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# Explaining retail offer adaptation through psychic distance

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## Abstract

**Purpose** – The purpose of this study is to examine empirically the relationship between psychic distance and adaptation of the retail offer across a range of countries.

**Design/methodology/approach** – Data were collected using a mail survey of randomly selected non-food retailers that operated stores in at least three foreign countries.

**Findings** – Findings of this study suggest that a substantial proportion of retail offer adaptation is explained by psychic distance. In particular, differences in market structure, business practices and language between the home and foreign market significantly increase the extent to which retailers adapt their offer.

**Research limitations/implications** – The research findings may be limited in terms of their generalisability across retail sectors, as the study focused on non-food retailers only.

**Practical implications** – These results have implications for researchers and managers in suggesting that we need to go beyond consumer behaviour differences to explain fully the degree to which international firms standardise or adapt their strategies in foreign markets.

**Originality/value** – Much of the existing research into standardisation and adaptation is limited in terms of geographic scope and a focus on the marketing strategies of manufacturing and export firms. Thus, this paper addresses a substantial gap in existing research by empirically examining the relationship between psychic distance and adaptation in a retail context and across a range of countries.

**Keyword(s)**: International business; Retailing; Marketing models.

## Introduction

A substantial body of literature exists in the area of strategy standardisation and adaptation. While research is predominantly in the export and international marketing areas, focusing on the marketing strategies of manufacturing firms (*Alashban et al.*, 2002; *Boddewyn et al.*, 1986; *Cavusgil and Zou*, 1994; *Chhabra*, 1996; *Jain*, 1989; *Ozsomer et al.*, 1991; *Shoham*, 1996; *Whitelock and Pimblett*, 1997), the debate

surrounding strategy standardisation and adaptation is even more relevant and important in the area of international retailing. This is because retailers are closer to consumers than manufacturing and exporting firms, which provides them with easy access to information, but also makes them more vulnerable to differences in consumer tastes across markets. In recognition of the importance of strategy standardisation and adaptation, some attempt has been made to investigate the issue in an international retailing context (Dupuis and Prime, 1996; Martenson, 1987; McGoldrick, 1998; McGoldrick and Blair, 1995; McGoldrick and Ho, 1992; O'Grady and Lane, 1996; Salmon and Tordjman, 1989).

The general question posed by researchers is whether it is more appropriate to pursue a predominantly standardised or adapted marketing strategy (Cavusgil and Zou, 1994; Clarke and Rimmer, 1997; Dupuis and Prime, 1996; Shoham, 1996; White, 1995). These empirical studies have provided limited and often conflicting findings regarding the performance implications of standardised and adapted strategies. Advocates of a standardisation approach argue that the homogenisation of world markets, combined with the advantages obtained through economies of scale and greater operating efficiencies increase the likelihood that firms will perform better with a standardised strategy. In contrast, supporters of an adaptation approach assert that firms will perform better when they adopt marketing and retailing strategies that accommodate the differences in markets. Hence, the standardisation/adaptation debate has tended to centre on the perception of market similarities or differences as the primary explanation for the relationship between strategy standardisation or adaptation and performance.

Despite the focus on market similarities and differences in the standardisation/adaptation literature, only a limited number of studies have sought to establish an empirical association. Research has identified similarities and differences in government regulations, consumer tastes, nationalistic sentiments, competition, technical requirements, language and product usage as antecedents to strategy standardisation or adaptation (Boddewyn and Grosse, 1995; Chhabra, 1996; Ozsomer *et al.*, 1991). These antecedents can be categorised as either cultural or business factors and, as such, highlight the important role played by psychic distance in determining the degree of standardisation or adaptation.

Thus, the purpose of this paper is to examine empirically the relationship between psychic distance and standardisation or adaptation of the retail offer. We begin with a brief discussion of the psychic distance construct and then examine the relationship between psychic distance and retail offer adaptation. We present the empirical findings from the survey in the form of two regression models and finally, we discuss the implications and limitations of the study.

### ***Theory and hypotheses***

Psychic distance is defined as the distance between the home market and a foreign market resulting from the perception and understanding of cultural and business differences. This definition is based on the work of Vahlne and Wiedersheim-Paul (1977), Nordstrom and Vahlne (1994), O'Grady and Lane (1996) and Lee (1998). These studies all highlight the importance of two factors: psychic and distance. First, psychic is derived from the term "psyche", which refers to the mind or soul. This

suggests that it is not the simple presence of external environmental factors that determines the degree of distance between the home market and a foreign market. Rather, it is the individual's perception and understanding of these factors, which forms the basis of psychic distance. Second, distance relates to similarity or difference in terms of the amount of separation between two points. Thus, the term "psychic distance" refers to the perceived degree of similarity or difference between the home and foreign market.

Research conducted by O'Grady and Lane (1996) and Lee (1998) also highlights the need to specify the factors that combine to determine psychic distance. O'Grady and Lane (1996) argue that psychic distance should incorporate both business differences and cultural differences. This supports the findings of Nordstrom and Vahlne (1994) who found that the two concepts capture "different but overlapping phenomena". Moreover, Evans and Mavondo (2002) assert that the true explanatory power of psychic distance can only be revealed when the individual elements are fully measured. Therefore, for the purposes of this study psychic distance is operationalised in terms of both cultural and business distance. Cultural distance is derived from Hofstede's (1991) dimensions of national culture, while business distance incorporates economic, legal and political, business practices, market structure and language differences.

### **Psychic distance and retail offer adaptation**

Traditionally, standardisation and adaptation were thought of as binary opposites. A firm either adopted the same strategy in all of its foreign markets or a completely adapted one. Standardisation and adaptation, however, are more properly viewed as two extremes on a continuum, with most companies adopting a strategy somewhere between the two polars (Chhabra, 1996; Ozsomer *et al.*, 1991; Whitelock and Pimblett, 1997). Within the marketing literature research has shown that, while some elements of marketing strategy such as pricing and promotion are adapted to suit the foreign market environment, other elements, particularly distribution and product, are more likely to be standardised (Cavusgil and Zou, 1994; Chhabra, 1996; Ozsomer *et al.*, 1991). In an international retailing context the degree of standardisation or adaptation refers specifically to elements of the retail offer. These elements include merchandise quality, range and fashion, level of services, facilities, layout, atmosphere, location, quality of display, advertising, general reputation, reliability, price and image in general (McGoldrick, 1998; McGoldrick and Blair, 1995; McGoldrick and Ho, 1992).

A number of studies have endeavoured to identify the antecedents to standardisation and adaptation. The longitudinal study reported by Boddewyn and associates (Boddewyn, 1989; Boddewyn and Grosse, 1995) on the marketing practices of US multinational companies operating in the European Common Market between 1973 and 1993 found that standardisation of marketing practices was increasing between 1973 and the early 1980s. However, the early 1990s witnessed a move towards greater adaptation. It was identified that the primary factors impeding standardisation were differences in government regulations, consumer tastes and habits, nationalistic sentiments, competition and technical requirements. These findings suggest that cultural and business differences are likely to result in a more adapted marketing strategy.

In a study of international firms operating in Turkey, Ozsomer *et al.* (1991) found comparable results. Their study found a positive relationship between standardisation of marketing strategies and similarity of market conditions between Turkey and the home country of the foreign firms. Similarity of market conditions refers to the nature of competition, retail structure, target consumer segments and marketing legislation (Ozsomer *et al.*, 1991). The results of Chhabra's (1996) study of American multinational companies in South America support the previous findings. The results indicate that the primary reasons for adapting marketing strategies were differences in the market infrastructure, government regulations, language and product usage conditions (Chhabra, 1996).

Research in international retailing has found similar results. In a case study of IKEA, Martenson (1987) argues that if managers believe cultural differences to be significant they are more likely to adapt their retail offer. Furthermore, in relation to external environmental factors, it was argued that differences between consumers and the retail environment in general might lead to greater adaptation of retailing strategies (Martenson, 1987). McGoldrick (1998) also argues that most retail formats require at least some adaptation of their offer to suit the specific conditions of the foreign market.

It is evident that research in both international marketing and retailing identifies a number of environmental differences that influence the degree of strategy adaptation employed by firms operating in foreign markets. These differences can be categorised as either cultural or business differences and, as such, it is possible to suggest that psychic distance has a positive relationship with adaptation of the retail offer. In light of perceived cultural and business differences retailers may adapt their offer to increase the likelihood that the format will be acceptable to the foreign market. For instance, Wal\*Mart encountered difficulties in Germany in 2000 because of the firm's failure to address the different regulatory environment when implementing its standard price "rollback" strategy. The German competition authority regulates retail prices as a means of protecting small, family-owned stores. When it was found that Wal\*Mart was selling some products below cost the firm was ordered to increase prices immediately or incur a fine of up to 1 million German marks. The case of Wal\*Mart highlights the fact that international retailers may be forced to adapt their retail offer, not just to accommodate specific consumer preferences, but also because the existing offer is unacceptable to the country's governing bodies.

Furthermore, Dupuis and Prime (1996, p. 32) assert that "when a retail format is exported it has to face a new context which may affect its original competitive advantage ...". A prime illustration is the case of IKEA in the USA. While IKEA's unique store format was a basis for competitive advantage in Europe, it was a source of frustration for American consumers. American consumers have a strong preference for convenience and time-saving devices. In response to this difference in consumer behaviour, IKEA adapted its store format by providing more directional cues and shortcuts in the navigation of the store. Thus, while IKEA generally attempts to standardise its retail offer as much as possible in pursuit of cost efficiencies, cultural differences have prompted the chain to be more flexible at a local level.

Hence, we advance the following hypotheses:*H1*. Psychic distance has a significant and positive relationship with the degree of adaptation of the retail offer in the foreign market. Disaggregating this hypothesis to reflect the constituent dimensions of psychic distance leads to the following hypotheses:*H2*. Perception of the following cultural and business differences between the home and foreign market will have a significant and positive relationship with the degree of adaptation of the retail offer in the foreign market:*H2a*. National culture.*H2b*. Legal and political.*H2c*. Economic.*H2d*. Market structure.*H2e*. Business practices.*H2f*. Language.

### ***Methodology***

The sample for this study consisted of randomly selected, non-food retailers that operated stores in at least three foreign countries. The mail survey method was used to collect data from respondents through a formal structured questionnaire. The study adopted the three key principles advocated by Dillman's (1991) Total Design Method: minimise the cost for the respondent, maximise the reward for responding and establish trust. Questionnaires were distributed internationally to senior executives based in the USA, UK, Western Europe and the Asia Pacific region. A useable sample of 102 responses was obtained, yielding a response rate of approximately 20 per cent. This amounts to a sample of 204 international retailing operations, as respondents were asked to answer all questions twice, once for a retail operation in a psychically close market and once for a retail operation in a psychically distant market. The majority of firms in the sample were based in the UK (24 per cent), USA (27 per cent) and Germany (27 per cent). This is consistent with both the composition of the sampling frame and the activities of retailers based in these three countries.

### **Operationalisation of constructs**

Respondents were provided with a definition of psychological distance and then asked to nominate a psychically close market and a psychically distant market in which the firm operated. These two nominated markets provided the basis for answers throughout the questionnaire.

*Psychic distance*. Based on a review of the international business and retailing literature, new measures were developed for legal and political, economic, industry structure, business practices and language differences. Items for cultural distance were developed based on Hofstede's definitions and descriptions of the dimensions, rather than the original items. This was done so that the items captured general aspects of a country's values and attitudes and did not focus specifically on work-related values. Furthermore, the items were adapted to capture the perception of differences between the respondent's home country and a foreign country. Respondents were asked to indicate the degree to which the foreign market was similar or different to the home market on a seven-point Likert scale, ranging from (1) totally the same to (7) totally different.

*Retail offer*. Items for retail offer were drawn from the work of McGoldrick and Blair (1995) and McGoldrick and Ho (1992). These included merchandise quality, merchandise range, level of customer services, pricing strategy, in-store customer facilities, store layout, store atmosphere, quality of display, provision of after sales

service and overall image presented to the customer (after exploratory and confirmatory factor analysis merchandise range, store layout and quality of display were deleted from the final analysis). These items were combined with the scales developed in the export literature (Cavusgil and Zou, 1994; Chhabra, 1996; Ozsomer *et al.*, 1991; Shoham, 1996; Whitelock and Pimblett, 1997) to form a measurement scale for the degree of adaptation of the retail offer. Respondents were asked to indicate the degree to which the retail offer in the close and distant foreign markets was similar or different to that in the home market on a seven-point Likert scale, ranging from (1) totally the same to (7) totally different.

The reliability of the scales was found to satisfactorily meet Nunnally's (1978) recommendation as the Cronbach  $\alpha$ s exceeded 0.7 for all of the constructs: psychic distance ( $\alpha=0.9475$ ), national culture ( $\alpha=0.9680$ ), legal and political ( $\alpha=0.9746$ ), economic ( $\alpha=0.9424$ ), market structure ( $\alpha=0.9206$ ), business practices ( $\alpha=0.9562$ ), language ( $\alpha=0.9439$ ) and retail offer ( $\alpha=0.9545$ ). Exploratory and confirmatory factor analyses were performed and all items significantly loaded on to the hypothesised constructs. The results of the confirmatory factor analysis for psychic distance ( $\chi^2=54.699$ ;  $df=27$ ;  $p=0.001$ ; GFI=0.949; AGFI=0.905; RMSEA= 0.071) and retail offer ( $\chi^2$  value=12.971;  $df=10$ ;  $p=0.225$ ; GFI=0.982; AGFI=0.950; RMSEA=0.038) indicate that our operationalisation fits the data well.

## **Results**

The results are presented as two models (see Table I). This approach is a response to the ongoing debate about the use of multidimensional scales and the explanatory power of psychic distance as a summary construct (Evans and Mavondo, 2002; Stottinger and Schlegelmilch, 1998). Model 1 is consistent with advocates of multidimensional constructs in that it relates a broad predictor (psychic distance) to broad outcomes (retail offer adaptation). Model 2 allows for the identification of those elements of psychic distance that significantly influence, either positively or negatively, adaptation of the retail offer.

The composite index of psychic distance was first entered into a simple regression analysis as a means of evaluating its predictive ability in terms of retail offer adaptation. The results depicted in Table I indicate that psychic distance explains a significant proportion (65 per cent) of retail offer adaptation. Second, the individual dimensions of psychic distance were simultaneously entered into a multiple regression analysis. The significant *F*-ratio demonstrates that the dimensions of psychic distance explain a significant proportion of retail offer adaptation. It is evident, that this fully disaggregated model has the most explanatory power as the  $R^2$  (0.729) is nearly 10 per cent greater than model 1. The relative importance and significance of each of the dimensions is assessed in terms of the beta values and *t*-values. With regard to the disaggregated model, market structure ( $\beta = 0.184$ ), business practices ( $\beta = 0.308$ ) and language differences ( $\beta = 0.245$ ) were found to have a significant positive effect on retail offer adaptation.

## **Discussion**

The results of the simple regression analysis provide support for *H1*. The results indicate that psychic distance does increase the degree to which retailers adapt their

offer in foreign markets. This positive relationship may be attributed to a number of factors. First, where retailers perceive a foreign market to be substantially different to their domestic markets, they may simply assume that the retail offer, in its current form, will not be suitable for the foreign market. Consequently, the decision to adapt the retail offer may be based on a subjective assessment. Second, retailers may perceive greater risk and uncertainty in psychically distant markets. In response to this perceived risk they will undertake more extensive research into the foreign market environment. The information provided by such research may suggest that certain aspects of the retail offer must be adapted to accommodate the various cultural and business differences.

In terms of model 2, the results of the multiple regression analysis provide support for *H2d*, *H2e* and *H2f*. The results indicate that the perception of market structure, business practices and language differences have a significant and positive relationship with adaptation of the retail offer. Market structure in particular has been consistently identified in previous research as an important determinant of strategy adaptation (Alashban *et al.*, 2002; Boddewyn *et al.*, 1986; Jain, 1989; Ozsomer *et al.*, 1991). Market structure differences, such as intensity and type of competition, may necessitate adaptation of the retail offer as a means of maintaining a competitive position in the foreign market.

It can be inferred that differences in business practices would necessitate changes in elements of the retail offer such as customer service and after-sales service. For instance, perceived differences in the concept of fair dealing may prompt retailers to adapt their after-sales service in terms of return policies and merchandise warranties. Moreover, credit and financial arrangement differences may compel retailers to adapt the credit terms offered to customers. Finally, while in some countries, staff may expect to be rewarded for providing superior personalised service, others may assume that they will be rewarded for quick and efficient service. Thus, the type and quality of customer service offered may be adapted in response to differences in the basis for rewards and recognition of staff.

It can be argued that because language differences influence interpersonal communication, which is intrinsically linked to the shopping experience, adaptation of the retail offer would be necessary. Aspects of customer service may need to be adapted because words and phrases do not necessarily have the same meaning when translated into another language. This could also have consequences for the overall image presented to consumers because of its effect on store atmosphere. Furthermore, elements of the retail offer such as signage, promotional materials and care labels on merchandise would all need to be adapted to suit the language of the foreign market.

It is interesting to note that cultural distance did not have a significant effect on adaptation of the retail offer. It was expected that this would have been a very important predictor of retail offer adaptation as it goes to the core of consumer tastes and values. Thus, it can be inferred that retailers undertake more obligatory, rather than discretionary adaptation. This can be attributed to the fact that differences in the market structure, business practices and language necessitate adaptation of the retail offer, whereas adaptation to suit consumer tastes is at the discretion of management. However, the argument of obligatory adaptation is not supported in the

case of legal and political differences. There are many examples of international retailers adapting elements of their operating procedures and strategies (i.e. trading hours and store locations) because they are legally required to do so. It is possible that legal and political differences do not necessarily influence the core elements of the retail offer, such as merchandise, customer service and store layout.

### ***Conclusion***

This study sought to establish empirically a relationship between psychic distance and retail offer adaptation. We also sought to broaden the area of study, which has been limited in terms of geographic scope and a focus on manufacturing and export firms, to include international retailing firms across a diverse range of countries. The results show that psychic distance, as a summary construct, explains a significant proportion of retail offer adaptation. The study also demonstrates that disaggregation of the dimensions of psychic distance significantly increases the explanatory power of the model. The findings indicate that, while national culture, legal and political and economic differences do not affect the degree to which retailers standardise or adapt their offer, market structure, business practices and language differences are strong predictors.

It is recognised, however, that a number of issues must be considered when interpreting the findings of this study. First, while the response rate was relatively low, the sample characteristics suggest that the sample is reasonably representative. Second, the sample size was too small for us to perform more sophisticated analyses; however, we took care to ensure that the analyses performed were robust. Third, the research findings may be limited in terms of their generalisability across retail sectors. The study focused on non-food retailers only and, thus, it must be acknowledged that the identified relationships may differ for food retailers.

These results may have implications for researchers and managers in suggesting that we need to go beyond consumer behaviour differences to explain fully the degree to which international firms standardise or adapt their strategies in foreign markets. While academicians continue to call attention to cultural and consumer factors in the standardisation/adaptation debate, the findings suggest that retailers are focusing on business factors. A suggestion for future research is to incorporate psychic distance with other internal factors, particularly international experience and entry strategy, as a means of explaining an even larger proportion of the variance in retail offer adaptation. A further suggestion for future research, which was beyond the scope of this paper, is to investigate the performance implications of retail offer adaptation.

	Model 1	Retail offer adaptation	Model 2
Psychic distance	0.804***	(19.239)	
National culture			0.056 (0.654)
Legal and political			0.152 (1.525)
Economic			0.017 (0.180)
Market structure			0.184* (2.685)
Business practices			0.308** (3.409)
Language			0.245*** (4.624)
$R^2$	0.647		
Adj $R^2$	0.645		
F-ratio	370.151***		88.443***

**Table I.** Psychic distance and retail offer adaptation

**Notes:** \* =  $p < 0.05$ , \*\* =  $p < 0.01$ , \*\*\* =  $p < 0.001$

### **Table I** Psychic distance and retail offer adaptation

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