A SURVEY OF CANADIAN EXPORT BEHAVIOUR

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PROJECT SUBMITTED IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE DEGREE OF

MASTER OF BUSINESS ADMINISTRATION

In the
Faculty
of
Business Administration
International Business

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SIMON FRASER UNIVERSITY

Summer 2005

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ABSTRACT

This article attempts to explain export behaviour of Canadian firms by testing whether psychic distance is a significant factor in the choice of export market. 250 Canadian exporters responded and the results were analysed. The survey proves inconclusive as to whether psychic distance plays a role in the choice of export markets, leading the authors to conclude that Canadian exports have increased significantly enough so as to require a more complex model involving more than one factor.
DEDICATION

I would like to dedicate this project to my wife Sally. Without your support, encouragement and understanding I would never had made through this program.

- Michael

To my fiancée, Elizabeth, to whom I owe an incredible debt of patience and understanding.

- Stephen
ACKNOWLEDGEMENTS

We would like to thank all our professors who have given us so much time and knowledge, we will be hard put to repay them.

We would especially like to thank Dave Thomas for all his help and guidance in bringing this project to completion. Also, Colleen Collins-Dodd, who through her own great generosity, assisted us in formulating the questionnaire and Jennifer Chang for her review and comments. Finally Melissa McCrae for her ideas and support.
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1 LITERATURE REVIEW

1.1 Introduction

The concept of companies expanding the scope of their business beyond their home country has been the subject of numerous empirical studies and theoretical papers. Most of the literature attempts to explain or provide a deepened understanding of the factors influencing the decisions faced by companies in the expansion of their business operations. For the purpose of this paper, we will often use the term “psychic distance” or “psychological distance” interchangeably when doing our analysis or comparing and contrasting the various literature published about the phenomena. It should be noted that when we refer to psychic distance, we believe that O’Grady and Lane (1996) have defined the term properly 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.”

1.2 Specification of Problem

The objective of our research is to determine if psychic distance is indeed a key factor that influences the export market selection of Canadian firms. We believe that through an extensive literature review of the psychic distance concept and through our own primary research that we can attempt to answer the question “when Canadian exporting companies expand their operations, what factors influence their decision in market selection?” We believe that psychic distance is the primary factor that influences the market selection decision of the companies. In fact our research is only concerned with psychic distance and its influence on the export market selection and perceptions of
Canadian exporting firms. Our hypothesis is that psychic distance is highly correlated with the market selection of Canadian firms. This means that Canadian firms are more likely to consider entering or actually do enter countries and/or economies that they believe are similar in nature to their own. We believe that there are 5 principle factors that comprise psychic distance between Canada and the host country including:

- difference in culture,
- difference in language,
- difference in the level of economic development,
- difference in the level of education,
- difference in the level of technological development.

The crux of these 5 factors has been derived from the research of Child, Ng and Wong (2002). The scope of these differences will be defined and discussed in the Research Design section of our paper in greater detail.

While there has been much research in the area of psychic distance, there has only been one study we are aware of that concentrates on the export behaviour of Canadian firms. This is the research of O'Grady and Lane (1996). Even though their research contributed greatly to our own understanding of the psychic distance concept, we believe that the research was limited in its scope since O'Grady and Lane only concerned themselves with psychic distance and its relationship with the business relationship between Canadian firms and the United States market. Therefore, after our extensive literature review, we believe that further research is needed to understand how psychic distance influences the export market selection of Canadian firms on a global scale, not just limited to one market.
1.3 Background

In the literature review part of our research we compare and contrast the different models and theories developed by other authors in much of the literature that we have read and cited, and develop our own theory and model in our attempt to understand the export behaviour patterns of Canadian companies.

Our research of Canadian exporting companies, attempts to explain what motivated them in the past to select a market, or conversely, what motivates them, or would motivate them, to make a particular market selection. O'Grady and Lane (1996) have stated that “although sequence of entry is an important consideration, we believe that one limitation if this literature is that is does not address how the perceived psychic distance between countries affects the decision makers’ choice of entry or the organizations’ ultimate performance in the new market.” In our attempt to answer our research question, we agree with O'Grady and Lane in respect to the fact that more emphasis should be placed on the perceived notion of psychic distance among the decision makers of market entry selection. Prior to the paper of O'Grady and Lane, few researchers had explored this avenue. Although subsequent to their findings, there has been more attention paid to O'Grady's and Lane's contribution to this matter. Researchers such as Stöttinger and Schlegelmilch (1998) created their own magnitude scale in order to quantify the perceived psychological distance of companies in multiple countries. Their analysis and model is quite unique and will be discussed in greater detail later in this paper.

Hofstede's (1980) cultural dimensions was one of the first steps in attempting to build a framework of psychic distance. Hofstede developed the five dimensions to help individuals, companies and countries understand potentially why an individual, company or country would do business or act in a certain manner. This framework that Hofstede
developed was intended to be a tool for companies looking to expand their export portion of their business. They could use the Hofstede data to see what countries were similar to their own and which they might want to select as their next export expansion.

Many other researchers used the Hofstede research as the basis for developing their own frameworks to define and predict psychic distance and how it affects the export behaviour of firms. As cited in O'Grady and Lane (1996) researchers such as Kogut and Singh (1988), and Benito and Gripsrud (1992) "relied primarily on Hofstede's (1980) research and measures of culture to quantify the cultural difference between countries. Thus, cultural distance was used as a synonym and proxy for psychic distance."

Hofstede’s cultural dimensions have been cited in countless research papers trying to explain psychic distance. We believe that while Hofstede’s cultural dimensions are a keen insight into the influences of a particular countries mannerism in the business context, the cultural dimensions are only part of the puzzle that is psychic distance.

Vahlne and Wiedersheim-Paul (1973), as cited in O'Grady and Lane (1996), expanded on some of the principles and concepts of Hofstede’s cultural dimensions and tried defining psychic distance, in regards to the Swedish companies they had collected their empirical data on, with 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.
Again, in the model created by Vahlne and Wiedersheim-Paul (1973) as cited in O'Grady and Lane (1996), Hofstede's cultural dimensions only comprise part of the definition of psychic distance. In their first paper in 1977, Johanson and Vahlne had mentioned that culture is one of the components of psychic distance. They determined that culture is only factors, that when summed together with other factors they listed “prevent the flow of information from and to the market”, which they determined is the definition of psychic distance. What Johanson and Vahlne did was to formulate a model used to explain the basic steps in internationalization of Swedish companies where they used empirical research from other papers. This model that was formulated was a two part model, each part containing two components, which will be discussed in greater detail later. The purpose of the model was to justify their position that the process of internationalization achieves a better rate of success once the company gains experience. This means that companies will perform more effectively and efficiently internationally as they gain more experience in operating in an international context. However, this theory that more international experience will garner better results in the future by Johanson and Vahlne was refuted by the findings of Douglas Dow (2000). Dow's findings indicated that while the influence of psychological distance decreases in between the first and second market entry, “the influence on subsequent market entry is much weaker.”

Overall, there seems to be a general split amongst the researchers who publish papers about the concept of psychic or psychological distance. The split is whether or not the concept is a valid framework for attempting to explain the export market selection. Researchers such as Child, Ng and Wong (2002) believe that geographical distance is no longer a valid argument for psychic distance due to the fact that the influence of geographical distance has been “diluted considerably as a result of the rapid
development of modern technology." The authors have called for a refinement of the concept. Stöttinger and Schlegelmilch (1998) also tend to side with Child, Ng and Wong. Stöttinger and Schlegelmilch call into question the validity of the psychic distance concept. They believe that the framework of psychic distance is “past its due date”.

Conversely, researchers such as Douglas Dow (2000) believe that his empirical findings confirm that “psychological distance is a highly significant predictor of early market selection for Australian firms.”

One of the more interesting theories and models was that developed by Whitelock (2002). In his paper Whitelock discusses four different types of models that have been developed to understand the impact of market entry selection. Whitelock compares models developed by Johanson and Vahlne (1977), Dunning (1988), the IMP Group, and Reid (1983) and Root (1987). The four models developed by the above mentioned researchers include; the Uppsala model, the Eclectic paradigm, Industrial networks, and Business Strategy model, respectively. The Uppsala model, as mentioned previously, concludes that “firms develop their activities abroad over time and in an incremental fashion, based on their knowledge development; and that this development is explained by the concept of psychic distance, with firms expanding first into markets which were psychically close, and into more “distant” markets as their knowledge developed” Johanson and Vahlne (1977). The Uppsala model is the two part model formulated by Johanson and Vahlne and discussed in greater detail later in the paper.

The interesting approach by Whitelock is that he discusses all four models, compares and contrasts them, and then formulates his own model using all four models as the foundation. Whitelock’s model of international entry looks at two positions, the
market and the firm, and uses the four models to show how they each relate to each other and to the two positions of the newly formed model. In his explanation, Whitelock concludes that "It would seem that, whilst acknowledging the distinctive contributions of each school of thought, a number of areas of convergence are also apparent. A model incorporating the key elements of each approach may present a more realistic and comprehensive picture of the market entry decision."

It is our belief that, as previously stated, psychic distance is one of the primary factors that influence the market entry selection of Canadian exporting companies looking to expand. While Whitelock's idea of integrating multiple factors and models seems the ideal method given its comprehensive nature, our research will be based on the analysis of just one model, psychic distance. In this respect our research and analysis of Canadian exporting firms is close to that of O'Grady and Lane (1996), just examining one element of influences of market entry selection.

1.4 Research Design

Our research involves an online survey of Canadian exporting companies and their perceived feelings about psychic distance. We have amassed 250 responses from Canadian exporting companies from an email to almost 4000 potential companies inviting them to participate in our online survey. Since Canada is considered by many to be lacking in terms of export health, we consider this survey to be very important to Canada's economic wellbeing.

In designing our research we compare and contrast some of the methods and findings of other researchers who look to prove or disprove the psychic distance concept as a means to explaining the export market selection of firms. We look at the methods and analysis of other research in the following context:
Who the data came from – sample/units of analysis. Specifically we will be looking at the companies and the countries that were sampled. More often than not the country being sampled was not Canada, but the models and frameworks look at the company’s decision criteria which can be applied to Canadian companies as well.

How the data were collected – refers to the research design, for example using a survey as we have for our empirical data.

How the data were measured – looks at the methods or measures employed by the authors. These measures include scales, objective vs. subjective, reliability vs. validity.

Other issues or problems with or identified by the various papers – what other issues came up as a result of their research and areas in which further research could shed new light in the subject area.

At the conclusion of each section we determine what the best course of action would be for our research in our attempt to determine if psychic distance is a significant influence in the export market selection of Canadian firms.

1.4.1 Who the data came from

The purpose of understanding who the data came from may explain discrepancies in contrasting views of other researchers in regards to the effectiveness of psychic distance to help predict export market selection of firms. It may not be appropriate to compare the findings of studies on Swedish firms and assume that the same assumption can be made for Canadian firms.

In the paper, “The internationalization process of the firm – A model of knowledge development and increasing foreign market commitments”, Johanson and
Vahlne (1977) used data from derived from previous research conducted by themselves as well as other researchers. There was no primary empirical data collected for this paper. The paper used some of the examples of companies surveyed from researchers findings, and applied it to their own model. Some of the companies included; Volvo, Facit, Atlas Copco and Sanvik, all of which come from Sweden. Due to the fact that the authors of this paper used examples from other empirical studies, there was no mention of size or specific industry studied. The only common link between the data examined was the fact that the companies were all Swedish based.

One the earliest researchers whose works comprise one of the many factors of psychic distance is Hofstede (1980). Hofstede's ground breaking book “Culture's Consequences: International differences in work-related values” was the launch pad for many researchers who were exploring the concept of psychic distance. The first data in Hofstede's research came from "a large data base of employee values scores collected by IBM between 1967 and 1973 covering more than 70 countries, from which he first used the 40 largest only and afterwards extended the analysis to 50 countries and 3 regions. In the editions of GH's work since 2001, scores are listed for 74 countries and regions, partly based on replications and extensions of the IBM study on different international populations." (http://www.geert-hofstede.com/). All totalled, Hofstede collected over 100,000 surveys from IBM employees from more than 70 countries.

One of the more comprehensive papers written specifically looking at the concept of psychic distance was done by O'Grady and Lane (1996) titled “The Psychic Distance Paradox”. O'Grady and Lane used two sources of data for conducting their research. The first source of data came from a “clinical study in which the experiences of ten Canadian retailers that expanded into the United States were documented and
analyzed." The second source of their data consisted of a questionnaire sent to the "Chief Executive Officers of Canadian and American retail companies."

Douglas Dow (2000) in his paper, "A Note on Psychological Distance and Export Market Selection", collected data from two different kinds of sources. First of all, Dow assembled an independent panel of experts together to produce a "single-indicator of psychological distance". From the independent panel of experts, four research questions were devised, which will be discussed in greater detail later. The second source of data comprised the analysis of the four research questions. Douglas Dow accessed an Australian database of 700 small to medium sized Australian exporters. The database, supplied by McKinsey and Company, contained 700 firms from which the author could sample from.

In contrast to number of companies solicited by Dow (2000), the authors Child, Ng and Wong (2002) only analyzed five firms conducting international business in Hong Kong. The firms were as not random; they were selected based on certain criteria. The requirements of the companies were that they needed to be primarily family or entrepreneurial owned and the companies needed to come from different sectors, not just one industry or firm size. The different industries from which the data came from were; food processing and distribution, two from banking, garment manufacturing, and public utilities.

The researchers Stöttinger and Schlegelmilch (1998) used a combination of primary and secondary empirical data in their analysis. The authors selected firms based in Texas and Michigan in their attempt to explain the influence of psychic distance in a companies export development. The goal in using Texas and Michigan as the primary empirical data was to select the two culturally different states that shared some
common export environments. Primarily, the two states were chosen as they are both in close proximity to the other two countries involved in NAFTA with the US. 50 Texas firms and 54 Michigan firms were used in the analysis. The authors selected the firms on a random sampling of the states with some criteria; specifically the companies were from the private manufacturing sector that employed anywhere from 50 to 1,000 employees. The individuals selected for their analysis were comprised of sales, export or general managers.

One of the more interesting papers published was that of Jeryl Whitelock (2002) titled “Viewpoint: Theories of internationalization and their impact on market entry.” Whitelock’s paper was unique in the sense that he did not collect any data from companies, did not solicit the judgments of CEO’s, managers, or executives on how they perceive other countries or other cultures. The data that Whitelock analyzed was the well-known models constructed by four other studies, previously mentioned in this paper, through which he constructed his own model on the basis of the well-known four.

In our research we were supplied a database of almost 4000 Canadian exporting companies from our project sponsor. Sampling these companies was important to us and our sponsor in that our goal was to determine if psychic distance is highly correlated with the export market selection. Selecting Canadian firms was important to our sponsor as the scope of their business encompasses advising Canadian companies the benefits of looking at selecting overseas markets to expand their business.

1.4.2 How the data were collected

Data collection looks at the different methods in which the researchers obtained their empirical data whether that be through case studies or surveys or personal interviews.
As mentioned earlier, Johanson and Vahlne (1977) did not collect any of their own empirical data for their paper. Instead Johanson and Vahlne used some of the results of other empirical research and evaluated the findings in the context of their own model that they created. No mention was made as to how the other data collected by the quoted authors was obtained.

The data that Hofstede (1980) collected for his research was tremendous considering that it comprised over 100,000 from over 70 countries. Hofstede used a database of IBM employees and had them participate in a survey.

In his research of Australian exporters, Douglas Dow (2000) first assembled an independent panel of experts to produce the “single-indicator of psychological distance” upon which four research questions were devised. In order to analyze the research questions, Dow mailed a survey to the 700 small to medium sized Australian exporting firms. Of the 700 surveys sent out, Dow received 315 usable surveys (45% response rate) which is fairly average considering that between 35 – 63% is a normal response rate for mailed out surveys (Respondent Cooperation and Industry Image Survey (The Council for Marketing and Opinion Research, http://www.cmor.org)) as quoted by Iacobucci and Churchill, Jr (2005).

O’Grady and Lane (1996) conducted research on two different levels. The first research they conducted involved documenting and analyzing the expansion of ten Canadian retail companies into the US. The researchers contacted the companies by accessing “the Canadian Key Business Directory, the Canadian Trade Index, and the Directory of Retail Chains in Canada.” From these sources the researchers identified a population of 32 companies from which a sample was drawn. There were some criteria that the companies needed to possess in order to qualify as potential “research sites”.
"First, a company had to be profitable in Canada to be considered a possible site for more in-depth study. 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 researchers conducted in-depth case studies on the companies in which "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 was two hours."

On the second level or phase of the data collected by O'Grady and Lane, "a questionnaire was designed using 125 items measuring sixteen cultural differences that had been suggested in the literature and the interviews." Again, Hofstede's cultural dimensions played a role in the development of psychic distance analysis. The researchers obtained a list of the top 400 retail companies in Canada and the United States from the Dun and Bradstreet database for Canada, and the Million Dollar Directory for the United States. "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 response rates in Canada and the United States were 55% and 37% respectively."

Child, Ng and Wong (2002) conducted their research and collected their data from their companies in a more personal and subjective manner. The researchers interviewed the senior managers of the companies on multiple locations over the span of more than one year. The researchers also supplemented their findings with company information such as annual reports and papers provided by the company. A total of 26 interviews were used in the analysis. The interviews were at least an hour in length and
“were relatively conversational, because the instrument used consisted largely of open-ended questions.”

In collecting their data, Stöttinger and Schlegelmilch (1998) used a more unique approach. The researchers used both primary and secondary empirical data in their analysis of psychic distance and its influence on export development. As mentioned before, their primary data came from random companies meeting certain criteria in Michigan and Texas. Stöttinger and Schlegelmilch also used a variety of ways in which to collect their data. The researchers first interviewed the managers over the phone, and then invited the respondents to a drop-in-questionnaire. A drop-in-questionnaire is a questionnaire completed in the presence of the researcher.

For their secondary data, Stöttinger and Schlegelmilch (1998) used the empirical results of Holzmüller and Kasper (1990, 1991) for their research on Austrian firms, and Dichtl et al (1984), and Müller and Köglmayr (1986) for their research on Austrian, Japanese, Finnish and German firms. The researchers extrapolated the empirical data from the aforementioned authors and applied it to their own model created to measure the influence of psychic distance on export development.

Due to the time constraints of our paper and the large number of potential companies from which to obtain data, our data collection was comprised of an online survey, which will be discussed in greater detail in the methodology section of our paper.

1.4.3 How the data were measured

Data measurement looks at the different ways in which authors and researchers analyzed their data in order to explain their findings.
Johanson and Vahlne (1977) did not collect any data in their paper titled ‘The internationalization process of the firm – A model of knowledge development and increasing foreign market commitments”. They took empirical research from other papers about the same topic and used the results to formulate a model used to explain the basic steps in internationalization of Swedish companies. The model that Johanson and Vahlne formulated was a two part model, each part containing two components. The two main categories are the state aspects (“the resource commitment to the foreign markets and knowledge about foreign markets and operations”) and change aspects (“decisions to commit resources and the performance of current business activities”). The two components of the state aspects are market knowledge and market commitment. The two components of the change aspects are commitment decisions and current activities. The overall conclusion of the authors when analyzing the empirical data from other papers within their formulated model is that the process of internationalization is achieves a better rate of success once the company gains experience.

In measuring the data he received from over 100,000 surveys, Hofstede used a factor analysis of the data. From his analysis, Hofstede originally developed four cultural dimensions Power Distance, Individualism, Masculinity and Uncertainty Avoidance. Through additional work and research, Hofstede added a fifth dimension to his cultural dimension model. Due to the overwhelmingy cited works of Hofstede and his five cultural dimensions, it warrants discussing each dimension as they pertain to psychic distance. The following information on the five dimensions was obtained at http://www.geert-hofstede.com/:

The first dimension is the Power Distance Index which “focuses on the degree of equality, or inequality, between people in the country’s society. A High Power Distance
ranking indicates that inequalities of power and wealth have been allowed to grow within the society. These societies are more likely to follow a caste system that does not allow significant upward mobility of its citizens. A Low Power Distance ranking indicates the society de-emphasizes the differences between citizen's power and wealth. In these societies equality and opportunity for everyone is stressed.”

Individualism is the second dimension which “focuses on the degree the society reinforces individual or collective achievement and interpersonal relationships. A High Individualism ranking indicates that individuality and individual rights are paramount within the society. Individuals in these societies may tend to form a larger number of looser relationships. A Low Individualism ranking typifies societies of a more collectivist nature with close ties between individuals. These cultures reinforce extended families and collectives where everyone takes responsibility for fellow members of their group.”

The third dimension is Masculinity which “focuses on the degree the society reinforces, or does not reinforce, the traditional masculine work role model of male achievement, control, and power. A High Masculinity ranking indicates the country experiences a high degree of gender differentiation. In these cultures, males dominate a significant portion of the society and power structure, with females being controlled by male domination. A Low Masculinity ranking indicates the country has a low level of differentiation and discrimination between genders. In these cultures, females are treated equally to males in all aspects of the society.”

The fourth dimension is Uncertainty Avoidance Index which “focuses on the level of tolerance for uncertainty and ambiguity within the society - i.e. unstructured situations. A High Uncertainty Avoidance ranking indicates the country has a low tolerance for uncertainty and ambiguity. This creates a rule-oriented society that institutes laws, rules,
regulations, and controls in order to reduce the amount of uncertainty. A Low Uncertainty Avoidance ranking indicates the country has less concern about ambiguity and uncertainty and has more tolerance for a variety of opinions. This is reflected in a society that is less rule-oriented, more readily accepts change, and takes more and greater risks.

The last dimension which was added subsequent to his initial book on the cultural dimension subject is Long-Term Orientation which “focuses on the degree the society embraces, or does not embrace long-term devotion to traditional, forward thinking values. High Long-Term Orientation ranking indicates the country prescribes to the values of long-term commitments and respect for tradition. This is thought to support a strong work ethic where long-term rewards are expected as a result of today’s hard work. However, business may take longer to develop in this society, particularly for an "outsider". A Low Long-Term Orientation ranking indicates the country does not reinforce the concept of long-term, traditional orientation. In this culture, change can occur more rapidly as long-term traditions and commitments do not become impediments to change.”

O’Grady and Lane (1996) had two kinds of data they needed to measure. The first was the data from the ten Canadian retail companies. There was a couple of ways in which the data from the companies were measured. First of all, the researchers asked the executives to “trace the history of the strategic decision to enter the United States market from pre-entry to post-entry.” The researchers asked the executive some questions related to the perceptions, specifically how the “cultural and other differences between the United States and Canada were taken into account in the strategic decision making process.” The researchers used several measurement methods to determine if the company was deemed to be successful in the United States market. The companies
were measured and evaluated using the following four criteria “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.” The researchers then categorized the performance of the firms into the following three categories:

1. “Unprofitable withdrawals (deemed a failure);
2. Holding in the U.S. (not profitable, but may have increased sales, gained market share, or met the expectations of the parent company)(deemed a success);
3. And profitability operating in the U.S.(deemed a success)”

For their second set of data, O’Grady and Lane (1996) had CEO’s from top Canadian and American retail store fill out questionnaires that had been mailed to them. In analyzing and measuring the data, the researchers used a questionnaire that measured the attitude or value orientations of the executives “using well-established instruments, such as Hofstede’s questionnaire, and Jackson’s Personality Research Form (PRF) and Personality Index (JPI).” In analyzing the result of the data, the researchers used Cronbach’s alpha to determine the reliability of the results.

Upon analyzing the results of their data, the researchers came to some general conclusions about psychic distance and the Canadian companies. Namely “the paradox was that what appeared to be similar and familiar turned out to be very different than expected. Although Canadian companies began their internationalization process by entering the United States as the theory would suggest, it is when we look beyond the 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 decision makers may not be prepared for differences.” The preceding statement by O’Grady and Lane deals with the psychic distance. They point out that
psychic distance as an influence can be detrimental if a company enters into a market perceived to be psychically close to their own, and the managers do not prepare themselves enough for the actual differences in culture and market environment that exist. It is as if companies view psychically close countries as an easy market to enter and that the same successful practices and procedures they perform in their own country will ultimately be successful as well in the psychically close countries. The authors also add that they found a “significant difference in the 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.”

In his paper “A Note on Psychological Distance and Export Market Selection”, Douglas Dow (2000) used a panel of experts to devise the four research questions he hoped to answer. The research questions were:

- “Is it valid to use geographical distance as the sole indicator of psychological distance when its influence on export market selection is being measured?”
- “Is it valid to use a scale based on Hofstede’s (1980) cultural dimensions as the sole indicator of psychological distance when its influence on export market selection is being measured?”
- “Is it valid to use a scale based on Sethi’s (1971) market similarity factors as the sole indicator of psychological distance when its influence on export market selection is being measured?”
- “Does the strength of the relationship between psychological distance and export market selection diminish as a firm gains international experience?”
- In the beginning of the survey the companies were asked “to rank the first five foreign markets to which they have exported products.” This question was the
dependent variable of the research, the frequency of market selection. The countries that were being exported to were the units of analysis, of which there were a maximum of 25 countries.

Each research question was considered a phase for analysis. Dow was trying to see if there are some simple explanations to market selection, i.e. geographical distance, or if some other research conducted, i.e. Hofstede and Sethi, could better answer the market selection questions by exporters. Dow modified a single item scale, first used by Nordstrom in 1991, to measure psychological distance and presented to the panel of experts, who were comprised of commissioners from the government trade organization AUSTRADE.

The results of the analysis of the surveys were what Dow had expected. Primarily, the panel of experts determined that, “psychological distance is a highly significant predictor of early market selection for Australian firms.” Moreover, the results of the analysis of the surveys completed by the Australian exporters, shows that “geographical distance is a highly significant predictor.” This means that the closer the country, the more likely to be an exporting destination of the Australian companies.

More significantly, and as the author decrees, “controversial”, neither Hofstede’s cultural dimensions, nor Sethi’s market similarity factors were effective indicators of export selection. The author, not the meaning to slight the work of other researchers concludes that “this does not meant that Sethi’s (1971) and Hofstede’s (1980) original research was flawed” rather that “scales based on Hofstede’s and Sethi’s work should be applied in the proper context and not hijacked to represent a construct to which they are only one of several contributing factors.
The last factor examined dealt with companies gaining more international experience and the impact it has on psychological distance. The author noted that his analysis indicates that the influence of psychological distance decreases in between the first and second market entry, “however, the influence on subsequent market entry is much weaker.” The author postulates that the findings of other researchers (Cavusgil (1980) was mentioned) characterize “the first foreign market entry as a unique and discrete stage in the internationalization process.”

In their analysis of the five business cases in Hong Kong, Child, Ng and Wong (2002) wanted to refine the concept of psychic distance, specifically they believed that the concept needed reformulated and to include some factors that they developed during their research.

Child, Ng and Wong discussed a number of shortcomings or short-sightedness from the conclusions of other researchers. In their analysis they made reference to the fact that Johanson and Wiedersheim-Paul’s (1992) conclusions on their analysis of Swedish exporting companies “may not apply universally”. In other words, the Swedish companies psychic distance influences may only be applicable to those companies or just Swedish companies in general. Child, Ng and Wong then go on to refute the notion, that of geographical distance being the strongest indicator of psychic distance, as being “diluted considerably as a result of the rapid development of modern technology.” Essentially the authors disagree with Dow (2000) and numerous other researchers as to what are the most significant explanations of psychological distance. The authors also mention that their interviews show that there may be more personal reasons for market selection, reasons that cannot be substantiated by statistics and market analysis.
In their analysis of the interviews with the Hong Kong companies, Child, Ng and Wong developed what they call a “conceptual refinement of psychic distance.” “The concept of psychic distance can benefit from applying an analytical framework based on the distinction between distance-creating, distance-compressing, and distance-bridging factors.” The three factors are what the authors determined to be the processes that underpin what psychic distance comprises.

From their interviews, the authors feel that Hofstede (1980) (although not explicitly mentioned) was correct in his assessment in that the respondents felt that “culture (including difference in language) is the most important element in creating distance and potential difficulty”.

The authors had numerous reasons for explaining market selection. Child, Ng and Wong (2002) believe that exporters may base their international expansion decisions on the general trend of market expansion relative to choice of market selection by their fellow country companies. This means that if the trend of Hong Kong companies is to expand to Russia, other Hong Kong companies may do the same. The authors labelled this a “migration tide”. Also, looking at countries as a single unit of analysis is not appropriate. Due to the nature and size of some countries, like Canada and the US, there will be regional characteristics on a smaller scale. Areas like Vancouver in Canada could be seen as having low psychic distance influence because of the large Hong Kong population residing there. The authors also agree with other researchers like Johanson and Vahlne (1977) in respect to the fact that previous international experience can impact the level of psychic distance felt by the decision makers.

In measuring their data, Stöttinger and Schlegelmilch (1998) formulated a unique method of measurement to assess the level of psychic distance in the answers of their
respondents. The authors used what they called “free magnitude scaling (i.e. without a reference stimulus) to capture individual differences in judgments. Stöttinger and Schlegelmilch developed a system to “relate the managers’ psychic distance to the actual geographic distance.” They calculated the psychic distance using the degrees of 0 longitude (Greenwich) and 180 (International Date Line). “This geographical distance of approximately 16,700 km was related to the respondents’ answers in the magnitude scale.” The magnitude scale formulated by the researchers was a scale in which the researchers determined where the managers would rate a country based on psychic distance out of 17. This answer was then multiplied by 16,700 to determine what the “perceived geographical distance” would look like in comparison to the actual distance. Some of results were quite unusual. For instance, Canada was rated 371 by Michigan companies. This means that the Michigan managers feel that there is a greater psychological distance influence than there is in actual geographical distance by 371%. Canada was still the lowest on the magnitude scale, as determined by Michigan and Texas, of all the countries that were listed on the scale. The catch of it is that Texas, for example rated Canada as the lowest psychic distance and Germany in second spot on the magnitude scale, but translated into the actual geographic distance, Germany is 68% of actual distance, while Canada is 440% of actual distance, even though they are lower on the magnitude scale.

When analyzing the US results and the extrapolated data from other research, the researchers were surprised by some of their findings. When looking at the perceived psychic distance between Austria and Italy, Austria perceived Italy as 430 percent of the actual geographical distance, meaning that the Austrian managers’ responses indicate that they feel there is a definite psychic distance factor between the two countries. This
is puzzling to the researchers as Italy is the second most important country to Austrian export.

In looking at the results of their empirical and extrapolated data, Stöttinger and Schlegelmilch call into question the validity of the psychic distance concept. “One way of interpreting the results is that the concept of psychic distance is “past its due date”. In other words, the importance of between two countries has diminished as a result of the increased interaction brought about through the globalization of markets.” This view is similar to those shared by other authors mentioned before; specifically Child, Ng and Wong feel that there needs to be a refinement of the concept of psychic distance.

As mentioned earlier, Whitelock (2002) did not collect any primary or secondary empirical data in his paper. Instead, Whitelock built a model by utilizing the frameworks of four models from previous research, as has been mentioned earlier in this paper. The four models that contributed to his own are valid and insightful; Whitelock believes that they are only part of the picture. He states that “whilst acknowledging the distinctive contributions of each school of thought, a number of areas of convergence are also apparent. A model incorporating the key elements of each approach may present a more realistic and comprehensive picture of the market entry decision.”

In our research we believe the five factors of psychic distance identified by Child, Ng and Wong (2002) are the most relevant factors to explain the concept of psychic distance. Those five factors include:

1. difference in culture,
2. difference in language,
3. difference in economic development,
4. difference in the level of education,
5. difference in the level of technology.

We differ from Child, Ng and Wong in that we apply the five factors in the online survey we conducted as opposed to the case studies approach by Child, Ng and Wong.

When looking at the difference in culture, we are referring to the possibility that Canadian firms may be more reluctant or averse to engage in trade with a country or economy that they deem to be significantly different culturally than their own. As far as language goes, the thought is that Canadian firms may avoid doing business with countries where there may be a perceived language barrier. This barrier would be an inability to communicate due to the significant differences in language. The difference in economic development may cause Canadian firms to not do business with a foreign country or economy if the Canadian firm is more apt to conduct business with a country or economy that is developed as opposed to being classified as 3rd world or developing. The fourth factor is the difference in the level of education between Canada and the host country. Canadian companies may tend to do business more often with countries that are deemed to be on the same level of education as Canada is. The final factor is the difference in the level of technological development. The school of thought here is that Canada may avoid doing business with countries or economies where they do not possess the same level of communication infrastructure that Canada possesses. This infrastructure would include the availability of the internet, telephones and other means of communication.

1.4.4 Other issues or problems

One of the problems that Johanson and Vahline allude to in their empirical verification section of their paper is that they did not conduct any case studies or empirical data collection themselves. They do go on to say their intention is to conduct a
case study and collect data in an attempt to prove the validity of their model. Furthermore, the authors concede that “we do not take into account how various factors other than scale may affect the economy of the market operations. The technology of the firm probably has a great impact on the economy of different types of market operations.” Also noted is that “the variable ‘firm’s approach to market risk’ is a very complicated factor” (Johanson and Vahlne, 1977).

Dow identifies several limitations with his research. The limitations noted by Dow are that “the sample of firms is biased by the size of the firm, the type of industry, and the nature of the originating market.” The fact that no large firms were sampled from ignores the resource base of larger firms, which can have an impact on the influence, or lack thereof, of psychological distance. Dow also states that the geographical location of Australia itself may impact the influence of psychological distance, an influence that may not affect companies from different geographical locations.

Dow states, “The most serious limitation of the results regards the use of a single item instrument with an expert panel to measure psychological distance.” Dow infers that panels of experts are subjective and present problems as far as their representativeness. Also, “the lack of multiple items limits the ability to measure and therefore ensure convergent validity.” Dow notes the prior works of Vahlne and Wiedersheim-Paul using an archival method to measure underlying dimensions is “ultimately a superior route.”

Similar to the limitations of other studies, O'Grady and Lane (1996) acknowledge that their study was not entirely representative of the potential overall psychic distance that other industries, as well as the countries as a whole may encounter. Their research involved a limited geographical representation of Canada, since the bulk of Canadian
retailers are located in the central and western parts of Canada. As well, since Canada is a country with two official languages, the researches also concede that no allowance was made to examine the potentially different responses a French company may give than an English company.

Despite stating that psychic distance may be past its due date, Stöttinger and Schlegelmilch acknowledge that “psychic distance, with its summary character, should not yet be dismissed altogether. Its theoretical appeal remains high due to its intriguing face validity.” One of the explanations that the researchers offer for the irregular results is that they “did not look at the concept of psychic distance in the context of initial export development, but in the context of ongoing relationships.” This approach is quite different from that of other researchers. Many papers dealing with the concept of psychic distance look at the concept from an initial market entry selection and not from the approach of ongoing relationships as was done by Stöttinger and Schlegelmilch.

Some of the issues that Stöttinger and Schlegelmilch note in their paper include the fact that neither their study, nor the study of many researchers exploring the psychic distance, uses a longitudinal approach. Instead the popular method is to use cross-sectional approaches, which the authors feel would not capture the evolutionary character of psychic distance, as they feel it would change over time.

Stöttinger and Schlegelmilch also feel that for future research “a more qualitative approach to capturing psychic distance may represent a way forward.” This would be similar to the approach used by Child, Ng and Wong (2002) in analyzing the five companies in Hong Kong. The authors also note that other factors may need to be taken into account such as media coverage of the intended country, and other factors like those suggested by O’Grady and Lane (1996, p. 328) including “business factors
such as legal and competitive environments need to be included when conceptualizing distance."
2 METHODOLOGY

2.1 Hypothesis

H₁: Psychic distance is highly correlated with the market selection of Canadian firms. We expect to find a negative relationship between the two variables (i.e. the higher the psychic distance, the lower the importance of the market).

2.2 Overview

Our research methodology consisted of designing a questionnaire, collecting the data, creating the necessary variables and conducting the tests. We test H₁ by measuring the psychic distance and importance of market for each region. We compose two lists of regions – one ranked by mean psychic distance score, and the other by mean importance of market score. A Pearson rank order correlation is then run to ascertain whether a correlation exists between the two variables.

2.3 Questionnaire

We developed the questionnaire in order to ascertain the perceived psychic distance to various international markets, the level of importance of each market to the company, and finally the perceived significance of various barriers to export. The first two measures are needed in order to test H₁, while the third is used as an aid in further explaining Canadian export behaviour as some markets may be avoided simply because they are inaccessible.

The individual countries/economies were chosen by consulting Statistics Canada's publication, Canadian International Merchandise Trade, which lists domestic
exports by country. The countries/economies to which Canada exported a significant amount of goods were listed individually on the questionnaire, while the other countries/economies were grouped according to geography and similar culture. Thus Norway, Sweden and Finland were grouped together as “Nordic Countries”. This allowed us to include the all the major markets, while keeping the number of questions to a minimum, so as maintain respondent participation. The respondents were asked to rate each market on a scale of 1 to 7 as to how important that market was to the company. This resulted in a total of 19 variables (one for each market/region).

Psychic distance was measured though five factors, identified by Child, Ng and Wong (2002) as the most important elements in creating distance and potential difficulty. These elements were: culture, language, level of economic development, level of education, and level of technological development. The respondents were asked to rate each country/region on a scale of 1 to 7 as to how different it was from Canada in respect to each element. This resulted in a total of 95 variables (19 markets * 5 elements).

Finally, participants were asked to rate 19 potential export barriers on a scale of 1 to 7 as to their level of relevance when entering a foreign market. The list of possible export barriers was compiled from a large number of surveys and articles, with the intent to include as many barriers as possible. In addition, similar export barriers were grouped together, as we wished to gain a broad understanding of which barriers were the most significant to Canadian export firms, rather than a detailed one. Thus various types of import tariffs were grouped together simply as tariffs.
2.4 Survey

The survey was hosted on-line by SurveyMonkey.com – a web based company devoted solely to survey hosting and data collection. This method allowed was not only cost-effective, but also allowed for easy access by respondents, quick data collection and entry, as well as error reduction (ambiguous response errors were eliminated). Using a tool provided by SurveyMonkey.com, we were able to upload a list of 3996 e-mail addresses, taken at random from Canadian Export Centre’s database of Canadian exporters and send an e-mail out to each explaining the survey and providing them with a link to the survey. The respondents were informed that the survey was a study of Canadian export behaviour; however $H_1$ was not made known to them. This was to give the respondent enough information to convince him/her of the importance of the study, while concealing the object of the survey to minimize influencing respondents’ answers.

The drawback of using an on-line survey and an e-mail invitation is related to the high volume of spam (unsolicited e-mail), which unfortunately has become a bane to businesses and consumers alike. Thus, a survey request is often treated simply as spam and ignored. Moreover, with the proliferation of viruses on the internet, many are wary of e-mail from unrecognized sources. Thus a very large number of e-mails were no doubt simply ignored or stopped by anti-spam programs. This is made all the more probable by the fact that we were unable to customize the message sent out by SurveyMonkey.com beyond specifying the text to be included. Logos, graphics and other measures that would have provided for a more genuine looking e-mail were unable to be included. Finally because the message was in plain text rather than HTML, it did not appear as professional as it could have, and the chances of it being regarded as spam increased. This also explains the high response rate from British Columbia – roughly 40% of respondents, the highest of all provinces – as they are much more likely
to recognize the Simon Fraser University name and are thus less likely to disregard the survey as spam or a hoax.

2.5 Data Reduction

In order to form the variable psychic distance, the five variables: culture, language, level of economic development, level of education and level of technological development, were combined together using the mean value of the variables. As stated previously, each respondent was asked to rate each country/region on a scale of 1 to 7 as to how different it was from Canada in respect to each element. The resulting 95 variables were reduced back to 19 – one variable per region. These variables were called psychic distance (region). Each psychic distance variable represents how like or unlike Canada each Canadian firm sees each region. Each new variable was tested for reliability to ensure that all factors loaded significantly.

2.6 Analysis

2.6.1 Descriptive Statistics

In order to ascertain how important a country/region was to each company we asked them to rate the importance of that country/region on a scale of 1 to 7. This variable, "importance", gave us a broad idea of how the company has expanded internationally and provided the basis for the comparison between how the company has behaved and how the company perceives other markets. Chart 2.1 depicts the mean importance value of each region and gives a broad idea of how important each region is to Canadian exporting firms in comparison to the other regions.
It comes as little surprise that the United States is by far the most important region for most companies, with a mean importance value of almost double that of the next most important market, Japan. What is surprising in light of the psychic distance theory however, are the relatively equal values of the remaining markets. Theoretically, the more psychologically closer countries (or those countries most like Canada in terms of culture, language, level of development, etc.) should be more important than those that are more psychologically different. Thus it is to be expected that those countries with the lowest psychic distance values (as depicted in Chart 2.2) also have the highest importance values. This is obviously not the case; however, further testing will provide more detailed information.

Chart 2.2 depicts the mean values of each variable and gives a general idea of the average Canadian firm's perception. Thus can be seen that the US is considered most like Canada, though slightly different, while European countries, followed by Asian countries are considered progressively more different (or psychically distant). This is logical as the English speaking countries are considered most like Canada (and we thus
have significantly more interaction and communication with them), whereas European countries, while familiar to us, either because it is a popular travel destination or because much of our culture finds its roots there, are nevertheless considered more distant, simply because the language is different enough to make communication more laborious. Asian countries are even more psychically distant from Canada because of a much different language (based on a completely different method of writing) as well as a completely different culture. Finally Africa finds itself as the most psychically distant region due to different culture and different language (although many speak English), however mainly due to lower levels of development.

Chart 2.2 Psychic Distance

![Chart 2.2 Psychic Distance](image)

Chart 2.3 depicts the outcome to the question, “What export barriers are the most relevant when entering a new market?” We can see that the barriers considered most insurmountable are those that deal with how welcoming the host government is. High corruption, hostility, tariffs and political instability are considered by the respondents to
be the most influential, while cultural and language issues are considered only moderately difficult to overcome. While it does make sense that a company would disregard all together a market deemed hostile, thus ruling out using these barriers as an indicator of market behaviour, it is also possible that exporters are simply not able to realize how influential these factors really are, as they are more subtle than the factors rated highly by exporters.
Chart 2.3 Barriers to Export

- There is high corruption in the host country's business and government sectors
- The host country has imposed high tariffs on the goods you wish to export
- The host country's government is hostile towards overseas investors
- The political and social system in the host country is unstable
- Import regulations of the host country are too bureaucratic
- There is unfair local competition in the host country
- Logistics/Distribution in the host country is too costly
- There is a lack of quality local agents/distributors in the host country
- The host country's legal system is not transparent
- Your firm lacks the resources needed to expand into a foreign market
- The host country's level of economic development is too low
- Information on the host country is difficult to obtain
- The host country's language is too different
- The host country's level of technological development is too low
- The host country's culture is too different
- The host country's level of education is too low
- The host country is too far away
- Your firm has inadequate export skills
- Your firm has no previous experience with the host country
2.6.2 Correlation Test

A bivariate correlation test was run between the psychic distance variable for each region and the corresponding importance variable (measures importance of each market to the firm). Thus one test was conducted for each of the 19 pairs of variables. Originally, the predicted outcome was that in the large majority of cases, a correlation between the two would be found. In light of the responses to the question regarding region importance to each company, we were not surprised to find that only in 6 cases out of 19 (i.e. 32%) was there a correlation. Table 2.1 lists the significance level of each region and whether or not a correlation exists. The significance level was set at 0.05. Those regions with a significance level over 0.05 were deemed insignificant.

<table>
<thead>
<tr>
<th>Country</th>
<th>Sig. Level</th>
<th>Correlation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>0.01</td>
<td>Yes</td>
</tr>
<tr>
<td>France</td>
<td>0.01</td>
<td>Yes</td>
</tr>
<tr>
<td>Mexico</td>
<td>0.01</td>
<td>Yes</td>
</tr>
<tr>
<td>Germany</td>
<td>0.01</td>
<td>Yes</td>
</tr>
<tr>
<td>Other parts of Asia</td>
<td>0.04</td>
<td>Yes</td>
</tr>
<tr>
<td>Western Europe</td>
<td>0.04</td>
<td>Yes</td>
</tr>
<tr>
<td>Africa</td>
<td>0.05</td>
<td>No</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.08</td>
<td>No</td>
</tr>
<tr>
<td>South America</td>
<td>0.11</td>
<td>No</td>
</tr>
<tr>
<td>Middle East</td>
<td>0.12</td>
<td>No</td>
</tr>
<tr>
<td>Eastern Europe</td>
<td>0.16</td>
<td>No</td>
</tr>
<tr>
<td>South Korea</td>
<td>0.17</td>
<td>No</td>
</tr>
<tr>
<td>Nordic Countries</td>
<td>0.31</td>
<td>No</td>
</tr>
<tr>
<td>Japan</td>
<td>0.34</td>
<td>No</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>0.57</td>
<td>No</td>
</tr>
<tr>
<td>India</td>
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<td>No</td>
</tr>
<tr>
<td>Taiwan</td>
<td>0.83</td>
<td>No</td>
</tr>
<tr>
<td>China</td>
<td>0.90</td>
<td>No</td>
</tr>
<tr>
<td>United States</td>
<td>0.95</td>
<td>No</td>
</tr>
</tbody>
</table>
As a further measure to ensure that the test results were not simply due to a lack of variance, we selected the top 10 countries rated the most important by the participants. We then ranked the countries/regions by their mean score and by their psychic distance score and ran a Pearson rank order correlation to further test whether psychic distance is related to importance. The results turned out negative once again however.

Since the number of cases with a correlation is both too low and too high as to rule one way or another on whether psychic distance is an important factor in explaining Canadian export firms' behaviour, we deem the survey inconclusive towards H₁ and in need of further study.
3 DISCUSSION OF RESULTS

The obvious question that needs to be answered in response to the inconclusive findings of the survey is: why is psychic distance not related to importance of country/region when numerous previous studies in other countries have shown a significant correlation between the two? We find several reasons that may account for this, the first being the abnormally high number of responses received from companies located in British Columbia.

As can be seen in Chart 3.1, British Columbians responded much more than any other province including Ontario, although Ontario has considerably more international businesses than BC. This is most likely due to the simple reason that British
Columbians are much more likely to recognize the Simon Fraser University name and therefore be more willing to donate their time towards a survey conducted by the university. Also, as mentioned before, the invitation e-mail to the survey is less likely to be viewed as spam or a hoax by those who recognize the sender.

British Columbians have a much stronger link to the Pacific Rim Countries not only due to the high volume of shipping activity between Asia and BC ports, most notably Vancouver, but also due to the high number of Asian immigrants choosing to settle in Vancouver. These immigrants encourage trade between BC and their home countries as well as aid non-immigrants in learning about their culture and introducing them to foreign contacts. While British Columbians will therefore recognize Asian cultures as being very different, it is very possible that they have set up networks overseas with the help of the Asian community in Vancouver. This would in turn affect the outcome of the correlation tests between importance and psychic distance, as Asian regions may have become very important to their business, however they will still perceive those same Asian countries as having a very different culture and language.

This explanation would suggest that the Uppsala model of internationalization, popularized by Johanson and Vahlne (1977), after which this survey is modelled, is too simple to explain the current behaviour of exporting firms in Canada. Mere psychic distance is no longer a significant enough variable to explain export behaviour. Perhaps Child, Ng and Wong’s model, which divides psychic distance variables into distance-creating (e.g. those variables used in this study), distance-compressing (e.g. those variables created by globalization and convergence of lifestyles), and distance-bridging (e.g. previous experience in another country), would be a more suitable model to explain Canadian export behaviour, although testing this would require a much more extensive survey.
Another possible explanation for the inconclusiveness of the survey is the selection of variables used in the measure of psychic distance. Those variables chosen may not accurately measure psychic distance perceived by Canadians towards foreign countries. Although they were identified by Child, Ng, and Wong as being the most important elements in creating psychic distance in Hong Kong, these factors may not be applicable to Canada because of cultural differences or because the current export market in Canada may have evolved differently than the one in Hong Kong. A study exploring the most influential factors that create psychic distance in Canada should be conducted to verify this.
4 CONCLUSION

Canadian exports have grown significantly in volume over the past few decades. Whereas psychic distance was once a powerful indicator of Canadian export behaviour, it is now too general a variable to sufficiently explain it. To those working to develop Canadian exports, this should come as both a blessing and blight. On the one hand, it should be welcomed as it signifies Canada’s exports have increased dramatically and have thus become significantly more complex. On the other hand, questions regarding the stimulation of Canadian exports will most likely go unanswered until a more complex model is developed and tested.
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