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**THE ROLE OF PSYCHIC DISTANCE
IN THE PROCESS OF COMPANIES
INTERNATIONALIZATION
– REVIEW OF RESEARCH RESULTS**

Abstract

The article presents the review of existing research on the role of psychic distance in the process of companies internationalization (both secondary and primary). The main attention was dedicated to the measurement of this phenomenon. The concept of psychic distance was compared to cultural distance, they are used interchangeably in the article.

The objective of the paper was also to discuss the conceptual and methodological properties of psychic (cultural) distance: the illusion of symmetry, stability, linearity, causality, discordance, as well as the assumption of corporate and spatial homogeneity and the assumption of equivalence.

The last part of the article is dedicated to the examples of research examining the role of psychic (cultural) distance in decisions of: choosing market entry mode (export versus foreign direct investment; acquisitions versus green field investment), choosing the level of strategy adaptation to local market conditions and decisions concerning other fields of international business.

Keywords: *psychic distance, cultural distance, conceptualization, measurement, internationalization*

Introduction

Psychic Distance is one of the most commonly cited and measured constructs within international business research. The construct of psychic distance, cultural distance along with other forms of national differences such as institutional distance, socio-cultural distance and country distance have been cited as potential predictor variables for a broad array of management decisions (beginning exporting, export market selection, FDI market selection, international performance, human resources management, and even communication in R&D joint ventures). However, one major gaps still exist in knowledge about this phenomenon. This concerns the manner in which the psychic distance is measured. At the core of most of these debates is the issue of whether distance should be defined and measures in terms of exogenous and observable differences among countries or in terms of perceptions of individuals.

The presented paper should be treated as an introduction to the Author's own research on the role of psychic distance on the Polish companies internationalization. It's main objective is the presentation of different approaches to the

measurement of this phenomenon and the presentation of the examples of research on the impact of psychic distance on different management decisions in international business field.

1. The concept of psychic and cultural distance

The concept of Psychic Distance was originally introduced by Beckerman in 1956. At the beginning, however, no extensive research was conducted in order to analyze the impact of Psychic Distance on the choice of foreign markets. After that, in 1970s, this concept was further developed by Johanson and Vahlne, the authors of the sequential model, as mentioned above. The economists from the Uppsala University define psychic distance as a set of factors preventing or disturbing the flow of information between the firm and the market. These difficulties may be directly connected with communication with existing and potential customers or with a lack of access to the information about a given foreign market.

The notion of psychic distance is seen slightly differently by Papadopoulos and Jansen, who additionally introduce a separate notion of cultural distance (Albaum, Strandkov & Duerr, 2002). According to these authors, psychic distance is an uncertainty about foreign markets and a perceived difficulty of obtaining information about these markets. Cultural distance, in turn, is defined as differences between the culture of one's own country and the culture of a target country (e.g. an export destination country). In this approach, the term of psychic distance refers to the perception (e.g. of customers' needs and expectations in a foreign country); it is culturally-determined, but subjective. Cultural distance has a more objective character – it acknowledges the existing cultural differences.

Distance to foreign markets may also be defined using the terms referring to the "temperature", which is understood as all the barriers for companies from the third world countries. In this concept, a country's "temperature" is determined by factors which describe its environment, i.e.: political stability, market potential, economic development, cultural homogeneity, legal barriers, physiographic barriers and geo-cultural distance (Doole and Lowe, 2001; Duliniec, 2004).

According to some authors, the terminological division into psychic distance and cultural distance failed to be accepted in research on international environment. In the literature of the subject, the terms of psychic distance and cultural distance are often used interchangeably (Kogut and Singh, 1988). These researchers are popularising the term of cultural distance, openly mention the term of psychic distance in their discussions and they cite the Uppsala-based psychic distance literature, when justifying their hypotheses. However, a review

of the empirical literature in this area reveals that the vast majority of researchers have operationalized cultural distance in a much narrower form, i.e. as differences in Hofstede's (1980) dimensions of national culture. In recent years, some authors (e.g. Sousa and Bradley 2008) have more explicitly endorsed the narrower interpretation of cultural distance and have argued that the other main distinction between the two constructs is that cultural distance is measured as exogenous differences at the national level. In effect, they are endorsing the perceptual approach to defining psychic distance. However, a review of these various definitions raises the issue of how Johanson and Vahlne's (1977) "sum of factors" other than cultural distance fits in. Dow and Larimo (2009) propose the scheme of different forms of distance (see Figure 1). They refer to perceptions of distance, measured at the level of the individual, as perceived psychic distance. Psychic Distance stimuli are referred to in the Johanson and Vahlne's (1977) sum of factors, which influence the perceptions of Psychic Distance. The authors list such factors as: national cultural distance, differences in language, institutional distance and other forms of distance.

Figure 1. Schematic illustration of the different forms of distance

Psychic Distance Stimuli National – level factors that may distort the flow of information between markets	National Cultural Distance (e.g. differences in Hofstede's national cultural dimensions)	Perceived Psychic Distance
	Language Distance (e.g. differences in language at the national level)	
	Institutional Distance (e.g. differences in legal, political, educational or religious institutions)	
	Other Forms of Distance (e.g. the listed stimuli are not necessarily exhaustive)	
<i>National – Level Exogenous Differences</i>	<i>Individual – Level Perceptions of Differences</i>	

Sources: [Dow and Larimo, 2009, pp. 74-98].

In the further part of the text the terms psychic and cultural distance will be used interchangeably.

2. Hidden assumptions in psychic and cultural distance constructs – conceptual and methodological properties

The hidden assumptions of cultural distance appear in two clusters, one emanating from the conceptual properties of the construct, the other from its methodological properties. Conceptual properties produce illusions that are the core of the cultural distance construct and undermine its validity within the context of FDI theories. Methodological properties present instrumentation and measurement biases that distort the accurate measurement of cultural differences, they are most closely associated with the Kogut and Singh (1988) index, but address broader measurement issues as well.

Taking into consideration conceptual properties O. Shenkar distinguishes the illusion of stability, linearity, causality and discordance of cultural distance (Shenkar, 1992).

“Distance”, by definition is symmetric: the distance from point A to point B is identical to the distance from point B to point A. Cultural distance symmetry is however difficult to defend in the context of FDI. It suggests an identical role for the home and host cultures. There is no support for such an assumption in the literature. There are no studies showing symmetry in distance between home and host country of FDI. Numerous studies have shown the importance of the investor culture in predicting investment, entry mode and performance (e.g., Kogut & Singh, 1988). Other studies have shown a role for the host culture. However, there are no studies showing symmetry between the two nor is there a reason to assume one. On the contrary, home and host country effects are different in nature, the former being embedded in the firm while the latter is in a national environment.

Measured at a single point in time, cultural distance is implicitly assumed to be constant. Cultures change over time. The culture measured at a market entry time may have changed by the time performance is measured. Further, a convergence thesis would predict cultural distance narrowing over time as more investors flock into the market and local employees become knowledgeable of MNE management methods. As firms learn more about the market, their cultural distance to that market decreases. It was found, that when a firm had more experience in a country, it was more likely to choose wholly owned subsidiary than joint venture. International experience may also lead firms to prefer acquisitions to green field investment.

Also embedded in the distance metaphor is the assumption of linear impact of investment, entry mode and performance. The higher the distance between

cultures, the higher the likelihood that invest will occur at a later stage in the investment sequence, a less controlling entry mode will be chosen, and the worse the performance of foreign affiliates will be. These are also questionable assumptions. On the contrary, the Scandinavian school acknowledges that the time lag between expansion waves will vary due to differences in learning curves. Erramilli (1991) showed that cultural distance and experience interacted to influence ownership in a nonlinear fashion. He suggested that firms taking their first investment steps were more likely to prefer culturally similar countries than those in an advanced stage of internationalization. The expatriate literature reports that adjustment to a relatively similar culture is often as difficult as adjustment to a “distance” because differences are not anticipated.

Implicit assumption in much of the literature is that cultural distance has a casual effect on FDI pattern, sequence and performance. The connotation is that culture is the only determinant of distance with relevance to FDI. Earlier work has been tuned to the problem and attempted to compensate by incorporating non – culture variables in a broader “distance” measure. Johanson and Vahlne’s (1977) definition of psychic distance refers to the “sum of factors” affecting information to the market. Shenkar (1992) treat geocultural distance as one of a number of variables (also including level of development, political stability), making a country a “hot” or “cold” investment opportunity. The measure of “socio-cultural distance” includes such variables as the foreign education of local executives. As Boyacigiller (1990) offers “key characteristics of nations such as dominant religion, business language, form of government, economic development and levels of emigration to the US indicate a country’s cultural distance from the US”, factors such as language, political instability, level of development, market size all play a role in establishing distance.

The implicit assumption that differences in cultures produce lack of “fit” and hence an obstacle to transaction is questionable. First, not every cultural gap is critical to performance. It is noted, that “different aspects of firm culture may be more or less central, more or less difficult to transmit, and more or less critical to operations”. Second, cultural differences may be complementary and hence have a positive synergetic effect on investment and performance. For instance, as global cooperation demands both concern for performance and concern for relationships, the two may be mutually supportive. Similar evidence can be found in the FDI, merger and acquisition and JV literature.

Methodological properties of cultural distance are as follows: the assumption of corporate homogeneity, the assumption of spatial homogeneity and the assumption of equivalence.

The cultural distance used to measure the construct relies on national culture measures and implicitly assumes lack of corporate culture variance, an as-

sumption that lacks support. Corporate culture can modify the behavior and beliefs associated with national culture, it alters the dynamics of national cultural distance thought not necessarily in the way of reducing its impact. As Schneider notes, “national culture” may play a stronger role in a strong corporate culture. The pressures to conform may create the need to reassert autonomy and identity, creating a national mosaic rather than a melting pot.

Measuring distance from one national culture to another, the cultural distance index assumes uniformity within the national unit. Quite to the contrary, evidence suggest that intra- cultural variation explains as much if not more than intercultural variation. Neither the spatial location of the firm in the home or host country nor the actual physical distance between the locations, have an impact upon the cultural distance measure calculated. This masks actual investment conditions, for instance a “border effect” formed across contiguous regions divided by a national border. A somewhat similar argument can be made regarding the variable location of industries from the cultural milieu, as, for instance, in the case of “cultural industries”.

The Kogut and Singh (1988) index is a rather simplistic aggregate of Hofstede’s (1980) dimensions and is hence liable to the same criticism levelled against Hofstede, e.g. non – exhaustiveness reliance on single company data, and the like. The index amplifies the problems associated with the Hofstede framework in the two important ways, however.

First, the index has not been updated to incorporate latter work by Hofstede and others, for instance the fifth dimension of Confucian dynamism or Long Term Orientation (LTO) (Hofstede and Bond, 1988). Because of its relationship to Confucianism, CD measures involving East – Asian countries, for instance, those used in studies of Japanese FDI. The second and most important way in which the Kogut and Sing’s measure amplifies the measurement problems associated with Hofstede is by making an invalid assumption of equivalence. Hofstede offers, that some cultural gaps are less disruptive than others, and that differences in uncertainty avoidance are potentially the most problematic for international cooperation due to their correlates in terms of differential tolerances towards risk, formalization, and the like.

The significant conceptual and methodological inadequacies relating to cultural distance construct carry important implications for theory and research.

For example, the illusion of symmetry pinpoints divergent transactions costs and the prospect of conflict between partners as each seeks to minimize its cost of the transaction regardless of the cost incurred by the other party; necessitating convergence of transaction and bargaining models.

In the case of psychic distance, the “distance” metaphor is translated into a focus on what sets cultures apart but not on what might bring them together. A balanced analysis of the relations between social entities should however consider both opening and closing mechanism. A number of key mechanisms with the potential of closing cultural distance follow.

Increased communication and interaction bridge cultural distance by encouraging the convergence of cultures. This implies a trend toward lower cultural distance over time albeit at different paces across the globe. The World Competitiveness Yearbook publishes an index of openness to foreign influences showing substantial differences between relatively open countries such as the Netherlands to closed countries such as France).

Often confused with cultural distance, geographic proximity reduces entry barriers, subject to transportation and information processing requirements. Geographical proximity lowers the costs of managerial coordination and control and reduces the cost of monitoring agent’s behaviour. It can also facilitate the personal contact that is necessary for effective transfer of knowledge and other resources.

The literature acknowledges the importance of foreign experience as a cultural distance closing mechanism. It is not always clear however whether it is international experience per se or experience in the host culture and to what extent the experience of individual managers can substitute for corporate experience, a point that would be especially important to smaller firms.

Acculturation can generally be assumed to reduce the cultural distance to the host country. It is interesting that in explaining one exception to the pattern of gradual involvement they observed (the establishment of a sale subsidiary in a new market), Johanson and Vahlne (1977) explain that the decision – maker in that case was partly educated in the other country. Nor is acculturation dependent upon actual experience. Black, Mendenhall, and Oddou suggest that “individuals make anticipatory adjustments to a relatively similar culture is often as difficult as adjustment to a distant one”.

Staffing is not only a means of control, but also a venue through which groups and individuals bring their cultural properties into a system. Shenkar (1992) discusses the role of employee groups as mechanisms affecting the national and corporate cultural distance in an International Joint Ventures. For instance, foreign parent expatriates bring with them both the national and corporate culture of the parent while third country nationals recruited by the foreign parent will likely bring the parent firm’s culture into the venture, but less of its national culture. Bicultural individuals play an especially important role in closing cultural distance between the foreign and host countries. By virtue of their familiarity with both cultures, such individuals bring the two countries together by serving as emissaries and interpreters of culturally embedded signals and behaviours.

3. Psychic distance in the process of companies internationalization – research overview

In management, Cultural Distance has been used as a key variable in strategy, management, organization behavior and human resource management. The construct has been applied to a multitude research questions, from innovation and organizational transformation to foreign expansion to foreign expansion and technology transfer.

Russel, Griffith & Tihanyi (2005) identified more than 180 studies using Hofstede culture dimensions for analysing the influence of cultural distance on companies' internationalisation decisions. In late 1980s Kogut and Singh conducted a comparative analysis of psychic distance from the point of view of a specific national market, using the four basic cultural dimensions, as proposed by Hofstede, namely: the Power Distance Index, individualism versus collectivism, masculinity versus femininity and the Uncertainty Avoidance Index (Kogut & Singh, 1988). In the studies carried out in late 1990s, Fletcher and Bohn, added also Confucian dynamism to the four criteria, when they analysed the Psychic Distance between Australia and the third countries.

Over the years, there has been a lot of criticism against this model for being used to measure psychic distance. Many authors suggested that some new approaches should be followed when analysing this phenomenon (Schwartz, 1994; Shenkar, 2001; Harzing, 2003). Attention has been drawn to two alternative models of national cultural dimensions, which may be employed to analyse the impact of cultural determinants on companies' decisions about expanding their business activities into foreign markets. These are the approaches proposed by Schwartz and GLOBE (House, Javidan, Hanges, Dorfman and Gupta, 2004; Javidan, House, Dorfman, Hanges and de Luque, 2006). Unfortunately, these approaches have not been used much in empirical research on companies' decisions to expand abroad. An exception was the research conducted by Drogendijk and Slangen (2006), which was aimed at measuring cultural distance by means of cultural models proposed by Hofstede and Schwartz. The authors also propose that Psychic Distance perceived by managers should be measured. Another example is the research of Dow and Larimo (2009). The aim of this research was to present the influence of the three cultural models: Hofstede, Schwarz versus GLOBE on companies' strategic decisions.

According to Dow and Karumaratna (2009) psychic distance is arguable one of the most fundamental constructs within the field of international business. Across the past four decades, it has been cited as an important predictor variable for:

- the decision to export (Fletcher and Bohn, 1998, Holzmatter and Kasper, 1990, Wiedersheim-Paul, Olson and Welch, 1978);
- market selection decisions – for both exporting (Dow, 2000; Johanson and Vahlne, 1977) and foreign direct investment (Davidson, 1980; Green and Cunningham, 1975; Grosse and Goldberg, 1991; Grosse and Trevino 1996);
- entry mode choices – concerning both the degree of control (Brouthers & Brouthers, 2001; Chang and Rosenzweig, 2001; Kogut & Singh 1988; Tihanyi, Griffith and Russel, 2005), and the use of acquisitions versus green-field entries (Brouthers and Brouthers, 2000; Harzing, 2002),
- the degree of adaptation in foreign markets (Dow, 2001; Sousa and Bradley, 2008),
- and a variety of other international phenomena (Boyacigler, 1990; Shenkar, 2001).

The second classification of research on psychic distance is following:

- the original Uppsala school research (e.g. Johanson and Wiedersheim-Paul, 1975),
- research and commentaries on Psychic Distance in other management settings (Dow and Karunaratna, 2006; Evans, Treagold and Mavondo, 2000b; Harzing 2003; Shenkar 2001; Stottinger and Schlegelmilch, 1998, Tihanyi, Griffith, and Russel 2005; Zhao, Luo, and Suh, 2004), and
- the emerging institutional distance literature (Kostova and Zaheer, 1999).

Within the last years 37 articles referring to psychic distance, or the closely associated concept – Cultural Distance, were published in the “Journal of International Business Studies”. Indeed, it is claimed that “no international business study can be considered complete unless there is no explicit variable controlling the cultural distance”.

Despite, this notoriety, the various empirical studies incorporating these two forms of distance show them to be empirically weak and sporadic predictor variables. In a meta analysis of international entry mode studies, Zhao et al (2004, p. 530) find the impact of cultural distance to be statistically significant, but it is the least influential factor among the six determinants (of entry mode choice). In another meta – analysis focusing specifically on cultural distance, Tihanyi et al. (2005) find that “the relationship between cultural distance and the three key variables (entry mode choice, performance and international diversification) was near zero across the 66 independent samples” and that “cultural distance... failed to contribute to prediction”.

These weak and mixed empirical results have provoked a wide range of reactions, including Stottinger and Schlegelmilch (2000) suggesting Psychic Distance is “a concept past its due date”. However, other commentators, most notably Shenkar (2001) notes, that Kogut and Singh’s (1988) composite index of Hofstede’s (1980) dimensions of national culture. Indeed, in the three meta – analyses mentioned earlier, the proportion of studies which use the Kogut and

Singh index as their sole indicator of index range from 71% to 94% of the respective samples. In his seminal article, Shenkar (2001) notes that Kogut and Singh index, as surrogate for Psychic Distance, only represents a narrow portion of a much broader construct. In their meta – analysis, Zhao et al. (2004, p. 534) concur with Shenkar, and state that “the use of Hofstede’s Cultural Index as a measure of uncertainty seems ineffective to capture the diversity and subtlety of cultural influences”.

In more recent times, a wider range of scales which are intended to represent the various underlying drivers of Psychic Distance have been put forward and tested (Dow, Karunaratna, 2006). However, while these are important contributions and have begun to address the breadth of the Psychic Distance construct, it is also important to remember that managerial decisions are made on the basis of the decision – maker’s perceptions (Evans and Mavondo, 2002; Harzing, 2003; Stottinger and Schlegelmilch, 1998). Scales, such as those put forward by Dow and Karunaratna (2006) are not direct measures of those perceptions, but rather, measures of the exogenous factors which may shape the decision – maker’s perceptions. That is precisely why Dow and Karunaratna refer to their scales as Psychic Distance stimuli.

Research on the process of companies’ internationalization were conducted also in Poland (Wiktor, Chlipała 2012, Witek-Hajduk, 2010; Fonfara, 2005; Grynia, Jankowska, 2008; Gorynia, 2005). The main objectives of these research was the conceptualization and operationalization of the term internationalization and identification of forms and directions of foreign expansion of Polish companies. The other objectives of research conducted in Poland was the identification of marketing strategies and business models of Polish exporters. There is no evidence of research on the role of Psychic Distance in Polish companies internationalization. This research problem will be explored by the author in future.

Conclusion

The study of literature shows that there is no consensus about the terms of Cultural Distance and Psychic Distance. A constantly debated issue is the conceptualization and measurement of these phenomena, but it will be a mistake to focus only on conceptual and methodological flaws of psychic (cultural) distance, important as they are, or even on the vital work that remains to be done in developing and measuring cultural friction, without reassessing the role of culture in theoretical frameworks.

Despite calls for a broader interpretation of the distance construct, the vast majority of researchers have continued to use a single measure indicator of cultural distance - namely Kogut and Singh index. According to other research

(Dow, Larimo, 2009) a much broader set of national distance factors are strong and highly significant predictors of entry mode choice. It should be noted that all distance variables should be viewed as complements of, rather the substitutes for the traditional measure of psychic (cultural) distance.

From practitioners perspective, the significance of this research lies in reaffirming the broad set of factors which may have an impact on internationalization of a firm, and recognising that the entry mode choice in particular, is a complex decision for which there is still not a full understanding.

The Polish contribution to the subject includes a variety of narrowly focused studies concerning proposed changes in the ways Polish enterprises act on international markets. There has also been empirical research on Polish companies' internationalization, including the studies on the importance of internationalization as a company's strategic goal, the forms and directions of geographic expansion and competitive advantages offered by Polish firms. However, the importance of Psychic Distance in the process of Polish companies' internationalization has not been identified yet. This problem is the subject of the Author's research. In order to solve this research problem, the following questions need to be answered: What are the motives for and the barriers to internationalisation of Polish companies? What forms and directions of internationalization are chosen by Polish companies? What is the pace of expansion and the number of foreign target markets? What are the value of sales and capital engagement of Polish companies on foreign markets? What is the cultural distance between Poland and foreign markets where Polish companies operate? What is the psychic distance between Poland and foreign markets of Polish companies' expansion? What impact does psychic distance have on the process of Polish companies' internationalization?

As the effect of the realization of the above mentioned research project the theory about psychic distance will be settled. The effect of the project will be the development of the psychic distance measurement methodology and the methodology for research into the impact of psychic distance on the process of companies' internationalization (the methodology could be applied also in the international field). The research will also result in a model for measuring the impact of psychic distance on decision-making process related to internationalization of Polish companies.

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