

“Business relationship development and the influence of psychic distance”

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Business relationship development and the influence of psychic distance

Abstract

This paper analyzes the various elements of psychic distance at each stages of the process of cross-cultural business relationship development. As we know psychic distance is an important concept that has been successfully applied in context of relationship management with special focus on cross-cultural businesses. It is an attribute of several factors among which culture and language are important. These two factors provide an initial advantage in the forms of cultural affinity/empathy. However, there are other crucial factors like experience, commitment, trust and communication that in combination or separately enhance or reduce the business relationships. Moreover, psychic distance forms a crucial element of relationship marketing strategy in international marketing. Relationship marketing (RM) theory when transferred from a domestic to an international context can lead to the emergence of various factors that may hinder the development of cross cultural business relationships.

Keywords: international business relationship development, business to business relationship, the process of cross-cultural business relationship development.

Introduction

Psychic distance forms a crucial element of relationship marketing strategy in international marketing. Relationship marketing (RM) theory when transferred from a domestic to an international context can lead to the emergence of various factors which may hinder the development of cross-cultural business relationships. This paper investigates the elements of business relationship development and the influence psychic distance has on this process.

1. Business relationships

1.1. Success factors in business relationships. Tuten and Urban (2001) assert critical factors that define successful business relationships are the amount of sales (objective measure) and satisfaction with the business relationships (affective measure). The factors of success where business relationships are concerned have been defined similarly in terms of two basically diverse methods of relationship management (Medina-Munoz & Garcia-Falcoan, 2000). The first approach links success of relationships in terms of the overall levels of satisfaction and goodwill achieved by the partners through the aegis of the relationship. Satisfaction here has to be understood in terms of the optimistic practices that have taken place within an organization due to the existence of the relationship. The second approach comes up with a definition of the quantitative degree of measurement in the context of the dual benefits that involved parties receive through the relationship.

In general, the business-to-business relationships might be considered as successful according to how fully its goals have been satisfied. One could therefore state with some confidence that the success or

the failure of the business relationship could be defined in most instances in terms of whether or not the involved parties have been allowed to achieve more by way of development, creativity and value for their respected interests than otherwise.

Relationship development has increased in terms of importance over the past three decades, given the global nature of the economy. Markets are increasingly fragmented, characterized by consumers that are increasingly more demanding and want increasingly more value for their money. There are various types of approaches to business relationship development. Through the years these approaches have proven to be effective but are often dependent upon the situational aspects of the business relationship. This section of the paper will discuss these approaches.

1.2. Buyer-seller approach. The buyer-seller approach focuses on the relationship between the company that purchases supplies or services and the business selling the supplies or services. According to Schurr (2007) within the context of business marketing buyers and sellers are involved in both social and economic exchanges which encourage working relationships. In addition the social aspect of the relationship is important because it can compensate for flawed legal contracts. The author explains if the commercial relationship between the buyer and the seller is to last, adjustments may have to occur so that commercial exchange can occur in the midst of changing situations. In this respect legal contracts can be problematic because changing circumstances cannot always be anticipated. Therefore, the business relationship becomes vitally important because companies may need the ability to renegotiate with one another to ensure that the needs of all parties are met (Schurr, 2007).

According to Parsons (2002) in today's environment, businesses increasingly dependent on the relationships they have with their suppliers and demand that adherence to high standards. It is increasingly important that buyers have strong relationships with their suppliers to stay ahead of competition. The establishment, development and maintenance of these relationships between exchange partners are critical to achieving economic success (Morgan & Hunt, 1994). There are many advantages for firms that enter into productive relationships with their suppliers such as lower risk, access to technology, more cooperation, increased knowledge, and information sharing (Ellram, 1995). Research in this area has begun to investigate what determines the success or failure of relationships between exchange partners by looking at both seller characteristics and the nature of interactions between buyers and sellers (Crosby et al., 1990; Morgan & Hunt, 1994).

1.3. Interaction approach. The interaction approach to relationship development in business has also been a popular approach for organizations. According to Turnbull et al. (1996) the interaction amongst businesses is a repository for the experience of those engaged in the relationship. This relationship is composed of the learned norms and rules of the behaviors of those that interact with one another. In addition the relationship "...provides the atmosphere within which individual episodes take place. These episodes include negotiations, payments, deliveries and social contacts etc. Each episode in turn is affected by and affects the overall relationship. Furthermore, relationships evolve over time and can be considered to traverse a series of stages characterized by increasing mutual adaptation, reduced "distance" and increasing commitment" (Turnbull et al., 1996, p. 44).

The interaction approach examines the totality of the relationship as opposed to simply examining individual transactions that occur amongst those in the relationship. As such, the interaction approach concerns itself with the examination of the behaviors of all participants in the relationship; in addition it places a great deal of emphasis on the parallels that exist between the marketing and purchasing tasks. Additionally, this approach maintains the quality of the relationship is a predictor of transactional behaviors.

1.4. Relationship marketing. Relationship marketing is defined as "... attracting, maintaining and enhancing customer relationships" (Morgan & Hunt, 1994, p. 20). The authors divide relationship marketing into two spheres: discrete transactions and relational exchange. Discrete transactions involves the presence of a "distinct beginning, short duration,

and sharp ending" (Morgan & Hunt, 1994, p. 20). On the other hand, the relational exchange has historical connotations traced to previous agreements and is longer in duration reflecting an ongoing process (Morgan & Hunt, 1994).

Barry et al. (2008) asserts that relationship marketing is vitally important as it pertains to the retention of customers. According to the authors, businesses gain greater profitability from the retention of old customers than from gaining new customers. Unlike other types of business relationship development, relationship marketing emphasizes the importance of customer retention as necessary to ensure the business remains profitable.

1.5. Networking. Networking is probably the most well-known form of relationship development within the context of business and is also one of the most popular approaches to relationship building. This popularity exists because networking is easy to engage in as a result of advances in technology and is also quite effective. Networking allows people with different skill sets to easily come together and collaborate. Such collaborations in the context of a business are important because they improve the quality of the products and services being offered.

The concept of a network is derived from the idea that businesses function within the context of a small amount of organizational entities or actors. These actors are in continual relationship with the business. Because this is the case, each individual party exerts considerable influence on the organization. This situation is encountered most often by industrial companies operating in business markets which include a limited number of suppliers, competitors, and customers. However, some more extensive empirical studies suggest that this type of situation may be the rule rather than the exception for a wider population of business organizations in general. This view of the network model refers to situations and cases in which the environment of the organization is of a concentrated and structured kind that is constituted by a set of other active organizations (Håkansson & Snehota, 2006). These organizations work together to make the realization of all of their individual goals possible. This is accomplished through the exchange of ideas and even the exchange of workers with specialized skill sets.

2. Objectives of business relationships

There are several objectives associated with the development of business relationships. One of the primary objectives is to secure a competitive advantage. Business to business relationships can improve the competitive advantage of a company because such a relationship can provide a company with le-

verage. This leverage can be used to negotiate lower prices for supplies needed in the manufacturing of products. If a company can get supplies (parts, components so forth) at a lower price than competitors, they will also have the ability to charge the consumer less for the product. This can lead to substantial increases in profitability and a competitive advantage.

Another objective of the development of business relationships is quality assurance. When business to business relationships are established and sustained all parties involved are aware of the type of products that are going to be produced and the type of quality that is expected. Once a relationship has been established companies can work together to ensure that the quality of the products are high and consistent. This also assists in ensuring that the company remains competitive.

The suppliers also benefit greatly from the development of relationships. This is particularly true if the buying company is well respected. The objective of the supplier in the scenario is to receive as many purchases as possible to increase profitability. The increase in business often occurs because the supplier has created a good product and other businesses want to have access to these products. Having good relationships with buyers increases the brand recognition of the supplier and translates to an increase in profitability.

The final objective involves the globalization and expansion of multinational corporations. The building of relationships is important to multinational corporations because they enable corporations to function outside of their home countries. Multinational companies benefit greatly from the presence of support from suppliers and vendors. These companies depend on such support so that they can function in a manner that is efficient.

It is a well-known fact that people across nations and cultures think, behave and believe differently. Nations and cultures differ in terms of how they define specific phenomena, and how they act and react to these phenomena. Events such as behavior, regulations, language and institutions all have cultural significance. In the global business environment researchers have long reported on the dominant role of a nation's culture in determining managing practices and strategies in the context of cross-border investments. Managing change in another culture involves understanding how objects or events are defined in that culture (Zineldin, 2007; James et al., 2008).

3. Elements of psychic distance and business relationship development

Psychic distance may be described by factors preventing or disturbing the flow of information be-

tween potential or actual suppliers and customers. These factors are concerned with country based diversities and dissimilarities and may be grouped into four areas: (1) linguistic differences and translation difficulty; (2) cultural factors, including societal norms, level of individualism or collectivism, values and customs; (3) economic situation, the existing trading links, infrastructure, local conditions, competition and investor confidence; and (4) political and legal system the government stability and risk of instability, import tariffs, legal protection and taxation levels.

Psychic distance has a direct bearing on RM strategy. The higher the level of psychic distance, the greater is the effort required to manage the business relationship. According to Conway and Swift (1999, p. 1391) "... the level of psychic distance has a direct bearing on financial and psychological investment required to develop a successful RM strategy."

RM strategy focuses on gathering information on their customers and then deciding with whom they can develop a dialogue. The focus of this approach is on customer retention (Gronroos, 1996; Gummesson, 1994). The relationship is seen to develop in gradual stages.

Scazoni (1979) postulates three stages of relationship development: exploration, expansion and commitment. Levitt (1983) and Dwyer et al. (1987) offer five stages of development of a relationship: awareness, exploration, expansion, commitment and dissolution. Along with these stages some variables go into determining the nature of the relationship. These variables are the level of commitment, trust, customer orientation/empathy, experience/satisfaction and communication (Conway & Swift, 1999).

Psychic distance itself is a consequence of a number of factors among which perception is of critical significance. However, perception is highly subjective and may be a result of the value system associated with a specific culture. Culture plays a crucial role in determining psychic distance (Swift, 1998). Hallen and Weidershiem-Paul (1984) have explored the concept of 'cultural affinity' as one of the three key determinants of psychic distance. According to Holden and Burgess (1994) 'psychic closeness' is achieved through cultural affinity, trust and experience, "...cultural affinity is an important determinant of a firms' ability to estimate the needs and requirements of the other party. High cultural affinity is a major factor in reducing psychic distance between two parties..." (p. 33). Trust, at the organizational level is an important consideration in business, "...many aspects of relations between custom-

ers and suppliers cannot be formalized or based on legal criteria. Instead relationships have to be on mutual trust. Experience operates purely at the cultural level and is not necessarily an expression of cultural factor. Nonetheless, it is a powerful determinant of psychic distance as it influences attitude formation” (Hallen & Weidershiem-Paul, 1984, p. 18). Individual experience can result in preconceptions regarding suppliers and customers and these prejudices will affect attitudes and behaviors towards those suppliers and buyers.

According to Swift (1998), culture has a pre-eminent role in determining psychic distance and comes prior to trust and experience; interaction is presupposed in trust and experience. Trust develops through interaction and experience comes through repeated interaction.

Cultural affinity, on the other hand, can be significant even before interaction begins. The term ‘affinity’ has been interpreted to mean ‘liking’ and ‘empathy’ is the ability to see something from the perspective of another. Cultural empathy, according to Phillips et al. (1994) is defined as: “...the ability to place yourself in the position of the buyer from another culture. In this way a strong attempt is made to the thinking approaches, the decision making process and the interaction between this and the cultural and other forces influencing the buyer” (p. 104). The International Marketing and Purchasing group found “liking” as a major factor in the development of business relationships as evidenced by the fact that 31 percent of French buyers did not like dealing with the UK suppliers (Swift, 1998). A correlation may be said to exist between cultural similarity and cultural affinity.

In the context of worldwide business, while cultural assimilation may be hard, if not impossible, it is more essential to avoid cultural blunders. Identification of issues surrounding cultural distance and differences help executives of international corporations avoid these blunders, while identifying cultural similarities can enhance relationships and build bonds. Consequently, culture becomes the site of both bridge and barrier in the international market place.

According to Swift (1998) demonstration of a relationship between cultural closeness and cultural affinity validates the hypothesis that cultural closeness (indirectly) determined psychic success. His study found a moderate, but statistically significant positive correlation between a respondent’s affinity for a particular culture, and the degree to which they perceive the overseas market of that culture to be similar to that of Great Britain. This being the case,

it can be claimed that cultural similarity or closeness is a contributory factor to cultural affinity. It is probable, therefore, that those countries which engender the greatest level of psychic distance as far as British executives are concerned, are those that are culturally most different to Great Britain. Broadly speaking these are to be found in the Far East (Asia), the Middle East (Arab world), and the “Latin” cultures of Southern Europe and South America. On the other hand, the study found high levels of psychic closeness, when comparing Britain with “Nordic” or “German” cultures and with cultures in the “Anglo” world that include Australia, New Zealand, Canada and the USA. A major contributory factor to psychic closeness in this group could be attributed to the use of a common language.

While there are barriers and bridges to successful business relationships, there are variables that may be considered more significant to overcome in the context of international business. These variables or factors are identified as: commitment, trust, customer orientation/empathy, experience/satisfaction, and communication. We shall briefly examine the role each of these factors play in successful business relationships:

- ◆ *Commitment.* The level of commitment plays a key role in success of business relationships. A relationship that is characterized by high interdependence over a period of time is a “close” relationship. Closeness enhances the size of investment in a relationship which in turn influences commitment. Jody (2000) and Evans et al. (2000) have highlighted the central role of commitment in sustaining a relationship. They have identified commitment as the most common dependent variable in buyer-seller relationship studies. The level of commitment has also been identified as the strongest predictor of voluntary decisions to remain in a relationship. Commitment level indicates the intention to continue an activity or the desire to maintain a relationship, demonstrated by ongoing investment in the relationship. According to Conway and Swift (1999), when the levels of satisfaction are high, the quality of alternatives is seen as poor, investment is large, and commitment is stronger.
- ◆ *Trust.* Ford (1984) highlights the importance of trust, “...many aspects of relations between customers and suppliers cannot be formalized or based on a legal criteria. Instead relationships have to be based on mutual trust” (p. 101). Trust is seen as a generalized expectancy held by an individual that the word of another can be relied upon. The concept is clarified in specific context

of economic exchanges, the expectation that parties will make a good faith effort to behave in accordance with any commitments, be honest in any negotiations, and not take advantage of the other even when the opportunity is available. Ali and Birley (1998) speak of two types of trust: characteristic based trust and process based trust. Characteristic based trust depends on criteria such as 'social similarity' between individuals, and is in fact oriented to individuals, "...an exchange partner may consider the ethnic background of their suppliers/customers to be an important factor in exchange since common social and cultural norms may make a satisfactory exchange easier to achieve" (p. 751). Process based trust is a more rational form of trust based on existing performance and relationships. Trust is further enhanced and reinforced by a number of other factors such as word of mouth opinions and media reports. The impact of trust on development of relationships is especially significant at the later stages of relationship development. Trust also impacts the development of two other major variables in business relationships, customer orientation/empathy and experience/satisfaction. A high level of trust leads to positive attitude thereby increasing the level of customer orientation/empathy, while low level of trust has the opposite effect. Mitchell et al. (1998) considers experience as crucial to trust for comparing preconceived expectations associated with a firm. Ganesan (1994) considers prior experience the of key factor in the development of trust. Trust may be difficult to build where little or no positive experiences yet exist, however low trust levels can be reinforced effectively by a single instance of negative interaction.

- ◆ *Customer orientation/empathy.* Palmer and Bijou (1994) consider customer orientation/empathy to be a crucial factor in business relationship development that is linked to social bonding. The term "empathy" is related to the ability to see and understand a situation from the perspective of someone else. Initially the onus is on the seller to empathize with the buyer; however, at the later stages of business relationship development mutual empathy becomes increasingly more important. A number of studies have shown that liking of one party by the other is important in the development of close interpersonal and business relationships (Conway & Swift, 1999). The barriers to relationships are fewer when the degree of empathy or liking between the parties is greater.

- ◆ *Experience/satisfaction.* The decision to continue the relationship may be seen as a result of the past experience. The level of congruity between relationship expectation and performance is a crucial determinant of continuity of relationship (Levitt, 1983). Negative knowledge can be a hindrance to maintenance of relationship. The last experience is remembered best and one positive experience may change previous negative perceptions. The overall level of happiness in a relationship is achieved when both parties have optimistic perceptions of the other. Diverse studies have shown that 'satisfaction' is a key factor both in its own right as well as in the way it is associated with other factors such as trust and commitment.

- ◆ *Communication.* Communication is a factor that is often taken for granted or overlooked as a component of relationship development. According to Jody (2000) communication is the practice of establishing a commonness or oneness of thought between a sender and a receiver. There is no doubt that communication is a crucial element in development of business relationships, it involves both giving and receiving with due importance attached to both. In the business context, the communicator is interested in the impact of the message communicated on the other party and is relying on feedback in order to plan a course of action. This is only possible when the communication is a two way process. Communication is both internal and external, and in context of overseas business external communication is of much greater importance especially when one is trying to establish business relationship. Communication is significant not only in its own right, but also has a strong influence on establishing trust.

4. Cross cultural business relationship development and influences of psychic distance

Hallen and Weidershiem-Paul (1984) provide analytical tools to effectively analyze the process of cross cultural business relationships as they have developed through various stages. According to the authors' cultural affinity, trust, and experience acting at the three levels, national, organizational and individual determine the psychic distance. The three component elements of psychic distance as outlined above are: the degree of cultural affinity (apparent at the national level), the level of mutual trust (apparent at organizational level), and the level of experience of the individuals concerned (operational at the individual level). The components of a successful business relationship as well as the influence of psychic distance upon

the relationship are more or less significant depending on the stage at which one examines the relationship.

Depending on the stage of evolution of relationship, the three determinants are assumed to influence the psychic distance with various strength (Hallen & Weidshiem-Paul, 1984). The four stages in the development of relationships are: pre-contact, initial interaction, development, and maturity.

In the pre-contact stage, psychic distance is assumed to exist at the medium level (not neutral). This level of psychic distance is presumed to exist between high and low levels as both parties have no personal experience to define the basis of their judgment. Attitudes are at best determined by indirect exposure, word of mouth, media reports and national image. In the initial interaction stage, the psychic distance is likely to be high because the differences between the two parties are highlighted rather than the similarities. However, over a period of time as the relationship is further established, it is quite possible that the psychic distance diminish. Once the relationship develops and matures, trust and experience assume greater importance (Hallen & Weidersheim-Paul, 1984). Let us now focus on somewhat greater detail on the stages in the development of business relationships that have an impact upon cross-cultural relationship management.

4.1. Pre-contact stage. There is neither a relationship nor contact at this stage. "In terms of market development, this is likely to correspond to the 'market scanning' stage of internationalization, during which potential markets are identified through secondary and then primary research" (Conway & Swift, 1999, p. 1406). Since there is no connection at this stage, no contrast can be made. The psychic distance at this stage is likely to be medium due to the lack of positive or negative feedback that could only be possible after contact. This lack of contact prevents from either enhancing or reducing uncertainty. Additionally, in absence of the contact, other factors like trust, experience, and communication are unavailable for interpretation. However, under certain circumstances national stereotypes might predispose business executives towards greater or lesser degree of trust. Nonetheless, empathy or cultural empathy could be a predominant factor at this stage which orients positively or negatively towards a particular culture. This pre-contact period may be used by business executives for building a positive attitude towards the culture of the buyer/seller with whom business relationship is to be developed. A communication strategy designed to develop empathy and cultural awareness might be a fruitful enterprise at this stage (Conway & Swift, 1999).

4.2. Initial interaction. Once contact has been made and the business relationship has begun to develop the comparisons between "them and us" also begin to take place. The differences between the two parties with their respective cultural baggage become more transparent at this stage. The level of psychic distance that was medium in the earlier stage becomes high at this stage as the cultural differences become rather apparent for the first time. Furthermore, this stage is the most critical from the perspective of the future of the relationship; if the relationship breaks down, it is usually during initial interaction. With this in mind the focus of communication at this stage should be on cultural empathy and liking before the relationship to enhance the probability of success. The initial customer satisfaction based on some initial experience is the decisive determinant of the course of the relationship even as commitment and trust are at their initial levels (Conway & Swift, 1999).

4.3. Development. There are only two future possibilities at the stage of initial interaction, either the business relationship breaks down or it grows. If the relationship has not broken down it is safe to assume that the next stage of development is taking place and psychic distances is diminishing. Typically during this phase the two parties become closer facilitating mutual psychological understanding and increasing the level of empathy. The role of communication becomes of greater significance as positive interactions can be reinforced and these experiences can be used to develop commitment and trust between the two parties (Conway & Swift, 1999).

4.4. Mature relationships. The relationship becomes mature when mutual familiarity and understanding leads to a significant reduction in psychic distance. However, it must be noted that communication has been shown as crucial through each of the different stages development in order to maintain and sustain relationship; communication is essential to maintaining existing levels of trust and commitment. Moreover, positive experiences and feelings of satisfaction need to be reinforced and enhanced through communication. In mature business relationships trust/commitment and experience/satisfaction are more crucial factors in maintaining the business relationship respectively (Conway & Swift, 1999).

5. Recommendations

In sum, the psychic distance concept focuses on significant cultural and business differences between countries that can introduce constraints to successful market entry and adaptation once established; however, such constraints can be overcome through learning in a process Nordstrom and Vahlne (1994)

termed “bridging the gap of psychic distance” (p. 3). Some recommendations provided by O’Grady and Lane for these purposes are as follows:

- ◆ *Treat even psychically close markets as foreign markets.* Executives should not assume that the different markets are the same, or that companies within each can be managed in the same way. When decision-makers start with the assumption that they are the same, they are more likely to take the appropriate steps toward entering the new market.
- ◆ *Test assumptions and perceptions prior to entry.* The success of a decision-making process relies on the accuracy of information and the knowledge of those making the decisions. The most important part of a company’s pre-entry orientation is the perceptions and assumptions of the executive team, because they act as a base from which all of the decisions regarding the venture are made. If the pre-entry aspect of the decision-making process is faulty, the remainder of the process is unlikely to be effective. The decision-makers’ initial perceptions and assumptions also affect their ability to learn from experience in a new market and to respond to this information. Strong beliefs about the similarity of the two markets or the power of a retail concept contributed to the difficulty of adjusting when faced with conflicting information. There comes a time when it is necessary to revise one’s basic assumptions and perceptions, rather than continue to alter operating decisions in a way that only supports the initial position.
- ◆ *Correct interpretation is key.* In the Age of Information, the research process can be likened to drinking from a fire hose. Simply gathering information about a market does not necessarily lead to knowledge of that market unless it is interpreted correctly. A number of the companies conducted market analyses and still failed. The failure of such companies highlights the difference between objective market information and the tacit knowledge or know-how that is critical to success. The real indicators of psychic distance are to be found much closer to the ground than researchers have been looking.
- ◆ *Develop the ability to learn.* A final recommendation is that those making the decisions for foreign markets must develop the ability to learn about the other countries. Learning has to do

with increasing one’s knowledge and understanding. Learning is more likely to occur under conditions where error is tolerated, assumptions are testable, and key aspects of information are not missing. Thus, it is vital to identify and check the assumptions of decision-makers prior to entry, because their assumptions often seriously limited the effectiveness of their entry decisions. Because assumptions are frequently highly subjective and hard to identify, it is a good idea to use an objective person from outside the decision-making process to help decision-makers to identify them. It appears that to gain the capacity necessary to compete even in “close” markets, companies should hire management talent experienced in the target market; these individuals should have an understanding of the targeted consumers, the competition, the competitive intensity of the supplier situation, and regional differences, among other factors (O’Grady and Lane).

Conclusion

Evans et al. (2000) have analyzed the concept of psychic distance and applied the tenets to explain variations in the performance of retail operations. They found, “...psychic distance alone cannot explain variations in organizational performance between countries...other factors are associated with the organizational performance of international retailers. The combination of these organizational factors together with the psychic distance concept provides holistic framework for further research which seeks to explain...differences in the performance of the retailers outside their domestic markets” (p. 387).

Psychic distance is an important concept that has been successfully applied in context of relationship management with special focus on crosscultural businesses. It is a characteristic of several factors out of which culture and language emerge as greatly significant. These two factors provide an initial advantage in the forms of cultural affinity/empathy. However, there are other crucial factors like experience, commitment, trust and communication that work in combination or separately to enhance or reduce the quality of business relationships. As business relationships go through the stages of pre-contact, initial contact, development, and maturity elements of psychic distance play a fundamental role in strengthening and reinforcing the relationship.

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