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Revisiting the psychic distance paradox: international retailing in China in the long run (1840-2005)

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Abstract

This paper uses original research on the roles played by two sets of foreign entrants into Chinese retailing since the 1850s - the overseas Chinese entrants and western entrants - to explore the psychic distance paradox over the long run. It explains how the advantages of psychic closeness in Chinese retailing have always been important in reducing entry barriers, but that the increasing costs of technology have increased the significance of firm proprietary strengths in some formats, notably supermarkets, so reducing the relative importance of psychic closeness. The paper therefore illustrates how taking the long-term perspective enables more sophisticated conclusions to emerge. A cross sectional analysis of one sector – Chinese supermarkets – would confirm the psychic distance paradox; overseas Chinese have been unable to translate psychic closeness into superior performance. By contrast their historic performance in department stores and more recently in fashion chains has been superior to the format leaders. This long term perspective therefore suggests that the understanding of the psychic distance paradox needs to be moderated by additional conceptualisation.

Key Words

Psychic Distance, China, International Retailing, Internationalisation Process

Revisiting the Psychic Distance Paradox: International Retailing in China in the Long Run (1840-2005)

Explaining the sequence of decisions in the internationalisation process remains a key area of scholarly discussion within the international business academic community. While economics models dominate the literature, neither macro economic nor internalisation approaches are particularly helpful in explaining how multinational enterprises (MNEs) evaluate entry decisions in conditions of great uncertainty. The Uppsala school incorporates a more behavioural approach to the internalisation process and has therefore become a favoured approach among scholars trying to understand foreign direct investment (FDI) patterns across more complex markets. A key assumption in the Uppsala model is that MNEs will increasingly commit to foreign markets over time as a result of organisational learning. It predicts that as firms accumulate experience and collect information and so reduce uncertainty, they will progressively diversify into markets with a higher 'psychic distance'.[1] While this seems intuitively attractive, it is nevertheless the case that after three decades scholars still lack a clear consensus regarding the conceptualisation and measurement of 'psychic distance'.[2] Conclusions on the pattern of firms' foreign expansion and its relationship with psychic distance remain elusive,[3] undermining the legitimacy of the concept.[4]

This article seeks to contribute to this debate by focusing on the role played by psychic distance in influencing investment decisions into China over a long period, the 150 years from 1850 to the present. Despite later research being dominated by cross-sectional panels, Johanson and Wiedersheim-Paul (1975) seminal work on psychic distance followed Nordic multinationals' internationalisation over time.[5] Indeed, a moment's reflection on the nature of the concept of psychic distance suggests that longitudinal approaches are likely to be more appropriate methodologies for assessing evolutionary patterns.[6] Any longitudinal approach to understand firm behaviour must of course be wary of falling into the traps of poor historical methodology. Most obviously any 'survivorship' bias must be avoided by scrupulously documenting a large proportion of all activities, as opposed to concentrating just on the successful actions.[7]

Ideally the article would be able to survey all instances of FDI into China since 1850, but in practice it has been necessary to reduce the population of entrants to manageable proportions. The article's particular focus is on the relationship between psychic distance and subsidiary performance, where (as will be discussed below) the empirical data has produced something of a paradox, in that subsidiary performance appears to be positively correlated with psychic distance, rather than the predicted negative correlation. One of the seminal empirical contributions here was the study of Canadian retailers in the United States.[8] For the purposes of including some replication of sectors in our study with this study, retailing industry in the Chinese market rather than any developed (or indeed any other developing) market is chosen, in particular our study has focused on assessing the relationship between psychic distance and the performance of subsidiaries in Chinese retailing since 1850.

Our results show that over this long period there was remarkable continuity, in that perhaps the majority of early entrants into Chinese retailing industry were overseas Chinese. This sequence of entry suggests that psychic distance plays a key role in retailers' internationalisation process; those who perceived the Chinese market with less uncertainty and risk entered first. These overseas Chinese entrants were, however, possessed few if any technological advantages in retailing. Despite their lack of firm-specific capabilities in novel retail formats, they were typically able to convert their first mover advantages into superior performance over a long period. Only in the supermarket sector did overseas Chinese entrants succumb to western competitors. In other words, only in supermarket sector did these retailers fail to transform psychic closeness into superior performance. Therefore, this paper offers some substantial revision to the widely accepted, but weakly supported idea that psychic distance has direct link with firm performance.

The article proceeds as follows. The next section provides an overview of the history of international retailing, situating the Chinese experience within the broader global experience. Section III then provides the theoretical background of the paper. This is followed by a detailed discussion of the key patterns and trends of foreign entry into Chinese retailing over the past 150 years. The final section concludes the whole paper by highlighting its contribution to research on psychic distance.

II

Retailing activities have been associated with some of the very earliest forms of FDI, with Chartered Trading Companies, for example, frequently incorporating retailing as a subsidiary element of their business activities in host locations. But it has only been since 1980 that retailing has generally recognised to be significant within global flows of FDI.[9]

Despite this lack of recognition of earlier activities, retailing has nevertheless experienced sustained and significant levels of internationalisation. This has typically been associated either with the diffusion of novel retail formats (like department stores around the end of the nineteenth century, or variety chain stores in the early decades of the twentieth century) or with the overseas marketing efforts of manufacturers of novel consumer goods, like sewing machines or automobiles, which included investing in company-controlled retail activities.[10] The best empirical data comes from a substantial study by Godley on inward investment into British retailing since 1850. Despite previous estimates suggesting that retail entrants were relatively rare before 1980, Godley has shown that the number of entrants was in fact surprisingly high, with 154 retailing subsidiaries of overseas firms entering between 1850 and 1979. Overwhelmingly they either failed, or were quickly acquired by British interests, or remained relatively obscure, contributing to their under-reporting. Nevertheless they can be grouped into several categories: foreign producers of luxury goods that needed to acquire retail premises to restrict price competition; those foreign producers of novel consumer goods who needed to gain greater control over the promotion of their branded goods even to the extent of investing in distribution outlets; and a small minority (only 18 between 1850 and 1962) of overseas retailers who had developed novel retail formats and wished to expand internationally.[11]

The Chinese experience of international retailing broadly follows the UK experience, albeit with some substantial lag and with a much smaller level of overall activity, both almost certainly arising from China's much lower per capita income level, and, hence, smaller market for retailing.[12] Moreover some allowance for the impact of political and economic shocks, like the Japanese invasion, or the Mao inspired autarchy, also need to be taken into account.

While there may have been some entrants into the Chinese luxury goods retailing sector, our research has not been able to identify any significant entrants. Indeed, to be sure, there was none of any great size in the UK either. It was simply that the concentration of demand in London provided an opportunity denied almost anywhere else in the world. Rather, given its much smaller potential market for luxury goods, it is surely the case that foreign luxury goods producers distributed in China via incumbent independent retailers, as they did elsewhere. Moreover, while Singer invested in a Chinese distribution system, as it did everywhere around the world, it was very much the exception among western manufacturers of branded consumer goods. However, Singer was relatively unsuccessful in China.[13] Rather, and in contrast with the British case, overseas entrants into Chinese retailing over this period were overwhelmingly retailers trying to internationalise some novel retail format, whether it was the department store, fashion store or supermarket formats. We turn to a more detailed consideration of these novel retail formats and the foreign entrants in Section IV. First we turn to a more detailed explanation of the underlying concept of psychic distance.

III

The studies of the internationalisation process of Nordic multinationals in the mid-1970s have been widely accepted as the starting point for research on psychic distance.[14] According to these studies, psychic distance referred to those factors that could prevent or disturb the flow of information between suppliers and customers.[15] Difference in the environments may incur learning costs, which makes psychic distance a significant deterrent to market entry. Thus, firms will start their international expansion from psychically similar markets before entering into those markets with greater psychic distance. In other words, a lack of experience of foreign markets is the dominant barrier to internationalisation, which can only be accumulated through firms' activities in specific markets.[16] In order to avoid uncertainty, the entry sequence may reflect an evolutionary learning-through-experience process, with psychically close markets being the first entered. [17]

Since then, the definition of psychic distance has been revised and changed within the literature, depending upon how the concept is operationalized.[18] For example, it was redefined by Nordstrom and Vahlne as 'factors preventing or disturbing firm's learning about and understanding a foreign environment'. [19] But later empirical research used culture distance as proxy for psychic distance, even though the conceptual difference between these two has been acknowledged. [20] Others treated psychic distance as a combination of cultural differences and business differences that presented barriers for firms to learn about foreign markets. [21] Child, Ng and Wong argued that psychic distance was a combination of distance-creating, distance-compressing and distance-bridging factors. While distance-creating factors created the difference between home and host countries, distance-compressing factors narrowed the difference. As for the distance-bridging factors, they mainly referred to how firms made strategic and operational decisions to reduce the uncertainty in overseas markets. [22] However, recently some scholars have argued that previous research fails to encapsulate the two most important elements in the concept of psychic distance: psychic and distance. While psychic means the mind or soul, distance relates to the degree of similarity or difference that exists in peoples' minds. [23] Therefore, they define psychic distance as 'the distance between the home market and a foreign market, resulting from the perception of both culture and business differences'. [24] In other words, psychic difference refers to individuals' perceptions of the differences between markets.

The various definitions mean that psychic distance remains one of the most vaguely measured constructs in the domain of international business. [25] Up till now, extant literature is still debating whether psychic distance should be measured by objective variables or people's subjective perceptions; or whether it should be measured at individual level or national level. [26] For example, while some researchers have used variables such as culture distance, business difference and religion difference to measure psychic distance, [27] others have argued psychic distance should be measured by decision-makers' perceptions of the target markets. According to these scholars, psychic distance refers to individuals' perceptions of the differences between the home country and the foreign country, which may not be stable over time, nor homogeneous within firms, and so it would be misleading if psychic distance was measured by objective variables. [28] In other words, research should measure managers' perceptions of psychic distance at the time of decision-making to gauge its importance. But in reality few researchers have the time and resources to do so. In addition, cognitive mapping (a compromise method measuring decision makers' perception *ex post*) cannot identify the direction of causality. [29]

A second debate among current research is about the level that psychic distance should be measured. Because individuals' perceptions are highly subjective, some scholars point out that psychic distance should only be applied at the individual level.[30] This is because people's ethnic background, religion and education level may vary within a country, thus measuring it at national level may hide important difference. However, others contended that national measurement of psychic distance could be appropriate if research just focused on the aggregate behaviour of firms. [31]

The above debates on the definition and measurement of psychic distance lead to mixed results in empirical research. For example, while some documented a negative correlation between psychic distance and market entry of Australian exporters, others failed to establish such a link.[32] In particular, the relationship between psychic distance and subsidiary performance has produced a paradox. One of the key assumptions of psychic distance is that psychically close countries are more similar to home countries, thus are associated with lower uncertainty.[33] This, therefore, implies a negative relationship between psychic distance and firms' performance; as the costs associated with higher uncertainty are *ceterus paribus* likely to adversely affect performance.[34] Despite its acceptance among international business researchers, the empirical research has generally found the opposite outcome: psychic distance is typically positively correlated with company financial performance and strategic effectiveness, a phenomenon called the psychic distance paradox. [35] For example, O'Grady and Lane, by focusing on Canadian retailers operating in the US markets, reported a situation where psychically close market was a handicap, perhaps because of the Canadian managers' inappropriate preconceptions about the US market.[36]

Several explanations have been put forward to attempt to account for the existence of the psychic distance paradox. First, it has been argued that similarity between home markets and those psychically close markets has made executives overlook subtle but important differences in the foreign markets.[37] Second, the concept of liability of foreignness (LOF) suggests when venturing abroad, multinational firms may incur extra costs than domestic firm due to the institutional and cultural differences between home and host countries. Previous research argues these differences depend on the perceived familiarity of the entrant firm with the foreign markets. Thus in psychically close markets managers may adopt limited learning efforts and fail to mitigate LOFs.[38] Finally, the positive relationship between psychic distance and organizational performance may be attributed to the high uncertainty in the psychically distant markets. As markets with high uncertainty are perceived with high risk, thus in order to reduce risk, firms may undertake extensive research to learn more about the market, which will result in an improvement in their strategic decision making and firm performance. [39]

In short, if we can assume that uncertainty avoidance is a key consideration explaining variations in the patterns of firm internationalisation, the theory predicts a positive relationship between psychic distance and the sequence of market entry and a negative relationship between psychic distance and company performance. But empirical support remains elusive. The Chinese example may become helpful here because of the large and continuous gap in psychic distance between it and western sources of new technological capabilities over the twentieth century. The paper uses original research on the roles played by two sets of foreign entrants into Chinese retailing industry since the 1840s - the overseas Chinese entrants and western entrants - to explore the relationship between psychic distance and retail performance over the long run.

IV

Over the long run, entry patterns into Chinese retailing followed broadly similar trends to those in more advanced economies,[40] with the late nineteenth century and early twentieth century characterised by department store formats, giving way to fashion chains and supermarkets and hypermarkets in recent decades. A common feature across all formats is that none of the global pioneers of new retail formats, the equivalents of those on the technological frontier (such as Harrods in department store format,[41] Carrefour in supermarket/hypermarket format and Benetton in fashion retailing), entered China before overseas Chinese entrants. The overseas Chinese were the pioneer entrants, but typically did not enter with their own novel retail formats, but rather with ideas that had been copied from western sources. The cases of the three different retail sectors of department stores, fashion chains, and supermarkets are discussed in more detail.

Department Stores

The emergence of foreign department stores in China could be partly attributed to the Opium Wars where seventeen treaty ports (including Shanghai and Nanjing) were opened to commerce, Hong Kong was colonized and foreign ships were allowed entry to the Yangzi River.[42] From that point, the country witnessed a huge influx of imported goods ranging from cottons, clocks, lamps, buttons and glassware, all of which became the key items distributed through the earliest department stores in China, the first novel retail format imported into China by overseas retailers.[43] Moreover, the rapid urbanization of the cities, [44] together with the improvement in city transportation infrastructure, [45] also supported the new department store format to spread.

The origins of the department store format in China can be traced back to middle of the nineteenth century, when several British department stores, such as Whiteaway, Laidlow and Hall & Holtz opened in Shanghai. As they mainly served the growing number of foreign residents in China, they had little or no direct impact on the Chinese retail sector. [46] Furthermore, these embryonic department stores were usually very small in size with limited merchandise. [47] They were little more than expanded speciality stores.

What we would understand as the modern department store format (with its many departments and much more significant size) was, in fact, introduced by overseas Chinese, who enjoyed no proprietary strengths in retailing before venturing into China. Among them, the Sincere, Wing On, Sun Sun and Dah Sun (collectively know as the Big Four) became well known in Chinese history as the pioneers of modern department stores in China and had an enormous impact on the evolution of the Chinese retailing industry. [48]

The key entrepreneurs behind these four department stores were all overseas Australian Chinese, who originally came from the same place (Canton province) before moving to Australia, and developed very close working relationships when they were in Sydney. Indeed, apart from one, Sun Sun, they even followed the same development route, namely, they all began their Chinese department store businesses in Hong Kong, establishing the headquarters there. As business grew, they opened new branches in the city of Guangzhou (Canton), and finally attracted by the huge market potential in Shanghai, they opened their stores on Nan Jing Road (Table I)

Table 1: Big Four Establishment in Shanghai

Firm	Date Opened	Location	Size	Founder
Sincere Department Store	20 Oct. 1917	Nanjing Road, Shanghai	Five floors	Ma Yin Baio
Wing On Department Store	5 Sept. 1918	Nanjing Road, Shanghai	Six floors	Guo Luo
Sun Sun Department Store	23 Jan. 1926	Nanjing Road, Shanghai	Seven floors	Liu Xiji
Dah Sun Department Store	10 Jan. 1936	Nanjing Road, Shanghai	Ten floors	Cai Cang

Source: Shanghai Social Science Academy, 1980

Notes – The sources do not list the size of each store in terms of square feet, but the proxy of the numbers of floors has been included here.

They all sold similar products ranging from clock and watches from Sweden, toys and mechanic tools from Germany to local specialities like silk from Su Zhou. They also had similar store design with a roof-top entertainment quarter above the store, and adjoining bars, restaurant and hotels attached to the store business. This store design was mainly based on the entrepreneurs' own shopping experience in Sydney's flagship department store Anthony Hordern & Son, combined with their own ideas. For example, in Sincere Ma adapted the original department store concept to the Chinese context by showing products in elaborate window displays, imposing fixed prices for each item, allocating different sales teams for each merchandise category, and adding a roof-top entertainment quarter on the store.[49]

All these stores achieved very rapid rates of growth, despite the growing instability in the wider economy, where patriotic boycotts, workers strikes and civil wars in the 1920s, were followed by the world economic depression and the Japanese invasion in the 1930s.[50] Table II gives a brief overview of the business situation of these stores from their opening till 1936.

Table 2: Big Four Department Stores Sales Growth to 1936

	Year Opened	Sales in First Business Year (Unit: Thousand Chinese currency)	Sales in 1936	Annualised rate of growth (%)
Sincere Department Store	1917	360	600	2.7%
Wing On Department Store	1918	455	869	3.7%
Sun Sun Department Store	1926	300	540	6.1%
Dah Sun Department Store	1936	110	-	-

Source: Shanghai No.1 Department Store, 1988

Interestingly, the Big Four Department Stores were all located on the same road in Shanghai as the British-origin department stores, thus competition was unavoidable. In order to increase their turnovers, the Big Four adopted very aggressive competitive strategies. For example, while the British- and other foreign-origin department stores sold relatively expensive products, as they were directly imported from Europe, the Australian overseas Chinese entrants used the following strategies to reduce prices and reach out to a broader market.

First of all, they adjusted their product ranges. They not only cut the prices on cigars and alcohol to attract more foreign customers, but also introduced some cheaper imported goods as well as local specialities.

Secondly, they sent direct mail printed in English to foreign customers' homes during Christmas time and advertised their prices in newspapers and magazines to attract customer' attention. Such aggressive advertising strategies had never been used in Chinese retailing industry before. [51]

In order to fight against the Big Four, those British-origin stores began to advertise their promotions on "*Shen Bao* (Shen Newspaper)" and "*Wen Hui Bao*" (Wen Hui Newspaper) to attract local custom. For example, on 1st, January 1937 both Whiteaway & Laidlow and Hall & Holtz department stores advertised on *Shen Bao* claiming that they offered special promotions on certain items with discounts ranging from 19% to 50%. But they lacked flexibility in adjusting their product portfolios. [52] and refused to sell any local products. So, in the 1930s these British-origin stores all closed down. By contrast, the Big Four survived the Japanese invasion and war, with Wing On the last one to close its stores in mainland in 1956.[53]

In sum, the Australian overseas Chinese entrants into Chinese retailing transformed the department store sector despite having no proprietorial knowledge or capabilities in the department store format. Nevertheless they (the Big Four) were able to copy a sufficient amount of the technology embodied in the department store format from visiting the flagship Sydney store, and then adapting it to the Chinese context using their own ideas, so that they outcompeted the western incumbents, who, it is safe to assume, had better access to the underlying technology in the retail format. The Big Four themselves were nationalised after the accession of the Communist Party to government, a period to which the article now turns in its examination of the second retail format to see significant international presence in China.

Fashion Retailing

After 1949 international retailing activities almost disappeared in China. In particular, after 1950s' nationalisation campaign, virtually all retail distributors in China were state-owned. Merchandise was manufactured by state-owned factories and food was grown on state-owned communes, a system of state-owned middleman distributed all goods, and prices were set by the government. [54] From 1978 China has been moving back from a centrally planned economy to a free market economy, and retailing internationalisation activities have also begun to re-emerge.

The first foreign fashion retailer came from the Hong Kong based Goldlion, who in 1986 rented a sales counter in a local department store in Canton to sell its products. [55] Established by Dr. Tsang Hin-chi in Hong Kong in 1968, Goldlion started its business as a family workshop for upmarket male neckties with total investment of 6,000 HK dollars, [56] one sewing machine and one pair of scissors. The brand logo – Goldlion - was created by Tsang in Singapore and then registered as a trademark in Hong Kong in 1971. By the middle 1970s, it had become one of the most successful fashion retailers in Hong Kong. Dissatisfied with Hong Kong's market potential, in the early 1973 Goldlion started its international expansion by going to Japan, where, through Hong Kong Trade Council, Dr. Tsang sold its ties to one Japanese department store. [57]

In 1983-1984, Goldlion first started its business activities in China through the revolutionary (for China at this time) route of placing its advertisement on China Central Television Station (CCTV) just after the 7 pm news program (the most popular TV program at that time). From this advertisement Chinese consumers first learned about the Goldlion brand. After that, the brand appeared in repeat advertisements on the radio, in newspapers, magazines and billboards, with the slogan ‘Goldlion, the men’s world’. Dr. Tsang believed in saturation advertising. Therefore, in 1983 Goldlion’s ads appeared in over 30 Chinese TV stations, with most of them broadcasting its ads throughout the year. Furthermore, he also sponsored a national football tournament in China, and named it ‘Goldlion football tournament’, where the best six teams in China competed. As the tournament was watched by millions of Chinese, Goldlion easily increased its brand awareness across the country. [58]

After three year advertising, on 4th March 1986, Dr. Tsang opened a joint venture in China to manufacture its products with total investment of (US) $1 million. The factory building was four-floors high, with all the machines imported from Italy and Germany. In the same year, with the aim of building Goldlion as a national brand that the Chinese could be proud of, it opened its first sales counter in a local department store in South China. From then, its Chinese business grew very quickly. In 1993 when China just officially opened its retailing industry to foreign investors, Goldlion already had 460 sales counters in most of the major cities such as Shanghai, Beijing, Guangzhou, and its total sales was over one billion Chinese RMB (around £6.3

million). By 2004, Goldlion had over 800 sales outlets in 32 provinces with six different product divisions and has become one of the major players in China's fashion retailing industry. [59]

By contrast, the first western fashion retailer entering into China was Benetton, the biggest Italy fashion firm, who in 1991 established a joint venture in Beijing, called Beijing Benetton Fashion Ltd. to manufacture garments (but it did not open stores at that time). Benetton, of course, began its international expansion as early as 1970s. By 1992 it had penetrated into over 100 countries across the world, becoming easily the most successful global fashion retailer. Its successful retail format mainly relies on franchising, where the franchisees purchase their entire inventory from Benetton and displaye them following company standards. This, combined with novel advertising and sponsorship strategies, have helped to create one of the world's foremost brands.[60] Its expansion into China has followed the same model.

What is so noteworthy here is that the owner of the technical knowledge embodied in the novel retail format – Benetton - has in fact been superseded by an overseas Chinese entrant in the Chinese market, an entrant with only a tiny fraction of the proprietary knowledge about fashion retailing.[61] As was the case with the department store format, it was the overseas Chinese entrant that has so far outperformed the technologically superior western counterpart. By 2004 Goldlion had opened over 800 stores across the whole country, by contrast, Benetton's aim was to open its 200th store in China by the end of 2008.

Supermarkets/Hypermarkets

The first foreign supermarket entered into China was Parkson, the retail division of the Malaysian Lion Group. In 1994 Parkson was approved by the central government to open foreign department stores and supermarkets in China. However, Parkson was a relative newcomer to retailing, it only started its retail business in Malaysia in 1987 and, before entering into China, it had only gained experience in the department store sector and had no experience of running supermarkets. [62]

In a same vein, the first foreign hypermarket approved by the Chinese central government was Lotus, part of the Thailand conglomerate Charoen Pokphand group (CP), in 1994. Although CP had opened some supermarkets in South East Asian countries to distribute its shrimp and chicken, it had no previous experience in running the hypermarket format before venturing into China. [63]

Both Parkson and Lotus founders were overseas Chinese, who had emigrated and started their businesses in the 1920s and 1930s in South East Asia. Both entrepreneurs had created large conglomerates in their own countries. But crucially neither had acquired any obvious proprietorial strength in the supermarket/hypermarket sectors before investing in Chinese retailing, nor did they subsequently acquire any technological expertise. Rather the entrepreneurs were attracted by the huge potential of the Chinese market and, exploiting their familiarity with the Chinese market, they acted opportunistically and ventured into Chinese retailing industry as soon as it was opened to the foreign investors in 1992 and simply copied what they could of the western supermarket/ hypermarket formats.

The first western foreign hypermarket entered into China was the French firm Carrefour, who, without the central government approval, opened its first store in Beijing in 1995. [64] The history of Carrefour's internationalisation can be dated back to 1970s, when the French government tried to limit the domestic expansion of hypermarkets to preserve the integrity of small grocery stores. With half of its sales coming from outside France, Carrefour has now become the most internationalised food retailer in the world with a presence in 30 countries. [65] Carrefour was also the first international retailer to expand into Asia, with its first store in Taiwan opening in 1989. [66] It is widely recognised as the world leader in internationalising the supermarket/ hypermarket retail format. Nevertheless, and as was the case with the fashion sector and the technological leader there, Benetton, Carrefour's entrance into China was later than the pioneer overseas Chinese entrants into Chinese the supermarket/ hypermarket sector.

However, and in contrast to the experience of the department store and fashion retailing sectors, those pioneering overseas Chinese entrants into the Chinese supermarket/ hypermarket sector, such as Parkson and CP, have failed to capitalise on their first mover advantages and have subsequently lost market share to later entrants. In this sector it is the western late-movers, like Carrefour, that have grown to become the biggest foreign retailers in the sector. By the end of 2005, Carrefour had opened 78 hypermarkets across the whole country with total sales 17.4 billion Chinese RMB (around (US) $2.1 billion). In contrast Parkson has only opened just over 30 stores, while Lotus hypermarkets are only located in Shanghai, Beijing and Guangzhou. [67]

V

Historical evidence therefore suggests that over the past 150 years early entrants into Chinese retailing industry have overwhelmingly been based in Hong Kong, Australia, Thailand and Malaysia. However, it does not make much sense to treat these entrants as typical entrants from those nations. Rather, when tracking the ethnic backgrounds of the founders, our results show that overseas Chinese founded retailers entered China earlier than their western counterparts. In other words, when measured at individual level, it is reasonable to infer that psychic distance had a clear impact on the entry sequence, with those retailers who perceived Chinese market with less uncertainty and risk entering first.[68] This is because market differences largely depend on the retail managers' perceptions of the target market. Therefore compared with their counterparts in the West, those overseas Chinese would perceive the Chinese market with less uncertainty, as they were quite familiar with the Chinese environment (culture and business environment). Some of them like Ma of Sincere and Dr. Tsang of Goldlion could even speak the same language, which would reduce their communication costs of business transaction. Furthermore, the *guanxi* (personal networks) these overseas Chinese entrepreneurs had in China may well have reduced institutional uncertainty and facilitated information exchange, both of which would have helped to mitigate LOFs and so led to early entry. [69]

However, while psychic closeness appears to correlate with entry in Chinese retailing, as elsewhere, the relationship between psychic distance and subsidiary performance in Chinese retailing varies across the different retail sectors. In the department store and fashion formats, the overseas Chinese entrants not only entered first but also converted their first mover advantages into superior performance. In the supermarket and hypermarket sector, by contrast, the western entrants have emerged as more successful. Perhaps what is observed then is a paradox within a paradox, as the psychic distance paradox seemingly emerges as an important interpretation of relative performance among foreign entrants in Chinese retailing only in one sub-sector. In contrast to the Canadian retailers in the US, in China the majority experience was for psychically close entrants, the overseas Chinese entrants, to have enjoyed more success than western entrants, despite western entrants being closer to sources of technological innovation in retail formats. The only exception, the only sub-sector where the pattern observed by O’Grady and Lane was also the case in China was in the supermarket sector.

Explaining this dual outcome requires a more nuanced understanding of the technological content of retailing, and hence, a better understanding of the nature of those firm-specific advantages that are able to be internalised in the internationalisation process. Previous research suggests different kinds of retail formats can be roughly divided into those formats that are mainly constituted of external elements and those mainly constituted of internal elements. While the former refers to those elements that are visible to consumers, such as the shopping environment and prices, the latter is defined as those elements that determine retailers’ operational strength and strategic directions, such as managerial skills and marketing techniques. [70] When using this framework to compare department store and fashion retailing with hypermarket/supermarket formats, it can be argued that they vary in the complexity of the elements of the formats.

For example, the key advantages of the department stores format over traditional retail outlets in the early twenty century could be summarized as: goods were displayed in windows; different kinds of goods were sold under the same roof; fixed prices were imposed for each item, and merchandise was assigned to different sales teams. [71] Furthermore, when foreign department stores began to take full shape in China, the key marketing techniques they used were also very simple, such as sending direct mail to their existing and potential customers to inform new products or promotions. [72] All of these techniques could easily be copied. Similarly, with the development of new digital technologies, fashion retailers' merchandise and clothes designs could also be easily copied at very low cost, thus making the fundamental offering in the fashion format hard to protect. [73]

By contrast, the hypermarket/supermarket format is relatively far more complex. Hypermarkets usually refer to those stores owned by food retailers with large sales area to sell both food items and non-food items under the same roof. Furthermore, hypermarkets may also include car parking areas, access areas for goods delivery and a petrol filling station. [74] A well-developed logistics system is crucial for hypermarkets to offer lower prices to consumer while maintaining high volumes of goods moving. But technologically this is very complex. For example, a logistics system could include at least five components: *communication, unitisation and packaging*, *transportation*, *inventory* and *storage facilities*. Furthermore, retailers need to cooperate with manufacturers to build and maintain an effective and efficient logistics system, as delays and errors from the manufacturers will influence retailers' performance. This can be even more challenging for international retailers whose suppliers may spread across the world. Therefore, recently retailers have begun to cooperate and collaborate with others (in particular manufacturers and logistics firms) to develop integrated logistics approaches to producing a seamless supply, such as efficient consumer response (ECR) and supply chain management (SCM). [75] But these systems require huge investments, new technology and a cooperative relationship between manufacturers and retailers. Thus they are very difficult to copy.

In both department store and hypermarket/supermarket format, none of those overseas Chinese entrepreneurs had any obvious propietorial strength in their own sectors before investing in China. The concepts of these new retail formats were mainly learned through those entrepreneurs' own shopping experiences in the department store/supermarket/hypermarket abroad. Hence they could just copy those external elements that were quite visible to consumers and competitors, but not the internal elements.

The key advantages of the department store format over traditional retail format were all quite visible to consumers. Thus those entrepreneurs could grasp the format just from their own shopping experiences. Since the department store format was so easy to copy, therefore the key determinants of success depended on the knowledge of the market and how to adapt the western technology (department store format) to local conditions. As the founders of Big Four Department Stores (Sincere, Wing On, Sun Sun and Dah Sun) had been local residents in Canton before they moved abroad, they were quite familiar with the Chinese market. Thus their access to the department store format in Sydney, Australia, enabled them to become the pioneers and introduce it to the Chinese market. Furthermore, based on their superior market knowledge, the overseas Chinese entrants then adapted the western technology to the local condition and so transform their psychic closeness into sustainable competitive advantages.[76]

Overseas Chinese-founded fashion retailers were also able to dominate Chinese fashion retailing sector for similar reasons, that is, their success mainly depended on the knowledge of the market and adapting a format to the local conditions. As was the case with the founders of Big Four, Dr. Tsang was originally from Canton before he moved to Hong Kong. He was the pioneer retailer to enter into fashion retailing in China, but the Goldlion format exhibits none of the organisational complexity or technological content of Benetton. It is rather a pared down, simple copy of a western retail format, yet one that when combined with superior local market knowledge has become transformed into a competitive performance superior to Benetton or any other western fashion entrant.[77]

But this was not the case for the supermarket/hypermarket format. One key advantage of a hypermarket/supermarket is its well-developed logistics system. This cannot be learned just from informal shopping experiences. Thus, although those overseas Chinese entrepreneurs might copy the shopping environment, merchandising plan and other external elements of the format, they would find great difficulty to achieve the same efficiency as their western counterparts. In other words, even though overseas Chinese retailers from Thailand and Malaysia enjoyed advantages of psychic closeness, because they lacked knowledge of the internal elements of the hypermarket/ supermarket format, they could not run their supermarkets/hypermarkets efficiently, and so failed to transform their psychic closeness into superior performance.

In short, the above evidence implies that the technological content of international retailing is now much higher than before, so that early entry (together with the superior market knowledge) is no longer sufficient to base a durable competitive strategy on. Instead the technological content of modern supermarket/hypermarket has enabled the format's global technological leaders to emerge successfully, despite not knowing much about the Chinese market, and despite being late entrants.

VI

By tracking foreign entrants into Chinese retailing industry over the past 150 years, this article has demonstrated that the construct of psychic distance has a clear impact on explaining the entry sequence when measured at an individual level. In other words, psychic distance should be conceptualised as decision makers' perceptions of the difference between home markets and host markets. Furthermore, while psychic distance has always been important in reducing retailers' entry barriers, the increasing complexity of technology has increased the significance of proprietary strengths in some formats, notably supermarkets. The culturally close overseas Chinese from the large Chinese diasporas enjoyed no proprietary strengths in retailing before venturing into China. They were not particularly important retail innovators in any of the immigrant economies. But they were able to copy retail innovations in advanced economies and export them successfully back to China. Unlike the psychically close Canadian retailers in the United States, the overseas Chinese entrants were hugely successful in the Chinese market, out-competing even western entrants with better access to proprietary technologies, but only in some formats – department store and in fashion chain. There is no evidence of any psychic distance paradox here. But the paradox re-emerges in the Chinese supermarket sector, where, despite enjoying first mover status, overseas Chinese entrants have succumbed to retailers from more psychically distant markets such as U.S. and West Europe. The article therefore illustrates how taking the long-term perspective enables more sophisticated conclusions to emerge. A cross sectional analysis of one sector – Chinese supermarkets – would confirm the psychic distance paradox; overseas Chinese, like Canadian retailers in the U.S., have been unable to translate psychic closeness into superior performance. By contrast their historic performance in department stores and more recently in fashion chains suggests that the psychic distance paradox needs to be moderated by additional conceptualisation.

Notes

[1] For a discussion about psychic distance and the sequence of foreign investments, see Benito & Gripsrud, 1992, pp. 461-476; for psychic distance and entry modes, see Agarwal, 1994, pp.63-80; and psychic distance and company performance see Evans & Mavondo, 2002, pp. 515-532.

[2] For recent debate on how psychic distance should be conceptualised see Evans & Mavondo, 2002, pp. 515-532; Sousa & Bradley, 2006, pp. 49-70; Brewer, 2007, pp.

44-66. For debate on psychic distance measurement see Dow & Karunaratna, 2006, 578-602 and Brewer, 2007, pp. 44-66.

[3] Very recently psychic distance research has been criticized as inconclusive (Ellis, 2008, pp.351-369). A similar argument can also be found in Evans, Mavondo & Bridson, 2008, pp. 32-63.

[4] Some scholars have argued that psychic distance is a concept past its due date (Stottinger & Schlegelmilch, 2000, pp.169-173).

[5] Although Beckerman first mentioned the concept of psychic distance, Uppsala scholars' research is widely accepted as a starting point for studying psychic distance in international business.

[6] A good introduction to the benefits of using historical methods in international business see Jones & Khanna, Bring History (back) into International Business, pp. 1-16.

[7] For discussions on avoiding survivorship bias see Bostock & Jones, Foreign Multinational in British Manufacturing, pp. 89-126 and Fletcher and Godley, Foreign Direct Investment in British Retailing, pp.43-62. Despite this well-known flaw in the design of longitudinal methods, the existing understanding of psychic distance and the sequential internationalisation process is largely based on surviving organisations rather than including any control for failed instances of FDI.

[8] The first empirical research focusing on the psychic distance and firms' overseas performance was O'Grady & Lane, 1996, pp. 309-333.

[9] Treadgold, Retailing Without Frontier, pp. 8-12.

[10] The characterisation of historic FDI in retailing being composed of retailers and manufacturers efforts is drawn from Godley, Foreign Multinationals and Innovation in British Retailing, pp. 80-100.

[11] We have conflated three sub-categories of manufacturers of consumer goods reported in Godley 2003 into one here.

[12] The correlation between income levels and foreign entry into British retailing was reported in Godley and Fletcher, Foreign Entry into British Retailing, pp. 392-400.

[13] Godley, Selling the Sewing Machine around the World, pp. 266-314.

[14] Johanson & Wiedershiem-Paul, The Internationalisation of the Firm, pp. 305-322 and Johanson & Vahlne, The Internationalisation Process of the Firm, pp.23-32 are widely accepted as the starting point of psychic distance research in the field of international business.

[15] Johanson & Wiedershiem-Paul, The Internationalisation of the Firm, pp. 305-322.

[16] Ellis, Does Psychic Distance Moderate the Market Size-Entry Sequence Relationship, pp. 351-369.

[17] A key assumption in psychic distance research is that psychically close markets are easier for firms to learn about (Kogut & Singh, 1988, pp.411-432).

[18] The proliferation of psychic distance concepts is mainly because previous research has not reached an agreement on how it should be measured (Child, Ng & Wong, 2002, pp. 36-56).

[19] Nordstrom and Vahlne, Is the Global Shrinking, pp. 41-56.

[20] For example, cultural distance and psychic distance were used interchangeably in Benito and Gripsrud, 1992, pp. 461-476.

[21] Psychic distance was defined as a combination of cultural and business distance (O'Grady and Lane, 1996, 309-333).

[22] Child, Ng and Wong, Psychic Distance and Internationalisation, pp. 36-56.

[23] It has been criticized that previous research ignores the two most important elements in the concept of psychic distance-psychic and distance (Sousa & Bradley, 2006, pp. 49-70).

[24] O'Grady and Lane, The Psychic Distance Paradox, pp. 309-333.

[25] Despite of its popularity in international business research, psychic distance remains vaguely measured (Dow & Karunaratna, 2006, pp. 578-602).

[26] For the debate on psychic distance conceptualisation, see Shenkar, 2001, pp. 519-535; Sousa and Bradley, 2006, pp. 49-70; Dow & Karunaratna, 2006, pp. 578-602 and Brewer, 2007, pp. 44-66.

[27] Examples of using macro objective variables to measure psychic distance, please see O'Grady & Lane, The Psychic Distance Paradox, pp. 309-333. It is also worth mentioning Zaheer's (1995 and 2002 – and other contributors to this special issue) contention that in many markets the liabilities of foreigness (which are in some as yet unspecified way linked to psychic distance) cannot be overcome.

[28] Examples of arguing measuring subjective perceptions to gauge psychic distance can be found in Shenkar, Culture Distance Revisited, pp. 519-535.

[29] When using cognitive mapping whether it is the perception that leads to action or whether it is the action that change the perception remains unknown (Dow & Karunaratna, 2006, pp. 578-602).

[30] Some scholars suggest psychic distance should only be measure at individual level while cultural distance would be valid only at national level (Sousa & Bradley, 2006, pp. 49-70).

[31] Other scholars argue measuring psychic distance at national level can be justified if the focus is the aggregated behaviour of firms (Dow & Karunaratna, 2006, pp. 578-602).

[32] While some studies have provided evidence supporting psychic distance impact on market entry (e.g. Dow & Karunaratna, 2006, pp. 578-602), others failed to establish a link between them (e.g. Benito & Gripsrud, 1992, pp. 461-476).

[33] Nordstrom & Vahlne, Is the Global Shrinking, pp. 41-56.

[34] This is because the concept of psychic distance assumes similar markets are easier to manage than dissimilar markets, thereby firms should be more likely to succeed in psychically close markets rather than psychically distant markets.

[35] The construct of psychic distance paradox was put forward by O'Grady and Lane, 1996, pp. 309-333.

[36] O'Grady and Lane's study was criticized as "speculative", as they did not compare close markets with distant markets, and thus they just inferred the conclusion (Evans & Mavondo, 2002, pp.515-532).

[37] O'Grady and Lane, The Psychic Distance Paradox, pp. 309-333.

[38] This is because firms in psychically close markets will be difficulty to differentiate them from competitors (Evans, Treadgold & Mavondo, 2008, pp. 32-63).

[39] Evans, Treadgold & Mavondo, Psychic Distance, pp. 32-63.

[40] Some examples of long term patterns of international retailing in advanced economies can be found in Fletcher and Godley, 2000b, pp. 392-400 and Godley, 2003, pp. 80-100.

[41] Up till 2008, Harrods still have not expanded into China.

[42] For detail discussion on the Opium Wars and their impact on Chinese foreign trade, see Osterhammel, 1989, pp.189-216.

[43] Two Chinese books - Shanghai No.1 Department Store (1988) and Shanghai Social Science Academy (1980), both in Chinese, have several chapters briefly documented the emergence of foreign department stores in Old Shanghai.

[44] For example in the early 1900s, Shanghai was recorded as the fifth largest city in the world with total population over 1 million while in 1840s it was no more than a fishing village (Mitchell, 2003).

[45] In 1899 the first tram was introduced into Peking that greatly increased Chinese consumers' mobility, and so made foreign department stores more accessible.

[46] The British-origin department stores had little impact on Chinese retailing industry, as they mainly, if not exclusively, focused on foreign residents in China (Chan, 1996, pp. 141-166).

[47] This was because they had to rely almost entirely upon West European and Japanese manufactures to supply their merchandise

[48] Chan, Personal Style, Culture Value and Management, pp. 141-166.

[49] The success of Big Four could be partly attributed to they adapted the western technology (department store format) to the Chinese context (Chan, 1996, pp. 141-166).

[50] A detail discussion about Chinese economy from 1900s to 1930s, please see Yan, 1933.

[51] Shanghai No.1 Department Store (Eds.), Contemporary History of Commerce in Shanghai.

[52] Because their merchandise mainly came from West Europe, as the founders were British

[53] Chan, Personal Style, Culture Value and Management, pp. 141-166.

[54] It can be argued the transformation of Chinese distribution reform in the 1980s set the stage of re-emergence of international retailing in China after 1949 (Vernon-Wortzel & Wortzel, 1987, pp. 59-76).

[55] Davies, Foreign Investment in the Retail Sector of the People's Republic of China, pp.56-69.

[56] The 6000 Hong Kong dollars were the life-savings of Dr. Tsang and his family when he moved from Fujian to Hong Kong in the 1960s

[57] This is recorded in a biography of Dr. Tsang.

[58] Davies, Foreign Investment in the Retail Sector of the People's Republic of China, pp.56-69.

[59] http://www.goldlion-china.com accessed on 6th May 2007.

[60] Crewe and Lowe, United Colours, pp. 271-283.

[61] And, indeed, H&M and other adapters of the Benetton model in China as elsewhere.

[62] For a list of pioneer foreign retailers into China after 1992, see Wang, Internationalisation of Retailing in China, pp. 114-135.

[63] For a detail case study of Thailand CP group, see Pananond and Zeithaml, The International Expansion Process of MNEs from Developing Countries, pp. 163-184.

[64] But this store was not under its own name but registered under its Chinese partner-China Venture Investment Co. Ltd (CVIC).

[65] Colla, International Expansion and Strategies of Discount Grocery Retailers, pp.55-66.

[66] Hitoshi, The Development of Foreign Retailers in Taiwan, pp. 35-50.

[67] These data were got from company websites: www.ourlotus.com; www.parkson.com.my (accessed on 7th May 2007).

[68] For Australian managers, Britain was a culturally and psychically close country (Fenwick, Edwards & Buckley, 2003, pp.297-309).

[69] Luo, Shenkar & Nyaw, Mitigating Liabilities of Foreignness, pp. 283-300.

[70] Some scholars argue retail formats can be roughly divided into external elements and internal elements (Goldman, 2001, pp. 1-21).

[71] Chan, Personal Style, Culture Value and Management, pp. 141-166.

[72] Shanghai No. 1 Department Store (Eds.), Contemporary History of Commerce in Shanghai.

[73] With the development of technology, fashion retailers' merchandise could be easily copies, thus branding plays an important role for multinational retailers to build competitive advantage (Fernie, Moore, Lawrie & Hallsworth, 1997, pp. 151-158).

[74] Guy, The Retail Development Process, pp.

[75] Sparks & Burt, Retail Logistics, pp. 251-272.

[76] Chan, Personal Styles, Culture Values and Management, pp. 141-166; Shanghai No.1 Department Store (Eds.), Contemporary History of Commerce in Shanghai.

[77] See Xia, the Biography of the Founder of Gold Lion-Dr. Tsang Zhixin.

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