

The Effect Of Psychic Distance On Kenya's Export Destinations

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ABSTRACT

Exports can be an important component of the growth strategy for developing countries, and an understanding of export destination choices can help to facilitate that growth. This paper uses the concept of psychic distance to examine Kenya's export pattern to selected markets. Regression analysis indicates that Kenya's total exports are significantly associated with countries that are psychically close (Uganda, Tanzania, and the United Kingdom), but not with countries that are psychically distant (Ethiopia, Egypt, and the United States). Thus, psychic distance explains Kenya's export choices better than geographic distance does. The paper concludes with suggestions about ways that an understanding of psychic distance can help Kenya and other countries that seek to expand their economies through export.

Keywords: Psychic Distance, Growth Strategy, Export Destinations, Internationalization

INTRODUCTION

International trade is a key component of many countries' economies. Economic theory says that nations export goods and services in order to generate the revenues to finance imported goods and services that they cannot produce domestically (Coutts and Godley, 1992), and a country's national export is the aggregation of the exports of individual firms within that country. Many firms seek international markets as part of their competitive strategy, which puts pressure on governments, especially in developing countries, to create liberal trade policies and pursue export-driven economic growth (UNCTAD, 2000). Given the importance of internationalization to developing countries, this paper examines Kenya's export economy and explores whether the concept of psychic distance helps to explain Kenya's market destinations.

Internationalization

Turnbull (1985) describes the process of internationalization as the outward movement of a firm's operations from local markets to a wider market. This requires firms to select and implement an appropriate foreign market entry strategy (Ekeledo and Sivakumar, 2004), but the costs of internationalization, as well as the benefits and disadvantages, vary considerably depending on the chosen entry mode (Root, 1974). Firms can choose to enter an international market through non-equity modes (exporting) or equity-based modes, such as foreign direct investment. Situational factors that affect this choice include country risk, socio-cultural distance, firm-specific factors, government regulations, and managers' international experience. Across firms, differences in risk tolerance, the need for control, resource commitments, and flexibility also influence the choice of an international entry strategy.

The most important choice in any entry strategy is the selection of the foreign markets that will become the export destinations (Root, 1974; Sarkar and Cavusgil, 1996). As the competition for international markets becomes more intense, firms must evaluate their options carefully. According to Root (1974), when choosing an export destination and a market entry strategy, managers must select (1) the export product and target market; (2) their goals for the target market; (3) the entry mode to penetrate the market; and (4) the control system to monitor export

performance. Some markets may be regarded as more favorable than others because the managers, as decision-maker, are influenced by their subjective perception of how distant the alternatives seem.

Psychic Distance

Research on export development has often used a transactional cost approach (Erramilli and Rao, 1993) or an eclectic framework (Dunning, 1988). However, an increasing number of researchers have sought to explain export development from a psychic distance perspective (Brouthers and Brouthers, 2001; Hennart and Larimo, 1998; Kogut and Singh, 1988) because this concept helps to capture decision-makers' perceptions of business and cultural differences between the exporter and the target market.

Firms often start by exporting to psychically close markets before they enter more physically distant markets (Bilkey and Tesar, 1977). As firms gain experience in exporting and their operations include more distant countries, psychic distance should decline (Grisprud, 1990), leading to expanded export opportunities. However, involvement in distant markets requires considerable learning effort, which increases as the psychic distance to the target markets gets larger (Keegan, 1979). It has been postulated that psychic distance affects a firm's choice of its foreign market destination and entry strategy because managers prefer trade with markets that they perceive to be closer. When the psychic distance is large, firms first adopt less expensive and less involved market entry strategies, such as export, and advance to more complex entry strategies, such as foreign direct investment, as the psychic distance decreases (Anderson and Coughlan, 1987; Davidson, 1980; Ramaseshan and Patton, 1994).

Kenya's Economy

Since its independence in 1963, Kenya's economic growth has been influenced by several governmental initiatives. Sessional Paper No. 10 of 1965 outlined the government's plan to stimulate rapid economic growth through public sector programs, agricultural support, and the pursuit of private sector investments. As a result, the country's economy grew steadily at an average rate of 6.5% until the oil crisis in 1973, when internal and external pressures threatened Kenya's economy. After consulting with the Bretton Woods Institution, the government published Sessional Paper No. 1 of 1986 on Economic Management for Renewal and Growth. This plan called for growth through liberalizing the economy, yet by 2000, Kenya began to experience negative economic growth, which highlighted the need for a different way to stimulate the economy. Based on the global trend toward international markets, the government began a program to help Kenya's economy by developing opportunities for export and foreign direct investments. In order to stimulate exports, the National Export Strategy of 2003-2007 created incentives in the form of export compensation, manufacturing-under-bond facilities, and export processing zones to facilitate trade in international markets. As a result of these actions, the export sector is now a significant force in Kenya's economic and social development.

Today, Kenya has a narrow, but important export economy. Agricultural commodities, such as coffee, tea, and horticulture, account for about 55% of Kenya's exports, primarily sent to the United Kingdom (UK), Germany, the Netherlands, and other countries in the European Union. In addition, Kenya exports refined petroleum products, oils, polishing and cleaning products, paper, fabrics, cigarettes, perfumes, disinfectants, and insecticides, primarily to other countries in Africa. In fact, the proportion of Kenya's goods exported to other African countries has increased from 29% in 1987-1992 to 44% in 1994 (Centre for Business Statistics, 2008). Within Africa itself, there has been a dramatic increase in exports to COMESA (Common Market for Eastern and Southern Africa) countries, especially those in East Africa due to economies of proximity.

PREVIOUS RESEARCH

Studies Describing Internationalization

Research on international business is grounded in the theory of industrial organization economics, which focuses on the "fit" between a firm's environment and its strategy as a driver of export development. This research considers the export environment in terms of management's perception of similarities and differences between the foreign market's environment and that of the domestic market. Cavusgil and Zou (1994) note that exporters rely on

objective information when making strategic decisions, but they also posit that the decision to internationalize a business is strongly influenced by subjective and perceptual factors. The internationalization process model (Johanson and Wiedersheim-Paul, 1975; Nordstrom and Vahlne, 1994) suggest one of the ways that firms begin their international activities is through a series of incremental steps that lead to further commitment to international activities. Johanson and Vahlne (1977) conceptualize these steps as 1) no regular export activities; 2) export through independent representatives; 3) establishment of a foreign subsidiary; and 4) establishment of production facilities in the foreign market. In addition, they use the concept of psychic distance to explain the propensity of firms to begin export activities in markets that are psychologically closer to them. A growing body of research links psychic distance to export performance (O'Grady and Lane, 1996), and the concept is widely accepted in the export behavior literature as a key determinant of firms' internationalization and export development (Klein and Roth, 1990; Shoham and Albaum, 1995).

Studies Describing Psychic Distance

The term "psychic distance" was first introduced by Beckerman (1956), who demonstrated that psychic distance influences trade patterns. Johanson and Wiedersheim-Paul (1975) define psychic distance as factors that prevent or disturb the flow of information between the firm and its market. These factors include differences in language, culture, political systems, education, and industrial development. O'Grady and Lane (1996) describe psychic distance as the degree of similarity in the characteristics of a country that can cause exporters to group that country with other countries exhibiting similar characteristics. Lee (1998) calls it the socio-cultural distance between the international marketer's home and target countries in terms of language, business practices, legal and political systems, and infrastructure. Thus, the consensus is that psychic distance comes from relational differences between entities where information access and processing are factors. This concept has been extended to include firms' learning and understanding of foreign markets (Nordstrom and Vahlne, 1994), the consequences of such learning (O'Grady and Lane, 1996), and the perception of cultural and business differences (Evans and Mavondo, 2002).

Although psychic distance has been accepted as a key factor to explain how managers choose export destinations (Brouthers and Brouthers, 2001; Barkema et al., 1996; Kogut and Singh, 1988), researchers disagree on the role that it plays. One argument suggests that when markets are perceived to be risky because they are psychically distant, firms are reluctant to commit their own resources (Tihanyi et al., 2005), and are more likely to adopt an entry strategy that incorporates an indigenous partner (Luo and Chen, 1995). The other argument is that greater psychic distance leads firms to choose an export entry strategy because of concerns about problems that may occur when adjusting to a foreign market (Barkema et al., 1996). Empirical evidence (Brouthers, 1995; Kogut and Singh, 1988) supports the contention that psychic distance leads firms to adopt a low-commitment export strategy in order to reduce the risks and costs of entry into foreign markets.

Researchers also disagree about the variables that should be used to measure psychic distance. In addition to language, culture, political systems, education, and industrial development used by Johanson and Wiedersheim-Paul (1975), Boyacigiller (1990) considers religion, business language, form of government, economic development, and emigration levels. Evans et al. (2000) develop a measure incorporating language, business practices, political and legal systems, education, economic development, marketing infrastructure, and industrial development, whereas Shoham and Albaum (1995) use geographical diversity, culture, economic climate, and legal barriers. Other combinations of factual measures of psychic distance include economic development, education, business language, and trading channels (Vahlne and Wiedersheim-Paul, 1973; Nordström and Vahlne, 1994), economic development, language, and education (Luostarinen, 1980), or native language, accepted business practices, economic environment, legal system, and communications infrastructure (Klein and Roth, 1990).

Other work has stressed the cultural or psychological dimension to assess psychic distance. Hofstede (1980) uses measures of uncertainty avoidance and cultural distance to form a composite index. O'Grady and Lane (1996) employ psychographic measures to capture differences in attitudes and values. Instruments such as Lodahl and Kejner's Job Involvement Scale, and Blood's Protestant Work Ethics Scale (Cook et al., 1981) have also been examined. Dichtl, Leibold et al. (1984) and Dichtl, Köglmayr et al. (1990) use cognitive mapping to add a subjective psychological dimension to their measures of psychic distance.

The relationship between psychic distance and cultural distance represents another area of disagreement. O'Grady and Lane (1996) argue that both business differences and cultural differences are components of psychic distance. Lee (1998) suggests that psychic distance and cultural distance are isomorphic, but Nordström and Vahlne (1994) find that they are overlapping phenomena. These alternative points of view may stem from the way that the concepts are defined. Cultural differences are commonly measured using Hofstede's (1983) dimensions of national culture. However, psychic distance is usually based on differences in language, business practices, political and legal systems, education, economic development, marketing infrastructure, industrial development, and culture (Lee, 1998; Nordström and Vahlne, 1994; Vahlne and Wiedersheim-Paul, 1973, 1977). Commenting on the validity of various factors in measuring psychic distance, Holzmüller and Stöttinger (1996) suggest that these measures are inconsistent, whereas Holzmüller and Kasper (1991) conclude that the concept of psychic distance can neither be accepted nor discarded from an empirical point of view.

Studies Using Psychic Distance

The concept of psychic distance has attracted considerable research attention (Hallen and Wiedersheim-Paul, 1984; Jain, 1989; Johanson and Vahlne, 1977, 1990; Shoham and Albaum, 1995). For example, Morosini (1994) examines the impact of cultural distance on the performance of firms after cross-border acquisitions, and shows that the development of a "culture-compatible" internationalization strategy improves a country's export ratings. In another study, Li and Guisinger (1993) look at the performance of international joint ventures, and find that the likelihood of poor export performance is higher when the parent is based in a culturally distant country. In another study of international joint ventures, Ali (1996) uses differences in culture, business practices, and communication to create a composite index for psychic distance, and finds that ease of communications has a significant affect on international joint ventures.

In a study that challenges the presumed relationship between psychic distance and export performance, Stöttinger and Schlegelmilch (1988) find that, in some cases, export sales to psychically distant countries exceed sales to countries that are psychically closer. Nevertheless, the authors still argue that psychic distance is a relevant factor in explaining export destinations and performance. Similarly, in a study of Canadian retailers in USA markets, O'Grady and Lane (1996) determine that operating in a psychically close country does not necessarily lead to superior export performance because the assumption of similarity prevents managers from noticing subtle, yet critical differences in the foreign market. Thus, although psychic distance may sometimes be negatively related to export performance, it still plays a key role in explaining export strategies.

Psychic distance influences the selection of market destinations during the internationalization process. Ramaseshan and Patton (1994) find that, as firms begin the process of entering foreign markets, they are likely to select countries with low psychic distance (see also Klein and Roth, 1990; Shoham and Albaum, 1995). It takes more effort to learn about markets that are more psychically distant (Keegan, 1979), but as firms gain more experience in international operations, the psychic distance is predicted to decline (Grisprud, 1990).

Studies of Export Behavior

Exporting is the most common strategy that firms use to enter foreign markets. The advantages of exporting over other market entry strategies include reduced business risk, lower resource commitment, and more flexible export management. Literature on export behavior has been biased toward large firms and firms from developing countries (Miesenbock, 2000; Aaby and Slater, 1989; Gemünden, 1991; Leonidou, 1995; Leonidou and Katsikeas, 1996). Factors that may impede or foster export ventures can be classified as market-based, firm-related, and managerial characteristics. Of these factors, the export environment and managerial characteristics are key predictors of export behavior (Grisprud, 1990). Among the managerial characteristics, considerable attention has focused on the decision-makers' psychic distance, which has been conceptualized as both a measure of international outlook (Simmonds and Smith, 1968) and as the aggregation of factors that impede the flow of information to and from the market (Johanson and Vahlne, 1977).

RESEARCH QUESTIONS

The concept of psychic distance has been used to describe the expansion of firms' activities into foreign markets (Shoham and Albaum, 1995). Geographical expansion of business activities into new markets is assumed to start in countries that evoke feelings of psychological proximity, i.e. countries with small psychic distance. This paper looks specifically at the effect of psychic versus geographical distance on the choice of export destinations for firms in Kenya, and more generally, at the role that psychic distance might play in formulating and implementing the development of export programs in Kenya. Thus, the research questions in this paper are:

- (1) Does Kenya export significantly more to countries that are psychically close (Uganda, Tanzania, and the UK) than to psychically distant countries (Egypt, Ethiopia and the USA)?
- (2) Does Kenya export significantly more to countries that are geographically close (Ethiopia, Uganda, and Tanzania) than to geographically distant countries (Egypt, the UK, and the USA)?

Significance of this Study

Over the last twenty years, the expansion of international business and the general belief that exports benefit national economies have stimulated research on the export behavior of firms and ways to improve export development (Aaby and Slater, 1989; Leonidou, 1995; Leonidou and Katsikeas, 1996). In Kenya, as in many other developing countries, a desire for export-oriented growth has spurred interest in this topic.

According to Zou and Stan (1998), the goal of any national export development program is to improve firms' capabilities, resources, strategies, and competitiveness, which in turn should improve export performance. However, many Kenyan firms seem unwilling or unable to pursue export sales aggressively due to lack of experience, limited resources, or other real or perceived obstacles. The government of Kenya hopes that its Export Promotion Council and other trade organizations will help Kenyan firms to overcome these limitations on export development, thus stimulating exporting firms to export more, and/or inducing non-exporters to start exporting. Research on factors that induce firms to start exporting has considered export initiation, motives for exporting, perceived obstacles, the role of management, and firm size (Bilkey, 1978), but many studies have focused on data from developed countries. More research attention should be given to examining the effect of psychic distance on the export destination of developing countries like Kenya. As more Kenyan firms become active exporters, psychic distance may play into efforts to increase their involvement with existing export destinations, and also in initiatives to help these firms expand into new international markets.

RESEARCH DESIGN AND METHODOLOGY

Variables Estimation

A number of parameters have been used to analyze psychic distance. The parameters used in this study are defined below.

Language: Communication is a critical part of any business transaction, and several studies use language as a key component of psychic distance (Davidson and McFetridge, 1985; Srivastava, 1986; Arora and Fosfurri, 2000). Other studies that use language to measure psychic distance include Vahlne and Wiedersheim-Paul (1977) and Klein and Roth (1990). Since English is the official language of Kenya, the UK and the USA markets should be psychically close to Kenya. Although not an official business language, the other language of trade in Kenya is Kiswahili, so Tanzania should also be psychically close to Kenya, whereas Uganda, Ethiopia, and Egypt should be psychically distant.

Education: Assessment of literacy levels and educational systems have been used as part of the education construct to measure psychic distance (Koblin, 1976; Davidson and McFetridge, 1985; Vahlne and Wiedersheim-Paul, 1977). When Kenya became independent in 1963, it inherited the British school model. The UK and Kenya have similar curricula and both are delivered in English. The educational systems in Uganda, Tanzania, and the USA are also

similar, so these four countries should also be psychically close to Kenya. By contrast, Ethiopia and Egypt would be psychically distant because their systems are significantly different.

Economic and industrial development: Several measures have been used as proxies for economic and industrial development. For example, Vahlne and Wiedersheim-Paul (1977) use per capita consumption of energy and steel, and the number of telephones per thousand inhabitants as economic indicators, whereas Koblin (1976) uses proportion of the population employed in agriculture, consumption patterns, extent of urbanization, and the gross domestic product per capita. Another way to assess economic distance is to compare economic systems and industrial development. On that basis, Kenya, as a former British colony, should be psychically close to the UK. Since Uganda and Tanzania have also adopted the UK and USA economic development models, Kenya should be psychically close to these countries as well, but psychically distant from Ethiopia and Egypt.

Political system: Researchers also associate political system with psychic distance (Goerzen and Beamish, 2003). The political system indicator is a well-respected measure of democracy or autocracy, which in turn affects a country's business climate. Kenya's political system is similar in many ways to that of the UK, Uganda, Tanzania, and the USA, and to some extent, Ethiopia, making these countries psychically close, as opposed to Egypt, which would be psychically distant.

Religion: These measures focus on differences between the dominant religions across countries and on similarities among the mainstream religious groups. Religion is an important component of psychic distance because it affects the beliefs and values that influence managers' behavior. Since its independence, Kenya has adopted western Christianity in place of its traditional beliefs. Furthermore, local groups in Kenya still maintain close ties with their counterparts in the UK and the USA, but are distinctly different from Islamic faith in Egypt or the Arhmalic practices in Ethiopia. Uganda and Tanzania also have religious systems that are similar to Kenya.

Geographical location and time zones: Countries that share borders and time zones may be psychically closer than other countries. On that basis, Ethiopian Uganda, and Tanzania would be psychically closer to Kenya than the USA, the UK, and Egypt. Geographical distance also affects export transportation costs, making Ethiopian Uganda, and Tanzania more attractive export targets than the USA, the UK, or Egypt.

Colonial ties: According to Srivastava and Green (1986), a history of colonial ties, measured by past political and economic domination of one country by another, can be a key factor for estimating psychic distance. The colonizing country brings its culture to the country being colonized (acculturation), and this leads to similar cultural values, consumption patterns, and even ways of doing business. The management of people and organizations in Kenya and other African countries comes from the British and American management traditions, so local managers find these styles more understandable and less threatening.

Hypotheses

Psychic distance is a multifaceted construct that is difficult to capture (O'Grady and Lane, 1996). Based on the factors described above:

H1: Kenya's exports should be higher to the UK, Uganda, and Tanzania because these countries are perceived to be psychically close.

H2: Kenya's exports will be lower to the USA, Ethiopia, and Egypt because they are psychically more distant.

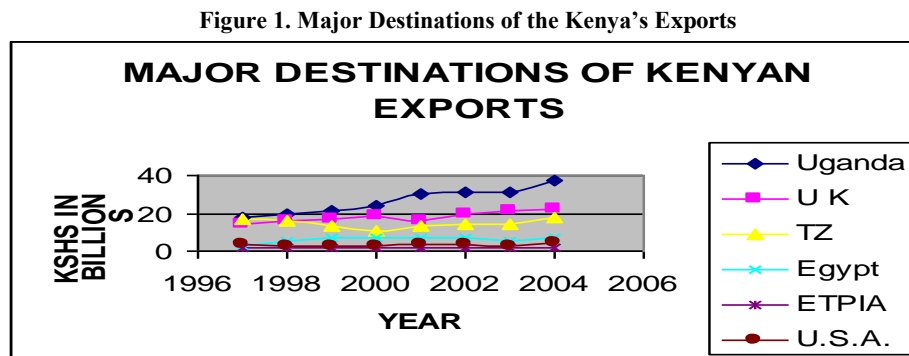
Research Methodology

This paper is based on case study analysis, and so follows a replication logic research paradigm, rather than sampling. Although the literature suggests that many factors might affect export development, this study focuses on psychic distance, and argues that it can explain Kenya's export destinations. Regression analysis is used on secondary time series data to analyze the relationship between psychic distance and Kenya's exports to the six countries discussed above. Since time series regression models are often subject to autocorrelation, this study uses the Durbin-Watson statistic to test for serial correlation of the residuals.

National trade data for this study came from the Kenya Export Promotion Council (2001) and the US Census Bureau’s Foreign Trade Division. The data includes annual compilations of trade statistics on imports and exports from 1997 through 2004. Individual firm’s exports are aggregated to represent national exports. Thus, the unit of analysis is Kenya’s export destinations, rather than the export patterns of specific firms.

RESULTS

Figure 1 shows Kenya’s leading export destinations between 1997 and 2004 in billions of dollars (Centre for Business Statistics, 2008). In descending order of export value, these countries were Uganda, the UK, Tanzania, Egypt, Ethiopia, and the USA.



Source: Centre for Business Statistics (2005)

The countries were then split into two groups for regression analysis. The first group includes the three countries (Tanzania, Uganda, and the UK) that are considered to be psychically closer to Kenya. The independent variables are Kenya’s exports to each of these countries, and the dependent variable is Kenya’s total exports (TOTEX). The results of this regression are shown in Table 1.

Table 1: Kenya’s exports to psychically closer countries

Dependent Variable: TOTEX				
Method: Least Squares				
Date: 11/25/08 Time: 16:49				
Sample: 1997 2004				
Included observations: 8				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	10.39157	4.798559	2.165561	0.0963
TZ	0.813602	0.237840	3.420797	0.0268
UGANDA	1.254693	0.136151	9.215432	0.0008
UNITEDK	0.826684	0.314280	2.630410	0.0582
Adjusted R-squared	0.985770	S.D. dependent var		10.96535
S.E. of regression	1.308056	Akaike info criterion		3.681814
Sum squared resid	6.844042	Schwarz criterion		3.721535
Log likelihood	-10.72726	F-statistic		162.6385
Durbin-Watson stat	2.160997	Prob(F-statistic)		0.000124

Based on the results of this regression model, changes in Kenya’s exports to these three countries explain over 99% of the variability in Kenya’s total exports ($R^2 = 0.991869$) and the model itself is highly significant ($F = 162.6385, p = 0.000124$). As expected, the coefficient for each country is positive and significant at the 0.05 level, indicating that changes in Kenya’s total exports are positively and significantly associated with changes in the extent

of exports to Tanzania, Uganda, and the UK. Furthermore, The Durbin-Watson Statistic of 2.16 indicates that there is no serial correlation of the variables.

The second group includes the three countries (the USA, Ethiopia, and Egypt) that are considered to be psychically more distant from Kenya. Again, the independent variables are Kenya's exports to each of these countries, and the dependent variable is Kenya's total exports (TOTEX). The results of this regression are shown in Table 2.

Table 2: Kenya's exports to psychically distant countries

Dependent Variable: TOTEX				
Method: Least Squares				
Date: 11/25/06 Time: 16:53				
Sample: 1997 2004				
Included observations: 8				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	13.14187	23.63093	0.556130	0.6078
UNITEDS	14.10689	7.239491	1.948602	0.1232
EGYPT	3.604875	2.244833	1.605854	0.1836
ETPIA	-5.473537	13.22545	-0.413864	0.7002
R-squared	0.684594	Mean dependent var		70.64875
Adjusted R-squared	0.448039	S.D. dependent var		10.96535
S.E. of regression	8.146605	Akaike info criterion		7.339932
Sum squared resid	265.4687	Schwarz criterion		7.379653
Log likelihood	-25.35973	F-statistic		2.894021
Durbin-Watson stat	1.130878	Prob(F-statistic)		0.165580

As shown above, changes in Kenya's exports to these countries explain only 68% of the variability in Kenya's total exports ($R^2 = 0.684594$, and the joint contribution of the variables is not significant at the 0.05 level ($F = 2.894021$, $p = 0.165580$). The coefficients for exports to the USA and Egypt are positive, as expected, but not significant. However, the coefficient for Ethiopia is negative, suggesting that Kenya's total exports increase as its exports to Ethiopia decrease, although the coefficient is not significant. Furthermore, The Durbin-Watson Statistic of 1.13 indicates possible serial correlation of the variables. Taken as a whole, these results indicate that Kenya's exports to the USA, Egypt, and Ethiopia is not a good predictor of changes in Kenya's total exports.

CONCLUSIONS

Based on the results of the regression analysis, psychic distance is a better predictor of Kenya's export destinations than geographic distance. Egypt and Ethiopia are geographically close to Kenya than the UK. Yet export to the UK, which is psychically close to Kenya, was a significant predictor of Kenya's total exports, whereas exports to Egypt and Ethiopia, which are psychically distant, were not significantly associated.

The results of this study can have important implications for Kenya and other countries seeking to expand their economies through export. The analysis of data on Kenya's export destinations suggests that psychic distance is, in fact, a component of managers' selection of export destinations. Therefore, psychic distance could be used as a criterion for choosing among possible plans to expand firms' international business presence. Differentiating between countries with high and low psychic distance can enable countries to tailor their export promotion programs and allocate their resources more effectively. In addition, psychic distance can help managers to be more comfortable with the internationalization process by allowing them to identify and target foreign markets with low psychic distance first. Finally, more research into the components of psychic distance could generate strategies to desensitize managers to large psychic distances so that firms in developing countries can take advantage of export opportunities in a wider range of international markets.

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