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THE PSYCHIC DISTANCE PARADOX

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Abstract. Companies tend to begin their internationalization process in countries that are 'psychically' close. Researchers describe the sequence of entry that firms follow and the mode of entry they choose. They suggest that psychically close countries are more easily understood than distant ones; and offer more familiar operating environments. Although not prescriptive, an unstated conclusion can be drawn linking sequence of entry to performance. Evidence from thirty-two Canadian retail companies shows that only seven (22%) were functioning successfully in the United States. The psychic distance paradox is that operations in psychically close countries are not necessarily easy to manage, because assumptions of similarity can prevent executives from learning about critical differences. Moreover, empirical evidence from 271 CEOs confirms greater cultural differences between Canada and the U.S. than assumed previously. Modifications are suggested to improve the psychic distance concept.

INTRODUCTION

It has been argued in the international business literature that companies begin the internationalization process in countries that are psychically close before venturing to more distant countries [Johanson and Vahlne 1992]. If this description is accurate, then Canadian companies would be expected to begin in the United States which is not only the closest but also, in many ways, the most similar country to Canada. Indeed, evidence from the retail industry indicates that firms have followed this pattern.

The literature on the internationalization process describes the sequence of market entry that firms follow when internationalizing. This sequence reflects a gradual, learning through experience process. What is not explicit in the

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literature is why firms follow this pattern. Researchers have suggested that entering countries that are psychically close reduces the level of uncertainty firms face in the new market [Johanson and Vahlne 1992]; and that psychically close countries are easier for companies to learn about [Kogut and Singh 1988]. Such explanations seem logical and implicitly support the conclusion that beginning in psychically close countries should improve a company's chances of success in these markets. Although the literature is not prescriptive, an unstated conclusion can be drawn from it linking sequence of entry to performance. There is an implicit assumption that psychically close countries are more similar, and that similarity is easier for firms to manage than dissimilarity, thereby making it more likely that they will succeed in similar markets.

Although sequence of entry is an important consideration, we believe that one limitation of this literature is that it does not address how the perceived psychic distance[1] between countries affects the decisionmakers' choice of entry or the organization's ultimate performance in the new market. This research presents evidence demonstrating that starting the internationalization process by entering a country psychically close to home may result in poor performance and, possibly, failure. We refer to this as the psychic distance paradox. Instead of psychically close countries being easy to enter and to do business in, we argue that perceived similarity can cause decisionmakers to fail because they do not prepare for the differences. The failure lies in the managerial decisionmaking aspect of the internationalization process, to which international business researchers have not paid enough attention [Johanson and Vahlne 1992]. In addition, even in psychically close countries such as Canada and the United States, there may be significant differences that can affect the ability of managers to conduct business. What appears on the surface to be psychically close may, in reality, be more distant than expected.

This research was exploratory in nature and focused on the performance of Canadian retail companies that entered the United States. With the American retail market worth more than $1.5 trillion, there is a very powerful incentive for Canadian retailers to understand how to compete in this market. Consistent with internationalization theory, domestically successful companies entered a country that is not only the closest physically, but probably the most similar country to Canada. However, of the thirty-two Canadian retail companies that entered the United States market, almost 80% failed and only seven (22%) were continuing to function successfully [Evans, Lane and O'Grady 1992]. The high failure rate suggests that there may be a paradox, or inherent contradiction, within internationalization theory and the psychic distance concept, and that executives cannot always rely upon measures of psychic distance when making their internationalization decisions.

The purpose of this paper is to use the experience of Canadian retailers entering the United States to analyze the psychic distance concept in greater detail and to suggest some possible qualifications that could improve its use in research and practice. First, a summary of the psychic distance concept is presented, as well as the evidence in the literature positioning Canada and the United States as being culturally close. Next, the results from both clinical and questionnaire data show areas in which cultural and business differences manifested themselves, as well as empirical evidence of these cultural differences. Then, the paradox inherent in the psychic distance concept is explored, which explains how the perception of a country as having a small psychic distance from one's own can lead decisionmakers to a number of faulty assumptions, creating an inability to learn about that country. Some recommendations are provided to help companies learn in these situations. Finally, we explore the psychic distance concept in greater depth, and propose some qualifications to it. The results of this study suggest that the psychic distance concept is more complex than is generally recognized in the literature and should be explored more fully.

BACKGROUND

The Psychic Distance Concept and the Internationalization Process

Although the term 'psychic distance' has been used in prior research [Beckermann 1956; Linnemann 1966], early studies of Nordic multinationals generally are taken as the starting point in discussions and research on the concept of psychic distance [Johanson and Vahlne 1977; Johanson and Wiedersheim-Paul 1975; Hornell, Vahlne & Wiedersheim-Paul 1973] and the internationalization process [Andersen 1993]. The Swedish researchers postulated that, when establishing international operations, firms need accurate market knowledge, which comes from direct experience in the foreign market and an understanding of its internal relationships, rather than more objective, factual, general market information that is easily transmitted and learned without the need for experience in interpreting it [Johanson and Vahlne 1977]. Psychic distance was an important variable in understanding the dynamics of the internationalization process. It was defined initially as "factors preventing or disturbing the flow of information between potential or actual suppliers and customers" [Nordström andVahlne 1992]. The concept was intended to increase the understanding of the location pattern of Swedish exports and foreign subsidiaries, and to complement existing explanations that relied on economic concepts and physical distance. Hornell et al. [1973], *cited in* Nordström and Vahlne [1992], showed that psychic distance had substantial value in explaining the patterns.

The definition of psychic distance varies greatly within the literature, depending upon the way in which the concept is operationalized. For example, Vahlne and Wiedersheim-Paul [1973], *cited in* Nordström and Vahlne [1992], operationalized psychic distance using the following indicators:

- level of economic development in the importing countries;
- difference in the level of economic development between Sweden and the host countries;
- level of education in the importing countries;
- difference in the level of education between Sweden and the host countries;
- difference in "business language";
- difference in culture and local language;
- existence of previous trading channels between Sweden and the host countries.

These indicators were measured using publicly available statistics and data from the Swedish Export Board. Later studies [Kogut and Singh 1988; Benito and Gripsrud 1992] relied primarily on Hofstede's [1980] research and measures of culture to quantify the cultural distance between countries. Thus, cultural distance was used as a synonym and proxy for psychic distance.

Nordström and Vahlne [1992] developed a cultural distance index that used adjusted Hofstede data. However, they [1992:10] suggested that cultural distance and psychic distance captured "different but overlapping phenomena," and that psychic distance included a component of business difficulty, as well as cultural distance. Psychic distance, in their view, is comprised of "cultural (such as those dimensions defined by Hofstede), structural (such as legal and administrative systems) and language differences" (p.10). Based on this expanded definition of the concept, they created a psychic distance index in which the rankings varied in some respects from those based on the adjusted Hofstede data. Our research supports an expanded definition of psychic distance and suggests including other business factors such as industry structure and the competitive environment, as well as cultural differences.

Psychic Distance: United States - Canada

On Nordström and Vahlne's cultural distance index, Canada ranked fifth (index score = 17.7) in distance from Sweden, and the United States ranked seventh (index score = 25.9). The overall range of the index scores was from 1.2 (Norway) to 78.1 (Japan). On their psychic distance index, the United States ranked ninth in distance from Sweden (25.3) and Canada tenth (27.1). This index ranged from 0.5 (Norway) to 79.2 (Chile). It is no surprise that Canada and the United States are so close to each other in both rankings given their proximity and apparent cultural similarities. From their review of eight comparative studies of attitudes and values conducted through the 1960s and 1970s, Ronen and Shenkar [1985] found that Canada and the United States were consistently in the same Anglo cluster. In addition, they were very close to each other in Hofstede's [1980] original research. It is reasonable to assume a substantial degree of cultural similarity between the two countries.

However, a limitation of the current indices used is that they measure cultural or psychic distance at a very high level of aggregation that may hide important variations. Measuring distance at the national level may overlook regional differences that exist within countries; cultural and structural differences that may exist by industry; and individual differences and experiences. For example, a firm that hires managers with significant experience in a target market that is distant from the culture of the firm's home country would have a much smaller psychic distance from that market than measurements at national levels of aggregation would indicate. One contribution of this research is that it investigates the concept of psychic distance at industry and firm levels.

Implications for the Internationalization Process

Psychic distance has been viewed as the degree to which a firm is uncertain about a foreign market [Kogut and Singh 1988], and the internationalization process as a *learning process*. Recently, Nordström and Vahlne [1992:3] updated the original definition of psychic distance as "factors preventing or disturbing firms learning about and understanding a foreign environment". This re-definition emphasizes and affirms the view of internationalization as a dynamic, learning process, whereby managers must not simply accumulate information, but must learn to interpret it correctly in order to generate an understanding of the market and adapt to it. An inability to learn about important differences hinders adaptation and affects performance outcomes.

As Benito and Gripsrud [1992:464] explain it, "firms are assumed to successively enter markets at an increasing 'cultural distance' from the home country. . . . Thus, firms are predicted to start their internationalization by moving into those markets they can most easily understand, entering more distant markets only at a later stage." This view is confirmed by a wide range of Nordic studies, such as Nordström and Vahlne [1992:4] who state that the "typical internationalization process tends to be a step-wise entry into gradually more distant markets"; and by Johanson and Vahlne [1992:5] who suggest that the reason firms begin in those markets is because "there they see opportunities, and there the perceived market uncertainty is low." Johanson and Wiedersheim-Paul [1975] found that the growth of four large Swedish multinationals was distinguished by a series of small, cumulative steps over time. The entry mode also followed an incremental pattern, with an agency operation preceding a sales subsidiary in 75% of the cases. This "Uppsala model of internationalization" [Andersen 1993] describes the pattern of entry of firms that have survived in the market.

Van Den Bulcke [1986] found that in a study of forty-one Belgian direct investments abroad, none was without earlier operations while 61% of subsidiaries had been preceded by exports-sales subsidiaries, again supporting the notion of moving sequentially to entry modes requiring more resources and greater company commitment. In addition, Luostarinen's [1979; *cited in* Luostarinen and Welch 1990] research revealed that Finnish companies tended to start their internationalization activities in those countries that were physically and culturally close and that had a short business distance to Finland. Later, these companies advanced stepwise to other countries with greater and greater business distance.

This model of the internationalization process has a practical, common-sense appeal to it. However, although its face validity is very high, the empirical support for it seems to be mixed.[2] There is some support for the concept that national culture and cultural distance have an influence on entry mode selection. Two studies have linked certain national cultures with specific entry mode patterns [Johanson and Vahlne 1977; Puxty 1979], but neither study systematically showed how perceived cultural differences influenced entry choices.

Kogut and Singh [1988] provided the first large-sample study showing that entry mode choice varied depending upon the cultural distance between countries. They found that the greater the cultural distance between the country of the investing firm and the country of entry, the more likely it was that the firm would choose a joint venture to reduce its uncertainty in those markets. Gatignon and Anderson [1988] state that sociocultural distance (the difference between the home and host cultures) causes uncertainty for firms, which makes them shy away from foreign ownership involvement. In their large sample study, they strived to discover if the sociocultural distance between countries affected the amount of control corporations had over their foreign subsidiaries. Their findings indicated that country risk was the most important variable affecting control, and that the sociocultural distance variable (which was based on Ronen and Shenkar's [1985] cultural clusters) did not have a large effect. Significantly, as multinational companies gained experience abroad, they tended to opt for wholly owned subsidiaries, as predicted.

The internationalization literature primarily addresses the *choice of entry mode* for a market and the *sequence of entry* into successive markets. Although mode and sequence are important considerations, we believe a shortcoming of this literature is that it uses an absolute measure of distance, using national averages, and does not deal with how the perceived psychic distance between countries affects the decisionmakers' entry choice or the organization's ultimate performance in the new market. More attention needs to be paid to the perception of similarity and difference, as well as to the decisionmaking process regarding entry and, ultimately, to performance outcomes.

This research presents evidence that demonstrates that starting the internationalization process by entering a country psychically close to home may result in failure. We refer to this as the psychic distance paradox. The similarity perceived to exist when entering psychically close countries does not necessarily reduce the level of uncertainty faced, nor make it easier to learn about the country, due to a failure in the managerial decisionmaking process. Whereas the implicit assumption of the model is that similarity is easier, our results show that similarity may hide unexpected and unforeseen barriers to successful entry and performance.

RESEARCH DESIGN

We designed our study to answer two research questions. First, why did domestically successful Canadian retailers perform poorly in the U.S., a country that is culturally closer to Canada than any country in the world? Second, what cultural and business differences exist between the two countries? Phase 1 involved a literature review and clinical study in which the experiences of ten Canadian retailers that expanded into the United States were documented and analyzed. The strategic decisionmaking process was also analyzed in each of the ten companies studied. In Phase 2, survey research was used to compare the values and attitudes of Chief Executive Officers of Canadian and American retail companies. Each of these phases will be discussed briefly in the following section.

Phase 1: Qualitative Research

Literature Review. First, in order to determine how culturally similar or different Canada and the United States are, the literature comparing the two cultures was analyzed. Culture is defined as the shared attitudes and values of the members of a country.[3] Thus, culture refers to common, deeply rooted attitudes and values, which exist largely irrespective of individual differences. There is a large general literature on attitudes and values that primarily focuses at the individual level of analysis. This shows that culture influences a person's attitudes and values which have an effect on his/her behavior.

Much less is known specifically about societal attitudes and values, or the differences in national culture between the United States and Canada. In fact, there are very few empirical studies available comparing the cultural characteristics of the United States and Canada [Hofstede 1980; Rokeach, 1973]. Although not empirically based, a number of authors (i.e., Lipset [1963, 1989]) have written extensively comparing the two countries. However, most of the published work on Canada-U.S. differences is based on observation and historical analyses. This literature, which focuses on comparing only these two countries, suggests that there are a number of cultural differences. Table 1 outlines the key cultural dimensions found in this literature.

The impact of attitudes and values on executive behavior has received attention from practitioners [Harmon and Jacobs 1985; Peters and Waterman 1982] and academics alike [Hambrick 1987; Posner and Munson 1979;

TABLE 1
Canada-U.S. Cultural Differences – A Summary of the Literature

U.S. > C = the U.S. is believed to have a stronger orientation, or a higher score on this factor than Canada; if U.S. < C, the opposite is true.

Achievement Orientation (U.S. > C)
  Lipset [1963, 1989], Rokeach [1973], Thorne and Meyer [1987]

Level of Aggressiveness (U.S. > C)
  Lipset [1963, 1989], Rokeach [1973]

Level of Optimism (U.S. > C)
  Lipset [1963], Berton [1982], Thorne and Meyer [1987]

Action Orientation (Belief in the Timeliness of Action) (U.S. > C)
  Newman [1972]

Belief in Hard Work (U.S. > C)
  Newman [1972]

Attitudes toward Authority (government)
Negative attitudes toward government, questioning of authority (U.S.) / positive attitudes toward government, deference to authority (C)
  Berton [1982], Lipset [1963, 1989]

Belief in Competitiveness (U.S. > C)
  Godfrey [1986], Newman [1972]

Risk Propensity
Positive attitudes toward risk (U.S.) / hunger for security (C)
  Lipset [1963, 1989], Berton [1982], Godfrey [1986]

Masculinity Dimension (U.S. > C)
  Hofstede [1980], Rokeach [1973]

Uncertainty Avoidance Dimension (U.S. < C)
  Hofstede [1980], Rokeach [1973]

Individualism/Collectivism Dimension (U.S. more individualistic than C)
  Hofstede [1980), Lipset [1963], Rokeach [1973], Godfrey [1986]

Power Distance Dimension (U.S. < C)
  Hofstede [1980], Lipset [1963, 1989], Rokeach [1973]

Commitment to Winning (U.S. > C)
  Thorne and Meyer [1987], Lipset [1963, 1989]

Mastery over One's Environment (U.S. > C)
  Newman (1972)

Cautiousness (U.S. < C)
  Lipset [1963, 1989], Berton [1982]

Attitudes toward equality
(U.S. more egalitarian)
  Lipset (1963, 1989)
(C more egalitarian)
  Rokeach (1973)

England 1978; Rokeach 1973]. Several have pointed out the impact of the top executive team's attitudes and values on their strategic choices [Chaganti and Sambharya 1987; Dess 1987; O'Reilly and Flatt 1986] by creating belief structures that influence their interpretation of information and outcome preferences [Walsh and Fahey 1986; Schwenk 1984].

The cross-cultural literature indicates that the culture in which people are raised can affect ways of thinking and behaving. Although it does not hinder the ability to manage within one's own country, where business practices generally are similar, it can affect the ability to manage in other countries /cultures. Business people seldom reflect on and articulate their values, although they feel uncomfortable when these values are violated. Also, they are often not aware of the assumptions that underlie and guide their actions. These assumptions can also lead to cross-cultural misinterpretations, such as subconscious cultural "blinders," a lack of cultural self-awareness, projected similarity, and parochialism [Adler 1991]. As a result of different mental programming, people from various cultures often see situations differently and have different approaches and solutions to problems. Each tends to believe that his or her way makes the most sense and is best. Frequently, managers from one country enter another country and assume that they can implement practices in the same way as at home.

A major contribution of the cross-cultural literature is the recognition that, to manage effectively cross-culturally, one must understand the culture of the people with whom they plan to do business and, correspondingly, deal with the implications of these differences for managing in that culture. However, one must be aware that one's own culture can act as a barrier to accurately understand the environment that one is facing. This may be even more crucial when differences are not obvious or noticed as is the case between Canada and the United States.

The Case Studies. A list of Canadian retailers that had entered the United States market was developed manually using the Canadian Key Business Directory, the Canadian Trade Index, and the Directory of Retail Chains in Canada. Major news sources were also used to identify Canadian companies operating in the United States. A population of thirty-two Canadian retailers was identified from which a sample could be drawn.

In identifying potential research sites, the following criteria were developed. First, a company had to be profitable in Canada to be considered as a possible site for more in-depth study. This criterion was used so that the results could not be attributed to poor management skills in Canada. Second, companies had to have been operating in the United States for a period of at least two years, unless they had withdrawn from the market and could be analyzed as failures. The two-year criterion was deemed necessary to assess performance and to avoid contaminating the results due to start-up.

Companies meeting the above criteria were contacted and ten companies agreed to in-depth case studies of their experiences in the United States. Eight of the ten companies were unsuccessful. The data were collected via semi-structured interviews with CEOs, as well as with other members of the top executive teams, including vice presidents of finance, merchandising, marketing, operations, administration and real estate. A total of twenty-eight executives were interviewed and the average duration of each interview was two hours. Interviews were conducted by two interviewers, recorded and content-analyzed. Themes were identified along with the number of individuals who referred to these themes. The inter-rater reliability was .95. In addition, secondary source data, such as company minutes, annual reports and newspaper clippings, were used to supplement the interview data.

The decisionmaking process was measured by asking executives to trace the history of the strategic decision to enter the United States market from pre-entry to post-entry. Included were questions about "whether" and, if so, "how" cultural and other differences between the United States and Canada were taken into account in the strategic decisionmaking process. Executives were asked about their pre-entry, entry and post-entry perceptions of American culture and whether their perceptions were incorporated into decisions made. The company's decisions related to the U.S. venture were also recorded. The interviews were content-analyzed individually, across teams within companies, and across companies, to identify factors contributing to successful and unsuccessful performance. Success was operationalized by aggregating the following measures: sales and profits in the U.S. over the period of operations; growth in sales and profits over the period of operations; market share over the period; and the ability to meet the expectations of the parent company. Company performance fell into three categories: unprofitable withdrawals; holding in the U.S. (not profitable, but may have increased sales, gained market share, or met the expectations of the parent); and profitably operating in the U.S. Companies in the latter two categories were considered successes. Unprofitable withdrawals were considered failures (there were no profitable withdrawals in our sample of ten).

Results

There were two important findings from Phase 1. First, the executives agreed that there were several cultural differences between Canada and the United States and that these differences affected their ability to compete effectively in the United States. The second and related finding was that, although cultural differences were perceived by the executives to be important, they alone were not responsible for the varying performance levels of the Canadian companies. Rather, it was the recognition of those differences, prior to entry, that differentiated performance. Each of these findings will be elaborated on now.

There was a very high level of agreement among the executives regarding the cultural differences between the United States and Canada in the retail industry. The following characteristics were found to be more descriptive of Americans than Canadians: Winning Attitude; Competitiveness; Sense of Mastery; Action Oriented; Belief in Hard Work; Aggressiveness; Risk Taking;

and Individualistic. These perceived differences were incorporated into the questionnaire measuring cultural differences in Phase 2 of the study.

The Canadian executives also concurred that the cultural differences were noticeable in the behaviors and business practices of Americans. Indeed, there were five major areas of the retail business in which cultural differences manifested themselves. These five areas can be grouped into those relating to the market (consumer differences; regional differences) and the competitive environment (level of competition; employee and management attitudes, values and behaviors; and relationships). Some of the more important differences are described briefly below.

Market

1. ***Consumers/Customers.*** American consumers demanded to be treated with importance when they shopped. They demanded service. In the United States, consumers would shop where the bargains were. In Canada, they were more likely to shop automatically at a national chain.

2. ***Regional Differences.*** Relative to Canada, executives generally found much larger regional differences in buying behavior in the United States. There were especially large East/West differences in the United States. Canada was seen to be more homogeneous politically, economically and socially and to have a more commonly accepted value system. Therefore, doing business in the United States was found to be much more difficult given this heterogeneity. Doing business in the United States required knowledge of each individual region, because the differences between them could be very large.

Competitive Environment

1. ***Relationships.*** The executives interviewed commented on the difficulty of gaining access to suppliers and the necessity of building rapport and long term relationships in the United States.

2. ***Employee and Management Attitudes, Values and Behaviors.*** American employees were described as possessing a greater desire for independence than Canadian employees, and to be much less interested in unions. American employees were found to be very hard working and much more conscientious about productivity. American employees' strong orientation toward work created an expectation that they would be rewarded based on merit. Since they worked more independently, the types of reward systems were different in the United States' retail industry.

American managers were also found to be different from Canadian managers in two major ways. First, the level of professionalism and experience in the retail industry were found to be higher in the United States. Second, the executives found that American executives were expected to live up to higher performance standards. For example, not meeting goals was more likely to lead to termination in the United States than in Canada.

3. ***Competition.*** Americans were found to be much more competitive than Canadians. Frequently the executives voiced comments typically used to describe battle, such as "It was all out war" or "Their arsenal was impressive". Not expecting this difference in the level of competitiveness, Canadian companies found themselves at a significant disadvantage.

The clinical studies highlighted that one of the most important factors in the decisionmaking process for Canadian companies was the accuracy of the top management team's perceptions of the United States market prior to entry. This aspect of their pre-entry orientation was the base from which all decisions regarding entry into the United States market were made. The executives from the companies that failed in the United States perceived there to be no difference between the two markets prior to entry, and based decisions such as product mix in the stores, store location and entry mode on this inaccurate perception. As a result, they found themselves unprepared for the level of competition and cultural differences they discovered upon entry, which affected their ability to operate successfully in their chosen markets. Although they conducted various forms of market research, their lack of experience in the U.S. market hindered their ability to interpret it. Unfortunately, even after they recognized the obvious differences in the two cultures, they continued to assume that they could operate in the United States as they had in Canada. Mental models appropriate for the Canadian market led top management teams to make decisions as they would at home – with generally disastrous outcomes. Consequently, they did not adjust to, nor learn about, the United States market and were forced to withdraw from it.

On the other hand, the companies that were successful in the United States recognized that there were differences prior to entry and incorporated this accurate knowledge into their entry decisions. Executives either had direct experience in the U.S. market, or they hired American management who did, ensuring that decisions made fit with the market.

The above analysis illustrates the psychic distance paradox. First, Canadian executives who erroneously assumed the United States was similar to Canada believed that their strategies were correct and that organizations in the two countries could be managed in the same way. Second, instead of this perceived similarity increasing the ease with which they learned about the market, and reducing the amount of uncertainty faced, it hindered their understanding by masking important differences, and led to decisions that were ineffective.

In addition, we discovered that executives with direct experience in the United States made better decisions because they understood the "true" distance between the Canadian and American markets. This is consistent with the findings of Johanson and Vahlne [1977]. Some of these executives were Americans working in Canada who had experience in the target markets; some were Canadians with experience in the United States; and others were Americans living in the United States who had the requisite experience. This raises the possibility of a further paradox within the psychic distance concept. If a company's management team has direct experience (perhaps through living or working there) in a market that normally would be considered as "distant" on the indices, the psychic distance to that market might be less than the distance to a "close" market in which they had no direct experience. Therefore, the paradox that a close market can be distant, and that a seemingly distant market can be close, ought to be recognized.

The ability to learn in a new market is an important skill. Many companies encountered unexpected differences in the United States, yet they did not change their modus operandi or their initial perceptions about the market to reflect the reality of what they were experiencing, and they continued to make decisions based on the faulty assumptions. Companies with executives who challenged their initial perceptions and adjusted them were able to alter their decisions to fit with the situation. The ability, or inability, to learn during the entry process affected the company's subsequent performance. The differentiating factor was what organizational learning theorists refer to as double loop learning [Argyris and Schon 1978] or an ability to modify underlying beliefs and assumptions, rather than simply changing behavior.

The implication of these findings is that executives or researchers should not assume that cultural or psychic distance measured at a national level of aggregation reflects the true distance between a company in one country and a market in another. The results from Phase 2, which now follow, show how inaccurate such an assumption can be.

The interviews confirmed that greater than expected cultural and business differences existed between consumers and retailers in the two countries, and that these influenced the ability of Canadian retailers to enter and adapt successfully to the United States. Although rich and informative, these findings were qualitative and perceptual in nature. They also came from a small, but important, sample. The question still remained whether the differences experienced were representative of the executives in the retail industry in the two countries.

Phase 2: Survey Research

In Phase 2, survey research was utilized to determine whether or not the cultural differences that the Canadian retailers experienced in the United States could be generalized beyond the responses from the interviews. A questionnaire was designed using 125 items measuring sixteen cultural differences that had been suggested in the literature and the interviews. These attitude/value orientations were operationalized using well-established instruments, such as Hofstede's questionnaire, and Jackson's Personality Research Form (PRF) and Personality Index (JPI).

Sample. The top 400 retail companies in each country were the populations of interest. The list was obtained from the Dun and Bradstreet Canadian Dun's Market Identifier database. The Chief Executive Officer's names were found in the Dun & Bradstreet Key Business Directory (Canadian) and the Million Dollar Directory (United States). However, not all of the companies could be found in the directories, leaving the list of potential respondents somewhat smaller than the original master list.

The questionnaire was mailed to the Chief Executive Officers of the top 369 companies in Canada, and the top 338 companies in the United States. The implementation of the questionnaire followed the Total Design Method (TDM) suggested by Dillman [1978]. The response rates in Canada and the United States were 55% and 37% respectively. The number of usable questionnaires was 180 in Canada and 91 in the United States.

Analysis and Results

The first step involved scale reliability analysis using Cronbach's *alpha*, which is presented in Table 2. The reliabilities for Jackson's PRF (achievement and aggression) and JPI (risk-taking and tolerance) measures and Lodahl and Kejner's job involvement measure were considered acceptable, given that these measures were both well-established, with proven reliability and validity (for the established properties of these scales see Jackson [1976, 1984; Cook et al. 1981]). However, there were no previously established reliabilities for Blood's Protestant Work Ethic Scale [Cook et al. 1981]. Therefore, the items from this scale were factor-analyzed to determine which items naturally grouped together and could be identified as factors on which the executives could be

TABLE 2
Scale Reliability Analysis

Scales	Reliability Coefficient
Jackson's PRF and JPI*:	
Achievement	.61
Aggression	.75
Tolerance	.63
Risk-Taking	.84
Lodahl and Kejner's:	
Job Involvement	.79
Blood's:	
Protestant Work Ethic	.63

*Spearman-Brown formula used.

TABLE 3
Mean Differences between Canadians and Americans

	Country	N	Mean	Standard Deviation	Probability
Jackson's PRF Scales:					
Achievement Orientation	C	180	6.32	1.45	.001
	U.S.	91	6.96	1.17	
Aggression	C	180	4.64	1.76	.782
	U.S.	91	4.70	1.89	
Jackson's JPI Scales:					
Risk-Taking	C	180	5.50	2.05	.001
	U.S.	91	6.52	1.79	
Tolerance	C	180	4.71	1.63	.017
	U.S.	91	5.21	1.62	
Lodahl & Kejner's					
Job Involvement	C	180	3.65	.52	.013
	U.S.	91	3.82	.50	
Hofstede's Scales:					
Uncertainty Avoidance	C	180	2.85	.45	.001
	U.S.	91	2.54	.58	
Power Distance	C	180	2.66	.48	.005
	U.S.	91	2.53	.40	
Individualism	C	180	3.16	.42	.001
	U.S.	91	3.76	.55	
Masculinity	C	180	3.22	.46	.001
	U.S.	91	3.43	.52	
Blood's Protestant Work Ethic:					
Factor 1: Pro-Protestant	C	158	−.21	.98	.000
Work Ethic	U.S.	79	.03	1.01	
Factor 2: Non-Protestant	C	158	−.09	1.06	.039
Work Ethic	U.S.	79	.17	.86	

compared. A principal components analysis was used with varimax rotation. From this analysis, the Protestant Work Ethic Scale items produced a two-factor solution (using an eigenvalue of 1), with one of the factors being labeled Pro-Protestant Work Ethic and the other Non-Protestant Work Ethic, consistent with Blood's findings.

The results comparing the Canadian and American Chief Executive Officers are presented in Table 3. The literature suggests that Americans are more achievement-oriented, aggressive and risk-taking than Canadians. The results supported significant differences for two of Jackson's scales – achievement and risk-taking (p <.001). The difference between the means on the aggression scale was not significant. However, the items measuring aggression tended to focus on physical aggression as well as expressing anger or disapproval. Many people use the word aggressive to mean competitive, which is quite different than what was measured. It also should be noted that many of the achievement items are more concerned with competitiveness than are the aggression items.

The other Jackson scale measured tolerance. This was included to determine whether any difference existed between Canadian and American executives in their tolerance for different people, points of view, culture, and so on. The results indicated that the American executives were significantly more tolerant than the Canadian executives ($p < .02$). This could be interpreted as one of the reasons Canadian retail companies failed in the United States – they could not adjust their Canadian pre-entry orientation to what was required to compete in the United States. When presented with a culturally different people and market, Canadians had difficulty accepting these differences. Jackson's items suggest that a person with a high score on tolerance accepts different attitudes and customs [Jackson 1976].

On Hofstede's four cultural dimensions, the results indicated that the two groups of executives were significantly different on each. Three of these were consistent with Hofstede's 1980 study of forty cultures. As in Hofstede's study, the American sample had a higher mean score on items measuring Individualism and Masculinity, and a lower score on items measuring Uncertainty Avoidance ($p < .005$). However, the results for the items measuring the Power Distance dimension were not consistent with Hofstede's findings. Whereas Hofstede found that Canada had a slightly lower Power Distance score than the United States, the reverse was true ($p < .005$) in this study. Thus, it appears that the Canadian respondents are more willing to accept power being distributed unequally in institutions and organizations than the American respondents. Although this finding contradicts Hofstede's findings, it is consistent with a number of others [Lipset 1963, 1989; Rokeach 1973] who have compared the two cultures. The consistent view has been that Americans are more egalitarian than Canadians. The present results provide support for this position.

Several of the Canadian executives interviewed stated that American executives work harder (meaning they had higher productivity levels, were held to higher performance standards, provided better service, and spent more time at work) than their Canadian counterparts. The questionnaire results were consistent with this, indicating that the American respondents were significantly more job involved than the Canadian executives ($p < .013$). In addition, the results indicated that the American executives had a significantly higher score than the Canadian executives on the Pro-Protestant Ethic factor ($p < .001$).

DISCUSSION

The Psychic Distance Paradox: Familiarity May Breed Carelessness

The phenomenon we have referred to as the psychic distance paradox seemed to be created by common, but unexplored, assumptions or underlying beliefs about the United States held by decisionmakers in the Canadian retail companies. These mental maps or preconceived ideas of the United States, and what it would be like to do business there, created barriers to learning about this new market. They are described briefly in this section.

Similarity. Canadian executives made the erroneous assumption that "the United States is just like Canada, only larger." Learning begins with the ability to see differences, and this projected similarity interfered with executives' ability to learn about the markets, the regions, the consumers, and the competition. It was often believed that Americans were just like Canadians, sharing a similar language, culture, values, tastes, and business practices. Notably, it was precisely the fact that these two countries probably are more similar than any other two that masked some fundamental differences in values and attitudes. Consumers were different; they were more competitive and they reacted differently than in Canada (even the small consumers); the indirect competition was often missed. The attitudes and values of CEOs from Canadian and American retail companies differed significantly also.

Proximity. The proximity of the United States to Canada contributed to the belief that because it was close it must be easier to do business there than in countries that were further away geographically. The view was that the United States was simply the southern extension of Canada, or that it was just like Canada's backyard. Given the assumption of similarity and a belief in Canada that "ties run north and south," regions of the United States that were contiguous to Canadian regions, in some cases, were organized as part of those Canadian districts. This assumption also may have been at work in the comment expressed by one of the executives, "If we can sell to a market 3000 miles west, there's no reason we can't sell to a market 90 miles south." The United States is a very complex and competitive country. Doing business there successfully is not easy, regardless of the geographic or psychic proximity to one's own country.

Success. This common myth was the belief that because the retail concept worked in Canada, and because the companies were important and well known in Canada, the retail concepts could easily be transferred to the United States, and the important relationships easily established there. This could be stated as "success in Canada is a predictor of success in the United States" and this belief was evident in a number of the cases. Some executives believed that their retail concept was so powerful that it could overcome any competition, even with disadvantages such as secondary locations.

Many Canadian retailers believed that they could extrapolate from their own past history, culture and experiences in Canada when entering the United States. Instead, the environment they faced was very different, and their experiences from the past were no longer providing useful guidelines. The old rules no longer applied, and what was required to learn the new rules was an attitude of inquisitiveness and sensitivity that many did not develop soon enough. Believing too strongly that success in Canada predicted success in the United States was very costly.

Size and Certainty. This was a modern Canadian variation of the old themes, "The streets are paved with gold in the United States" or "You can make more money by mistake in the United States than you can on purpose in Canada." This myth simultaneously conveys a sense of enormous wealth in the United States and the ease, or certainty, of obtaining one's share of those riches. After all, the belief was, it was there for the taking. The size and assumed accessibility of this market were like a soporific, a drug that induces sleep. In the case of Canadian businesses they induced a sense of satisfaction, leading to carelessness, and often, failure. Realizing that the United States retail market is larger than the Canadian market led to dreams of "if we could just get one percent, we could make it," and the subsequent assumption that this probably would not be very difficult to do.

There is most likely another assumption related to the one about size that creates problems – the myth of "the American market." In reality, as we saw throughout the research, there is no such thing as *the* American market. Rather, there are many regional markets each with their own distinct characteristics, and a series of retail industry systems that must be entered.

LEARNING TO OVERCOME BARRIERS POSED BY PSYCHIC DISTANCE

The psychic distance concept calls attention to important cultural and business differences between countries that can create obstacles to successful market entry and adaptation. These obstacles can be overcome through learning. Nordström and Vahlne [1992] call this process bridging the gap of psychic distance. It is evident from our research that assumptions held by Canadian retailers about doing business in the United States market contributed to their performance problems there. In order to overcome these barriers, it is important to follow an appropriate "process" in making decisions regarding entering a new market – the United States or any other country – as executives go about completing the activities set forth on their strategic agenda. Some suggestions include the following:

- Treat even psychically close markets as foreign markets. Executives should not assume that the Canadian and American markets are the same, or that companies within each can be managed in the same way. When decisionmakers start with the assumption that they are the same, they are more likely to take the appropriate steps toward entering the new market.

- Test assumptions and perceptions prior to entry. The success of a decisionmaking process relies on the accuracy of information and the knowledge of those making the decisions. The most important part of a company's pre-entry orientation is the perceptions and assumptions of the executive team, because they act as a base from which all of the decisions regarding the venture are made. If the pre-entry aspect of the decisionmaking process is faulty, the remainder of the process is unlikely to be effective. The decisionmakers' initial perceptions and assumptions also affect their ability to learn from experience in a new market and to respond to this information. Strong beliefs about the similarity of the two markets or the power of a retail concept contributed to the difficulty of adjusting when faced with conflicting information. There comes a time when it is necessary to revise one's basic assumptions and perceptions, rather than continue to alter operating decisions in a way that only supports the initial position.

- Correct interpretation is key. An important observation of the study was that gathering information about a market does not necessarily lead to knowledge of that market unless it is interpreted correctly. A number of the companies conducted market analyses and still failed. The failure of the companies in our study underscores the difference between objective market information and the tacit knowledge or know-how that is critical to success. It seemed that the only ways that Canadian companies were assured of gathering the right information, and accurately interpreting it, were by having executives in Canada who had already learned from previous experience in the United States, or by having qualified American managers as part of the team. The nationality of the executives was not the key, but their having had direct experience in the market was critical. The real indicators of psychic distance are to be found much closer to the ground than researchers have been looking.
- Develop the ability to learn. A final recommendation is that those making the decisions for foreign markets must develop the ability to learn about the other countries. Learning has to do with increasing one's knowledge and understanding. Learning is more likely to occur under conditions where error is tolerated, assumptions are testable, and key aspects of information are not missing. Thus, it is vital to identify and check the assumptions of decisionmakers prior to entry, because their assumptions often seriously limited the effectiveness of their entry decisions. Since assumptions are often subjective and hard to identify, it is a good idea to use an objective person from outside the decision-making process to help decisionmakers to identify them. It appears that to gain the capacity necessary to compete even in "close" markets, companies should hire management talent experienced in the target market. These people should have an understanding of the targeted consumers, the competition, the competitive intensity of the supplier situation, and regional differences, among other factors.

Only through careful attention to management decision processes can the potential negative consequences of the psychic distance paradox be avoided.

PROPOSED QUALIFICATIONS TO THE PSYCHIC DISTANCE CONCEPT

To improve our understanding of the psychic distance concept and its use in international business research, qualifications or refinements are suggested below.

Refinement of the Concept. This study supports the idea that psychic distance is a larger, more encompassing, concept than simply cultural difference. Business factors, such as legal and competitive environments, need to be included when conceptualizing distance in the internationalization process. Further work is necessary that should determine which are the most important factors to consider. For example, American companies entering Canada had a number of advantages over their Canadian counterparts. They had greater financial and managerial resources to apply to their internationalization efforts, and greater sophistication (the retail industry in the United States is estimated to be approximately ten years ahead of Canada's). American retailers are noted for being excellent niche and regional marketers. They have benefited from their large home market by having had greater experience in dealing with its diversity and complexity. This experience may have helped them accurately assess the differences between the United States and Canada. These are the types of issues that need to be included in a concept of "business difficulty," such as that proposed by Johanson and Vahlne [1992].

There may also be an issue of directionality or symmetry. Large numbers of Canadian retailers have failed in the United States, but we have found that American retailers have been very successful in Canada. Of the twenty-three American retailers we identified as having entered Canada, all twenty-three were successful. However, the psychic distance from Canada to the United States should be the same as from the United States to Canada. Or should it be? This situation suggests that an asymmetry may exist in the psychic distance concept, at least when performance is taken into consideration. This raises another potential paradox that the "distance" between the same two countries could be different depending upon the direction one travels.

To learn more about the issue of directionality, future research efforts would be particularly useful in two areas. First, considering Canada's small size in terms of economics and population compared to the United States, it would be interesting to learn whether companies from other small countries have difficulty when entering larger countries. Agren [1990] found that Swedish MNCs were consistently disappointed in the performance of their U.S. affiliates and concluded that Swedish managers have greatly underestimated the difficulty of managing in the United States. Similarly, European MNCs are often unprepared for the intensity of competition in the U.S. [Rosenzweig 1994].

Conversely, perhaps the United States represents a special case, and it is simply a difficult market for everyone. Or perhaps the retail industry has characteristics that make it unique. Arguably, internationalization theory and the psychic distance concept should be able to account for special cases. Further work needs to be done to determine if there are special cases and to map these anomalies.

Measurement. Researchers need to exercise care in the way that they quantify psychic distance. Although several studies show that Canada and the United States are very similar, company experiences within an industry point out significant differences that must be recognized. These differences relate directly to what Nordström and Vahlne referred to as business difficulties. The cultural component of the concept generally utilizes national boundaries, when there may be substantial variations in regional cultures, or industry cultures (i.e. retail). Moreover, as this study has illustrated, true distance to a market must take into account the perceptions, understanding and experience of a company's management team.

Clarify Links to Performance. We believe that there is an assumption underlying the use of the psychic distance concept that needs to be clarified. The assumption is that similarities are easier to learn about and manage than dissimilarities. A prescription for managers would be that companies should find it easier to begin their internationalization process in countries that are psychically close or similar to their own. Although this is intuitively appealing it has not, until now, been tested using company performance data. However, there is no evidence that pursuing this strategy will lead to better performance than if a company entered a more distant country. Indeed, our findings suggest that perceived similarity can lead to carelessness and failure. We think it would be useful to compare the performance of companies pursuing different internationalization sequences in order to make research into the internationalization process more normative.

In particular, it would be useful to analyze the performance of companies from other countries trying to enter "psychically close" countries, to learn whether they also have difficulty performing. Consistent with the literature on the internationalization process, Akoorie and Enderwick [1992] found that New Zealand companies attempt to minimize "psychic distance" in their overseas operations. Therefore, Australia is the country chosen most for their internationalization efforts. However, moving beyond the internationalization decision, to studying the actual performance of New Zealand companies in Australia would fill an important gap in the literature. Similarly, research could be extended to studying the performance of Austrian firms in Germany, Belgian firms in France or firms from Finland and Norway in Sweden. Such studies would be very valuable for testing how widespread the psychic distance paradox is, if at all.

Limitations of the Study. The survey responses came primarily from central Canada, where the greatest number of top retail companies are located, and the case studies were of companies in central and western Canada. English/French cultural differences were not examined, nor were differences across respondents from various states – often due to the low number of respondents in each region. By using a cross-sectional research design that focuses on two countries and one industry, we cannot generalize our findings to other industries or other combinations of countries without further research. Comparing two similar countries directly may serve to illuminate the differences that exist more so than when the two are examined in the context of many other countries that are very different. However, comparing them in the context of these other countries may diminish the important and significant differences that we found.

CONCLUSION

The intent of this article is to contribute to the development of internationalization theory and the concept of psychic distance, to improve our understanding of the internationalization process as not only a descriptive, but a prescriptive tool. We have proposed some modifications to the conceptualization and measurement of psychic distance and have suggested that industry could be a moderating variable in the internationalization process.

The study of Canadian retailers has allowed us to identify and explore what we believe to be an implicit assumption in internationalization theory, namely, that following a sequence of entry starting with psychically close countries is related to improved performance in these markets. The paradox was that what appeared to be similar and familiar turned out to be very different than expected. Although the Canadian companies began their internationalization process by entering the United States as the theory would suggest, it is when we look beyond sequence of entry to performance that the paradox lies. Instead of similar cultures being easy to enter and to do business in, we argue that it may be very difficult to enter these markets because decisionmakers may not be prepared for differences.

We found a significant difference in values and attitudes between two countries that on the surface do not appear to have such a gap. Our findings indicate that important cultural and business differences exist that can influence the success of internationalization attempts. They also point to the need for further research to examine the ability of companies to identify accurately, and bridge the gap created by, psychic distance.

NOTES

1. Psychic distance is defined in this paper as a firm's degree of uncertainty about a foreign market resulting from cultural differences and other business difficulties that present barriers to learning about the market and operating there.

2. See Johanson and Vahlne [1992], Benito and Gripsrud [1992], and Andersen [1993] for a discussion of this topic and for a more detailed set of references.

3. Cultural groupings are often larger or smaller than a country. However, in this study, country is used as the level of analysis exclusively to highlight the differences between the United States and Canada.

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