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# INTERNATIONALISATION OF FINNISH SMALL AND MEDIUM-SIZED COMPANIES TOWARDS THE NEW EU MEMBER STATES IN THE BALTIC SEA REGION

**A focus on SMEs based in Southwest Finland**

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## Contents

## Appendices



## Figures



## Tables

# 1 INTRODUCTION

## 1.1 Background to the study

As Estonia, Latvia, Lithuania and Poland joined the EU in May 2004, the Baltic Sea became virtually an inland sea within the European Union leaving only Russia outside of the integrated area. The EU-membership of the four countries has increased the interest of foreign companies to increase and initiate exporting and investment operations in the area. For example foreign direct investments in Estonia have over doubled in three years' time from EUR4035 million in 2002 to EUR10415 million in the third quarter of year 2005 (Bank of Estonia 2006). According to the Bank of Lithuania (2006), foreign direct investments in the country have increased from EUR3818 million in 2002 to EUR5278 million in the third quarter of 2005. Also the statistics of the Bank of Latvia (2006) and the National Bank of Poland (2006) show a growing trend in FDI towards the countries respectively.

The increased interest towards the Baltic Sea Rim's new EU countries is well justified as all of the four countries' economies have been growing rapidly. Estonian and Lithuanian economies are expected to continue their strong growth, whereas Latvia currently holds the position of the fastest growing EU country. The Polish economy is not expanding as rapidly as that of the Baltic States. Nevertheless, the Polish economy shows positive signs of accelerating growth. (Baltic Rim Economies 2005.) According to the European commission, the Estonian GDP accelerated to 8,6% during the first six months of year 2005. The GDP growth in Latvia, on the other hand, reached a peak of 11,6% in the second quarter. The Lithuanian economy expanded by 7,4% in the third quarter of 2005. The real GDP growth in Poland in the second quarter of 2005, on the other hand, was 2,8%. (European Commission 2005.)

Finnish FDI and exports towards the Baltic States and Poland has been growing steadily in the recent years. (Table 1) The growth is to be expected as the Northern companies can derive significant benefits from the fact that the countries are nearby in terms of time zones and geography. The Baltic States along with Eastern Europe provide also an attractive alternative to Far Eastern manufacture for Nordic manufacturing companies that are seeking a low-cost manufacturing solution (Suonsilta 2004).

**Table 1 Finnish exports and FDI stock in the Baltic States and Poland (source Bank of Finland 2005; Finnish Customs 2006)**

| | 2002, € million | % | 2003, € million | % | 2004, € million | % | 2005, € million | % |
|---|---|---|---|---|---|---|---|---|
| **Exports** | 2613 | 5,6 | 2569 | 5,6 | 2815 | 5,7 | 2834 | 5,9 |
| **FDI stock** | 1221 | 2,0 | 1462 | 2,4 | 1448 | 2,5 | N/A | N/A |

Poland, Estonia, Latvia and Lithuania have been transition economies and still are striving to reach the level of EU15 countries. This has had an effect on how easy it has been to enter those markets as for example the business practices and infrastructures have been very different compared to EU15 countries. It could be expected, that the EU enlargement has an impact on the operation mode decisions and the decision to enter those markets. Economic integration has been noticed to accelerate the internationalisation process of firms (Lautanen 2000, 107). A recent study by Alho et al. (2004) confirms that Finnish companies are planning to increase both marketing and direct investment operations in the new EU countries.

Southwest Finland is situated logistically close to other Baltic Sea region countries. Little is known about the business operations or future plans of companies in Southwest Finland related to the Baltic Sea Rim's new EU countries. This provides interesting grounds for a research. Furthermore, economic activity in Southwest Finland lies heavily on small and medium-sized companies (SME). The internationalisation of small and medium-sized companies has accelerated strongly since the eighties (OECD 1997) and the statistics since then have shown increasing importance of SMEs in home economies as they are key contributors as job generators, exporters and innovators (UNCTAD 1993). Though SMEs are increasingly active in international markets, the internationalisation literature has been mostly concentrating on the large multinational company as the unit of analysis. However, interest in SME internationalisation has been increasing during the recent years.

Until recently the studies concerning internationalisation of small and medium-sized companies mostly concentrate on the process model of internationalisation (Coviello & McAuley 1999). Little is known about how SMEs make international entry mode decisions (Brouthers & Nakos 2004). It has been suggested in the literature that the international entry mode selection of small and medium-sized companies is a new and important area of research (Burgel & Murray 2000). Therefore this study, while taking a look at the internationalisation of Southwest Finnish SMEs in the Baltic Sea region's

new EU countries, also aims at adding to the SME internationalisation research by integrating entry mode choice into the research setting.

## 1.2 Empirical studies on international business activities in the Baltic States and Poland

Several empirical studies have been conducted recently focusing on the Baltic States and Poland as a marketing and investment area of Finnish companies. This implicates great interest in this economically growing area. Poland and the Baltic States are an integral part of the Baltic Sea region and a numerous studies concerning the whole region have also been conducted. The empirical economic research focusing on the Baltic Sea region has been concentrating on explaining the economic connections and links as well as the diversity of economies within the region (e.g. Kivikari 1996) as well as the economic development of the transition countries (e.g. Tiusanen 2004). International business activities particularly in the Baltic Sea region have been studied in the late 1990's and early 2000 focusing on e.g. networking, macro economic comparison of national economies, firm strategies, FDI determinants and enterprise entry mode issues as well as barriers to trade and FDI (Lindström 2003). Empirical research literature addresses also issues concerning the transformation of economies and the EU enlargement as well as special aspects concerned with business activities in the countries. (e.g. Liuhto 2001; 2002). Empirical studies concerning the liberalisation of business environment as well as the trade and FDI barriers have been conducted for instance by Hernesniemi (1996) and Hazley and Hirvensalo (1998). Entry mode issues in the Eastern European context have been investigated for example by Törnroos and Nieminen (1999).

The significance of the Baltic Sea region for business activities of companies in Southwest Finland, and particularly the Turku area, was researched in 1997 by Lindström. Small companies were the largest size group among the studied companies. The results showed that the Baltic States, and especially Estonia, were notably more significant than Poland or Russia in terms of the amount of interest showed for possibly starting business activities in those countries. (Lindström 1997.)

Lindström (2003) has studied Finnish companies' international business operations in the Baltic Sea region from a perspective of locational competitiveness. Though the perspective of the study differs from the perspective of this thesis, it is useful to take a look at some of the findings. The findings showed that in 1999 the role of the EU countries was far more important for Finnish FDI or foreign trade than the transition countries within the Baltic Sea region when observing the volumes. The analysis was based on statistical information concerning year 1999. Then the share of Sweden,

Germany and Denmark in Finnish exports was 26% and approximately 42% of Finnish FDI stock was located to those countries. The share of the Baltic States, Poland and Russia were 10% in exports and less than 2% of the total Finnish FDI stock was located in those countries. Structural analysis on Finnish foreign trade revealed, that in 1999 there was unused trade potential in Finnish trade in the Baltic Sea region' eastern economies, mainly in Poland and Russia. The most recent studies will be shortly reviewed in the following.

Pirilä (2002) studied the effects of EU enlargement on Finnish small and medium-sized companies and found that the enlargement affects SME in a different way compared to larger firms. SMEs often need a longer time to adjust to the new environment compared to larger companies and they also profit less from the new situation. Most of the small and medium-sized companies operate only in Finland and the microcompanies as well as small companies often are not interested in increasing their business operations.[1] Therefore, the effects of EU enlargement for the smallest companies are minor. According to Pirilä's estimations those SMEs that are manufacturing for example machinery or producing knowledge intensive products as well as services for businesses will benefit from the enlargement.

Alho et al. (2004) studied the effects of EU enlargement on the strategies of Finnish companies. The findings showed that almost all of the companies that answered to the survey were planning to expand their business activities in the new member countries. 55 % were planning to increase exports. Nearly 30 % of firms were planning to move some of their operations, mainly manufacturing, to the new member countries. The study indicates that exporting and direct investments support one another. That is, the estimated growth in direct investments is on average the higher the more the firm's exports to the new EU member countries is estimated to grow. (Alho et al. 2004)

The findings showed that the growing markets were the factor that was considered to offer the most possibilities for business activities. This was something that both smaller and larger companies in manufacturing as well as services agreed on. The second most important factor was considered to be the low level of costs. This advantage, however, will in time be diminishing. Smaller companies considered low cost level as slightly more important factor compared to larger firms. Third most important factor was regarded to be the widening of the inner market to new member countries. This was something that larger companies considered to be more important than smaller companies. (Alho et al. 2004)

Though companies were interested in expanding their operations as new possibilities were at hand, there exist also some barriers to successful business activities. The most

[1] Small and medium-sized firms are firms that employ less than 250 people. Companies that employ less than 50 employees are defined as small companies and those firms employing less than 10 people are defined as microcompanies.

important barrier came up to be the lower level of public administration in the new member countries compared to Finland. Economical instability and insufficient infrastructure of the new countries was considered be the second most important barrier. These barriers will diminish in time, though differences compared to EU15 countries will continue to exist for a long time. (Alho et al. 2004.)

The Central Chamber of Commerce of Finland (2005) conducted a survey to find out how Finnish business executives perceive the developments in the Baltic and Polish markets after the first year of their EU membership. The results show, that Estonia is the most significant market area of the four studied countries. The respondents considered the business culture in Estonia to have been improving over the last years. They also considered that the country's EU membership and economic growth have increased companies' interest towards Estonia. The EU membership was considered as a positive development in all of the countries within the survey. The significance of all the four countries, and especially the significance of Poland, is expected to increase substantially over the next five years. Companies will increase exports, establish subsidiaries and cooperate with local companies.

The Center for Markets in Transition (2005) studied the internationalisation of Finnish firms in the Baltic States in 1987-2004 and Finnish investment experiences from Estonia. According to the study the Finnish firms have been active in the Baltic States, especially in Estonia, since the bilateral trade between the Soviet Union and Finland. During the first years of re-independence of the Baltic States lower production costs attracted manufacturing companies whereas the rapidly growing consumer demand attracted the retailers. The geographical proximity of the Baltic States has made it possible to organise the operations from Finland. The location, therefore, was considered to play an important role in the internationalisation of Finnish companies to the Baltic States.

Furthermore, the study found that the operations of Finnish firms have been growing constantly though the motives for Baltic operations have to some extent changed in time. Companies that were seeking cost advantages have often benefited from the local market potential. Business service providers that have followed their customers to the Baltic States have later expanded their customer base to local businesses. Firms in the field of textile and furniture as well as information technology have been seeking cost advantages through outsourcing or own production operations. The growing Baltic markets, on the other hand, have attracted the retailers, foodstuff industry and construction companies.

According to the study Estonia has been the easiest country to enter among the Baltic States and it has served as a test market for internationalisation for many Finnish firms. Latvian business environment is notably more difficult than in Estonia and although there are Finnish companies active in various sectors in Latvia, the individual

investments made have been relatively small. Finnish investments to Lithuania have been larger in value compared to Latvia, but fewer in number. However, the study finds that many Finnish companies consider the Baltic States as a part of their home market. Estonia is no longer the only interesting target market, but rather serves as a stepping stone to Russia and other Baltic States. In case of Russia, however, Estonia's potential as a stepping stone has not realised so far. (The Center for Markets in Transition 2005.)

**Table 2 Empirical studies relating to internationalisation of Finnish companies in the Baltic States and Poland**

| | |
|---|---|
| **Alho, Kaitila, Kotilainen (2004)** *The effects of EU enlargement on the strategies of Finnish companies (EU:n laajenemisen vaikutukset suomalaisten yritysten strategioihin*) | **Some main findings:** Of Finnish companies with existing business ties with the Baltic States and Poland 55 % were planning to increase exports, nearly 30 % of firms were planning to move some of their operations to the new member countries. Growing markets were the factor that was considered to offer the most possibilities for business activities. The second most important factor was considered to be the low level of costs. |
| **The Central Chamber of Commerce of Finland (2005)** *Finnish companies' views on the markets in the Baltic States and Poland (Suomalaisyritysten näkemyksiä Baltian maiden ja Puolan markkinoista)* | **Some main findings:** Estonia is the most significant market area of the four studied countries. EU membership was considered as a positive development in all of the countries within the survey. The significance of all the four countries, and especially the significance of Poland, is expected to increase substantially over the next five years. Companies will increase exports, establish subsidiaries and cooperate with local companies. |
| **Center for Markets in Transition CEMAT (2005)** *Internationalization of Finnish firms in the Baltic States in 1987-2004 and Finnish investment experiences from Estonia.* | **Some main findings:** The location was considered to play an important role in the internationalisation of Finnish companies to the Baltic States. Estonia has been the easiest country to enter among the Baltic States and it has served as a test market for internationalisation for many Finnish firms. Estonia is, however, no longer the only interesting target market, but rather serves as a stepping stone to Russia and other Baltic States. |

## 1.3 Research questions and objectives

This study is twofold as it incorporates two interrelated objectives. Firstly this study aims at describing the significance of the Baltic States and Poland in the internationalisation of small and medium-sized companies in Southwest Finland. The thesis is to provide information on entry/operation modes used focusing on the Baltic States and Poland and to analyse the significance of marketing and investment operations in that area for the studied companies. In addition to finding out the current state of the internationalisation of SMEs in Southwest Finland, this thesis collects and analyses valuable information also on the future trends in the internationalisation strategies of companies.

Several theories and concepts have been suggested in the literature to capture the process of internationalisation as well as reasons for companies to internationalise. The studies concerning internationalisation of small and medium-sized companies mostly utilise the process model of internationalisation as a framework (Coviello & McAuley 1999). Therefore the second objective of this thesis is to assess whether the Eclectic paradigm also referred to as OLI paradigm can explain or predict the SME entry mode choice within the geographical setting of this thesis.

The research questions and sub-questions are defined in the following:

1. What is the significance of the Baltic States and Poland in the internationalisation of small and medium-sized companies in Southwest Finland?
   - What is the significance of the Baltic States and Poland in the exporting activities of small and medium-sized companies in Southwest Finland in 2004 and 2010?
   - What is the significance of the Baltic States and Poland for small and medium-sized companies in Southwest Finland in terms of foreign investments in 2004 and 2010?

2. Can Eclectic paradigm explain or predict the internationalisation of small and medium-sized companies in the research setting of this thesis?

The research hypotheses relating to the second research question will be addressed in Chapter 2.6.

# 2 THEORETICAL BACKGROUND

## 2.1 Defining internationalisation

Before going further, however, it is necessary to define the concept of internationalisation. Different definitions for the concept are found in the literature. All encompassing definition is yet to be found. Internationalisation has been described as the outward movement in a firm's international operations (Turnbull 1987). Internationalisation has also been defined as *"the process of increasing involvement in international operations"* (Luostarinen &Welch 1990, 249). Both inward and outward sides of the internationalisation process are included in this definition. Calof and Beamish have defined internationalisation as being *"the process of adapting firms' operations to international environments"* (Calof & Beamish 1995, 116). This definition takes into account that the process of international involvement is not necessarily increasing continuously and changes in the strategies of firms may lead to discontinuance of some operations.

This thesis will concentrate solely on the outward internationalisation of the SMEs in Southwest Finland. However, the author considers Calof and Beamish's definition of internationalisation addressing most accurately the globalising phenomenon that is affecting firms in a modern day.

## 2.2 Internationalisation modes

As this thesis takes a look at the exporting and investing activities of the small and medium-sized companies in Southwest Finland, the entry mode questions will be addressed and discussed in the following.

When firms decide to expand their activities to foreign countries they have to make a decision on which entry mode to choose. This is considered to be a critical strategic decision, which will affect firm's performance (Lu & Beamish 2001). Entry mode is a key concept in internationalisation. The international entry mode choice will to large extent be included in the research on the firm's internationalisation process (Andersen 1997, 28). According to Root (Root 1987, 5), international market entry mode is an institutional arrangement that makes it possible for a company's products, technology, human skills, management, or other resources to have an entry in a foreign country. Firms entering foreign markets can choose from variety of different entry modes from different forms of exporting to different forms of foreign direct investment. These

different entry modes are presented later in this chapter. Entry modes vary in the degree of control, which means the ability to influence systems, methods and decisions. Control, then, leads to assuming transaction costs associated with resource commitment (Anderson & Gatignon 1986). Several frameworks that identify different constructs influencing the entry mode decision have been developed in the field of internationalisation research. These will be discussed later.

There are different approaches to how to classify different entry modes. Root (1987) classifies entry modes into three categories: export entry modes, contractual modes and investment entry modes. Luostarinen (1977; 1994), on the other hand, categorises outward-going international operations into four categories: non-direct investment marketing operations, non-direct investment production operations, direct investment marketing operations and direct investment production operations. Pan and Tse (2000) suggest entry modes to be classified hierarchically. (Figure 1)

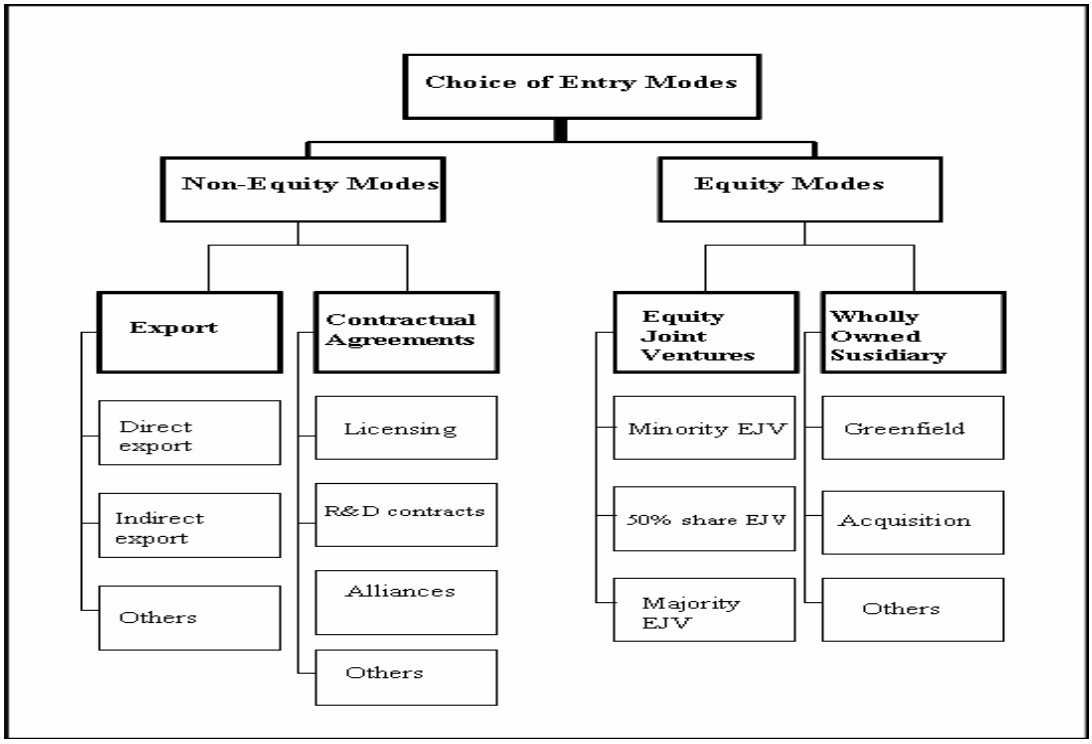


**Figure 1 A hierarchical model of choice of entry modes (adapted from Pan & Tse 2000, 538)**

The hierarchical categorisation classifies entry modes first as equity-based and non-equity based, then, in the next level dividing equity modes into wholly owned operations and equity joint ventures when non-equity modes are divided into export and contractual agreement. This classification is based on the dramatically different nature of equity and non-equity modes. Exporting includes both direct export mode and

indirect export mode. Exporting is the most commonly used foreign market entry mode (Luostarinen & Welch 1990, 20; Hollensen 2001, 224). A company encaged in direct exporting has a direct contact to the first intermediary in the target country and takes care of all of the duties involved in exporting. Direct exporting is more active way of internationalisation than indirect exporting. Indirect exporting involves no international marketing or sales operations. It also minimises the risks involved in internationalisation and offers small and inexperienced companies possibilities for entering international markets. (Luostarinen & Welch 1990, 22-25.) There are five different ways a company can be encaged in indirect investment. A company can use the help of an export buying agent, trading companies, broker, export management companies or piggybacking. (Hollensen 2001, 245-251.)

Licensing, R&D contracts and alliances are, then, contractual agreements. In licensing licensors give in exchange of a fee the licensee e.g. rights for a patent or a trademark. Licencing is a fairly inexpensive way to enter foreign markets and the risks are quite low. (Hollensen 2001, 265-267). Alliance, on the other hand, is a partnership of two or more companies. Alliances differ from joint ventures as the companies do not have any capital in the alliance. Alliance is a useful way of entering the foreign markets for those companies that do not wish to assign any of the resources in the international operations. (Hollensen 2001, 273.)

Equity joint ventures include minority, majority and 50% share equity joint ventures. Greenfield investments and acqusitions belong to the category of wholly owned subsidiaries. (Pan & Tse 2000, 535-534). Equity modes require resource commitment in the overseas location (Anderson & Gatignon, 1986) as well as a direct management of the overseas establishment with interaction with local parties (Hennart, 1988). An equity joint venture is a new company created by investors that share ownership and control (Hollensen 2001, 273). The degree of ownership affects the possibilities of a firm to have an influence in the operations. In a joint venture company can share the risks involved inoperating in the international markets.

Wholly owned subsidiaries, on the other hand, can be either greenfield investments or acquisitions. A company makes a greenfield investment when it establishes a separate production unit in a foreign country (Luostarinen & Welch 1990, 156). In acquisitions, on the other hand, a company buys a controlling share of another company.

When firms consider a decision between equity modes and non-equity modes, they need to assess the investment risk and return, adaptation to local environment, control of operation and the location choice among others. Equity modes differ from non-equity modes in risk, resource commitment, return, control and other characteristics. According to Pan and Tse (2000, 539) location factors are important for the choice of

equity modes whereas they are not especially important for the choice of non-equity modes (Pan & Tse, 2000).

## 2.3 Literary review on internationalisation theories

There are many theoretical avenues in the field of internationalisation studies. Wilska (2002) has collected the main theoretical avenues for the study of FDI in a form of a map of connections between different theories. This collection, in addition to addressing the research focusing on explaining FDI activity, also illustrates well the connections between existing internationalisation theories and the historical development of internationalisation research.

Having knowledge of different avenues of the internationalisation research is necessary in order to be able to place this study to its theoretical roots. Therefore, Wilska's mapping of internationalisation theories has been chosen to serve as a short review on the theoretical roots of the research area this study is concerned with. Figure 2 illustrates the connections between theories. The Eclectic paradigm will be discussed separately and more thoroughly as it serves as a theoretical framework on which the research hypotheses relating to the second objective of the study are based on.

Theories explaining the location of economic activity originate from classical economics. Smith, Ricardo, von Thünen and Weber are the pioneering authors developing theories concerning the locational aspect. The locational aspect is a part of almost every study concerning actions of international firms. (Wilska 2002)

*Market power approach* has been introduced and discussed in the 1960's and 1970's by for instance Hymer (1960). The basic idea of the market power approach deals with existence of internally transferable advantage, which allows quasi-monopolistic opportunity to enter host country markets (Buckley & Casson 1985).

*The product life cycle theory* by Vernon (1966) takes into account the interaction occurring between the location-specific advantages, product life cycle and firm-specific advantages (Wilska 2002).

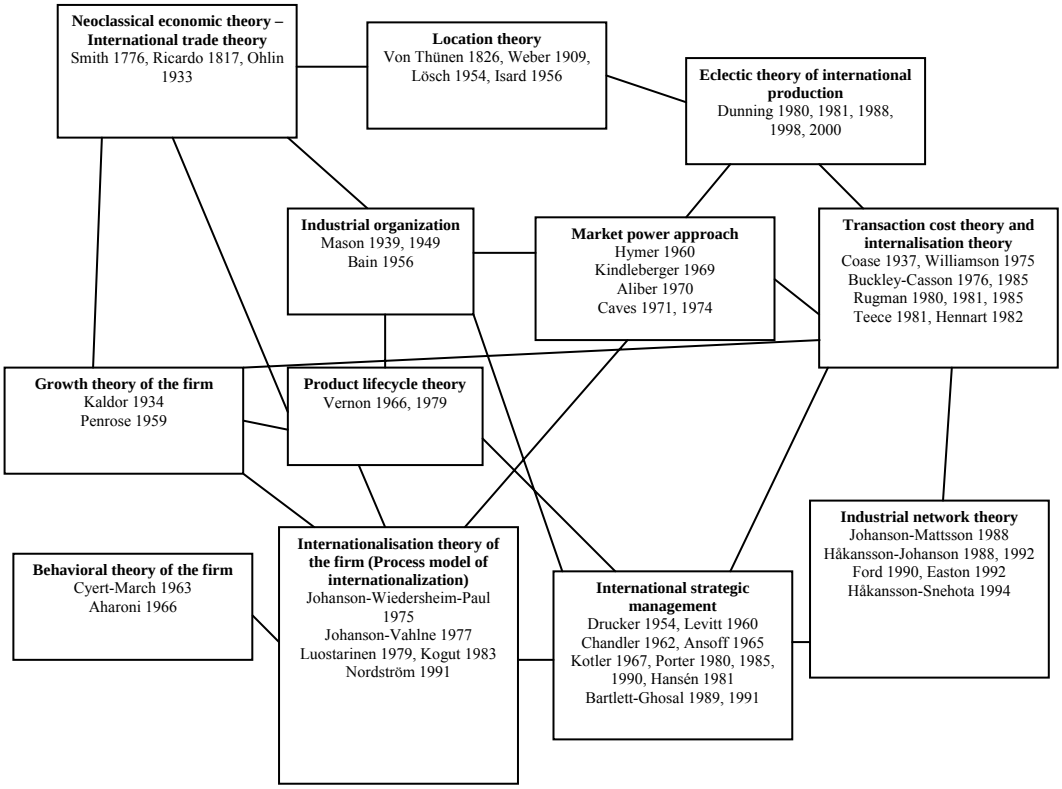


**Figure 2 Main theoretical avenues in the field of internationalisation research (adapted from Wilska 2002, 29)**

*International strategic management* developed among others by Kotler (1967) and Porter (1980) is based on the concepts in the fields of marketing, economic, organisational behaviour and psychology research. *Industrial network theory* originating from the work of Johanson and Mattsson (1988) and Håkansson and Johanson (1988), on the other hand, focuses on internationalisation, relationships in industrial markets as well as distribution channels. (Wilska 2002.)

*The process model of internationalisation* also referred to as the Nordic School basing on the work of Johanson and Wiedersheim-Paul (1975), Johanson and Vahlne (1977) and Luostarinen (1979) has its roots in *the behavioural theory of the firm* originating from the work of Cyert and March (1963) and the *growth theory of the firm* by Penrose (1959). Business operations in overseas markets is seen inherently risky because of the different political, cultural and market systems that the company must adapt to; therefore, the firm increases its international involvement gradually. When the firm first enters a foreign market, it is most likely to choose a low commitment mode such as exporting. The process moves on as the firm increases its knowledge about the foreign markets and operations and increases the commitment of resources to the

markets. (Johanson & Vahlne 1977). Thus, the Nordic studies indicate there is a tendency to change the method or methods by which companies serve foreign markets as companies increase their international involvement. (Luostarinen & Welch 1990, 251). The Nordic studies also indicate, that not only do companies gradually increase their involvement in one country after encaging in activities in that country, but they also expand to new countries in a gradual fashion by expanding to those countries which are psychically close first (Johanson & Vahlne 1990).

## 2.4 Eclectic paradigm and entry mode choice

*The eclectic framework* which serves as theoretical framework of the hypothesis setting relating to the second research objective of this study is a multi-theoretical approach for studying entry mode decisions. Dunning (1980, 1981, 1988a, 1993) first proposed the eclectic framework also referred to as OLI paradigm for explaining international production. This framework integrates existing theoretical perspectives on multinational enterprises' foreign direct investment activities.

According to Dunning three factors influence a firm's choice of entry-mode: ownership advantages, locational advantages and internalisation advantages. Ownership advantages are a firm's skills such as the ability to develop differentiated products, and assets such as the firm's size. The internalisation advantages come from costs of choosing a hierarchical operation mode over an external mode. (Dunning 1993.) These costs have also been referred to as transaction costs and are the core element of transaction cost and internalisation theory (see eg. Williamson 1981; Anderson & Gatignon 1986). Assuming the company possesses both ownership and internalisation advantages, it is in the global interests of the company to utilise these advantages utilising at least some factor inputs outside its home country. These advantages are called locational advantages. (Dunning 1988a, 25-26.) Similarity of market infrastructures and culture as well as the availability of lower production costs are measures of location advantages (Dunning 1993). Locational advantages also reflect the attractiveness of the specific country in terms of its market potential and investment risk (Root 1987). The concept of locational advantage is considered likely to have an influence on the international market selection yet the nature of the interrelationship is yet unknown (Andersen 1997, 35).

The eclectic paradigm has been referred to widely in the literature. Empirical support for the paradigm is increasing. A number of researchers have found empirical support for the OLI paradigm for large multinational enterprises (e.g. Dunning 1988b; Agarwal & Ramaswami 1992). Past research has identified several ownership resources that may impact international entry mode choice. These include the size of the firm, the extent of

international experience and the ability to produce differentiated products or services. The studies have tended to find a positive relationship between firm size and the use of equity-based modes of entry. (Agarwal & Ramaswami 1992; Brouthers et al. 1999.) Experience in international markets has been shown to be an important ownership advantage which tends to influence entry mode choice (Anderson & Gatignon 1986).

Location advantages have been conceptualised e.g. as a market's sales and growth potential. Entry mode researchers have found that equity modes are preferred in high growth markets (e.g. Kwon & Konopa 1993; Pan & Tse 2000). Internalisation has been conceptualised as contractual risk such as the relative costs of making and enforcing a contract, the risk of disseminating proprietary know-how and the costs of controlling and monitoring product or service quality (e.g. Agarwal & Ramaswami 1992; Brouthers et al. 1999).

Brouthers et al. (1999) among others have examined Dunning's OLI variables in large multinational enterprise context and attempted to see if relationship between and among Dunning's eclectic framework affecting mode choice exists. Their findings suggest that OLI framework can be used for predicting entry mode choice. They found also, that firms perceiving high location-specific, ownership-specific and internalisation advantages tend to prefer more integrated mode of entry such as joint ventures and wholly owned subsidiaries. On the other hand, firms that perceived these advantages low preferred less integrated modes such as exporting.

However, the paradigm has also received some criticism. It has been criticised of being static in nature and thus being unable to explain long-term changes in the firms' activities (e.g. Johanson & Vahlne 1990; Melin 1992). Hill et al. (1990), on the other hand, criticise the paradigm and argue that a unifying conceptual framework, which would allow the relationships between different factors to be analysed is needed.

## 2.5 Internationalisation of small and medium-sized firms

Though SMEs are active in international markets, the internationalisation literature has been mostly concentrating on the large multinational company as the unit of analysis. However, interest in SME internationalisation has been increasing during the recent years.

It has been argued that SME's often lack sufficient resources, skills and experience for operating on international markets (Burton & Schlegelmilch 1987). Studies have shown that SMEs face internal constraints to international growth in the form of limited capital, experience, time, management and information sources (Buckley, 1989). Size is not necessarily, however, a barrier to internationalisation (Calof, 1994). Driving forces of globalisation have been considered having an influence on the internationalisation of

SMEs by for instance diminishing barriers (Knight, 2001). It has nevertheless been argued that in the context of globalisation SMEs do have a disadvantage compared to larger companies due to their insufficient resources and inadequate management skills (Etemad, 1999).

Whether theories on entry mode selection of larger firms can be applied to SMEs is still unclear in the SME literature. It has been suggested that as SMEs differ from larger firms, their entry mode choice may also differ (Erramilli & D'Souza 1993). A study by Zacharakis (1997) suggests that SMEs use non-equity modes of entry, such as exporting and licensing, because they have few managerial and financial resources. Also other studies have found that firms with few resources tend to rely on non-equity modes of entry which are less resource-intensive (Contractor 1984). However, several studies examining the SME internationalisation have shown a strong connection between international experience and the use of equity entry modes (Nakos & Brouthers 2002).

According to the review on SME internationalisation studies by Coviello and McAuley (1999), most of the SME internationalisation studies are based on the Stages Model. Stages Model in the context of SME internationalisation have been studied and supported among others by Dalli (1995) and Bell (1995). It has been suggested that SME entry mode selection has received little attention in the literature (Burgel & Murray 2000). Futhermore, a recent study by Lu and Beamish (2001) found that entry mode type is significantly related to SME performance. A study by Rasheed (2005) found that firms will have a higher rate of international revenue growth using exporting as foreign market entry mode in growing foreign environments. Therefore, aqcuiring more knowledge about the SME entry mode selection is essential.

The studies concerning the international entry mode choices of both large multinationals as well as small and medium-sized firms that test the applicability of OLI paradigm use various kinds of operationalisations. The findings may therefore be influenced by the choices on how to operationalise the three advantages. The studies concerning SME entry mode choices using the Eclectic paradigm as a framework are few. Some of them are collected in Table 3. As these studies serve as a reference point to the study at hand, the operationalisation used in these studies are shortly discussed in the following.

Brouthers et al. (1996) applied the Eclectic paragdigm to small US computer firms. They operationalised ownership advantages among other as firm experience and firm size. Market infrastructure and market demand were among the operationalised location advantages. Hollenstein (2005) applied the OLI paradigm to Swiss companies. Hollenstein used six operationalisations on ownership advantages. These were among others R & D performing and gross capital income per employee. Firm size was, in contrast to numerous studies on large multinationals, operationalised as internalisation advantage. Hollenstein utilised additionally several operationalisations on location

advantages. These included for example share of firms confronted with difficulties in hiring qualified manpower.

Nakos and Brouthers (2002) applied OLI paradigm to SME entry into Central and Eastern Europe. They used three operationalisations to capture ownership advantages. These were firm size, international experience and the ability to produce differentiated products. Location advantages were operationalised as market potential and investment risk.

**Table 3 Studies on SME international market entry mode choice**

| | | |
|---|---|---|
| **Brouthers, Brouthers & Werner (1996)** *Dunning's Eclectic Theory and the Smaller Firm: the Impact of Ownership and Locational advantages on the Choice of Entry-modes in the Computer Software Industry* | The paper investigates the entry mode selection activities of small US computer software firms based on Dunning's eclectic framework. | **Findings:** Ownership and locational advantages influence small and medium-sized firms' entry mode decisions in a similar way that they influence larger firms' decisions. As the ownership and location advantages increased, the firms tended to utilise more integrated (wholly owned) modes of entry. |
| **Nakos & Brouthers (2002)** *Entry Mode Choice in Central and Eastern Europe* | The paper uses Dunning's eclectic framework to examine SME entry into Central and Eastern Europe (CEE) | **Findings:** Eclectic framework is useful in predicting SME entry mode selection in CEE. |
| **Hollenstein (2005)** *Determinants of International Activities: Are SMEs Different?* | The study applies Dunning's OLI paradigm to Swiss companies. | **Findings:** The study confirms that SME FDI is consistent with OLI paradigm, in case of exporting only O advantages are relevant. |

Criticism towards the current SME internationalisation research exists. It has been argued that there are not many empirical studies, which compare the internationalisation behaviour of small companies with that of large firms systematically. Therefore, the SME-specific behaviour of internationalisation identified in SME-oriented studies may not be as size-specific as is often concluded. (Hollestein 2005, 432). Also, the majority of studies are derived from the United States where the definition of size differs from that of in the European Union (Fillis 2001, 767).

## 2.6 Research hypotheses

In order to be able to fullfill the second objective of this thesis it is necessary to formulate research hypotheses. A hypothesis asserts the relationship between concepts. (Bouma & Atkinson 1995, 37). The theoretical framework is drawn from the Eclectic paradigm. The hypotheses developed for this study are based on previously reviewed studies that use the Eclectic paradigm as a framework. The operationalisations as well as used measurements are discussed more in the next chapter concerned with research methodology.

This study focuses on the ownership (O) and locational (L) advantages. Internalisation advantages are not included in the analysis as the author considered these diffucult to measure. The OLI paradigm is developed to explain international production and therefore the chosen ownership and locational variables are expected to affect mainly the decision to invest. O advantages have nevertheless been noticed to additionally have an effect on the use of export entry mode (Dunning 1988a, 28; Hollenstein 2005).

O advantages are expected to be positively related to international activities. In this study O advantages are represented by firm size and international experience. Input related labour costs and market related market demand and market growth were chosen to represent the L advantages. These are also expected to be related to internationalisation and especially investment choice.

Table 4 collects the research hypotheses relating to the second objective of this study. The expected direction of connection is represented by plus or minus sign. The table includes information on the scale of the data and the statistical test used in the analysis. These are discussed in the following chapter concerning the research design. In the table exports in 2004 and in 2010 and investments in 2004 and in 2010 are presented separately. The year 2004 is considered to represent the current day, and provides basis for analysing the explanatory power of OLI paradigm. Year 2010 represents the future and thus provides basis for analysing the predictive powers of the tested paradigm.

**Table 4 Hypothesised connections between ownership and locational advantages and internationalisation in the Baltic States and Poland**

| | Exporting | | Investing | | |
|---|---|---|---|---|---|
| **Explanatory variable** | **2004** | **2010** | **2004** | **2010** | **Scale and used test** |
| | | | | | |
| *O advantages* | | | | | |
| | | | | | |
| Firm size measured by number of employees | + | + | + | + | Nominal by nominal, $x^2$ |
| Firm size measured by turnover | + | + | + | + | Dichotomous nominal by ratio, Pearson correlation |
| International experience measured by value of exports from turnover | + | + | + | + | Dichotomous nominal by ratio, Pearson correlation |
| International experience<br>• Baltic States and Poland<br>• Others | | + | | + | Nominal by nominal, $x^2$ |
| *L advantages* | | | | | |
| Market demand | + | + | + | + | Dichotomous nominal by interval, Pearson correlation |
| Prospects for market growth | + | + | + | + | Dichotomous nominal by interval, Pearson correlation |
| Labour costs | | | - | - | Dichotomous nominal by interval, Pearson Correlation |

The research hypotheses including both explanatory and predictive aspects as illustrated in Table 4 in the written form are as follows:

*Hypothesis 1: The higher the ownership advantages, the more likely it is that a company chooses to export to the Baltic States and Poland.*

*Hypothesis 2: The higher the ownership advantages; the more likely it is that a company chooses to invest in the Baltic States and Poland.*

The larger the company in terms of the number of employees and the turnover the more likely it is that the company will export and/or invest in the focus area. The larger the share of exports from turnover or the experience of operating in the Baltic States and Poland or other international markets, the more likely it is that a company will export or invest in the focus area. If a company has experience in the focus area or other

international market areas in 2004, the more likely it is that the company will export or invest in the focus area in the future (year 2010).

*Hypothesis 3: The higher the location advantages the more likely it is that a company will choose to invest in the Baltic States and Poland.*

The more positively the manager of a company perceives the market related location advantages, the more likely it is that the company will invest in the focus area. The lower the manager of a company considers the labour cost level to be, the more likely it is that the company will invest in the focus area.

*Hypothesis 4: The higher the market related location advantages the more likely it is that a company will choose to export in the Baltic States and Poland.*

The more positively the manager of a company perceives the market related location advantages, the more likely it is that the company will export to the focus area. Hypothesis 4 is based on findings in the empirical studies reviewed in Chapter 1.3.

The hypotheses are designed to test only the choice between non activity and activity within an individual entry mode context. The preference of choosing one entry mode over the other is not tested in this study.

# 3 RESEARCH DESIGN

## 3.1 Research methodology

The methodological choices are made according to the research problem. Quantitative methods can be used when aiming at describing and explaining a phenomenon (Hirsjärvi et al. 1997, 136). This thesis uses quantitative methods for meeting the research objectives stated earlier. The study is both descriptive and explanatory in nature. In the first descriptive part the significance of the Baltic States and Poland in the internationalisation of small and medium-sized firms in Southwest Finland is described and analysed using crosstabulations and distributions of means and percentages. After the descriptive part, the collected data is used to test the applicability of ownership advantages and location advantages in explaining and predicting the entry mode choices of Southwest Finnish SMEs in the Baltic Sea region's new EU countries.

## 3.2 Data collection

This study approached the research proposal by sending a questionnaire to small and medium-sized companies in Southwest Finland[2] that already are encaged in exporting activities. These companies were chosen for the reason that the most of the business ties with new EU members will most likely be based on activities of those firms. Empirical data was collected during August and September 2005.

The names and addresses of the companies were retrieved from Statistics Finland's database on exporting companies. The small and medium-sized firms were defined to be firms that employ less than 250 people. EU council recommends this definition and it is widely used in the European Union. According to the same recommendation companies that employ less than 50 employees can be defined as small companies and those firms employing less than 10 people can be defined as microcompanies. Those companies that have their registered office in Southwest Finland were considered as Southwestern companies. The total population of exporting small and medium-sized Southwestern firms was 574 companies. As the number of companies included in the total population was relatively low, the questionnaire was sent to the whole population. Letters

[2] Southwest Finland consists of 54 municipalities, which are: Alastaro, Askainen, Aura, Dragsfjärd, Halikko, Houtskari, Iniö, Kaarina, Kemiö, Kiikala, Kisko, Korppoo, Koski TI, Kustavi, Kuusjoki, Laitila, Lemu, Lieto, Loimaa, Marttila, Masku, Mellilä, Merimasku, Mietoinen, Muurla, Mynämäki, Naantali, Nauvo, Nousiainen, Oripää, Paimio, Parainen, Perniö, Pertteli, Piikkiö, Pyhäranta, Pöytyä, Raisio, Rusko, Rymättylä, Salo, Sauvo, Somero, Suomusjärvi, Särkisalo, Taivassalo, Tarvasjoki, Turku, Uusikaupunki, Vahto, Vehmaa, Velkua, Västanfjärd and Yläne. (Statistics Finland 2005)

containing the questionnaire with a covering letter addressing the purpose of the study were sent to the executive managers of the companies.

The mail survey was carried out first in mid-August and later again in mid-September. Additionally, the companies were offered a possibility for answering the questionnaire by filling up an internet-based version of it. However, only a few companies used the internet-version. As the response rate was quite low during the first mailing, the same questionnaire was sent again to those companies whose responses had not been received during the first round. The response rate after the first mailing was 10%. The second mailing increased the total response rate to be 17% i.e. the study is based on the response of 100 companies.

## 3.3 Questionnaire development

The questionnaire was developed based on practical and theoretical considerations and was composed in Finnish, as the author expected most if not all of the survey population to have a good command on that language. The Finnish version of the questionnaire can be found at Appendix 1. The questionnaire was translated in English in order to provide a possibility of replicating the study in foreign settings. The English translation can be found at Appendix 2.

The first part of the questionnaire was designed to collect information mainly on the exporting and investing operations of the surveyed companies and the second part collected information on the managers' perceptions on the markets and labour costs in the Baltic States and Poland. In addition to questions relating to Poland and the Baltic States selected geographical areas were included in both parts of the questionnaire to allow a possibility for comparisons. First seven questions collected background information such as the size of the firm and the turnover including the estimations on the turnover in 2010 as well as the share of different geographical areas of the turnover.
In order to find out the relative significance of different areas in exports and investments the questions 11 (relating to exports) and 16 (relating to investments) were designed as follows. Eight different areas including different countries as well as larger areas were chosen including Estonia, Latvia, Lithuania, Poland, Russia, North-America, Asia and the EU as well as European countries that are not members of the European Union. As the question was designed in a way that would allow assigning percentages to different areas so as the total sum would amount to 100%, also category 'Other' was included in. For the same reason the European Union was defined in this case to be excluding Estonia, Latvia, Lithuania and Poland. Also, the European non-members were in this case defined to be excluding Russia. This same categorisation is used in the figures

illustrating the findings and must be taken into consideration. The figures concerning exporting and investing in the European Union and elsewhere Europe are, in reality, higher. The managers of the SMEs were asked about the value of exports and investments in euros. The geographical distribution of the total values was designed to be calculated by using the information derived from the questions 11 and 16. However, many of the respondents did not assign the percentages appropriately (so as the sum would amount to 100%). Therefore, the author stresses that the results relating to the values of exports and investments may not represent the whole population sufficiently. Thus, these empirical findings must be assessed with caution. Furthermore, the failure of receiving high quality information on the percentual shares leads to the need of recoding the data to be able to salvage at least some of the information value of the invalid responses. However, recoding of the data affects negatively to the quality of the data and therefore also to the use of statistical tests. This issue will be discussed more in the following.

## 3.4 Data analysis

Measuring in the context of statistical analysis is defining the characteristics of statistical units (Heikkilä 1998, 79). Measurements are created based on existing theories. To be able to create a working measurement, the central concepts need first to be developed and operationalised. (Metsämuuronen 2000a, 49.) For the purposes of this study, locational and ownership variables of interest were chosen and then operationalised to be used as measures. The operationalisations were collected with in connection with the research hypotheses in Table 4.

Direct measures of current market demand, the prospects for market growth and labour costs and their expected development are obtained in this case by evaluating managerial perceptions. Locational advantages are often treated as constant across companies for a given host country. Managerial perceptions, however, can be useful for assessing the location advantages of a specific country. Therefore, this study will measure those variables as a function of managerial perceptions. These perceptions may be different due to different reasons, such as the differences in managers' past experiences in that country, individual bias or level of knowledge about that country. Studies in the field of behavioural research argue that managerial perceptions effect internationalisation decisions.

The questions 1 to 16 and 20 of the questionnaire are measured using both nominal scale as well as ratio scale. Nominal scale variables can be placed under different categories and no calculations can be done based on nominal values. Ratio scale variables have a clear zero point and can be used in various types of calculations.

(Heikkilä 1998, 79.) In this case nominal variables include for example the size of the company and ratio scale variables for example the value of exports. The questions 17 to 19 are perceptual measures in an ordinal scale from value 1 to value 5. Ordinal scale variables can be placed in an order, but the actual distance between values cannot be measured. If it is necessary to calculate means for the purposes of providing a general picture of the findings, the scale must be designed so as the distances between values are as even as possible. Then the variable can be managed in the same way as the interval scale variables. The distances between values of an interval scale are known and some calculations are possible. (Heikkilä 1998, 79-80.) The scales of questions 17 to 19 were, therefore, designed in a way that allows considering the distances between the perceptual values to be even. Thus, only the extreme values 1 and 5 were defined by opposite statements. Therefore, the perceptual values in between of the two extremes can be considered to be distributed evenly.

The collected data was analysed using SPSS as a tool and described by using distributions of means and percentages and crosstabulations. The connections between Eclectic paradigm and entry mode choices were analysed and tested using crosstabulations and Chi-Square test or Pearson correlation depending on the level of available data. As the response-rates between questions as well as sufficient answers within questions varied, in some cases even considerably, the percentages presented in this study are calculated based on the actual number of responses in question and not the total response rate of the study. This way the percentages are more valid. In the case of questions where the managers were asked to assign shares of exports or investments from the total values to different geographical areas many of the respondents, as mentioned, did not assign shares that would amount to the total of 100%. If those answers would be included in the analysis, the percentual shares would be biased. Therefore, when analysing value related questions those responses that did not meet the requirements were not used. The questions and answers concerning the shares were recoded from ratio scale to nominal scale to show whether the companies export or have investments in a country with value 0 representing no activity and value 1 representing either exports or investing. Also those answers that were excluded from the value-related analyses were taken into account in the recoding. Therefore, shares of different areas from the value of exports or investments are not straightforwardly comparable with the number of exporters and companies having foreign investments.

As said, in order to find out whether the chosen location and ownership factors affect the entry mode choice of small and medium-sized companies, two measures of association, Chi-square test $X^2$ and Pearson correlation coefficient, were chosen to serve as statistical tests. These tests examine whether or not there is an association between characteristics. The tests, however, cannot prove causality, but merely describe the strength of the association between variables. Though the tests cannot prove causality,

in the analysis causality is assumed to exist based on the research hypotheses derived from the theoretical framework. Chi-square tests can be conducted using any level of data, that is nominal, ordinal, interval or ratio. (Riley et al. 2000, 217-218.) Pearson correlation requires at least interval scale data. However, dichotomous nominal scale variables can also be used in correlations. (Heikkilä 1998, 193.)

Crosstabulation is the simplest way to analyse the connection between two variables. Chi-square test aids in assessing whether there exists a difference between variables or does the difference stem from coincidence. In other words, $X^2$ measures the independence of two variables. Null hypothesis is, that there exists no dependence between variables. The higher the result, the more unlikely it is that there would be no dependence between variables.

Correlation coefficient can have values between -1 and 1 which indicates the direction of relationship between variables. The closer the value is to zero, the less there is connection between variables. The correlation can be considered extremely high when the coefficient is between 0.8 and 1. Values between 0.6 and 0.8 represent high correlation, whereas values between 0.4 and 0.6 represent moderate correlation. (Metsämuuronen 2000b, 45.)

Furthermore, the relatively low response rate, in its part, hinders the possibility of proving dependencies between variables as some of the cell counts required for statistical testing are not sufficient. The expected frequency counts often fall below five. The minimum requirement for using the Chi-Square test is that at maximum 20% of the expected frequency counts may fall below five. The data is often regrouped in order to overcome the hindrance by increasing the cell count (Riley et al. 2000, 218). In this case, when possible, the data was regrouped to meet the requirements of used tests. However, the recoding of the data from higher level data to lower level nominal data due to the insufficient responses affects negatively analysing the dependencies.

Statistical tests aim at assessing whether or not research hypotheses are true in a population. Whether testing is meaningful in case of research on whole population has been discussed in the literature. However, statistical tests are based on finding out the probability of random error and can be useful also in case of studies including the whole research population. (Heikkilä 1998, 181.)

Table 4 in the previous chapter presented the hypothesised connections between ownership advantages and locational advantages and the internationalisation of SMEs in the Southwest Finland towards the Baltic Sea Rim's new EU countries as well as the scale of data and the statistical test used. The original idea of the study was to use the ratio and interval scale data and study the correlations between variables. However, in most cases the data needed to be recoded to nominal scale. Therefore the used tests are chosen based on the availability of data.

Issues concerning the recodings and recomputations of data performed in order to ensure sufficient quality data that can be processed for the statistical tests will be discussed in the following. As mentioned the overall response rate was quite low, which complicates the data analysis and the generalisability of the results of the study. Also, the question-related response rates varied substantially between the different questions. Therefore, the base of the analyses both in the descriptive part as well as explanatory part is served by nominal dichotomously coded variables stating no or yes to exporting and investing activities. In case of descriptive analysis nominal data can provide rich enough information. However, in case of statistical testing problems may arise. Nominal data is difficult to process as it cannot be used in most of statistical tests. The dichotomous variables concerning exporting and investment decisions were present in each of the tests. As the Baltic States and Poland were treated separately in the questionnaire, the recoded nominal variables were recomputed to be representing the whole area for the purposes of statistical testing. In those cases when higher level scale variable was available and usable, Pearson correlation tests were conducted as dichotomous nominal variables can be utilised in this kind of testing. In those cases when only nominal data was available crosstabulations tested with Chi-square test were utilised.

In case of testing the connection between firm size measured by the number of employees no recoding of the test variable was needed. The firm size was categorised in three nominal categories including microcompanies, small companies and medium-sized companies. In order to test the association of this variable with the decision to export or invest the variables were crosstabulated and then tested using $X^2$ test. Firm size was tested again by running correlation test between firm size measured by turnover in 2004 and the entry mode decisions. Using turnover measured in euro value enabled exploiting higher quality testing as the turnover represented higher level ratio scale variable. International experience was measured by value of exports from turnover which was considered to represent the level of international involvement and thus also the experience. The percentual share representing also ratio level data was correlated with the decisions to export and invest. No recoding was necessary.

The international experience was tested again placing dichotomous nominal variables expressing exporting to the Baltic States and Poland and exporting to other international market areas in 2004 against exporting and investing in the Baltic States and Poland in 2010. The variables were crosstabulated and tested with Chi-square test. The difference between the two ways of testing international experience, in addition to different test methods, was also that the first test could examine both explanatory and predicting power of the international experience, whereas the second was designed to test only the predicting power.

In case of locational advantages the interval scale data on the perceptual values concerning each of the four countries separately was recomputed to include all of the values into one variable representing the whole area of the Baltic States and Poland combined. The individual values were summed up, thus the values remain at interval scale. Summing up the values does not hinder testing the association between locational variables and the entry mode choices as the recomputed value illustrates well the level of the locational advantages.

The development in labour costs in the four countries until 2010 present in the questionnaire could not be used in the analyses as this variable was unrecodable. This variable is, however, present in Appendix 3, which provides more in-depth descriptive analysis on the managerial perceptions on the studied locational variables. The statistical significance of the test results[3] founds the basis of the analysis in case of testing the applicability of Eclectic paradigm in the geographical setting of the study.

## 3.5 Evaluation of the survey

Survey is a practical way of gathering wide research material at a relatively low cost. However, surveys have weaknesses such as non-response and possible interpretation problems arising when the questions are too difficult for the respondents. (Hirsjärvi et al. 2004, 184.) Non-response problem affects the general response rate as well as the question-related response rate.

External validity of a survey has to do with the question of whether other researchers would interpreter the results in a same way as the author (Heikkilä 2004, 186) and can the results be generalised to other populations or settings (Ghauri et al. 1995, 33). Issues relating to external validity will be addressed in the following.

The questionnaire consisted of three pages and 20 questions relevant to the study. The questionnaire was designed to be short for the purposes of increasing the response rate. The covering letter informed about the purpose of the study and about the possibility to answer using a web-based questionnaire. A pre-paid return envelope was enclosed in the letter sent to the research population. These were aimed at increasing the response rate and the validity of the study.

The response rate was not very high being 17%. However, low response rates are common nowadays as increasing number of survey studies directed at companies may

[3] Null hypothesis H0 states that there is no dependence between variables. H1 then states that the there exists dependency between variables. Significance (Sig.) measures the statistical reliability of making right conclusions when choosing between accepting H0 or H1. Most commonly used significance levels are 0,05 and 0,01. This thesis adopts the significance level 0,05 and therefore the H0 will be rejected if the significance is 0,05 or below.

irritate potential respondents (Hurmerinta-Peltomäki 2001, 93). Additionally, small-business research has typically been suffering from low return rates (Smith et al. 1989, 44). Demonstrated lack of response bias, however, is more important than high response rate (Babbie 1975, 265). The size of the firm measured by the number of employees and the industry were the two variables chosen for bias evaluation in this study.

Figure 3 indicates that the respondents did not deviate notably from the population in terms of the size of the companies. 18% of the research population belonged to the group of companies that employ 50-249 employees. Of the respondents 21% belonged to the same group. 39% of the population are companies that employ 10-49 employees, whereas among respondents 46% of the firms represented the same size category. The distribution is therefore somewhat biased in favour of the two larger size categories. 43% of the exporting SMEs in Southwest Finland, the majority, belong to the group of microcompanies, whereas 33% of the respondents belonged to the same group.

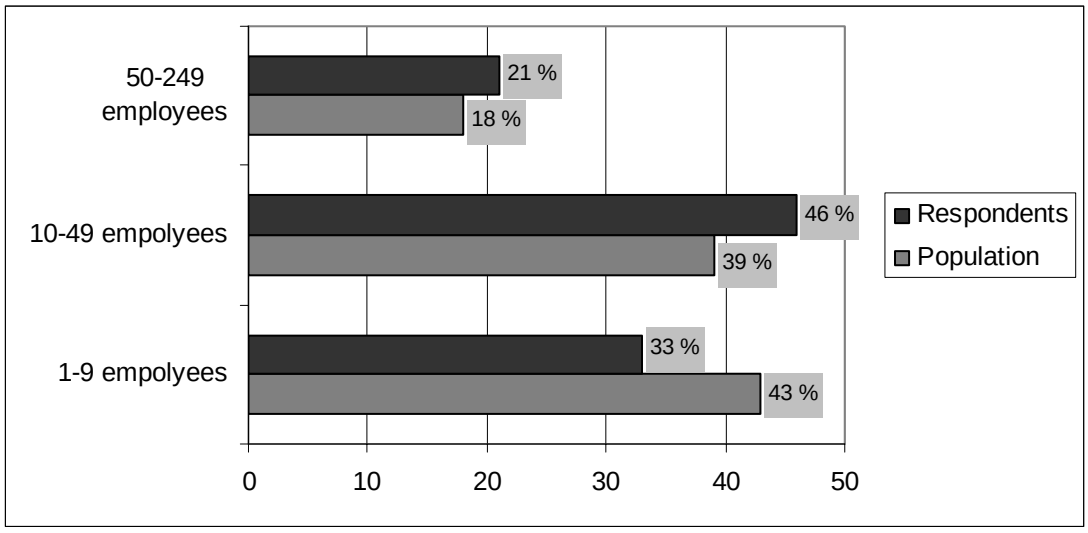


**Figure 3 Respondents and population according to firm size measured by the number of employees**

Hectic workdays of the entrepreneurs may partly explain the slightly lower response activity among managers of microcompanies. Also, microcompanies may not be as interested in expanding their international business activities as are the small or medium-sized. Based on the feedback received from the managers of the smallest size category firms the author find that many of them seem to have a belief that their company's operations that are associated with internationalisation are not significant enough for participating in a study. Overall, the differences between the frequencies of the respondents and population are, however, not substantial. The respondents can be

considered to represent the research population adequately in terms of the distribution of companies according to firm size.

Figure 4 indicates that the industrial distribution is slightly biased in disfavour of trade. 30% of the whole research population are trading companies, whereas only 22% of the respondents belong to this line of business. The majority, two thirds of the population, are industrial companies 58% among the population and 62% among respondents. When looking at the companies in services sector a deviation similar to the industrial firms can be observed as 9% of the population belong to service sector and the figure for the respondents is 12%. However, the distribution does not deviate significantly.

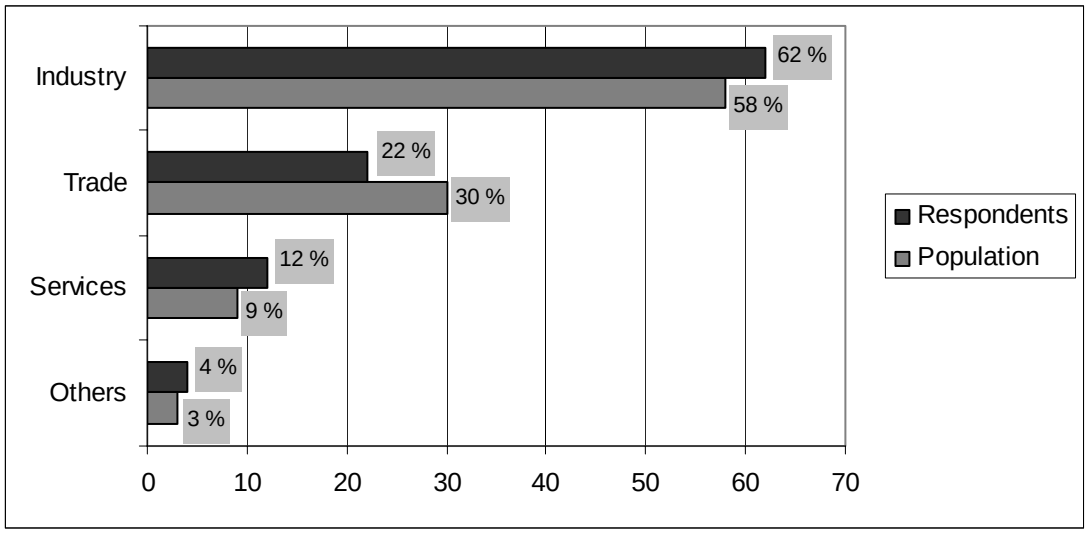


**Figure 4 Respondents and population according to industry**

Based on the bias analysis the respondents can be considered representing the whole population of exporting small and medium-sized firms in Southwest Finland rather adequately.

The question-related response rate varied from 17% to 100%. This affects the comparability of the data received from different questions somewhat negatively. The non-response rate increased when the question dealt with future investments or when respondents were asked to assign a share of investments or exports in percentages to different pre-determined geographical areas. The respondents most likely found those questions too difficult or time-consuming. Some respondents informed that they considered year 2010 to be too far in the future that they could have any idea about the business development that take place then.

The relatively low response rate as well as the extreme variations in question-related response rates weakens the possibility for generalisation of the results. However, the

results can be considered to represent the Southwest Finnish exporting small and medium-sized companies sufficiently. Furthermore, some generalisations concerning the whole population of Finnish exporters can be made with caution. According to Brown (1980), any subgroup of a universe represents a sample of that universe.

As the low number of usable responses and data plagues the whole of this study, the author stresses the need to treat the findings with caution. The number of used responses is available for all of the analyses in this thesis, either along with the text or graphic or present in the tables presenting the results of statistical processing. The higher the number of used responses, the better the results can be generalised to the whole population of SMEs in Southwest Finland and subsequently to the SMEs in the whole of Finland. The information on exporting and investment activities of Southwest Finnish SMEs may be more bound to the area of focus, although the results may implicate also some trend possible existing in the whole of Finland among small and medium-sized companies.

*Internal validity* refers to the question of whether the results obtained within the study are true (Ghauri et al. 1995, 33) and do the measurements correspond to the concepts in the theoretical background of the study (Heikkilä, 2004, 186). In their part the issues concerning questionnaire development and data analysis answer to the question of internal validity. These were discussed in the previous Chapters 3.3. and 3.4. The measures have been designed based on the theoretical framework of this study. Similar measures and operationalisations have been used in the existing literature concerning international market entry mode studies.

## 3.6 Description of the respondents

Before going further to analysing the results some of the characteristics of the respondents will be described. The studied companies vary in size, thus, it is natural that they vary also in terms of their turnover and ability and willingness to make investments.

Table 5 illustrates the frequencies of different sized companies within an industry. Most of the industrial companies are small companies (10-49 employees). Almost all of the medium-sized companies (50-249 employees) among the respondents are industrial. Firms operating in trade are for the most part microcompanies (1-9 employees) and firms operating in services microcompanies and small companies. Mean turnover of the companies in year 2004 was EUR7,29 million and the mean turnover will increase to EUR11,96 million in 2010. There are, however, great variations between the individual companies' turnover.

The estimated increases in turnover in five years' time show that the Southwest Finnish SMEs have positive expectations concerning the future of their enterprises. The same positive outlook can be observed overall in the received responses. Internationalisation, in fact, in part may increase the possibilities of SMEs to hire new employees. This was found as the study proceeded and the issue will be addressed in Appendix 4.

**Table 5 Firm size by industry (in number of companies)**

| | | Industry | | | | Total |
|---|---|---|---|---|---|---|
| | | **Industrial** | **Trade** | **Services** | **Other** | |
| **Number of employees** | **1-9** | 13 | 14 | 5 | 1 | **33** |
| | **10-49** | 32 | 7 | 6 | 1 | **46** |
| | **50-250** | 17 | 1 | 1 | 2 | **21** |
| **Total** | | **62** | **22** | **12** | **4** | **100** |

According to the managers of SMEs in Southwest Finland, the total value of exports increases during the next five years from the average of year 2004 EUR 183 000 (N=93) to the average of 2010 EUR403 000 (N=94). This means a substantial annual growth of 24%. The figures are the average of the responses; therefore, the actual value differs greatly between companies. The geographical distribution of the value differs also between companies. Although the information of the research population were retrieved from a database including only those companies, that encage in exporting activities, seven of the respondents reported their total value of exports in 2004 to be EUR0. Noteworthy is that the increase in the total value of exports in 2010 may not be very descriptive of the whole population, though the figure indicates correctly the trend of increasing value of exports. The standard deviation is quite high and the maximum value has increased considerably compared to the value in 2004. This may stem from the significantly increased export operations of only few companies that in their part contribute to the notable increase in the average value in 2010.

The value of exports is at the moment on average 36% of the companies' turnover (N=93). It will increase to approximately 41% in five years' time (N=92). According to the managers of the SMEs, the cumulative value of foreign investments was on average EUR264 000 (N=83). The cumulative value will increase to the average of EUR894 000 (N=81) during the next five years. These figures are the average of the responses; therefore, the actual value differs greatly between companies. The geographical distribution of the value differs also between companies.

# 4 INTERNATIONALISATION OF SMALL AND MEDIUM-SIZED FIRMS IN SOUTHWEST FINLAND TO THE BALTIC STATES AND POLAND

The descriptive part of the empirical results of this study is presented first in this chapter. The results concerning the exports and foreign investments as well as the geographical distribution of employees of the small and medium-sized companies in Southwest Finland are described in an order that corresponds to the order of questions in the questionnaire. In the descriptive part the Baltic States and Poland are analysed both as one market area and then separately for the purposes of providing richer information and analysis.

The explanatory part testing the applicability of the Eclectic paradigm in explaining and predicting the entry mode choice of SMEs in the geographical setting of this thesis will follow the descriptive part.

## 4.1 Exporting and investing in the Baltic States and Poland

### *4.1.1 The relative significance of the Baltic States and Poland for the exports*

For the purposes of finding out the relative significance of the Baltic States and Poland to small and medium-sized firms in Southwest Finland in terms of internationalisation via export entry mode, some additional selected areas were chosen to be included in the questionnaire. As can be seen from Figure 5, the number of exporting SMEs in Southwest Finland will be increasing in each of the selected areas. EU is defined to be excluding Estonia, Latvia, Lithuania and Poland and Europe outside of EU excluding Russia. This is done for making the differences between areas as well as the changes in the exporting behaviour clearer and more illustrative.

Most of the studied companies are and will be exporting to several destinations. 62% (N=93) of the companies are exporting in the European Union, Estonia, Latvia, Lithuania and Poland excluded, in 2004 and 67% (N=88) in 2010. The increase is not as notable is in the case of Estonia, Russia and Poland as well as Latvia and Lithuania. The number of companies that are exporting to the Baltic States and Poland as well as to Russia increases notably in five years' time. Russia will become almost as important export destination as Estonia, as the number of companies exporting to Russia increases from 30% (N=93) in 2004 to as high as 53% (N=88) in 2010.

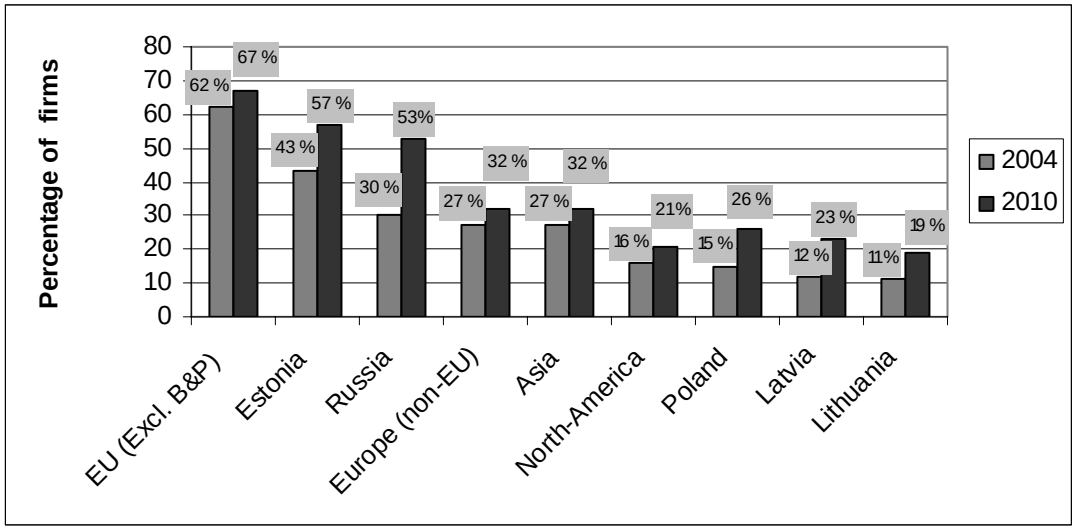


**Figure 5 Firms exporting to different geographical areas**

Though the number of companies exporting to each of other areas included in the questionnaire increase as well, the increases are not significant. 27% (N=93) of the respondents exported to Asia and non-EU European countries in 2004. The numbers increase in both of the areas to 32% (N=88) in 2010. Of the respondents 16% (N=93) exported to North-America in 2004 and the number increases to 21% (N=88) in 2010.

As a market area for exports the Baltic States and Poland combined is nevertheless the most significant destination for small and medium-sized companies in Southwest Finland measured by the number of exporting companies. Estonia is the single most significant and Russia is the second most significant export destination both in 2004 and 2010. The situation has changed from 1997 when according to the study on the significance of the Baltic Sea region for business activities of companies in Southwest Finland and particularly the Turku area by Lindström (1997) the Baltic States and especially Estonia were clearly more significant in terms of the amount of interest shown for initiating business activities in than were Russia or Poland. The results of this study show that though Estonia is still the most significant export destination to the SMEs in Southwest Finland Russia is no longer far behind. Also Poland is now and will be in 2010 more attractive export destination to the respondents measured by the number of exporting companies than Latvia and Lithuania.

Looking at the statistics on the share of the value of exports the combined proportion of Poland and the Baltic States will increase from 16% in 2004 to approximately 20% in 2010.

While the share of the Baltic States and Poland will increase in five years time the share of the European Union, the Baltic States and Poland excluded, will be decreasing from 49,1% in 2004 to 41% in 2010. The decrease is quite notable. Most of the decrease can be explained by the fact that the Baltic Sea region's eastern countries combined

increase their importance as an export destination when looking at the shares of exports as the share of Russia also increases from 9,5% in 2004 to 12,6% in 2010.[4]

The share of the EU25, the Baltic States and Poland included, is the largest with the share of 65,3% in 2004 and 60,9% in 2010. The share of EU25 of the exports of Southwest Finnish exports in 2004 is, thus, only slightly larger than it is of the Finnish exports (57,8% in the first half of year 2005, Finnish Customs 2006). However, the share of the Baltic States and Poland of the Finnish exports was only 5,7%, whereas of the exports of the studied SMEs the share was significantly larger in 2004 being 16,2%. The share of Russia of the respondents' exports is similar to the total Finnish exports. The Baltic States and Poland combined is, thus, the most significant export destination to the SMEs in Southwest Finland and far more significant to the exports of the area than to the Finnish exports as a whole.

When comparing the significance of the areas to individual companies the European Union, North-America and Asia (mainly China or Japan) in addition to Estonia and Latvia may be the sole export destinations to some companies both in 2004 and 2010. The share of Russia is at maximum 95% of the exports of a company. The main export destination may be determined by the line of business the companies operate in.

### *4.1.2 Exporting to the Baltic States and Poland*

The results indicate that the countries nearby are important export destinations to SMEs in Southwest Finland. Estonia has a long history of being one of the most important export destinations, and the results implicate that it will be increasingly significant in the future.

Figure 6 illustrates the percentages of respondents that export to the Baltic States and Poland in 2004 and 2010. The results indicate that the number of SMEs exporting to the four countries will increase notably.

Of the respondents 43% reported exporting to Estonia in 2004. The figure for Poland was then 15%, whereas for Latvia 12% and for Lithuania 11%. SMEs in Southwest Finland have clearly increased their interest in the Baltic Sea Rim's new EU-member countries and in the growth opportunities those countries offer as market-areas. Though the results show that in year 2004 Estonia was clearly the single most important export destination for SMEs in Southwest Finland, the number of companies exporting to Estonia still increases by 32% during the next five years. In the year 2010 almost two-thirds of the exporting companies − 57% − will be exporting to Estonia. Other countries in the area increase their share as exporting destinations as well.

[4] Share of exports in 2004, N=44; share of exports in 2010, N=42.

In year five years' time 26% of the respondents will be exporting to Poland, 23% to Latvia and 19% to Lithuania. The increase of the number of companies exporting to Poland and to Lithuania increases thus by around 70% in five years' time. The number of firms exporting to Latvia almost doubles. The steep increase can be explained by the growing interest towards the countries. In case of Poland, Lithuania and Latvia, the growth figures stem partly from the fact that the number of companies operating in those countries is still relatively low and as the companies are beginning to find the countries, the increases can easily be notable. In case of Estonia the growth figures are not as high yet substantial considering the already large proportion of companies active in exporting operations.

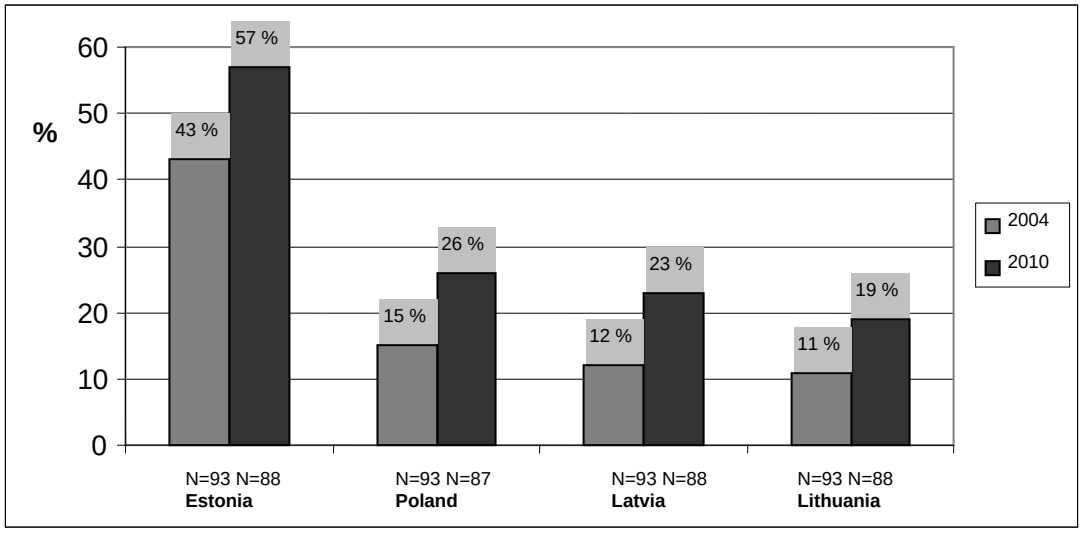


**Figure 6 Firms exporting to the Baltic States and Poland in 2004 and 2010**

Looking at the share of exports[5], Estonia is the most significant export destination of the four new EU countries in the Baltic Rim area with the share of 11,2%. The Lithuanian share at 0,5% in 2004 and 0,2% in 2010 is very low. The shares of Latvia and Poland are low compared to Estonia both in 2004 and 2010. The shares of these countries, however, increase notably in five years' time. The share of Latvia increases from 2,9% in 2004 to 4,1% in 2010 and the share of Poland from 1,5% to 2,4%. However, the author stresses that these figures must be generalised with great caution as the number of the responses is quite low. These figures may not represent the population adequately.

In terms of export value, Estonia and Latvia are notably more significant to the small and medium-sized companies in Southwest Finland than these countries are for the Finnish exports as a whole. When the share of Estonia is 11% of the exports of the

[5] Figures concerning year 2004 N=44; figures concerning year 2010 N=42.

respondents, the country's share of the Finnish exports is only 2,5% (first half of year 2005, Finnish Customs Statistics 2006). This infers that Estonia is notably more significant export destination for the small and medium-sized companies in Southwest Finland than to the total Finnish exports. The share of Finnish exports to Latvia was 0,8% whereas the country's share of the exports of the studied companies is notably higher being 2,9%. The shares of Poland (1,8%) and of Lithuania (0,6%) of the Finnish exports are similar to that of Southwest Finnish SMEs. In the case of Latvia, on the other hand, a difference can be observed. Latvia's share of the studied SMEs' exports is notably higher, though not as much as the Estonian share, than the country's share of Finnish exports in total.

Estonia and Latvia are especially significant export destinations to some of the companies, as their maximum share of the total exports may be as high as 100% in the exports of individual firms in 2004 and 2010. The share of Poland of the individual companies' exports is at the maximum 30% of the total exports both in 2004 and 2010 whereas the maximum share of Lithuania 10% in 2004 and only 3% in 2010.

The tables in the following illustrate the industrial distribution of companies exporting to Poland and the Baltic States both in 2004 and 2010. The tables also allow assessing the relative significance of each country to companies operating in different industries. Most companies encaging in exporting operations in the area of interest are industrial, which is a natural reflection of the distribution of all exporting SMEs in the Southwest Finland. Due to the differences in question related response rates, the comparability of results concerning year 2004 and 2010 is slightly weakened. Table 6 shows the industrial distribution of companies exporting to Estonia in 2004 and 2010.

**Table 6 Exports to Estonia by industry in 2004 and 2010 (in number of companies)**

| | | Exports to Estonia 2004 | | |
|---|---|---|---|---|
| | | No exports | **Exports** | Total |
| Industry | **Industry** | 32 | **28** | 60 |
| | **Trade** | 10 | **8** | 18 |
| | **Services** | 8 | **3** | 11 |
| | **Other** | 3 | **1** | 4 |
| Total | | 53 | **40** | 93 |
| | | Exports to Estonia 2010 | | |
| | | No exports | **Exports** | Total |
| Industry | **Industry** | 26 | **32** | 58 |
| | **Trade** | 3 | **13** | 16 |
| | **Services** | 6 | **4** | 10 |
| | **Other** | 3 | **1** | 4 |
| Total | | 38 | **50** | 88 |

Almost half of the industrial companies reported exporting to Estonia in year 2004. The proportion among trading companies was similar. Of the companies operating in services one out of four were exporting to Estonia. The ratios change when looking at the numbers of year 2010. Over half of those companies that answered to the question concerning exporting to Estonia reported to be encaging in exports to that country in 2010. As the number of exporting companies increases somewhat among industrial firms, among trading services the number of companies exporting to Estonia nearly doubles. It is evident, that trade companies consider Estonian markets interesting as most of them are planning to initiate exporting activities in the country during the coming years. Part of the increase can be explained by the relatively more positive perceptions of service and trade companies' managers on the market growth in Estonia. (See Appendix 3) Among service companies, however, the number of exporters will not increase notably.

It can be concluded that Estonia as an export destination is significant for industrial, trading and service SMEs. However, trading companies will initiate relatively most of the new export ties in five years' time.

The number of small and medium-sized companies exporting to Latvia is highest among industrial firms both year in 2004 and 2010. (Table 7) The relative importance of exports to Latvia is highest to the industrial companies. Latvia is not equally interesting destination for firms operating in trading or services. The numbers indicate that one of four of exporting industrial SMEs in Southwest Finland will be exporting to Latvia in year 2010. Of trading and service companies the ratio is one out of five.

**Table 7 Exports to Latvia by industry 2004 and 2010 (in number of companies)**

| | | Exports to Latvia 2004 | | Total |
|---|---|---|---|---|
| | | No exports | **Exports** | |
| Industries | **Industry** | 52 | **8** | 60 |
| | **Trade** | 17 | **1** | 18 |
| | **Services** | 9 | **2** | 11 |
| | **Other** | 4 | **0** | 4 |
| Total | | 82 | **11** | 93 |
| | | Exports to Latvia 2010 | | Total |
| | | No exports | **Exports** | |
| Industries | **Industry** | 43 | **15** | 58 |
| | **Trade** | 13 | **3** | 16 |
| | **Services** | 8 | **2** | 10 |
| | **Other** | 4 | **0** | 4 |
| Total | | 68 | **20** | 88 |

When assessing the relative importance of Latvia to SMEs operating in different lines of business the Latvian export is most common among industrial companies. Also, two-thirds of the companies exporting to Latvia in 2004 are industrial and in 2010 three out of four of the companies are industrial. This is, as previously mentioned, caused in part by the fact that industrial companies are the dominant group among respondents.

The distribution of companies exporting to Lithuania is similar to the distribution of companies exporting to Latvia. Most of the companies are industrial and the increase in the total number of companies exporting to Lithuania in year 2010 is mainly due to the increase in industrial exports. The crosstabulations presented in Table 8 implicate that when considering the relative importance of Lithuania to the SMEs operating in different industries, the significance of the country as an export destination increases most among companies in trade and industrial sectors. Of industrial companies one out of nine were exporting to Lithuania in 2004, whereas the ratio has changed in 2010 to one out of five companies.

**Table 8 Exports to Lithuania by industry 2004 and 2010 (in number of companies)**

| | | Exports to Lithuania 2004 | | |
|---|---|---|---|---|
| | | No exports | **Exports** | Total |
| Industries | **Industry** | 53 | **7** | 60 |
| | **Trade** | 17 | **1** | 18 |
| | **Services** | 10 | **1** | 11 |
| | **Other** | 3 | **1** | 4 |
| Total | | 83 | **10** | 93 |
| | | Exports to Lithuania 2010 | | |
| | | No exports | **Exports** | Total |
| Industries | **Industry** | 46 | **12** | 58 |
| | **Trade** | 13 | **3** | 16 |
| | **Services** | 9 | **1** | 10 |
| | **Other** | 3 | **1** | 4 |
| Total | | 71 | **17** | 88 |

In 2004 among trading companies there was only one exporter out of eighteen that had Lithuania as an export destination. The ratio will change notably in five years' time as in 2010 one out of five trading companies will be exporting to Lithuania. Of companies that are exporting to Lithuania in 2004 seven out of ten are industrial whereas in 2010 the ratio is twelve out of seventeen. The vast majority of exporters to Lithuania are, thus, industrial.

The distribution of companies exporting to Poland is similar to the distribution of companies exporting to Latvia and Lithuania. Table 9 shows that most of the companies are industrial and similarly to Latvia and Lithuania the increase in the total number of

companies exporting to Poland in year 2010 is mainly due to the increase in industrial exports. Most of the exporters are industrial but rather opposite to the situation in other studied countries one out of seven exporters belong to the category 'other' that is twice as much as to trade or services.

**Table 9 Exports to Poland by industry 2004 and 2010 (in number of companies)**

| | | Exports to Poland 2004 | | |
|---|---|---|---|---|
| | | No exports | **Exports** | Total |
| Industries | **Industry** | 50 | **10** | 60 |
| | **Trade** | 17 | **1** | 18 |
| | **Services** | 10 | **1** | 11 |
| | **Other** | 2 | **2** | 4 |
| Total | | 79 | **14** | 93 |
| | | Exports to Poland 2010 | | |
| | | No exports | **Exports** | Total |
| Industries | **Industry** | 42 | **16** | 58 |
| | **Trade** | 15 | **1** | 16 |
| | **Services** | 6 | **3** | 9 |
| | **Other** | 1 | **3** | 4 |
| Total | | 64 | **23** | 87 |

Most of the increase in the importance of Poland as an export destination, however, will take place in service sector. One third of the responded companies in service sector reported having export operations in Poland in 2010. Of industrial companies one fourth will be exporting to Poland in five years' time. Notable is that Poland is an important export destination to companies that include in the category 'other' as a half of the firms belonging to that category were exporting to Poland in 2004 and three out of four will be exporting to the country in 2010.

### *4.1.3 The relative significance of the Baltic States and Poland in terms of investment entry mode*

For the purposes of finding out the relative significance of the Baltic States and Poland to small and medium-sized firms in Southwest Finland in terms of internationalisation via investment entry mode, some additional selected areas were chosen to be included in the questionnaire. As seen from Figure 7, the number of investing SMEs in Southwest Finland will be increasing in each of the selected areas. However, the increase in the number of companies investing in the Baltic States and Poland is notable. It is evident

that the Baltic Rim region's new EU-member countries are the most important investment locations for the studied companies measured by the number of investing companies. Estonia is the single most important investment destination. In 2004, the number of investing SMEs was the same in the Baltic States and Poland and the European Union, excluding Estonia, Latvia, Lithuania and Poland, at 8% (N=86-87). However, the number of firms investing to the Baltic States and Poland increase substantially to 27,1% (N=84-85) in 2010 when at the same time the number of companies investing in the European Union increases to 15,3% (N=85). The number of SMEs investing to Russia increases also substantially from 3,5% (N=85) in 2004 to 14,1% (N=85) in 2010. Again, the Baltic Sea region's eastern countries attract the companies more than do other areas. The number of companies investing in Asia increases from 3,5% (N=86) in 2004 to 7,2% (N=83) in 2010. The number of companies investing in North-America or non-EU European countries does not show signs of increasing. The number of investors in North-America remains around 2,4% (N=85-87) and in Non-EU European countries around 3,5% (N=85-87). Those areas that attract the most exporters seem to attract also the most investors as has been observed also in other empirical studies.

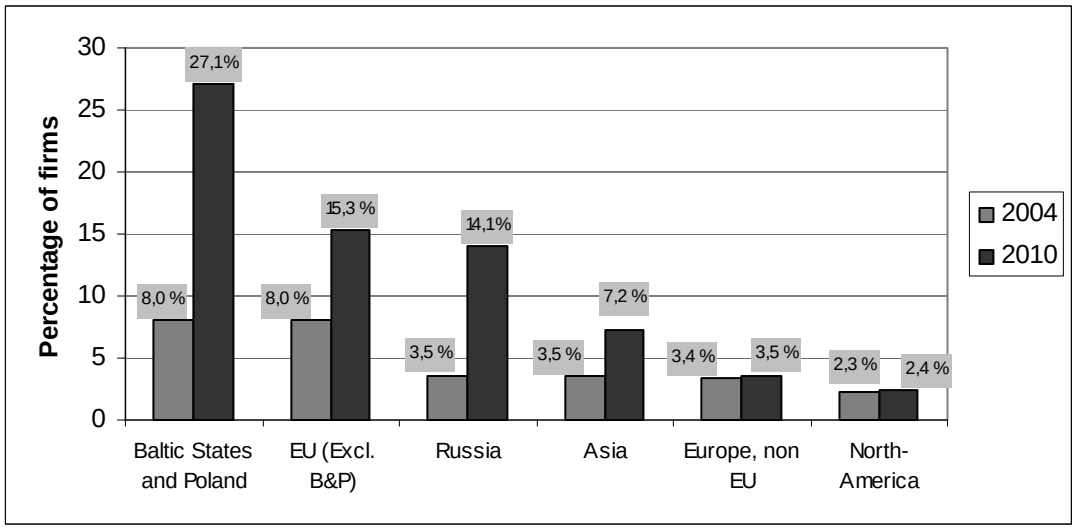


**Figure 7 Firms investing in different geographical areas**

According to the results the proportion of the Baltic States and Poland (mainly Estonia) of the total value of foreign investments increases from 28% in 2004 to 30% in 2010.[6] The share of the Baltic States and Poland is nearly as considerable as is the total share of other European Union countries in 2004. In 2010, the share of Poland and the Baltic States is more substantial than the share of other EU countries. However, due to

[6] Share of foreign investments in 2004, N=17; share of foreign investments in 2010, N=25.

the especially low response rate of the questions relating to the value of investments and the geographical distribution of that value, these figures cannot be considered to be representing the whole population adequately. Therefore, the findings cannot be analysed without reservation. However, the author considers that the figures in the following table will give some idea of the trends. Therefore the figures will be included in the analysis.

Cautiously assessing the figures above the special status of the Baltic States and Poland in the investment activities of small and medium-sized companies in Southwest Finland is evident. The four countries, and especially Estonia, are clearly more important investment destinations to the studied companies' than to Finnish FDI as a whole. The difference is significant as in 2004 only 2,5% of Finnish FDI stock was in the Baltic States and Poland (Bank of Finland 2005). In 2004 the share of Russia of the foreign investments of SMEs in Southwest Finland was notably lower at 7,7% than the share of the Baltic States and Poland. By 2010, however, Russia has increased its share considerably to 23,8% and possesses nearly as substantial a share of the foreign investments of the studied companies as do the Baltic States and Poland. It may be that the companies' experiences of operating in Poland and the Baltic States act, in part, as a stepping stone to the growing Russian markets. The eastern countries of the Baltic Sea region combined attract the most of the investments in 2010. The share of European Union, excluding Estonia, Latvia, Lithuania and Poland, on the other hand, decreases in five years' time from 34,7% in 2004 to 25,8% in 2010.

In addition to Estonia, individual companies may direct all of their foreign investments in 2004 to the European Union, North-America or Asia. The maximum share of Russia in 2004 is 50% and it will increase to 100% in 2010. The maximum share of North-America decreases to 50% and the maximum share of Asia decreases to 80%.

### *4.1.4 Investments in the Baltic States and Poland*

Estonia is notably the most interesting country to invest in measured by the number of investing companies. Figure 8 illustrates the number of SMEs in Southwest Finland that have invested in the Baltic States and Poland in 2004 and in 2010. While 6,9% of the respondents reported having made investments in Estonia until year 2004, the figure for 2010 was 17,6%. The number of companies investing to Estonia over doubles in five years' time. Only 1% of the respondents had made investments in Poland until 2004, whereas none of the respondents reported having invested in Latvia or Lithuania. In five years' time 5,9% of the respondents have invested in Poland, 1,2% to Latvia, and 2,4% to Lithuania.

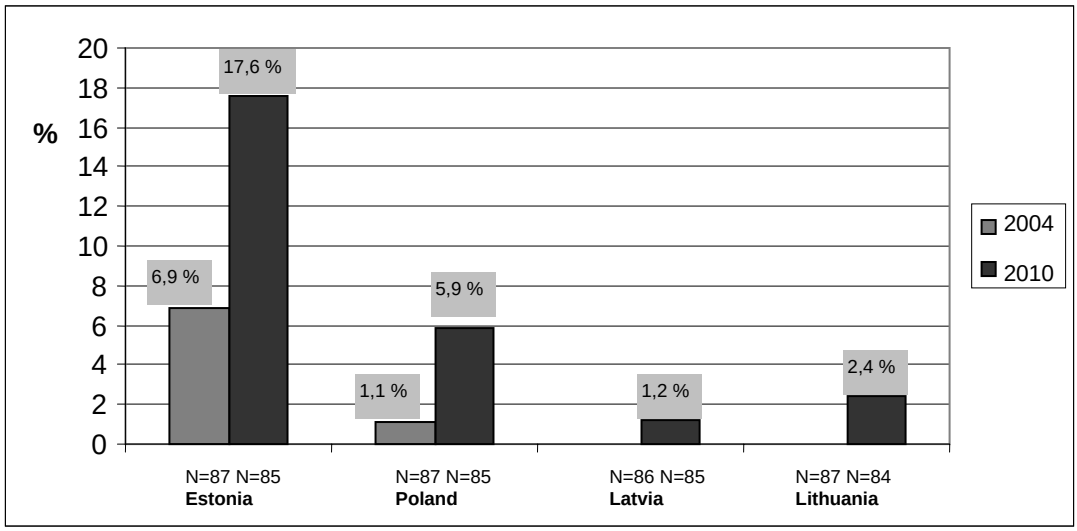


**Figure 8 Firms investing in the Baltic States and Poland in 2004 and 2010**

Estonia is also the most significant investment destination out of the four new EU countries in the Baltic Sea region when looking at the share of foreign investments.[7] However, due to the especially low response rate of the questions relating to the value of investments and the geographical distribution of that value, these figures cannot be considered to be representing the whole population adequately.

The results must be analysed with great caution as the response rate is very low. For example, the share of Latvia is 0% in 2010 even though investments in that country have been made until then.

If cautiously assessing the figures, it is possible infer that the significance of Estonia as an investment destination is notable as the country's share of investments made by small and medium-sized companies in Southwest Finland is 27,7% in 2004 and 27,4% in 2010. The Polish share is only 0,4% in 2004, yet it increases up to 2% in 2010. Lithuanian share increases from 0% to 0,8%. Estonia represents the vast majority of the combined share of the Baltic States and Poland.

When looking at the significance of the four countries to the individual firms, Estonia is clearly the most important destination of foreign investments as its share is 100% of some of the respondents' foreign investments in 2004 and also in 2010. The share of Poland is at maximum 6% of the individual companies' investments, yet it increases in some cases up to 20% in 2010. In 2010, the maximum share of Lithuania of the foreign investments of small and medium-sized companies in Southwest Finland is also 20% .

[7] Share of foreign investments in 2004, N=17; share of foreign investments in 2010, N=25.

The number of SMEs that have invested in the Baltic States and Poland until year 2004 as well as year 2010 is rather small compared to the number of companies exporting to those countries. Questions relating to investments both made until year 2004 and until 2010 suffered from low response rates. This needs to be taken into consideration when analysing the results. In the following the industrial distribution of the SMEs that have invested in the Baltic States and Poland until 2004 and until 2010 is discussed.

The Table 10 shows that until year 2004 one out of five trading companies had invested in Estonia and that the number will double until year 2010. Though most of the companies investing in Estonia until year 2010 are industrial, trading companies are investing the most relative to the total number of trading companies within the respondents. Of the respondents until year 2010 seven industrial companies and six trading companies have invested in Estonia.

**Table 10 Investments to Estonia by industry in 2004 and 2010 (in number of companies)**

| | | Investments to Estonia 2004 | | |
|---|---|---|---|---|
| | | No invest. | **Investments** | Total |
| Industry | **Industry** | 56 | **2** | 58 |
| | **Trade** | 12 | **3** | 15 |
| | **Services** | 9 | **1** | 10 |
| | **Other** | 4 | **0** | 4 |
| Total | | 81 | **6** | 87 |
| | | Investments to Estonia 2010 | | |
| | | No invest. | **Investments** | Total |
| Industry | **Industry** | 50 | **7** | 57 |
| | **Trade** | 9 | **6** | 15 |
| | **Services** | 7 | **2** | 9 |
| | **Other** | 4 | **0** | 4 |
| Total | | 70 | **15** | 85 |

No investments were made until year 2004 to Latvia and Lithuania. Of the respondents one industrial company reported having invested in Latvia until year 2010 (N=85) and one industrial company as well as one in the category 'other' reported having invested in Lithuania in five years' time (N=84). The numbers concerning Latvia and Lithuania are, thus, very low.

Of the respondents one trading company had invested in Poland until year 2004 (N=77). The numbers of year 2010 (N=75) show that among the respondents there are two industrial companies, two service firms and one other having made investments in

Poland until 2010. The one trading company that reported having invested in Poland in 2004 no longer has investments in the country in 2010.

## 4.2 Ownership and locational advantages and internationalisation of SMEs in Southwest Finland to the Baltic States and Poland

The applicability of Dunning's Eclectic paradigm in terms of ownership and location andvantages on the entry mode choices of the studies SMEs is analysed and tested in the following sections. The SPSS tables consisting of tests relating to O advantages as well as L advantages can be found at Appendix 5. The SPSS table are presented in the same order as the operationalised variables appear in the table on research hypotheses in Chapter 2.6.

Chapter 4.2.1. will discuss tests relating to ownership advantages in the following. After that the locational varibales are tested in Chapter 4.2.2.

### *4.2.1 Ownership advantages and SME entry mode choice*

In the previous descriptive part the four countries were in some cases analysed separately. When conducting the statistical testing the information on the four countries have been merged and the countries are treated as one market area. In the following the crosstabulations and the results of the Chi-square and correlation tests are analysed. A note is made that the total numbers of exporters and/or non-exporters as well as in case of investors and/or non-investors may vary between the crosstabulations. This is due to the differences between question-related response rates. The SPSS tables on the crosstabulations and the Chi-square tests as well as correlations concerning the O advantages can be found at Appendix 5. Table 11 illustrates the findings concerning the explanatory and predicting power of ownership advantages. The findings are analysed in the following.

The first operationalisation of O advantages is the firm size measured by the number of employees. As discussed in Chapter 2.4. several studies in the field of international entry mode studies have found that firm size is positively related with the choice of equity-based entry mode. The nominal scale firm size is crosstabulated with non-exporting/exporting and non-investing/investing. The dependencies are tested with Chi-square test. According to the crosstabulations in year 2004 nearly half of the microcompanies were exporting to the Baltic States and Poland. Over a half of the small companies were exporting to the four countries, whereas in case of medium-sized companies less than half were encaged in exporting in the area. The Chi-square test can

be conducted as the cell counts are over 5 in all of the studied cells. The Sig. value, however, is notably over 0,05 and therefore the null hypothesis must be accepted. There is no dependency between firm size and the exporting in 2004.

In 2010 the number of exporting microcompanies has increased substantially. Over two-thirds of the smallest category companies will be exporting to the area of interest in five years' time. The increase in the two larger categories is not as notable. The Chi-square test can be conducted also in this case. The Sig. value exceeds 0,05 and again the null hypothesis must be accepted. There is no dependence between the variables.

Looking at the numbers of investing SMEs in 2004, most of the investing companies are small and microcompanies. Among the companies included in the crosstabulation there are no medium-sized companies reporting having invested in the Baltic Sea Rim's new EU countries. The Chi-square test cannot be conducted in this case as 50% of cells have cell count less than 5. It seems, however, that the size of the company is not associated with the investment choice. Furthermore, in contrast to the research hypothesis, the investments are, in fact, made by companies belonging to the two smaller size categories and not by the larger, medium-sized companies.

In 2010 most of the investing companies are yet again the microcompanies and small companies. The number of investors increases suprisingly the most among the microcompanies. 16,7% of the cells have cell count less than 5. The Chi-square test can therefore be conducted. The null hypothesis must be accepted as the Sig. value is over 0.05. There is no dependence between the variables.

The second operationalisation of O advantages is firm size measured by turnover in 2004. The effect of the firm size is tested again using Pearson correlation, which is in this case possible as turnover in euro value is a ratio scale variable. The correlations concerning both exporting and investing in 2004 and 2010 were found weak. The direction of the weak correlations suggests that the firm size is negatively correlated with exporting and investing. In other words the smaller the firm, the more likely it is that it will export or invest in the Baltic States and Poland in 2004 and/or 2010. The finding is similar to the first operationalisation. However also in this case none of the correlations were statistically significant and therefore the null hypothesis must be accepted.

The findings are in contrast to the results concerning studies on large multinational companies. However, the results are similar to the findings of a study on SME entry into Central and Eastern Europe by Nakos and Brouthers (2002). The study concluded that firm size was found not to be significant predictor of entry mode choice. Why the size does not affect the entry mode choices may stem from the fact that due to the small size, regardless of the size differences within the SME category, all of the studied companies have had to deal with similar kind of constraints. Overall, if cautiously generalising, the

findings show that firm size cannot explain or predict the choice of exporting or the choice of investing.

**Table 11 O advantages and the use of export and investment entry modes in the Baltic States and Poland in 2004 and 2010**

| Explanatory variable | Exporting 2004 | Exporting 2010 | Investing 2004 | Investing 2010 |
|---|---|---|---|---|
| *O advantages* | | | | |
| Firm size measured by number of employees | No dependency | No dependency | N/A | No dependency |
| Firm size measured by turnover | No dependency | No dependency | No dependency | No dependency |
| International experience measured by value of exports from turnover | | No dependency | | No dependency |
| International experience | | *Dependency* | | No dependency |
| • *Baltic States and Poland* *(Exports 2004)* | | | | |
| • Others (Exports 2004) | | No dependency | | No dependency |

International experience was also tested twice using different statistical tests. The third operationalisation of O advantages considers the ratio scale value of exports from turnover to represent the level of international experience of a company. Pearson correlation test can be conducted. The correlations proved weak and statistically insignificant. The null hypothesis must be accepted.

The number of exporters in 2004 both in the Baltic States and Poland and other areas are crosstabulated with the exporters and investors in 2010 in the Baltic Sea region's new EU countries. The crosstabulations are tested with Chi-square test. This is done for the purposes of finding out whether the previous experience affects the entry choice.

Of 42 companies not exporting to the Baltic States and Poland in 2004 15 will be exporting in 2010. Of 45 companies exporting to the Baltic States and Poland in 2004 43 will be exporting still in 2010. Tests prove the dependency between the variables and the null hypothesis must be rejected. Of 44 companies exporting to the Baltic Sea region's new EU countries in 2004 9 will be investing in the area in 2010. Out of 39 non-exportes 10 will be investing in 2010. The statistical test proves no dependency between the variables. It appears that the exporting experience affects the investment choice very little as most of the companies investing in the Baltic States and Poland in

2010 do no have exporting experience from that area. However, the result implicates also increasing interest among those not yet active in the area towards initiating equity-based operations in the Baltic Sea region's new EU countries.

Out of 73 companies exporting to other areas in 2004, 48 will be exporting to the Baltic States and Poland in 2010. Of 14 companies not encaged in exports to other areas in 2004 10 will be exporting to the Baltic States and Poland in 2010. Statistical test proves no dependency. Null hypothesis is thus accepted. Out of 68 companies exporting to other areas in 2004 13 will be investing the Baltic States and Poland in 2010. Of 15 firms not encaged in exporting activities in other areas 6 will be investing in the Baltic States and Poland in 2010. The statistical test proved no dependency between variables and yet again the null hypothesis is accepted.

The findings are yet again consistent with the findings of the study by Nakos and Brouthers (2005) who conclude that international experience was not found significantly connected with entry mode choice. Overall, if cautiously generalising, the findings show that international experience can only in part predict the choice of exporting or the choice of investing. Exporting experience in the target market seems significantly to affect the future exporting decision but not investment decision.

Based on the analysis it can be concluded that Hypothesis 1 *"The higher the ownership advantages, the more likely it is that a company chooses to export to the Baltic States and Poland"* is only partially supported. The size of a company was found to have no statistical connection with the export entry mode choice. In terms of international experience only exporting experience in the Baltic States and Poland seems to be associated with exporting to the same area in 2010. Hypothesis 2 *"The higher the ownership advantages; the more likely it is that a company chooses to invest in the Baltic States and Poland"* is not supported by the statistical tests. The finding contradicts a number of studies in the field of MNE entry mode studies that argue that the higher the ownership advantages the more the firms tend to utilise equity entry modes. This may stem from the fact that the smaller sized companies do not have sufficient resources and capabilities to utilise equity entry mode when entering foreign markets, but in stead choose to use non-equity entry modes.

Hollenstein's (2005) study found that the O advantages were the main driver of internationalisation small and medium-sized companies regardless of the internationalisation strategy used. According to Hollestein ownership advantages affect also export entry mode choices. The findings of this study do not support Hollestein's findings.

### *4.2.2 Location advantages and SME entry mode choice*

Location advantages and their association with the exports and investments in 2004 and 2010 are described and analysed in the following. Market related advantages and input related advantages are analysed separately. The results of the statistical tests concerning L advantages are collected in Table 12. The strenghts and the directions of the associations are included when applicable. Positive direction of association is marked with plus sign.

The managers of the companies were asked to evaluate market demand, prospects for market growth and labour costs and their development according to their industry.[8] Perceptions on market demand, market growth and labour costs are connected to the exporting activity and investments as previously described using Pearson correlation to be able to assess the explaining and predicting power of the locational factors in context of SME internationalisation.

The market related variables are analysed in the following. The respondents evaluated the level of market demand by choosing the most suitable value from a continuum of one to five. Value 1 represented "no market demand" and value 5 the opposite side being "extremely high demand". The prospects for market growth until 2010 were evaluated by choosing the most suitable value from a continuum of one to five. Value 1 represented "no market growth" and value 5 the opposite side being "extremely positive prospects for market growth". Thus, in the case of these market related factors it is hypothesised that the higher the evaluations the more probable it is that the company will choose to invest in the area.

Correlation results show that market demand correlates statistically significantly with the number of exporting companies in 2010 but not with the number of exporting companies in 2004. In case of year 2010 the null hypothesis must be rejected as the Sig. value is below 0,05. Correlation coefficient being 0,420 a moderate dependency can be observed. In case of year 2004 the correlation coefficient indicates low dependency, however, the null hypothesis must be excepted as the Sig. value exceeds 0,05. Thus, perceptions on market demand in the Baltic States and Poland does have a statistically significant effect on the decision to export in five years' time but not on the on going exporting activities (in 2004). Looking at the results concerning the correlation between market demand and investment entry mode choice, the findings are similar. Market demand shows very weak correlation with investment entry mode in 2004. This weak correlation, however, is not statistically significant. Sig. value exceeding 0.05 the null

[8] A more in-depth descriptive analysis on the perceptual values are presented at Appendix 3 for the purposes of providing a general idea of how the managers perceive the market demand, prospects for market growth and labour cost issues in the Baltic States and Poland respectively. The perceptions of industrial companies and others are additionally analysed separately.

hypothesis must be accepted. There is no statistically significant correlation between the variable. In case of choosing to invest in 2010 the results show yet again weak correlation. This correlation proves to be statistically significant. The null hypothesis in this case is rejected. It may be, that companies that consider the market demand high currently, are not yet active in the area in numbers. They are, however, aware of the demand, and those perceiving the demand to be high will initiate more business operations in five years' time.

Market growth correlates statistically significantly with the number of exporting companies both in year 2004 and 2010. Correlation coefficient concerning year 2004 indicates low dependency, whereas the dependency between market growth and number of exporting companies in 2010 is of moderate strength with 0,447. Perceptions on prospects for market growth have statistically significant effect on the exporting activities both in 2004 and 2010. Market growth correlates statistically significantly with the number of investing companies both in 2004 and 2010. The correlations, being at 0,251 and 0,264, are low.

**Table 12 L advantages and the use of exporting and investment entry modes in 2004 and 2010**

| Explanatory variable | Exporting | | Investing | |
|---|---|---|---|---|
| | 2004 | 2010 | 2004 | 2010 |
| *Market related L advantages* | | | | |
| Market demand | No dependency | Moderate + dependency | No dependency | Low + dependency |
| Prospects for market growth | Low + dependency | Moderate + dependency | Low + dependency | Low + dependency |
| *Input related L advantages* | | | | |
| Labour costs | | | No dependency | Low + dependency |

As can be seen from Table 12, market related L advantages are positively correlated with both exporting activities and investing. The more positive the perception the more likely it is that a company is or will be exporting to or investing in the Baltic States or Poland. The correlation was stronger in case of future exports. Market related advantages can somewhat explain the exporting activities. The predicting power of these advantages is, however, stronger. High market potential has been found to affect the equity entry mode choice of SMEs (Nakos & Brouthers 2002). The findings of the study at hand are in line with this.

Current labour costs were measured with perceptual values form 1 to 5. Value 1 represented "extremely low labour costs" and value 5 the opposite side being "extremely high labour costs".

As can be seen from Table 12 concerning the investments the null hypothesis stating no dependence was accepted in case of investing in 2004. The results show statistically significant low correlation between the level of labour costs and the number of investing companies in 2010. The correlation is positive, which is in contrast with the research hypotheses. According to the results it seems that the higher the level of labour costs the more probable it is, in fact, that a company will invest in the area. This can be explained by the higher levels of activities in Estonia and Poland compared to Latvia and Lithuania. As is concluded in Appendix 3, the labour costs are considered to be notably higher in Estonia and Poland.

Thus, based on the results it can be concluded that Hypothesis 3 "*The higher the location advantages, the more likely it is that a company will choose to invest in the Baltic States and Poland"* is to some extent supported. When looking at the market related L advantages, the hypothesis is to a large extent supported. However, in case of input related advatages the hypothesis was not supported. Hypothesis 4 *"The higher the market related location advantages the more likely it is that a company will choose to export in the Baltic States and Poland"* is for the most part supported by the findings.

# 5 CONCLUDING REMARKS

The purpose of this thesis has been to shed a light firstly on the question of the significance of Poland and the Baltic States for small and medium-sized companies in Southwest Finland and secondly on the question of whether the Eclectic paradigm can be used to explain or predict entry mode choice within SME context. There was no recent study concentrating on internationalisation of companies based in Southwest Finland in Baltic Sea region's new EU countries. Therefore this study was called for. Furthermore, SME entry mode choice has not been investigated sufficiently even though the smaller companies are increasingly active in the international markets. The previous entry mode research including the research on Eclectic framework has been concentrating on the activities of large multinational companies. This thesis has aimed at filling the gaps in literature by investigating the internationalisation of SMEs in Southwest Finland and integrating entry mode questions into the research setting.

The results of the descriptive part indicate that the Baltic Sea region's new EU countries are and will be important export and investment destinations to SMEs in Southwest Finland. The number of companies exporting to the area is high. The combined proportion of Poland and the Baltic States of the share of the value of exports will increase from 16% in 2004 to approximately 20% in 2010. The importance of the four countries for SMEs in Southwest Finland was in 2004 substantially higher compared to the total Finnish exports. Estonia was the most popular export destination to the studied companies. Of the respondents 43% reported exporting to Estonia in 2004. The figure for Poland was then 15%, whereas for Latvia 12% and for Lithuania 11%. In year 2010 almost two-thirds of the exporting companies – 57% − will be exporting to Estonia. As the number of exporting companies increases somewhat among industrial firms, among trading companies the number of companies exporting to Estonia nearly doubles. This can be in part explained by the positive expectations of the service and trading sectors on the Estonian market growth. In year five years' time 26% of the respondents will be exporting to Poland, 23% to Latvia and 19% to Lithuania. Most of the increase stems from industrial companies.

The importance of the Baltic States and Poland to the studied companies is in line with the empirical studies reviewed in Chapter 1.2. The area is familiar in terms of exporting and still continues to attract more companies to initiate exporting activities in the future. Compared to exporting investments are, however, few. This is in line with numerous studies concerning internationalisation of SMEs reviewed in Chapter 2.5. Previous studies have argued that SMEs choose to use non-equity modes of entry due to lack of sufficient resources. Even though the studied companies are not as inclined to encage in FDI as they are in exports, it is clear that the Baltic States and Poland attract the SMEs to invest the most. The Baltic Sea region's new EU countries are the most

important investment destination for the studied firms measured by the number of investing companies. According to the empirical findings, the proportion of the Baltic States and Poland (mainly Estonia) of the total value of foreign investments increases from 28% in 2004 to 30% in 2010. These figures are, however, based on a quite small number of responses and therefore are to be assessed with caution. The number concerning 2004 is nevertheless significant as only 2,5% of the total Finnish FDI stock was in the Baltic States and Poland in the first half of year 2005.

As to what extent Eclectic paradigm can explain or predict the entry mode choices of small and medium-sized companies, the findings are to some level in contrast with the similar studies in the field of SME internationalisation research. The previous studies reviewed in Chapter 2.5. suggest that OLI paradigm would be useful in explaining the entry mode choices of SMEs. However, this study only partially supports the applicability of the paradigm in this setting.

The results concerning the explanatory part aiming to test the research hypotheses formulated in Chapter 2.6. conclude that Hypothesis 1 *"The higher the ownership advantages, the more likely it is that a company chooses to export to the Baltic States and Poland"* is only partially supported. A study by Hollenstein (2005) referred to in Chapter 2.5. suggested that the O advantages are relevant also in case of exporting. In this study the only statistically significant connection relating to O advantages was observed between the number of companies exporting in the Baltic States and Poland in 2004 and the number of companies exporting in the area in 2010. The companies active in the area now will continue to be active in the future. Experience in other international markets was found not to be significantly associated with the future export entry mode choices concerning the Baltic States and Poland. The size of a company was found to have no statistical connection with the export entry mode choice.

Hypothesis 2 *"The higher the ownership advantages; the more likely it is that a company chooses to invest in the Baltic States and Poland"* is not supported by the statistical tests. Overall, if cautiously generalising, the findings show that firm size cannot explain or predict the choice of exporting or the choice of investing. Exporting experience in the target market seems to affect the future exporting decision but not investment decision. The findings concerning the effects of O advantages are in contrast to the results concerning studies on large multinational companies. However, the results are similar to a study by Nakos and Brouthers (2002) which concluded that firm size or international experience were not significant predictors of SME entry mode choice. Interestingly enough, the crosstabulations implicate rather surprisingly that the smallest of companies are a relatively active group to invest in the focus area. Why the microcompanies are more active investors than the medium-sized companies is difficult to explain. Most of the microcompanies are trading companies and these are relatively active in investing in the Baltic Sea region's new EU countries and especially Estonia.

The growing markets of the four countries have been noticed to attract among others retailers. However the industrial distribution of microcompanies cannot solely explain the finding. Certainly the finding implicates that the target area is easy enough to enter even for companies with fewest resources.

Furthermore, based on the results it can be concluded that Hypothesis 3 "*The higher the location advantages, the more likely it is that a company will choose to invest in the Baltic States and Poland"* is to some extent supported. When looking at the market related L advantages market growth and market demand, the hypothesis is to a large extent supported. However, in case of input related advatages the hypothesis was not supported. Most of the investments were directed to Estonia and Poland, which, out of the four studied countries, were considered to have the highest labour costs. Labour costs, therefore, do not act as a driving force for the studied SMEs for choosing investment entry mode. When looking at the distribution of employment presented in Appendix 4, it is evident, that the studied SMEs mostly increase the number of employees in Finland, whereas the average number of employed personnel remains low in the Baltic States and Poland as well as other foreign markets.

Hypothesis 4 *"The higher the market related location advantages the more likely it is that a company will choose to export in the Baltic States and Poland"* is also for the most part supported by the findings. The growing markets are a strong incentive for SMEs to be encaging in exporting operations in the four countries.

All in all Estonia is the most significant destination in the internationalisation of the small and medium-sized companies in Southwest Finland. It has been important before and continues to strengthen its position in the future. However, a trend can be observed that the interest towards other Baltic States as well as Poland will be increasing in the coming years yet the significance of Russia will increase even more. Estonia may very well be acting as a stepping stone to the Russian markets as well as to the Southern markets of Latvia, Lithuania and Poland. The small and medium-sized companies, in their part, seem to begin exploiting the previously unused trade potential in the vast and growing markets of Russia and Poland. It appears that the studied companies are to a large extent directing their exports and investments in the eastern part of the Baltic Sea region. The findings indicate that the main market area of small and medium-size companies in Southwest Finland is shifting from the previously more important EU countries to the near east. Though one objective of this study was to find out the significance of the Baltic States and Poland to the studied companies, the growing significance of the Russian markets became clear as a by-product of the analysis. The trade with the Baltic States and Poland may be complementary to the trade with Russia. The significance of the European Union (the Baltic States and Poland excluded), though still considerable, will be decreasing in the favour of the Baltic Sea Rim's eastern countries. Though studies have shown that companies see the EU-membership of

Estonia, Latvia, Lithuania and Poland as a positive development, it may be that the membership is not such a significant factor affecting the internationalisation of SMEs in Southwest Finland. Looking at the figures concerning the number of exporting and investing companies in different areas, the substantial increase of interest towards Russia in addition to the Baltic States and Poland would suggest, that companies are making their decision to internationalise based on some other factors, such as growing markets and unused market potential. The location has been found to play an important role in the internationalisation of Finnish companies to the Baltic States. The figures implicate that the studied SMEs prefer to have their marketing and investment operations in the geographically near countries. The whole Baltic Sea Rim area may very well be considered as a home market by the SMEs in the coming years and the question of EU-membership may not play such a big role in it. The closeness of those countries and Poland may be even more important incentive for the smaller sized companies to enter the markets.

## 5.1 Recommendations

The Baltic States and Poland are growing economically and thus provide possibilities for Finnish SMEs to expand their international operations to the countries. Especially Poland, being a large country with plenty of market potential, still offers companies good possibilities to enter the markets before the markets develop more competitive. The small Baltic States may already have reached a point where the markets are becoming very competitive. However, there are still plenty of business opportunities. Furthermore, the Baltic States offer also a geographically convenient location as the countries could be used as stepping stones to the larger markets in Russia and other neighbouring countries.

As the empirical findings showed, the international experience in other markets does not affect the decision of companies to enter the Baltic Sea region's new EU countries. Mainly those companies already experienced in the area are active in the area in the future. The companies active in other international markets, however, could easily benefit from the economical growth and favourable location of the four countries. It could be beneficial for the managers of small and medium-sized companies to get acquainted with this market area. However, due to the contraints stemming from the small size, the companies need assistance from organisations providing business support.

Those organisations and actors that are working for developing local economies should direct efforts to increasing and developing further those expert services that are intended for the smaller companies interested in increasing their business activities in

the Baltic Sea region's eastern countries. As the Baltic Sea region as a whole is gradually developing into a home market for Finnish small and medium-sized companies and the most of the growth and opportunities exist in the eastern part of the region, it would be in the interests of all parties involved in developing Finnish economy in local and national level to support and encourage the companies to increase their involvement in the eastern part of the Baltic Sea Rim. The countries are close even for the smaller companies to operate in and offer good possibilities for those acting early on the rising opportunities. The companies need actors that provide them an easy access to reliable information about the markets and the market developments. In addition to the information needs, the companies must be offered hands-on assistance in the practical level.

## 5.2 Suggestions for further research

This study has aimed at filling the gap in the literature on international entry mode choice of SMEs as well as in the empirical literature on Finnish SME internationalisation by focusing on the internationalisation and entry mode choices of small and medium-sized companies in Southwest Finland. This study, however, suffered from a number of limitations, which could be surpassed in future studies.

This study divided entry modes into two broad categories, equity and non-equity. This may mask the potential differences that may exists among the different equity and non-equity modes. The Eclectic paradigm might be useful, for example, in explaining why SMEs often choose joint ventures over wholly owned subsidiaries in the future studies. Also, this study did not explain or analyse the issue of preferred entry mode. This issue could be addressed in the future studies with larger sample and a different research construct.

Furthermore, as the results clearly indicated a shift towards the near east, that is Russia, Estonia and to some extent Poland, the internationalisation and entry mode choices of small and medium-sized companies should be studied in this setting. For example Russia being growing yet challenging market area could provide grounds for interesting findings in SME context.

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# Appendix 1 The original questionnaire in Finnish

**LUOTTAMUKSELLINEN**

1. **Yrityksen nimi** _____

2. **Vastaajan asema yrityksessä** _____

3. **Mikä on yrityksenne henkilöstömäärä?** Ympyröikää sopiva vaihtoehto

   Yksinyrittäjä 2-9 10-49 50-250

4. **Mikä on yrityksenne pääasiallinen toimiala?**

   Yrityksemme pääasiallinen toimiala on:_____

5. **Mikä oli yrityksenne liikevaihto 2004?** _____ €

6. **Mikä on yrityksenne arvioitu liikevaihto vuonna 2010?** _____€

7. **Kuinka suuri osuus yrityksenne kokonaisliikevaihdosta tulee seuraavilta Suomen ulkopuolisilta alueilta vuonna 2004 ja vuonna 2010?** Merkitkää prosenttimäärä sen alueen kohdalle, josta osuus peräisin. Mikäli yrityksellänne ei ole mitään toimintaa alueella rastittakaa 'ei toimintaa' vaihtoehto.

| ALUE | 2004 | Ei toimintaa 2004 | 2010 | Ei toimintaa 2010 |
|---|---|---|---|---|
| **Viro** | _____% | □ | _____% | □ |
| **Latvia** | _____% | □ | _____% | □ |
| **Liettua** | _____% | □ | _____% | □ |
| **Puola** | _____% | □ | _____% | □ |
| **EU-maat (poislukien Viro, Latvia, Liettua ja Puola)** | _____% | □ | _____% | □ |
| **Venäjä** | _____% | □ | _____% | □ |
| **EU:n ulkopuoliset Euroopan maat (poislukien Venäjä)** | _____% | □ | _____% | □ |
| **Pohjois-Amerikka** | _____% | □ | _____% | □ |
| **Aasia** | _____% | □ | _____% | □ |
| **Muu, mikä_____** | _____% | □ | _____% | □ |

8. **Mikä on yrityksenne henkilöstön jakauma vuosina 2004 ja 2010?** Merkitkää henkilömäärä sopivaan kohtaan. Mikäli henkilöstöänne ei työskentele jollain alueella, rastittakaa 'ei henkilöstöä'.

| | 2004 | Ei henkilöstöä 2004 | 2010 | Ei henkilöstöä 2010 |
|---|---|---|---|---|
| **Yrityksemme henkilöstöstä työskentelee Suomessa** | _____hlöä | □ | _____hlöä | □ |
| **Baltiassa ja Puolassa** | _____hlöä | □ | _____hlöä | □ |
| **Muualla** | _____hlöä | □ | _____hlöä | □ |

9. **Kuinka suuri oli yrityksenne kokonaisviennin arvo vuonna 2004?**_____€

10. **Kuinka suuren arvioitte yrityksenne kokonaisviennin arvon olevan vuonna 2010?**_____€

**11. Kuinka yrityksenne kokonaisviennin arvo on jakautunut alueellisesti vuosina 2004 ja 2010?**
Merkitkää prosenttimäärä sen alueen kohdalle, josta osuus peräisin. Mikäli yrityksellänne ei ole vientiä alueelle, rastittakaa 'ei vientiä' vaihtoehto.

| ALUE | 2004 | Ei vientiä 2004 | 2010 | Ei vientiä 2010 |
|---|---|---|---|---|
| **Viro** | _____% | □ | _____% | □ |
| **Latvia** | _____% | □ | _____% | □ |
| **Liettua** | _____% | □ | _____% | □ |
| **Puola** | _____% | □ | _____% | □ |
| **EU-maat (poislukien Viro, Latvia, Liettua ja Puola)** | _____% | □ | _____% | □ |
| **Venäjä** | _____% | □ | _____% | □ |
| **EU:n ulkopuoliset Euroopan maat (poislukien Venäjä)** | _____% | □ | _____% | □ |
| **Pohjois-Amerikka** | _____% | □ | _____% | □ |
| **Aasia** | _____% | □ | _____% | □ |
| **Muu, mikä_____** | _____% | □ | _____% | □ |

**12. Kuinka paljon yrityksenne kokonaisinvestoinnit olivat vuonna 2004?**_____€

**13. Kuinka paljon yrityksenne arvioidut kokonaisinvestoinnit tulevat olemaan vuonna 2010?**

_____€

**14. Kuinka paljon yrityksenne on kokonaisuudessaan investoinut ulkomaille vuoteen 2004 mennessä?**
_____€

**15. Kuinka paljon yrityksenne on kokonaisuudessaan investoinut ulkomaille vuoteen 2010 mennessä?**
_____€

**16. Kuinka yrityksenne ulkomaiset kokonaisinvestoinnit ovat jakautuneet alueellisesti Suomen ulkopuolella vuosina 2004 ja 2010?** Merkitkää prosenttimäärä sen alueen kohdalle, josta osuus peräisin. Mikäli yrityksellänne ei ole investointeja alueella, rastittakaa 'ei investointeja' vaihtoehto.

| ALUE | 2004 mennessä | Ei investointeja 2004 | 2010 mennessä | Ei investointeja 2010 |
|---|---|---|---|---|
| **Viro** | _____% | □ | _____% | □ |
| **Latvia** | _____% | □ | _____% | □ |
| **Liettua** | _____% | □ | _____% | □ |
| **Puola** | _____% | □ | _____% | □ |
| **EU-maat (poislukien Viro, Latvia, Liettua ja Puola)** | _____% | □ | _____% | □ |
| **Venäjä** | _____% | □ | _____% | □ |
| **EU:n ulkopuoliset Euroopan maat (poislukien Venäjä)** | _____% | □ | _____% | □ |
| **Pohjois-Amerikka** | _____% | □ | _____% | □ |
| **Aasia** | _____% | □ | _____% | □ |
| **Muu, mikä_____** | _____% | □ | _____% | □ |

**17. Arvionne seuraavilla Suomen ulkopuolisilla alueilla olevan kysynnän suuruudesta yrityksenne toimialan kannalta**
Ympyröikää arviotanne vastaava numero skaalalta, jossa 1= ei kysyntää ja 5= erittäin paljon kysyntää

| | | | | | |
|---|---|---|---|---|---|
| Viro | 1 | 2 | 3 | 4 | 5 |
| Latvia | 1 | 2 | 3 | 4 | 5 |
| Liettua | 1 | 2 | 3 | 4 | 5 |
| Puola | 1 | 2 | 3 | 4 | 5 |
| EU-maat (poislukien Viro, Latvia, Liettua ja Puola) | 1 | 2 | 3 | 4 | 5 |
| Venäjä | 1 | 2 | 3 | 4 | 5 |
| EU:n ulkopuoliset Euroopan maat (poislukien Venäjä) | 1 | 2 | 3 | 4 | 5 |

| | | | | | |
|---|---|---|---|---|---|
| Pohjois-Amerikka | 1 | 2 | 3 | 4 | 5 |
| Aasia | 1 | 2 | 3 | 4 | 5 |
| Muu, mikä_____ | 1 | 2 | 3 | 4 | 5 |

**18. Arvionne seuraavien ulkomaisten alueiden kasvunäkymistä vuoteen 2010 mennessä yrityksenne toimialan kannalta**

Ympyröikää arviotanne vastaava numero skaalalta, jossa 1= ei kasvua näkyvissä ja 5= erittäin hyvät kasvunäkymät

| | | | | | |
|---|---|---|---|---|---|
| Viro | 1 | 2 | 3 | 4 | 5 |
| Latvia | 1 | 2 | 3 | 4 | 5 |
| Liettua | 1 | 2 | 3 | 4 | 5 |
| Puola | 1 | 2 | 3 | 4 | 5 |
| EU-maat (poislukien Viro, Latvia, Liettua ja Puola) | 1 | 2 | 3 | 4 | 5 |
| Venäjä | 1 | 2 | 3 | 4 | 5 |
| EU:n ulkopuoliset Euroopan maat (poislukien Venäjä) | 1 | 2 | 3 | 4 | 5 |
| Pohjois-Amerikka | 1 | 2 | 3 | 4 | 5 |
| Aasia | 1 | 2 | 3 | 4 | 5 |
| Muu, mikä_____ | 1 | 2 | 3 | 4 | 5 |

**19. Arvionne siitä, kuinka alhaiset työvoimakustannukset Suomen ulkopuolisilla alueilla on yrityksenne toimialan kannalta**

Ympyröikää arviotanne vastaava numero skaalalta, jossa 1=työvoimakustannukset ovat erittäin edulliset ja 5= työvoimakustannukset ovat erittäin korkealla

| | | | | | |
|---|---|---|---|---|---|
| Viro | 1 | 2 | 3 | 4 | 5 |
| Latvia | 1 | 2 | 3 | 4 | 5 |
| Liettua | 1 | 2 | 3 | 4 | 5 |
| Puola | 1 | 2 | 3 | 4 | 5 |
| EU-maat (poislukien Viro, Latvia, Liettua ja Puola) | 1 | 2 | 3 | 4 | 5 |
| Venäjä | 1 | 2 | 3 | 4 | 5 |
| EU:n ulkopuoliset Euroopan maat (poislukien Venäjä) | 1 | 2 | 3 | 4 | 5 |
| Pohjois-Amerikka | 1 | 2 | 3 | 4 | 5 |
| Aasia | 1 | 2 | 3 | 4 | 5 |
| Muu, mikä_____ | 1 | 2 | 3 | 4 | 5 |

**20. Arvionne siitä, kuinka paljon työvoimakustannukset ovat nousseet Virossa, Latviassa, Liettuassa ja Puolassa vuoteen 2010 mennessä.** Rastittakaa sopiva vaihtoehto.

| | **alle 20%** | **20-60%** | **61-100%** | **101-200%** | **yli 200%** |
|---|---|---|---|---|---|
| **Viro** | □ | □ | □ | □ | □ |
| **Latvia** | □ | □ | □ | □ | □ |
| **Liettua** | □ | □ | □ | □ | □ |
| **Puola** | □ | □ | □ | □ | □ |

**Kiitos vastauksestanne!**

# Appendix 2 The English translation of the questionnaire

1. **The name of the company** _____

2. **The position of the respondent** _____

3. **The number of employees?** Please circle the right alternative

   1 2-9 10-49 50-250

4. **What is the industry your company operates in?**

   Our company operates in:_____

5. **What was the turnover in 2004?** _____ €

6. **What is the estimated turnover in 2010?** _____€

7. **How much is the share of foreign areas from the turnover in 2004 and in 2010?** Please write down the percentage next to the area in question. If your company has no activities in the area, cross 'No activities'

| AREA | 2004 | No activities 2004 | 2010 | No activities 2010 |
|---|---|---|---|---|
| **Estonia** | _____% | □ | _____% | □ |
| **Latvia** | _____% | □ | _____% | □ |
| **Lithuania** | _____% | □ | _____% | □ |
| **Poland** | _____% | □ | _____% | □ |
| **EU countries (excluding Estonia, Latvia, Lithuania And Poland)** | _____% | □ | _____% | □ |
| **Russia** | _____% | □ | _____% | □ |
| **Europe, non EU (excluding Russia)** | _____% | □ | _____% | □ |
| **North-America** | _____% | □ | _____% | □ |
| **Asia** | _____% | □ | _____% | □ |
| **Other _____** | _____% | □ | _____% | □ |

8. **What is the geographical distribution of employees in 2004 and 2010?** Write down the number of employees in appropriate spot. If there are no employees in an area, mark 'No employees'.

| | 2004 | No employees 2004 | 2010 | No employees 2010 |
|---|---|---|---|---|
| **Employees in Finland** | _____ | □ | _____ | □ |
| **Employees in the Baltic States and Poland** | _____ | □ | _____ | □ |
| **Employees elsewhere** | _____ | □ | _____ | □ |

9. **What was total value of your exports in 2004?**_____€

10. **What is the estimated total value of exports in 2010?**_____€

**11. How is the total value of exports distributed geographically in 2004 and 2010?** Please write down the percentage next to the area in question. If your company has no exports to the area, cross 'No exports'

| AREA | 2004 | No activities 2004 | 2010 | No activities 2010 |
|---|---|---|---|---|
| **Estonia** | _____% | □ | _____% | □ |
| **Latvia** | _____% | □ | _____% | □ |
| **Lithuania** | _____% | □ | _____% | □ |
| **Poland** | _____% | □ | _____% | □ |
| **EU countries (excluding Estonia, Latvia, Lithuania And Poland)** | _____% | □ | _____% | □ |
| **Russia** | _____% | □ | _____% | □ |
| **Europe, non EU (excluding Russia)** | _____% | □ | _____% | □ |
| **North-America** | _____% | □ | _____% | □ |
| **Asia** | _____% | □ | _____% | □ |
| **Other _____** | _____% | □ | _____% | □ |

**12. How much were the total investments of your company in 2004?**_____€

**13. How much are the estimated total investments in 2010?**

_____€

**14. What is the cumulative amount that your company has invested abroad until 2004?**
_____€

**15. What is the cumulative amount that your company has invested abroad until 2010?**
_____€

**16. How is the total value of investments distributed geographically in 2004 and 2010?** Please write down the percentage next to the area in question. If your company has no investments in the area, cross 'No investments'

| AREA | 2004 | No investments 2004 | 2010 | No investments 2010 |
|---|---|---|---|---|
| **Estonia** | _____% | □ | _____% | □ |
| **Latvia** | _____% | □ | _____% | □ |
| **Lithuania** | _____% | □ | _____% | □ |
| **Poland** | _____% | □ | _____% | □ |
| **EU countries (Excluding Estonia, Latvia, Lithuania And Poland)** | _____% | □ | _____% | □ |
| **Russia** | _____% | □ | _____% | □ |
| **Europe, non EU (excluding Russia)** | _____% | □ | _____% | □ |
| **North-America** | _____% | □ | _____% | □ |
| **Asia** | _____% | □ | _____% | □ |
| **Other _____** | _____% | □ | _____% | □ |

**17. What is your estimate on the level of market demand in your industry in the following areas outside Finland?**

Circle the appropriate number from the scale where 1 = No market demand and 5= Extremely high demand

| | | | | | |
|---|---|---|---|---|---|
| Estonia | 1 | 2 | 3 | 4 | 5 |
| Latvia | 1 | 2 | 3 | 4 | 5 |
| Lithuania | 1 | 2 | 3 | 4 | 5 |
| Poland | 1 | 2 | 3 | 4 | 5 |
| EU countries (excluding Estonia, Latvia, Lithuania and Poland) | 1 | 2 | 3 | 4 | 5 |
| Russia | 1 | 2 | 3 | 4 | 5 |
| Europe, non EU (excluding Russia) | 1 | 2 | 3 | 4 | 5 |
| North-America | 1 | 2 | 3 | 4 | 5 |
| Asia | 1 | 2 | 3 | 4 | 5 |

**18. What is your estimate on the prospects for market growth in your industry until year 2010 in the following areas outside Finland?**

Circle the appropriate number from the scale where 1 = No market growth and 5= extremely positive prospects for market growth

| | | | | | |
|---|---|---|---|---|---|
| Estonia | 1 | 2 | 3 | 4 | 5 |
| Latvia | 1 | 2 | 3 | 4 | 5 |
| Lithuania | 1 | 2 | 3 | 4 | 5 |
| Poland | 1 | 2 | 3 | 4 | 5 |
| EU countries (excluding Estonia, Latvia, Lithuania and Poland) | 1 | 2 | 3 | 4 | 5 |
| Russia | 1 | 2 | 3 | 4 | 5 |
| Europe, non EU (excluding Russia) | 1 | 2 | 3 | 4 | 5 |
| North-America | 1 | 2 | 3 | 4 | 5 |
| Asia | 1 | 2 | 3 | 4 | 5 |

**19. What is your estimate on the level of labour costs in your industry in the following areas outside Finland?**

Circle the appropriate number from the scale where 1 = extremely low labour costs and 5= Extremely high labour costs

| | | | | | |
|---|---|---|---|---|---|
| Estonia | 1 | 2 | 3 | 4 | 5 |
| Latvia | 1 | 2 | 3 | 4 | 5 |
| Lithuania | 1 | 2 | 3 | 4 | 5 |
| Poland | 1 | 2 | 3 | 4 | 5 |
| EU countries (excluding Estonia, Latvia, Lithuania and Poland) | 1 | 2 | 3 | 4 | 5 |
| Russia | 1 | 2 | 3 | 4 | 5 |
| Europe, non EU (excluding Russia) | 1 | 2 | 3 | 4 | 5 |
| North-America | 1 | 2 | 3 | 4 | 5 |
| Asia | 1 | 2 | 3 | 4 | 5 |

**20. What is your estimate on how much have the labour costs increased in Estonia, Latvia, Lithuania and Poland until year 2010.**

| | **under 20%** | **20-60%** | **61-100%** | **101-200%** | **over 200%** |
|---|---|---|---|---|---|
| **Estonia** | □ | □ | □ | □ | □ |
| **Latvia** | □ | □ | □ | □ | □ |
| **Lithuania** | □ | □ | □ | □ | □ |
| **Poland** | □ | □ | □ | □ | □ |

# Appendix 3 Managers' perceptions on the markets and labour costs in the Baltic States and Poland

## Market demand

The respondents evaluated the level of market demand by choosing the most suitable value from a continuum of one to five. Value 1 represented "no market demand" and value 5 the opposite side being "extremely high demand". When looking at the overall results, which included the comparison areas, the European Union (average of 3,32, N=85) and Russian markets (average of 3,01, N=76) were considered to have the highest demand. However, the demand was considered relatively high also in Estonia (average of 2,78, N=87). Overall, the market demand in Estonia was considered quite notably higher than that of Latvia (2,17, N=87) and Lithuania (2,13, N=84) and somewhat higher than that of Poland (2,39, N=80). The results seem to have a connection with the number of exporting of investing companies. Estonia is the destination of most of the exports and investments and Poland attracts the marketing and investments operations more than Latvia or Lithuania. These results may to some extent reflect the size of the markets. However, regardless of the actual size of the country, the market demand in Estonia is nevertheless considered rather high.

*Market demand according to industry*

When looking at the differences in the perceived market demand according to the industry in the Baltic States and Poland it can be seen that the industrial companies evaluate market demand consistently lower than do the other companies. (Figure 1) Comparing the industrial evaluations to the evaluations of the other industries, however, it can be seen that all industries evaluate the market demand in a country in a similar way; Estonia receiving the highest evaluations and Poland the second highest regardless of the line of business of the evaluators. The differences between the means of industrial evaluations and the means of evaluations of service, trade and others combined are 0,11 in case of Latvia, 0,13 in case of Estonia, 0,2 in case of Poland and 0,25 in case of Lithuania. The highest evaluations, the mean being 2,86, are assigned for Estonia by the companies in services, trade or other. The number of trading companies exporting to Estonia increases notably in five years' time. This may in part stem from the positive perceptions on the market demand. The lowest evaluation was given by industrial companies to the market demand in Lithuania.

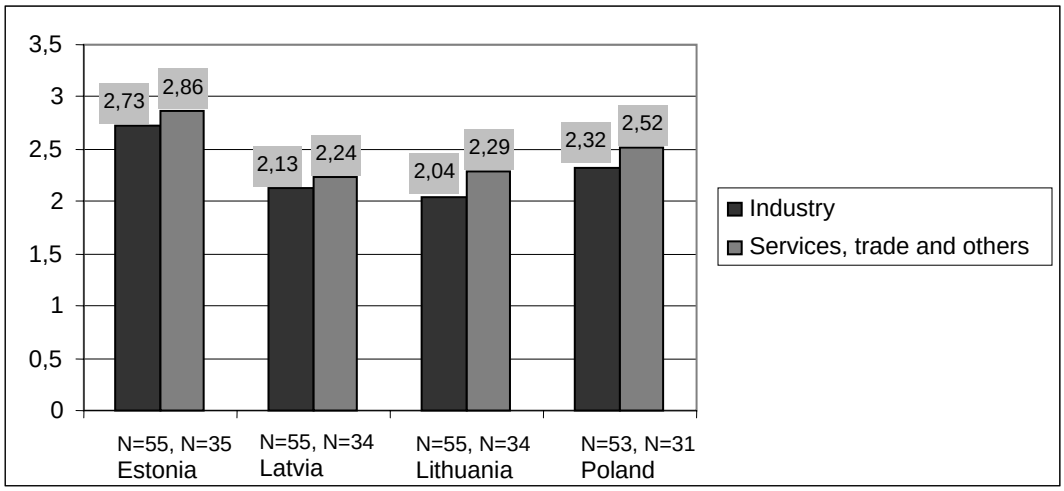


Figure 1 Market demand in the Baltic States and Poland by industry

*Perceptions on market demand and exporting activity*

The perceived market demand is crosstabulated with the number of exporting and non-exporting companies in both years 2004 and 2010 for each of the four countries. A note is made that the numbers concerning year 2004 and year 2010 are not straightforwardly comparable as the number of responses may vary.

When looking at the distribution of values assigned for market demand in Estonia, it is evident that those companies that are involved in exporting consider the market demand to be higher than those companies not involved in exporting to the country. Most of the evaluations fall under values 2 to 4. Among non-exporters the evaluations vary from 1 to 4 whereas among exporters the values vary from 2 to 5. The positive perceptions in this case seem to possibly increase the interest to start exporting to the area, as most of those companies that rate the market demand high will be exporting to Estonia in year 2010 whereas those companies that consider the market demand in Estonia to be rather low plan not to be exporting to Estonia in 2010. Some connection between the perceptions of market demand and exporting activity can be observed.

When looking at the distribution of values assigned for market demand in Latvia, on the other hand, the trend is similar to that of Estonia. The positive perceptions seem to possibly somewhat increase the interest to start exporting to the area, as a shift from non-exporting to exporting can be observed mainly among those companies that evaluated the market demand in Latvia positively. There are, however, three companies among the respondents that have evaluated the market demand quite low with value 2 and still are planning to be exporting to Latvia in 2010 though not having exported to Latvia in 2004. The values vary from 1 to 4 among non-exporters and from 1 to 5 among exporters. However, most of the evaluations fall under values 1 and 2, which implicates that the market demand is considered to be relatively low in Latvia. There is

one company exporting to Latvia in 2004 that has evaluated the market demand to be non-existent. In 2010 there are no longer exporters among the group that evaluates the market demand to be non-existent.

The values assigned for the market demand in Lithuania vary from 1 to 4 among non-exporters, and from 2 to 5 among exporters. Most of the given values fall under 1 and 2. This implicates that the market demand in Lithuania is in general considered relatively low. When looking at the distribution of values assigned for market demand in Lithuania, the shift from non-exporting to exporting can be observed equally among those companies that consider the market demand in Lithuania to be not particularly high and those that evaluate the demand rather high. Over all, however, the trend is similar to the previous: non-exporters evaluate the market demand to be lower than exporters. However, the perceptions on market demand cannot explain the choice of using export mode in Lithuania very well.

When looking at the distribution of values assigned for market demand in Poland, the trend is similar to the previous: non-exporters evaluate the market demand to be lower than exporters. However, in this case the distribution among exporters is relatively evenly spread. Most of the assigned values fall between values 1 to 3. The values vary from 1 to 5 among both non-exporters and exporters in 2004. The positive perceptions on the market demand in may have an effect on the decision to initiate exports to Poland as many of the non-exporters evaluating the market demand in Poland to be high will be exporting to the country in 2010.

*Perceptions on market demand and investment modes*

The number of investing companies is notably lower than the number of exporting companies. The crosstabulations that set evaluated market demand against the number of investing and non-investing companies are presented in the following. In the case of Latvia and Lithuania only the crosstabulations concerning year 2010 are presented, as there were no investments made the two countries until year 2004. A note is made that the numbers concerning year 2004 and year 2010 are not straightforwardly comparable as the number of responses may vary.

The evaluations of companies investing in Estonia fall between values 3 to 5. The most notable increase in the number of exporters can be observed among the group that evaluated market demand high with the value of 4.

Comparing to the crosstabulation concerning exports and market demand, it is evident, that the positive perception on market demand is connected to the willingness to invest more so than it is connected to willingness to export. This finding is consistent with the theories in the field of internationalisation research.

The crosstabulations show that those companies that have invested in Estonia until year 2004 also evaluate the market demand in the country to be relatively high. Those firms that will invest in Estonia until 2010 are firms that have evaluated the market demand quite high. The number of investing companies doubles in five years' time, and the increase derives from the group that perceive the Estonia market demand to be high. There seems to be a connection between the positive perceptions and investment behaviour. However, not all of those companies that rate market demand high have invested in or will invest in Estonia.

When looking at the figures concerning Latvia and Lithuania, it can be seen that those companies that will be investing in those countries consider the market demand of the investment destination to be high. However, regardless of positive perceptions, most companies choose not to invest in these countries. Also, on both cases a company, though perceiving the market demand extremely high, will not be investing in 2010. The perceptions on market demand in Latvia do not explain the choice of using investment entry mode very well. Most of those companies that evaluate the demand to be high will not invest in Latvia.

There is only one company that has invested in Poland until year 2004. This company evaluated the market demand to be non-existent in Poland. When looking at the figures concerning year 2010, among those evaluating 'no market demand' investments are no longer reported. The evaluations of companies having invested in Poland until 2010 are interestingly distributed quite evenly from evaluations almost non-existent demand to extremely high demand. This would suggest that the perceptions on market demand may not, in fact, affect the investment decision considerably.

## Prospects for market growth

The respondents evaluated the prospects for market growth until 2010 by choosing the most suitable value from a continuum of one to five. Value 1 represented "no market growth" and value 5 the opposite side being "extremely positive prospects for market growth". Overall, placing all areas present in the study under scrutiny, the respondents considered Russia to have the most promising prospect for market growth (the mean being 3,33, N=82), the prospects were rated second most promising in Estonia (2,94, N=90). The mean of all responses for Latvia was 2,53 (N=88), for Lithuania 2,45 (N=88) and for Poland 2,63 (N=84). Again, the overall trend correlates with the number of exporting and investing countries. Estonia and Poland received the highest evaluations on market growth of the four countries and those countries also attract more exporters and investors.

*Market growth according to industry*

Industrial companies evaluate the prospects for market growth in Latvia, Lithuania and Poland to be lower than the other companies. (Figure 2) The average of evaluations among industrial firms and others, however, are nearly the same for Estonia. The perceptions of industrial companies weigh down the total average assigned for Poland, as the mean of industrial evaluations is on the same level that of the Latvian mean. The difference between the evaluations is quite high as the companies in service, trade or other consider the prospects for market growth in Poland to be in nearly the same level as in Estonia. Companies operating in other lines of business rate the prospects for market growth in Poland somewhat higher than do the industrial companies. The difference between the evaluations concerning prospects for market growth in Latvia is quite small. The industrial companies evaluate the prospects for market growth somewhat lower than companies operating in other lines of business do as the difference between the evaluations is 0,25. The highest evaluations on the prospects for market growth were assigned by industrial companies for Estonia. The lowest evaluations, on the other hand were assigned to Lithuania again by the industrial companies.

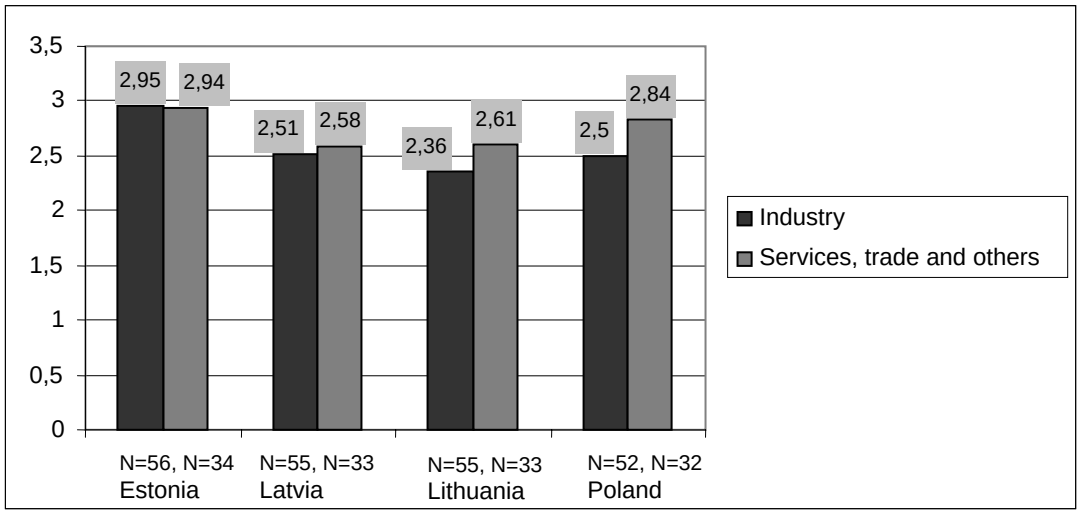


Figure 2 Prospects for market growth until year 2010

*Perceptions on the prospects for market growth and exporting activity*

When looking at the distribution of values assigned for the prospects for market growth in Estonia, the shift from non-exporting to exporting can be observed mostly among those companies that considered the prospects in Estonia to be positive. Over all, non-exporters evaluate the prospects to be lower than exporters. The evaluations among non-exporters vary from 1 to 5 in 2004 and from 1 to 4 in 2010. Notable is that nearly all of those companies that evaluate the prospects for market growth to be positive will be

exporting to Estonia in 2010. The evaluations of exporters, on the other hand vary from 1 to 5. This implicates that the perceptions on the prospects for market growth do not have a substantial effect on the decision to export.

The most of the evaluations on the prospects for market growth in Latvia fall under values 2 and 3. The increase in number of exporting companies stems from the group that evaluates the prospects for market growth to be positive. However, the values assigned by exporters are distributed between 1 and 5. However, the prospects for market growth in Latvia cannot explain the choice of using export entry mode in Latvia very well.

Most of the values assigned for Lithuanian market growth fall under values 1 to 3. Most of the respondents consider the prospects for market growth in Lithuania are not too positive. The evaluations of exporting companies fall between values 2 and 5. The number of exporting companies will increase in all of those value categories. The prospects for market growth do not explain the choice of choosing and export mode in Lithuania.

Most of the respondents consider the prospects for market growth in Poland to be poor. The evaluations of exporting companies vary from 1 to 5. The perceptions on market growth in Poland do not explain the choice of using entry mode in Poland. However, most of the increase in the number of exporting companies takes place among those companies that evaluate the prospects for market growth in Poland to be positive.

*Perceptions on the prospects for market growth and investment modes*

The results show that those companies that have invested in Estonia until year 2004 also evaluate the prospects for market growth to be relatively positive. However, not all of those companies that rate have invested in or will invest in Estonia. Most of the firms that will invest in Estonia until 2010 have evaluated the prospects to be positive. The number of investing companies doubles in five years' time, and the increase stems in its part from the group that perceive the prospects positively. The evaluations among non-investors vary from value 1 to value 5; among investors the variation in from 3 to 5 in 2004 and from 2 to 5 in 2010. This shows that even those companies evaluating the prospects for market growth in Estonia to be relatively non-existent may, in fact, decide to invest in the country. Most of the increase in the number on investing companies, however, can be observed among those companies perceiving the prospects for market growth to be positive.

Most of those firms that will invest in Latvia, Lithuania or Poland will be those that perceive the prospects for market growth to be positive. In case of Latvia and Lithuania only figures concerning year 2010 are presented, as there were no investments made until 2004. Though the number of respondents investing in Latvia or Lithuania in 2010

is low, it is evident that the companies planning to invest belong to that group of companies that evaluated the prospects for market growth positively.

The evaluations of companies planning to be having investments in Poland in 2010 vary from 3 to 5. Those companies belong to the group of companies that evaluate the prospects for market growth in Poland positively.

## Labour costs

The respondents evaluated the level of labour costs by choosing the most suitable value from a continuum of one to five. Value 1 represented "extremely low labour costs" and value 5 the opposite side being "extremely high labour costs". When looking at the mean evaluations on all of the areas included in the questionnaire the managers of SMEs in Southwest Finland evaluated the labour costs to be the lowest in Asia. Latvia and Lithuania were considered to provide nearly as low a cost of labour as Asia. The mean of all responses on the level of labour costs were for both Latvia and Lithuania 1,83 (N=87-84). The figure for Poland was 2,06 (N=80) and for Estonia 2,17 (N=87). The labour costs seem not to have a notable effect on the number of investing companies, as the highest labour costs of the four countries were considered to be in Estonia and Poland yet the most of the companies investing in the Baltic States and Poland in fact invest in those countries.

*Labour costs according to industry*

Figure 3 illustrates the differences between the perceptions of industrial companies and companies operating in different lines of business. Industrial companies evaluate labour costs in Estonia notably lower than other companies.

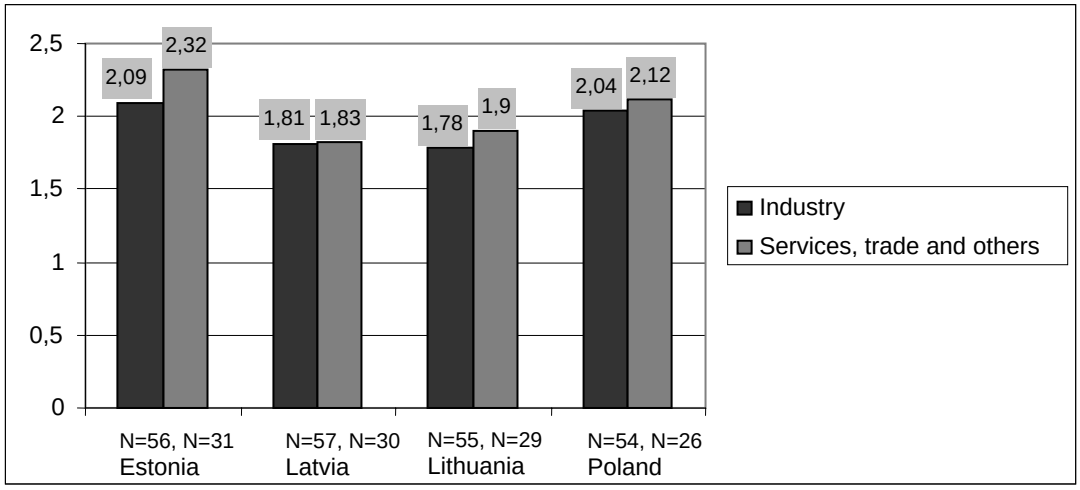


Figure 3 Labour costs in the Baltic States and Poland

The difference between the means is apparent, whereas the differences between the evaluations of different industries concerning Latvia, Lithuania and Poland are very small.

Industrial companies perceive labour costs lower than companies operating in other lines of business in all of the four countries. The highest labour costs were perceived to exist in Estonia by companies in services, trade and others. The labour costs were considered to be the lowest in Lithuania by industrial companies.

*Perceptions on labour costs and foreign investments*

The evaluations concerning the level of labour costs in Latvia, Lithuania and Estonia vary between values 1 and 3. The variation concerning the Polish labour costs is between 1 and 4. As can be seen from the crosstabulations, most respondents, nevertheless, consider the labour costs to be at the low end of continuum.

The most common value assigned for all of the four countries is value 2. Most of the values 1 indicating extremely low labour costs were assigned to Latvia and Lithuania. Companies that have invested in Estonia until 2004 as well as until 2010 belong to the group that evaluate the labour costs to be relatively low with assigned values 2 and 3. Numerous of companies evaluate the labour costs to be extremely low in Estonia, Latvia, Lithuania as well as Poland. There seems to be, however, no interest in encaging in investment operations among those companies.

Those companies that have invested in Latvia, Lithuania or Poland in 2010 belong to the group that consider the labour costs in those countries relatively low with assigned value 2. The low labour costs seem not to attract the SMEs to invest in Poland.

The increase in the number of companies having invested in Poland until 2010 takes place among companies that evaluate the labour costs relatively low with assigned values 2 and 3. Interestingly enough, none of those companies that evaluated labour costs extremely low in a country actually invested in that country. The level of labour costs, therefore, may not be in the most determining role for the investment decisions of the studied companies.

## The development of labour costs until year 2010

The managers of the small and medium-sized companies were asked to evaluate how much the labour costs in the four countries will increase until year 2010. Most of the respondents consider the increase to be moderate. Approximately 60% of the managers estimate the increase of Latvian, Lithuanian and Polish labour costs remain under 60%. Over 20% of the respondent, however, estimate the labour costs in Estonia to double in five years' time. Regardless of the fact that the labour costs are estimated to increase the

most in Estonia, the number of companies initiating investment operations in Estonia increases the most. Low labour costs, thus, seem not to be the main motivator of the companies to enter Estonian markets vie investment entry mode. In the following the estimations on the increase in labour costs are crosstabulated with the number of investing companies in 2010 in order to be able to assess the impact of the increase in labour costs on the investments plans of the studied SMEs.

*Perceptions on the development of labour costs and foreign investments*

The perceptions on the development of labour costs seem not effect substantially the investment decision. The estimates of those companies that will be investing in the Baltic States or Poland spread quite evenly between the low and high end.

The estimations of companies that will have invested in Estonia in 2010 vary from the very low increase of under 20% to the increase of 101-200%. Some of the companies that are not planning to invest in Estonia estimate the increase in labour cost to be over 200%. Overall, most of the respondents have evaluated the increase to be something from 20-100%. The expected increase in the labour costs seems not to affect the choice of the SMEs in Southwest Finland to invest in Estonia significantly.

Though the number of companies investing to Latvia and Lithuania is low, an observation can be made, that the increase in labour costs is not a major factor behind the investment decision as all of the companies in question estimate the increase of labour costs to be 101-200%. Half of the respondents estimate the increase in labour costs in both Latvia and Lithuania to be between 20% and 60%. There are two companies among the respondents that evaluate the increase in labour costs to be over 200% in Latvia and Lithuania respectively.

Most of the respondents evaluate the increase in labour costs in Poland to be 20-60% until year 2010. Most of the respondents planning to be investing in Poland estimate the increase to be something between 20% and 200%. There is one company that estimates the increase in labour costs to be over 200% in five years' time that is nevertheless planning to invest in Poland until 2010.

The companies' plans on investing to the Baltic States and Poland in 2010 seem not to be effected to by the estimated increases in labour costs. The companies planning to invest in the countries invest regardless of the increase in labour costs. Of those estimating the increase in labour costs to be under 20%, only one company will initiate investment operations in Estonia.

## Appendix 4 Distribution of employment

The companies were asked the distribution of their workforce in 2004 and 2010 for the purposes of finding out whether the companies will increase or even relocate employees outside Finland. 4,4% (N=91) of the respondents reported to be having employees in the new Baltic Rim EU countries in 2004 and 15,4% in 2010 (N=91). 9,9% (N=91) reported having employees somewhere else outside Finland in 2004 and 16,5% (N=91) in 2010.

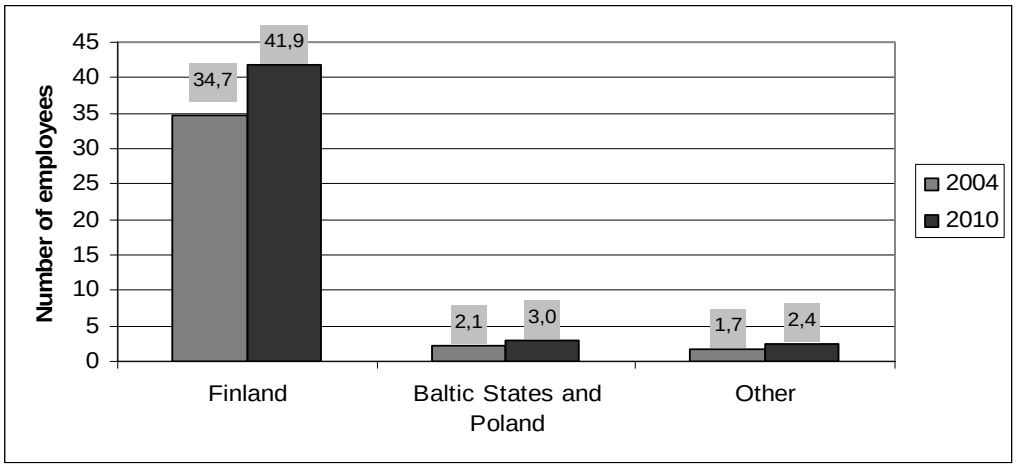


Figure 1 The number of employees in 2004 and 2010

The number of companies having employees outside Finland increases somewhat in five years' time. The companies are not, however, relocating their employees from Finland to other countries. The average number of employees outside Finland remains low. In five years' time the average number of employees increases from two to three in the Baltic States and Poland, whereas the number elsewhere outside Finland remains at a level of approximately two employees. (Figure 1)

When looking at the location of employees of the SMEs in Southwest Finland abroad, it is evident, that the share of the Baltic States and Poland is notable. Over half of the employees outside of Finland are situated in Poland and the Baltic States whereas the share of the area is only 10% of the total Finnish statistics.

Interestingly enough, the average number of employees in Finland increases in five years' time by seven employees. Internationalisation in its part, thus, has a positive influence in local employment.

# Appendix 5 Some statistical tests

## *O advantages*

Size of the firm* Exports to the Baltic States and Poland in 2004

Count

| | | BPexports04 | | |
|---|---|---|---|---|
| | | No exp. | Exports | Total |
| | 1-9 employees | 16 | 14 | 30 |
| | 10-49 employees | 17 | 25 | 42 |
| | 50-249 employees | 12 | 9 | 21 |
| Total | | 45 | 48 | 93 |

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 1,991(a) | 2 | ,370 |
| Likelihood Ratio | 2,000 | 2 | ,368 |
| Linear-by-Linear Association | ,010 | 1 | ,921 |
| N of Valid Cases | 93 | | |

a 0 cells (,0%) have expected count less than 5. The minimum expected count is 10,16.

Size of the firm* Exports to the Baltic States and Poland in 2010

| | | BPexports10 | | |
|---|---|---|---|---|
| | | No exp. | Exports | Total |
| | 1-9 employees | 8 | 19 | 27 |
| | 10-49 employees | 11 | 28 | 39 |
| | 50-249 employees | 10 | 11 | 21 |
| Total | | 29 | 58 | 87 |

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 2,557(a) | 2 | ,278 |
| Likelihood Ratio | 2,473 | 2 | ,290 |
| Linear-by-Linear Association | 1,496 | 1 | ,221 |
| N of Valid Cases | 87 | | |

a 0 cells (,0%) have expected count less than 5. The minimum expected count is 7,00.

Size of the firm* Investments in the Baltic States and Poland in 2004

| | | BPInv2004 | | |
|---|---|---|---|---|
| | | No inv. | Inv. | Total |
| | 1-9 employees | 24 | 2 | 26 |
| | 10-49 employees | 35 | 5 | 40 |
| | 50-249 employees | 20 | 0 | 20 |
| Total | | 79 | 7 | 86 |

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 2,796(a) | 2 | ,247 |
| Likelihood Ratio | 4,289 | 2 | ,117 |
| Linear-by-Linear Association | ,663 | 1 | ,416 |
| N of Valid Cases | 86 | | |

a 3 cells (50,0%) have expected count less than 5. The minimum expected count is 1,63.

Size of the firm* Investments in the Baltic States and Poland in 2010

| | | Inv2010BP | | |
|---|---|---|---|---|
| | | No inv. | Inv. | Total |
| | 1-9 employees | 18 | 8 | 26 |
| | 10-49 employees | 30 | 8 | 38 |
| | 50-249 employees | 17 | 3 | 20 |
| Total | | 65 | 19 | 84 |

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 1,703(a) | 2 | ,427 |
| Likelihood Ratio | 1,700 | 2 | ,427 |
| Linear-by-Linear Association | 1,644 | 1 | ,200 |
| N of Valid Cases | 84 | | |

a 1 cells (16,7%) have expected count less than 5. The minimum expected count is 4,52.

Size of the firm measured by turnover in 2004* exports and investments

| | | Turnover 2004 |
|---|---|---|
| Turnover 2004 | Pearson Correlation | 1 |
| | Sig. (2-tailed) | |
| | N | 98 |
| BPexports2004 | Pearson Correlation | -,146 |
| | Sig. (2-tailed) | ,165 |
| | N | 92 |
| BPexports2010 | Pearson Correlation | -,195 |
| | Sig. (2-tailed) | ,072 |
| | N | 86 |
| BPinv2004 | Pearson Correlation | -,095 |
| | Sig. (2-tailed) | ,385 |
| | N | 86 |
| BPinv2010 | Pearson Correlation | -,038 |
| | Sig. (2-tailed) | ,732 |
| | N | 83 |

** Correlation is significant at the 0.01 level (2-tailed).

International experience measured by the value of exports from turnover in 2004* exports and investments

| | | Value of exports from turnover |
|---|---|---|
| Value of exports from turnover | Pearson Correlation | 1 |
| | Sig. (2-tailed) | |
| | N | 93 |
| BPexports2004 | Pearson Correlation | ,056 |
| | Sig. (2-tailed) | ,602 |
| | N | 90 |
| BPexports2010 | Pearson Correlation | ,092 |
| | Sig. (2-tailed) | ,401 |
| | N | 86 |
| BPinv2004 | Pearson Correlation | -,131 |
| | Sig. (2-tailed) | ,232 |
| | N | 85 |
| BPinv2010 | Pearson Correlation | -,056 |
| | Sig. (2-tailed) | ,618 |
| | N | 82 |

** Correlation is significant at the 0.01 level (2-tailed).

**Exports to the Baltic States and Poland in 2004 * exports to the Baltic States and Poland in 2010**

Count

| | | BPexports10 | | Total |
|---|---|---|---|---|
| | | No exp. | Exports | |
| BPexports04 | No exp. | 27 | 15 | 42 |
| | Exports | 2 | 43 | 45 |
| Total | | 29 | 58 | 87 |

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) | Exact Sig. (2-sided) | Exact Sig. (1-sided) |
|---|---|---|---|---|---|
| Pearson Chi-Square | 35,007(b) | 1 | ,000 | | |
| Continuity Correction(a) | 32,366 | 1 | ,000 | | |
| Likelihood Ratio | 39,642 | 1 | ,000 | | |
| Fisher's Exact Test | | | | ,000 | ,000 |
| Linear-by-Linear Association | 34,605 | 1 | ,000 | | |
| N of Valid Cases | 87 | | | | |

a Computed only for a 2x2 table
b 0 cells (,0%) have expected count less than 5. The minimum expected count is 14,00.

**Exports to the Baltic States and Poland in 2004 * investments in the Baltic States and Poland in 2010**

| | | Inv2010BP | | Total |
|---|---|---|---|---|
| | | No inv. | Inv. | |
| BPexports04 | No exp. | 29 | 10 | 39 |
| | Exports | 35 | 9 | 44 |
| Total | | 64 | 19 | 83 |

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) | Exact Sig. (2-sided) | Exact Sig. (1-sided) |
|---|---|---|---|---|---|
| Pearson Chi-Square | ,315(b) | 1 | ,575 | | |
| Continuity Correction(a) | ,090 | 1 | ,765 | | |
| Likelihood Ratio | ,315 | 1 | ,575 | | |
| Fisher's Exact Test | | | | ,610 | ,382 |
| Linear-by-Linear Association | ,311 | 1 | ,577 | | |
| N of Valid Cases | 83 | | | | |

a Computed only for a 2x2 table
b 0 cells (,0%) have expected count less than 5. The minimum expected count is 8,93.

**Exports to other countries in 2004 * exports to the Baltic States and Poland in 2010**

| | | BPexports10 | | |
|---|---|---|---|---|
| | | No exp. | Exports | Total |
| Other, exports04 | ,00 | 4 | 10 | 14 |
| | 1,00 | 25 | 48 | 73 |
| Total | | 29 | 58 | 87 |

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) | Exact Sig. (2-sided) | Exact Sig. (1-sided) |
|---|---|---|---|---|---|
| Pearson Chi-Square | ,170(b) | 1 | ,680 | | |
| Continuity Correction(a) | ,011 | 1 | ,918 | | |
| Likelihood Ratio | ,174 | 1 | ,677 | | |
| Fisher's Exact Test | | | | ,766 | ,469 |
| Linear-by-Linear Association | ,168 | 1 | ,682 | | |
| N of Valid Cases | 87 | | | | |

a Computed only for a 2x2 table
b 1 cells (25,0%) have expected count less than 5. The minimum expected count is 4,67.

**Exports to other countries in 2004 * investments in the Baltic States and Poland in 2010**

Count

| | | Inv2010BP | | |
|---|---|---|---|---|
| | | No inv. | Inv. | Total |
| Other, exports04 | No exp. | 9 | 6 | 15 |
| | Exports | 55 | 13 | 68 |
| Total | | 64 | 19 | 83 |

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) | Exact Sig. (2-sided) | Exact Sig. (1-sided) |
|---|---|---|---|---|---|
| Pearson Chi-Square | 3,036(b) | 1 | ,081 | | |
| Continuity Correction(a) | 1,968 | 1 | ,161 | | |
| Likelihood Ratio | 2,754 | 1 | ,097 | | |
| Fisher's Exact Test | | | | ,097 | ,084 |
| Linear-by-Linear Association | 2,999 | 1 | ,083 | | |
| N of Valid Cases | 83 | | | | |

a Computed only for a 2x2 table
b 1 cells (25,0%) have expected count less than 5. The minimum expected count is 3,43.

## *L advantages*

BP17= Market demand

BP18= Prospects for market growth

BP19= Level of labour costs

**Correlations**

| | | BPexports04 | BPexports10 | BP17 | BP18 | BP19 |
|---|---|---|---|---|---|---|
| BPexports04 | Pearson Correlation | 1 | ,634(**) | ,204 | ,231(*) | ,031 |
| | Sig. (2-tailed) | | ,000 | ,067 | ,037 | ,788 |
| | N | 93 | 87 | 81 | 82 | 76 |
| BPexports10 | Pearson Correlation | ,634(**) | 1 | ,420(**) | ,447(**) | ,145 |
| | Sig. (2-tailed) | ,000 | | ,000 | ,000 | ,229 |
| | N | 87 | 87 | 76 | 77 | 71 |
| BP17 | Pearson Correlation | ,204 | ,420(**) | 1 | ,612(**) | ,246(*) |
| | Sig. (2-tailed) | ,067 | ,000 | | ,000 | ,037 |
| | N | 81 | 76 | 84 | 81 | 72 |
| BP18 | Pearson Correlation | ,231(*) | ,447(**) | ,612(**) | 1 | ,201 |
| | Sig. (2-tailed) | ,037 | ,000 | ,000 | | ,087 |
| | N | 82 | 77 | 81 | 84 | 74 |
| BP19 | Pearson Correlation | ,031 | ,145 | ,246(*) | ,201 | 1 |
| | Sig. (2-tailed) | ,788 | ,229 | ,037 | ,087 | |
| | N | 76 | 71 | 72 | 74 | 78 |
| | | Inv2004BP | Inv2010BP | BP17 | BP18 | BP19 |
| Inv2004BP | Pearson Correlation | 1 | ,472(**) | ,111 | ,251(*) | ,093 |
| | Sig. (2-tailed) | | ,000 | ,339 | ,028 | ,442 |
| | N | 86 | 83 | 76 | 77 | 71 |
| Inv2010BP | Pearson Correlation | ,472(**) | 1 | ,290(*) | ,264(*) | ,292(*) |
| | Sig. (2-tailed) | ,000 | | ,012 | ,022 | ,016 |
| | N | 83 | 84 | 74 | 75 | 68 |
| BP17 | Pearson Correlation | ,111 | ,290(*) | 1 | ,612(**) | ,246(*) |
| | Sig. (2-tailed) | ,339 | ,012 | | ,000 | ,037 |
| | N | 76 | 74 | 84 | 81 | 72 |
| BP18 | Pearson Correlation | ,251(*) | ,264(*) | ,612(**) | 1 | ,201 |
| | Sig. (2-tailed) | ,028 | ,022 | ,000 | | ,087 |
| | N | 77 | 75 | 81 | 84 | 74 |
| BP19 | Pearson Correlation | ,093 | ,292(*) | ,246(*) | ,201 | 1 |
| | Sig. (2-tailed) | ,442 | ,016 | ,037 | ,087 | |
| | N | 71 | 68 | 72 | 74 | 78 |

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).