researchers also developed at the same time a theory of “stage” internationalisation which argues that firms consolidate their positions in their overseas markets in stages, developing their businesses through higher and higher levels of commitment over time, broadly from export through distributors to a local marketing office to joint venture or subsidiary operation as appropriate (Andersen 1997). “Stages” theory of ongoing deeper commitments to foreign markets over time has been supported by many researchers (Crick 1995; Moon & Lee 1990; Rao & Naidu 1992). The combined theories of psychic distance and increasing commitment thus broadly define the countries that firms will begin to export to, which are also the countries in which the firms first consolidate and expand.

If psychic distance identifies the markets a nation’s firms are initially attracted to and if those countries are the ones the firms first consolidate and expand operations in, then that process might help explain differences in a nation’s trading pattern with other countries. Under these circumstances Australia’s total export performance would be skewed towards those countries which were psychically near, as it is those countries that Australian firms would initially sell to and it is those countries that would be the subject of the firms’ increasing commitment to international activities,

as suggested by the “stages” model. When confronted with the extraordinarily high levels of market penetration achieved by Australia in New Zealand’s import market (DFAT 1999b), psychic distance seems indeed to hold some explanatory power.

### **The psychic distance anomaly**

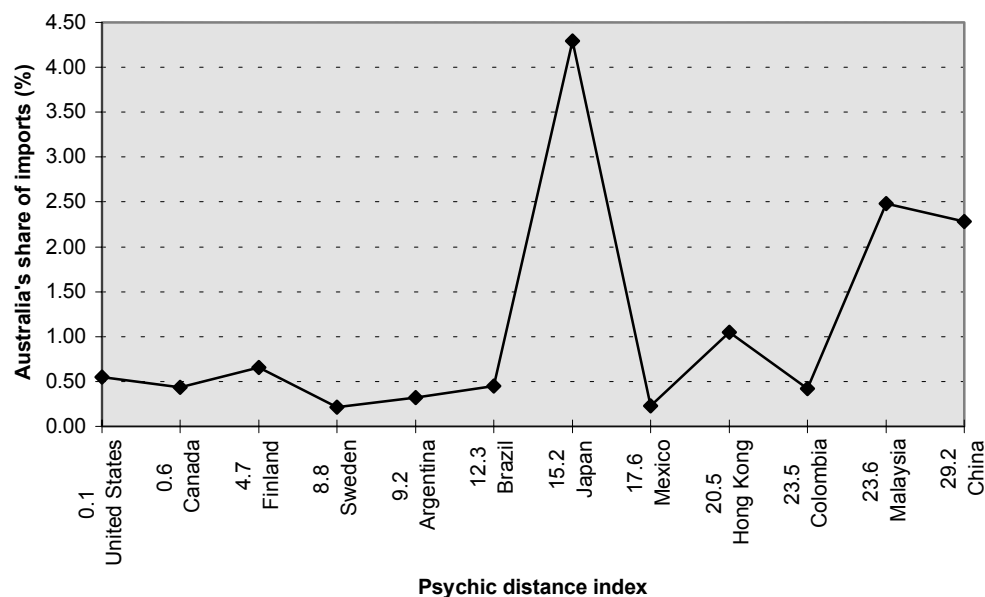
Pursuing this line of explanation, the authors sought to match Australia’s export performance over a range of diverse trading partners with the dimension of psychic distance. Export performance was assessed by the percentage of import market share captured in each country rather than dollar sales to avoid distortions caused by differing country market sizes. To operationalise psychic distance, the authors use Fletcher and Bohne’s (1998) adaptation for Australia of a measure of psychic distance developed by Kogut and Singh (1988). The Kogut and Singh measure was based on Hofstede’s (1980) dimensions of cultural differences which, it is argued, directly influence business dealings (Cicic, Patterson & Shoham 1999). In particular cultural differences impact directly on managers’ perceptions of a foreign country and their desire to do business there (Fletcher & Bohn 1998). Indeed the relevance of cultural distance to the internationalisation process has been claimed to be “confirmed” by Johanson and Vahlne (1990, p.14). Fletcher and Bohn’s psychic distance ratings for Australia are reproduced in Appendix 1.

An examination of this table throws up a host of interesting anomalies. If the principle of psychic distance holds, Australia should trade at noticeably higher levels of market share with psychically close nations than with distant ones. In the psychic distance table at Appendix 1, Argentina is considered at a medium level of psychic distance from Australia and Malaysia is at a much further distance. Yet Malaysia is one of Australia’s major trading partners and Argentina is insignificant in terms of

both dollar values and market share (DFAT 1999a). Similar difficulties arise in attempting to understand the relationship between trade and psychic distance between Australia and China, one of Australia's most important markets and yet at the extremity of psychic distance. Australia's largest export market by far, Japan, is mid way along the psychic distance continuum. Inconsistencies exist with many other countries.

Figure 1 highlights the apparent lack of correlation between psychic distance as operationalised above and Australian export sales.

**Figure 1 Australia's psychic distance and import market share - selected countries (1997).**



Source: prepared for this research from IMF 1998 data and Appendix 1.

Thus, there appears to be something fundamentally flawed with either the psychic distance concept in explaining Australia's internationalisation or in the part that national culture is thought to play in the phenomenon.

Petersen and Pedersen (1996) claim that confusion in understanding the

concept has led to psychic distance being based on irrelevant national aggregate measures instead of criteria that relate specifically to the firm itself, as it is the firm's managers that have the perception of psychic (as well as geographic) distance and national averages are misleading. National level measures of psychic distance are thus justifiably criticised but this does not invalidate the theory, merely its common operationalisation. Their position is that "all deviations from a certain psychic distance pattern can be explained by special circumstances on the part of the observed company" (p.131). This proposition underlines the importance of managers' behaviour within firms and implies that national psychic distance calculations of the type used by Fletcher and Bohne (1998) can be highly misleading. The firm level explanation of psychic distance as interpreted through the behaviour of managers is logically appealing in an Australian context because, firstly, the diverse mix of the Australian population in itself means that the Australian business community may be psychically closer to many countries with which it trades. Secondly, the multicultural nature of Australia means that even Australians whose heritage is Anglo-celtic or another psychically close European origin, are likely to be exposed to a variety of cultures and feel psychically closer to these cultures than expected.

We propose that there are several important forces that we suggest are facilitating the cultural openness, and therefore affecting perceptions of psychic distance, within Australia's national business culture. Australia is a country made up predominantly of migrants. 23% of Australia's population were born overseas, and 61% of these came from non-English speaking countries. (ABS, 2000b). The 1996 census data shows a further 27%, or 3.8 million people born in Australia had at least one overseas born parent (ABS, 2000b). 2.6 million Australians used a language other than English at home and there were 112 major non-indigenous languages spoken in

Australia (ABS, 1999). Australian Bureau of Statistics demographic data for 1999 shows that Chile, Former USSR, Former Yugoslavia, Greece, Hong Kong, India, the Philippines and Vietnam, are in the top 10 countries for overseas born Australian residents (ABS, 1999). All these countries are rated as having high psychic distance in the calculations of Fletcher & Bohn (1998). Further to this when we examine recent migration patterns, we find there are five countries of the top 10 sources of arrivals which are large trading partners of Australia's, but have high psychic distance scores. These include China, Hong Kong, the Philippines, Vietnam and India (DIMA, 1999a).

The migrant settlement pattern in Australia also diverges from that of many other countries. Generally, migrants disperse either at the first or second generation level into the broader community, rather than concentrate in particular suburbs (ABS, 1995). In addition, there is a high level of cultural diversity in marriages in Australia. In 1974, 39% of marriages were between people of different birthplace groups, and this rose to 52% in 1998 (ABS 2000a). If, based on low psychic distance, we exclude those born in the UK, Ireland and New Zealand from these figures, we still have 14% of marriages in 1974 and 23 % of marriages in 1998 being culturally diverse based on birthplace (ABS, 2000a). A further 21% of marriages were between "long-time" Australians and second generation Australians in 1998, up from 16% in 1974 (ABS, 2000a).

There are other contributing factors that would support this multicultural trend. In the five years to June 1998, 1.2 million people arrived in Australia (settler arrivals, Australian residents returning from overseas trips of 12 months or more, overseas visitors intending to stay for more than one year) and 791,000 people departed on a permanent or long term basis (ABS, 2000c). Again, we argue that given Australia's small population (about 18 Million), the exposure to diverse cultures that this type of

population movement represents contributes to a changed perception of psychic distance.

In addition, short-term tourism also is a major part of Australia's socio-cultural experience. Tourism to Australia is the second largest export earner for the country at \$A7.8 billion in 1998/99 (IDP, 2000a). In the 12 months ending February 2000, over 700,000 Japanese short-term visitors arrived in Australia, with a further 1.183 million visitors arriving from other Asian countries. By comparison, 1.84 million Australian residents, or approximately 10% of the population, made short term visits overseas in the 12 months ending June, 1999 (DIMA 1999b). Again, we suggest that psychic distance would be reduced by the exposure to other cultures that this level of tourism gives to Australians.

Finally, the impact of international education also acts to reduce psychic distance in a multi-dimensional way. International education in 1998-99 was Australia's eighth largest export industry, earning \$A3.149 billion (IDP, 2000a). In the first semester of 2000 there were 108,600 foreign students studying at Australian universities; resident in Australia (70,400), by distance (6,300) or on Australian university campuses abroad (31,900). This represents 14.8% of the total Australian university population. Two thirds (67%) of these students came from Malaysia, Indonesia, China, Hong Kong or Singapore (IDP, 2000b), all of which are described as psychically distant. Asian students studying in Australia is not a new trend. The Colombo Plan which began in 1960, brought 'thousands of Asian students to Australia' (BRW 2000). A significant proportion of these students study business and commerce related undergraduate and postgraduate degrees. Again consistent with the literature on cultural adaptation, the exposure of Australian business students to international students should result in the development of cultural openness, which in



turn modifies perceived psychic distance in both these cohorts.

Thus the concept of psychic distance appears to be a much more complex issue than implied by much of the literature. Consequently it was a central issue examined in a recent case study involving a number of Australian firms. The research question addressed was *how does psychic distance affect the international market selection decisions of Australian firms?*

## **Methodology**

This research seeks to describe and explain a business phenomenon and in accordance with much of today's explanatory research employs a non-positivist approach (Remenyi et al. 1998). The project was designed in a manner that would provide for theory development grounded in primary research data (Glasser & Strauss 1968). The project design is based on the road map developed by Eisenhardt (1995) which utilises qualitative study of cases to develop theory through analytic induction. Such designs have been widely used to generate the rich, qualitative, grounded results required to answer "how/why" research questions (eg Coviello and McAuley 1999).

Eisenhardt's (1995) design calls for a sample of between 4 and 10 cases, a range supported by Remenyi (1998). For this work some 25 firms were sequentially approached until 6 had agreed to participate. A purposive sampling technique (Zikmund 1997) was employed to select the firms originally approached and finally selected. The cases were chosen to span different sizes, different industries and different degrees of international involvement to capture "generic" practices. As a secondary consideration diversity in age and ownership form were sought. The only conditions applied were that the firms be registered in Australia and owned by

Australian based interests and that they already be involved in international business in two or more countries over two or more years. This last condition was intended to ensure that there was some international business track record to study. The case firms have the characteristics shown in Table 1.

**Table 1: Case study characteristics**

<b>Case no.</b>	<b>Industry</b>	<b>Size (employees)</b>	<b>Ownership</b>	<b>Int'l. sales as % of total</b>
1	Horticultural products	35	Private company	50
2	Lighting systems	24	Public company	95
3	Prefabricated buildings	700	Subsidiary of public company	20
4	Mining equipment and associated services	219	Subsidiary of public company	65
5	Education services	5000	University	12
6	Software	17	Private company	65

All firms are exporters and all except Case 6 have some form of overseas production.

Interviews were conducted by the author with the executive in each firm chiefly responsible for entry into new markets. This was usually a designated international business development manager but in two cases it was the managing director. The interviews were held over a number of weeks and included 4 to 6 sessions of 2 to 3 hours each with each firm. In all cases except one they included interviews with a second executive within the same organisation to provide triangulation support. Interviews were unstructured although a protocol was employed to ensure the same themes were covered with each firm. Interviews were recorded and later transcribed into hard copy for content analysis. In addition relevant documentation, such as newspaper reports, annual reports, business plans and

brochures, was also studied in the expectation of eliciting further evidence of the IMS processes employed by the firms.

## **Research results**

The text of discussions with the case firms were analysed for references to their international market selection procedures. The “significant” markets of firms are listed in Appendix 2. These countries are the ones mentioned by case interlocutors as being important in sales terms (ie markets already entered) and markets which are currently receiving priority marketing resources. Thus they reflect the overall firm’s past and current priorities in country terms. Whilst this data is not claimed to be statistically valid, in terms of understanding firms’ approaches to IMS it is revealing.

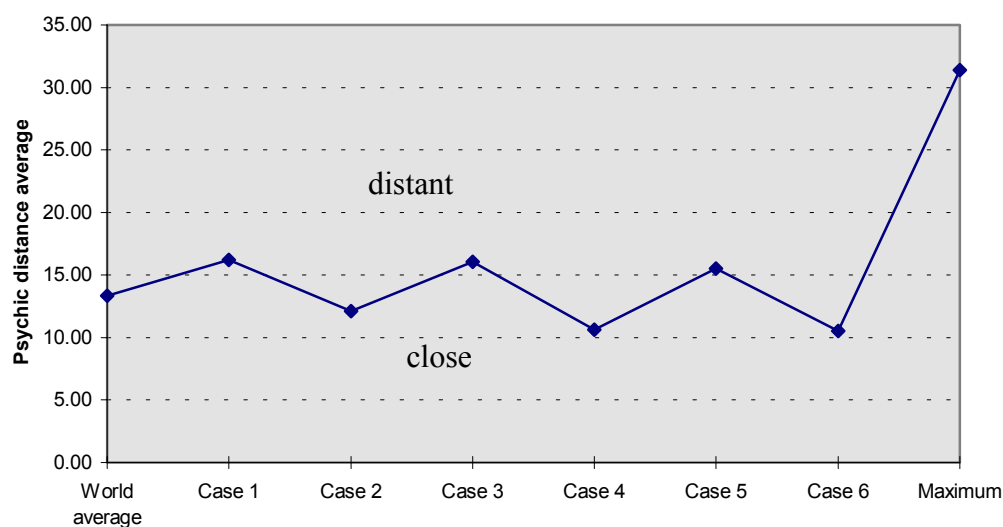
### **National psychic distance**

Case 1 has a particular focus on Japan, the Philippines and China, markets which are described as “distant” from Australia (Fletcher & Bohn 1998). It is not active in New Zealand, the United Kingdom, Canada or the USA which are much “closer”. Case 2 has accorded the psychically close USA top priority but has sold first into Singapore/Malaysia, China and the Middle East. Case 3 has a strategic focus on Asia and does nothing in culturally similar markets. Case 4 is active in the USA, South Africa and West Europe but also in South America, Russia, Turkey, Iran and especially India. Case 5 has been heavily dependent on Asia for customers since its internationalisation began. West Europe, USA, Canada are minor markets and still under recent development. Case 6 has made sales since its relatively recent move into international markets to Indonesia, Chile, Zimbabwe, PNG and UK, a mixture of psychically close and distant markets. The USA has been left for later attention as it is “too difficult.” The top five country markets in terms of frequency of appearance on

firms' significant market listings are Indonesia, Malaysia, Japan, China and the United States in that order. Clearly there is a significant predilection towards Asia in spite of the relative “difficulty” of the region in terms of cultural differences as measured in the literature.

When Fletcher and Bohne's (1998) psychic distance ratings are applied to the country markets listed in Appendix 2 and averaged, the result can be interpreted as a measure of the tendency of each firm to select psychically close markets. The average rating on Fletcher and Bohne's table across a wide selection of world countries is 13.32. A firm which targeted psychically close countries could expect to attain average country ratings within the sector marked “close” in Figure 2. Figure 2 shows that of the case firms three are a little below the world average and three are somewhat above it. This leads one to conclude that for the case firms national psychic distance appears to be neutral, that is, there is negligible effect.

**Figure 2: Case firms and psychic distance**



Source: Fletcher and Bohne (1998) and authors' research.

### **Firm level psychic distance**

A more difficult issue to explore was whether firm managers themselves had particular perceptions about psychic distance which were likely to affect their IMS. This exploration was conducted through unstructured conversations which focused on two aspects of the firms' operations. Firstly was there a connection between the characteristics of the managers and their firms' markets? Secondly, was culture considered important by managers in their IMS?

On the first aspect, all of the projects interlocutors were Australian born except two who were foreign born but of Anglo Saxon descent. In spite of this cultural orientation, as has been explained, many of the firms have a non-Anglo market focus. Investigation into the selection processes of those markets indicated there were significant connections drawn in some cases between the experience of managers and their firms' markets. Case 2 first targeted the market where its Managing Director previously worked before founding the firm. Case 3 was heavily focused on East Asia where its international business development manager had lived for some years (in two countries). Case 4 established one of its first overseas markets in the home nation of its then corporate owners. Case 5 at the time of interview was diversifying its attention to a new region that one of its new marketing managers had recent experience of. Case 6 made one of its first sales to the country of origin of its Managing Director. Its international business development manager had lived in one of the firm's primary target markets. Thus in terms of actual market penetration there appears to be links between cultural exposure and market selection.

On the second question, managers' cultural perceptions, particular note was taken within the interview texts of discussions incorporating cultural aspects of the firms' business. Within a total of 29 formally recorded meetings, with 11 managers,

references to culture in the context of international business dealings were counted and recorded in Table 2.

**Table 2: References to culture by case firms**

Case	References
1	3
2	2
3	4
4	0
5	10
6	5

Only in one case was the concept of culture more than once on average per meeting. This occurred during discussions with the education services provider which has until recently a long tradition of focus on a small number of Asian country markets. For the other firms culture at least as represented in conversational references has only minor importance.

Notwithstanding the apparent irrelevance of national psychic distance parameters on case firms' IMS practices, there appears to be important factors at work in terms of firm level psychic distance. Managers that had had experience in other country markets sometimes targeted those countries on the basis that they understood them well, were comfortable operating in those environments and were well connected to buyers. This firm level psychic distance phenomenon is the concept preferred by some of the theory's current supporters (Petersen & Pedersen 1996) and has considerable logical appeal.

## Conclusion

On the basis of the research findings in relation to the case firms' international markets, we conclude that there is little support for the relevance of psychic distance within Australian business as measured by Hofstede's (1980) national dimensions. Discussions with case firms did provide some support for the idea that psychic distance at the firm level does affect international market selection, initially, at least for small and medium sized Australian firms (Petersen and Pedersen 1998). But as firms become more international in their activities, psychic distance becomes less relevant to their country market selection decisions.

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## Appendix 1. Psychic distance from Australia - various countries.

The higher the index number the greater the psychic distance.

Country	Index	Country	Index
United States	0.1	Turkey	13.6
Great Britain	0.6	Japan	15.2
Canada	0.6	Philippines	15.7
New Zealand	0.7	Russia	16.0
Switzerland	1.5	Nigeria	16.3
Germany	1.7	Ghana	16.3
Ireland	1.7	Uruguay	16.4
South Africa	2.0	Thailand	16.5
Italy	2.2	Pakistan	17.3
Finland	4.7	Mexico	17.6
Netherlands	5.5	Greece	18.0
Belgium	6.1	Indonesia	18.3
France	6.1	Singapore	19.3
Austria	6.3	Korea	20.3
Israel	7.1	Taiwan	20.4
Denmark	7.3	Hong Kong	20.5
Norway	7.4	Chile	20.7
Spain	8.6	Portugal	21.2
Sweden	8.8	Yugoslavia	21.9
Argentina	9.2	Peru	23.3
Iran	9.3	Colombia	23.5
India	9.7	Malaysia	23.6
Kenya	12.2	Costa Rica	25.0
Zimbabwe	12.2	Venezuela	26.2
Tanzania	12.2	Ecuador	27.4
Rwanda	12.2	China	29.2
Brazil	12.3	Panama	31.4

Source: Fletcher and Bohn 1998.

## Appendix 2: Significant markets of case firms.

Country	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6	Total appearances
Argentina						◆	1
Brazil				◆	◆		1
Chile						◆	1
Colombia					◆		1
Costa Rica							1
Finland				◆			1
France	◆						1
Israel		◆					1
Kenya				◆			1
New Zealand		◆					1
Norway					◆		1
Pakistan			◆				1
Russia				◆			1
Spain	◆						1
Turkey				◆			1
Zimbabwe						◆	1
Iran			◆	◆			2
Nigeria			◆	◆			2
South Korea	◆				◆		2
Sweden				◆	◆		2
Taiwan	◆						2
Tanzania			◆	◆			2
Thailand			◆		◆		2
United Kingdom					◆	◆	2
Canada	◆			◆	◆		3
Germany		◆		◆			3
Hong Kong	◆		◆		◆		3
India			◆	◆	◆		3
Philippines	◆		◆		◆		3
Singapore		◆	◆		◆		3
South Africa			◆	◆		◆	3
United States		◆		◆	◆		3
China	◆	◆	◆		◆		4
Japan	◆	◆	◆		◆		4
Malaysia	◆	◆	◆		◆		4
Indonesia	◆		◆	◆	◆	◆	5