INTERNATIONALISATION OF COMPANIES

Matching the Baltic countries strengths and weaknesses with Swedish companies strategic objectives in the Cross border investment model.

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Sammanfattning
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The purpose of the study is to explain how foreign companies strategies theoretically match the Baltic countries strengths and weaknesses and what kind of entry modes provides a good match between the investor´s strategy and the local attractiveness.

Nyckelord
Keyword
Jörgen Ljung, internationalisaton, foreign direct investments, the Baltic, strategy

LÄNGE
LEVE
KUNSKAPERNA !

The internationalisation process in the Baltic region

Neil Yman

Abstract

Background: Since the disintegration of the Soviet Union all conditions and principles for doing business in the area have changed. The shift from a planned economy to a market economy is connected with rapid and basic changes in political, social, economic and technological conditions. The Baltic countries Estonia, Latvia and Lithuania are going through a gradual transition and the decrease of central economic power leads to the liquidation of state monopolies. The markets of the Baltic is giving great opportunities for Western companies since the Baltic is a good springboard to the more Eastern European markets which consists of over 400 million possible customers. The Baltic countries is not a homogeny group they have different language, culture and history which western companies need be aware of if they are going to be successful in their establishment. The western companies choose different entry modes in order to fulfil their international ambitions and the entry mode signals to host governments and competitors the ambition the company will have in the country. For the majority of companies the most significant international marketing decision they are likely to take is therefore how they should enter new markets.

Purpose: The purpose of the study is to explain how foreign companies strategies theoretically match the Baltic countries strengths and weaknesses and what kind of entry modes provides a good match between the investor's strategy and the local attractiveness.

Realisation: The study was supposed to be done in Estonia with the Tolaram group but the connection with the company was broken and the angle of the study has to be changed. For that reason Swedish companies with activities in the whole Baltic were chosen for the empirical findings and the bad Swedish summer of 2000 was used to view and review the literature. The study was made in a deductive way, which means that I first found theories and from them draw hypothesis. I then went out in reality to observe and made a couple of qualitative interviews and finally I sat in the rain in my summercottage and made some conclusions from the material.

Conclusions: The Baltic region has become a Swedish home-market which nearness to the more Eastern European markets attract a lot of foreign direct investments. Companies do an establishment in order to stay competitive and exploit the opportunities of low input factors and the advantage of being there first and take market shares. The best way of entering seems to be through joint venture in order to take advantage of the local partners connections. One of the main problems in the internationalisation process are the bureaucracy, which is constantly changing but will certainly improve with an EU membership. Russia will always influence the Baltic region since its economy is the dominating one in the area and of the Baltic countries historical roots with its big neighbour.

Search words: Jörgen Ljung, internationalisation, foreign direct investments, the Baltic, strategy

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1. INTRODUCTION

In the following chapter I will describe the background of the current topic and try to give you the reader an understanding of why this area of research is of interest. I will also discuss the problems of the study and finally formulate the purpose of the thesis.

1.1 BACKGROUND

Since the disintegration of the Soviet Union in 1989 all conditions and principles of doing business in the area has changed. The shift from a planned economy to a market economy is connected with rapid and basic changes in the political, social, economic and technological conditions in all the Eastern European countries. The transition from a planned economy to a market economy will differ from country to country, since each individual country has to decide between a sudden or gradual transition period. Basically, all countries have opted for a gradual transition, although the speed of the reforms varies from country to country. The transition to a market economy requires the abolishment of the planned economy bureaucracy and the reduction of central economic power. This decrease of central economic power leads to the liquidation of state monopolies in foreign trade and foreign currency management. (Fahey L & Narayanan V K, 1994)

New markets have emerged as a result of the transformation in Eastern Europe and this has increased the number of markets in this region. The nine former communist states have been split into 27 new democratic states. Companies are given new opportunities to expand their business in this part of the world. Western firms face new type of problems with the internationalisation process into the new markets that have emerged in the former communist states (Fahey L & Narayanan V K, 1994).

The markets of Eastern Europe have given a great opportunity to potential foreign investors, since 1989. This market consists of 400 million possible customers, with an unsatisfied demand and with a market with a low degree of competition. Before 1989 the investments in Eastern Europe were scarce and there were only a few joint ventures. Two years after the reforms of 1989, the number of foreign investments in Eastern Europe had increased tenfold (Dezutter, 1997, Djarova, 1999).

The countries of the former Soviet Union offer Western firms cost advantages, in terms of cheap labour, raw materials, energy and services, unutilised production capacities, a potential of highly qualified technical and executive employees and European like consumer behaviour. The companies that invest in the Baltic region are also attracted by the size of the markets in Eastern Europe. Foreign companies put up production facilities in the Baltic countries in order to supply the European market and the potentially growing post Soviet markets, based on the availability of a skilled labour force and relatively low labour costs. Another reason for considering the Baltic countries is that companies are heavily dependent of good transport and communication infrastructure in order to meet their customers requirement of fast deliveries (Ivarsson, 1993).

The collapse of socialism and the ensuing transition process have revealed the position of Estonia, Latvia and Lithuania in an international economic perspective. The Baltic's have become competitive in sectors that generate little value-added as a result of their inferior level of technology relative to their trade partners, which are mainly the OECD-countries (Reardon 1996). Contrary to western perception the Baltic republics of Estonia, Latvia and Lithuania are not homogenous. They have different language, culture and history. Latvians and Lithuanians are the only surviving nationalities of the Baltic people, an ancient group that at one time extended all the way from Hungary to Siberia, whereas the Estonians are of the Finno-Ugric heritage. Lithuania is predominantly Catholic, whereas Estonia and Latvia are predominantly Protestant. The perception of a common identity is a consequence of fate. Each country was part of the Russian empire during the nineteenth century and briefly enjoyed independence between 1920 and 1940 before they became incorporated into the Soviet Union. Each declared independence from the Soviet Union in 1991 and has since begun a transition to a market economy. Each country is legitimising its independence as a historical continuum of the inter-war republics, interrupted only by the Soviet occupation. This means that they are modelling its constitution, currency and state institutions on those that existed during the independence period. (Reardon, 1996)

"Foreign direct investments (FDI) generally refer to investments where the investors purpose is to exert significant influence on the management of the enterprise in the foreign country. As opposed to passive investments such as portfolio investments where the investor is mainly motivated by the return foreseen on the investment, the emphasis in FDI is on controlling the management in the target company" (Hazley C & Hirvensalo I, 1998). FDI is done in mainly two different ways, 1. green field investments that requires newly created enterprises or 2. acquisitions, which means that investors acquire existing companies or parts from them. Joint ventures refer to partly owned affiliates and subsidiaries refer to wholly owned affiliates. *"Therefore cannot co-operation agreements, subcontracting arrangements or other forms of non equity linkages be considered direct investments, unless they involve capital transfers tied to voting rights from the investing company"*. (Hazely C & Hirvensalo I, 1998).

Table: 1. Comparing facts of the nations that are of interest for my report, 1999
Source: http//www.virtualtourist.com.commercial 157/?s=@976972439-19953, 2000-12-16

	Sq km	Population	GDP/capita	GDP billion	GDP growth	Inflation	Unemployment
Sweden	4.449.964	8.873.052	20.700 US $	184,0 US $	4 %	0,4 %	**10,5 %
Russia	17.075.200	146.001.176	4.200 US $	620,0 US $	3,2 %	86 %	12,4 %
Estonia	45.226	1.431.471	5.600 US $	7,9 US $	-0,5 %	3,7 %	11,7 %
Latvia	64.589	2.404.926	4.200 US $	9.8 US $	0 %	3.2 %	9,6 %
Lithuania	65.200	3.620.756	4.800 US $	17,3 US $	- 3 %	0,3 %	10 %

** 5 % in training programs
*In Estonia are People below poverty line 6,3 %

The global trend of doing FDI´s is increasing and in 1996 FDI´s was hitting a new record of 349 billion dollars, this was an increase with 10 %. More than 44 000 companies with over 280 000 foreign affiliates are active investors today. The USA attracted 25 percent of all FDI in the world, and then came the EC countries, the UK, Germany and France. FDI to eastern and central Europe accounted for 3,5 percent of the total FDI. Among the Baltic countries Estonia has attracted most FDI but the phase of investment has stagnated and Latvia has continued to grow. Investments in Lithuania has staggered behind both Latvia and Estonia but started to increase in 1996, see table 2 (Hazely C & Hirvensalo I, 1998).

Table: 2. FDI inflows and inward stocks in the Baltic countries in million dollars
Source: Own work of Hazley C & Hirvensalo I, 1998,
http://www.ida/invest.cp.basiseconomicdata.html

	1992	1993	1994	1995	1996	1997	1998	1999
Estonia	82 $	162 $	215 $	202 $	138 $	?	?	?
Latvia	29 $	45 $	214 $	180 $	292 $	?	?	?
Lithuania	10 $	30 $	31 $	73 $	152 $	1041 $	1975 $	2413 $

Table: 3. The importance of FDI in the Baltic countries 1997
Source: Hazley C & Hirvensalo I, 1998

	FDI inflows per capita	FDI inward stock as percentage of GDP
Estonia	123 $	17,6 %
Latvia	98 $	10,5 %
Lithuania	14 $	2,4 %

Above table shows the significance of FDI for the domestic economy is greatest in Estonia. FDI investments as percentage of gross investments rise above the world average, which is 4-5 percent. The share of FDI of the GDP is also above world average (10 percent) in Estonia. The conclusions Hazley C & Hirvensalo I (1998) draws from the above table is that the FDI inflows into Estonia are close to "normal" levels of FDI inflows in market economies, whereas in all the other Baltic countries there are plenty potential for the FDI inflows to reach "normal levels".

Table: 4. The major investors in the Baltic area 1997
Source: Own work of Eesti Pank, Estonia in Hazley C & Hirvensalo I, 1998

Estonia	Latvia	Lithuania
Finnland 23,1 %	Denmark 27 %	USA 25,2 %
Sweden 23,9 %	USA 15 %	Sweden 12,6 %
Russia 6,5 %	Russia	Germany 11,4 %
UK 4,4 %	UK 13 %	UK 8,4 %
Austria 3,5 %	Germany 7 %	Luxembourg 6,5 %
USA 3,3 %	Sweden 5 %	Finland 6,3 %

International studies show that acquiring new markets and increasing sales have been the main motivation for making foreign direct investments. In Eastern Europe cost factors play a significant role in investment decisions and it is predominantly low labour costs that influence the decision. Surveys that Estrin & Meyer (1997) and Pye (1997) did shows that in addition to market considerations both strategic position factors and investment climate factors played very important roles in the decision process. The strategic factors in the Eastern Europe are first of all to gain a first mover advantage or to follow competitors or customers. Also strategies that enable spill over effects and create synergies are taken into considerations (Hazley C & Hirvensalo I, 1998).

One of the most significant trends of the past three decades has been the globalisation of the marketplace. Previously isolated markets have been opening to competition from foreign firms and companies have therefore begun to seek sales and profit opportunities in overseas markets with greater frequency. The flow of products and resources across countries has expanded and this has an impact on the structure and competitiveness of the marketplace in general (Cavusgil, 1990).

There are a lot of forces behind the globalisation of markets. The market environment has changed due to the drop of planned market systems, tariffs and quotas. It is much easier today to conduct overseas transactions since modern and economic forms of communication transaction and transportation are available (Cavusgil, 1990).

Factors that hold internationalisation back are the lack of information, competition, language and unfamiliarity with the procedures of internationalisation. Developing markets abroad requires managerial and financial resource commitment to a great amount until satisfactory benefits are realised (Cavusgil, 1990). Internationalisation efforts has been conducted by The Swedish Trade Council, The Chambers of Commerce and The ALMI of Sweden which supports Swedish companies with advises and matching Swedish companies with Baltic companies.

Doing business in a former soviet republic brings several challenges to the company, new tasks, unfamiliar environment gives greater uncertainty, all this means that the company takes greater risks. The company meet six challenges when going abroad. 1. The geographical distance which makes the physical distribution more difficult. 2. The psychic distance, which creates communication problems. 3. The multiple environments such as public policy, traditions of trade, barriers to trade and competitive forces. 4. The problem with multiple currencies and exchange rate variations. 5. The conflict with the governments. The one at home which thinks those employment opportunities is placed outside the country and the host government which think that they compete against the countries own companies and that foreign companies take over ownership and take the profit out of the country. 6. Cross-cultural interaction as differences in business customs and ethics which may complicate business transactions (Cavusgil, 1990).

1.2 PROBLEM DISCUSSION

The internationalisation process researchers such as Root, Kotler, Cavusgil among others, tries to understand how firms move beyond their national borders, particularly in terms of their modes of operation. It has for long been recognised that internationalisation is an incremental process in which firms move through stages of development such as export, licensing and joint venture. Internationalisation is a commitment decision based on an appreciation of the strengths and weaknesses of the opportunities in the host country. The decision to do a foreign direct investment in another country leads to increased commitment, greater understanding of the local business environment and the possibility of further investment in the future. Companies chooses different entry modes in order to fulfil their international ambitions and the strategic importance of the entry mode choice is recognised in the corporate strategy literature. Firms are attempting to gain competitive advantages by acquiring resources and capabilities in other countries. This is called strategic asset seeking and is likely to be the most efficient way of obtaining a competitive advantage (Williams, 1997).

When companies are planning a foreign direct investment (FDI) in the Baltic countries there are many factors that companies need to consider. These countries have a varied degree of development of the infrastructure. They may have a slow registration process, lack of experience in dealing with foreign investors and an overall slow privatisation process. Companies are often also inefficient in operation and are therefore not competitive (Dezutter 1997). The Baltic region has come a good way in the transition process and could be used as a prudent step and as a model case for other potential investments in the area.

- Why do companies do a Foreign Direct investment (FDI) in the Baltic area?

The rapid changes in central and Eastern Europe have challenged western companies to consider the region and its emerging markets as an investment area. Before 1989 the non-convertibility of the currencies had effectively hindered any expansion into Eastern Europe. Early penetration was believed to provide an important psychological basis. Acquisitions in the Baltic area could be expected due to competitive reasons and anti-trust problems within the EC/EFTA region (Vahlne et al 1993).

- What kind of strategy was used when entering the Baltic area and was that the best form?

The most significant international marketing decision the majority of foreign companies are likely to make is how they should enter new markets. The commitments they make will affect every aspect of their business for many years ahead. There are cons and pros with each market entry method and there are assessments of the cost and risk associated with each method. A great importance in the investment decision is the level of involvement the company is allowed by the government or wishes to have in the market. These factors determine the degree of control the company can exert over the total product chain. In order to select an appropriate and potentially successful market entry method there are a number of factors to take in consideration such as company objectives, tariff and non-tariff barriers etc. (Fahey L & Narayanan V K, 1994)

- What kind of problems arises for an investor when entering the Baltic area?

When a company enter another country which are not fully democratic and economically developed and stabilised it need to consider what internal and external factors that might impact the business today, or in the future. These factors will to a great extent influence the choice of entry mode a company decides to use to implement and fulfil its strategy in the Baltic region. The entry strategy a company chooses decides the objectives, goals, resources and policies that will guide the company's international business operations over a long period. The entry-strategy time horizon for most companies is from three to five years. Managers need to adopt different strategies for different markets because the business-environment will change from country to country. The market entry strategies require decisions on the choice of market, the objectives and goals in the target market and a marketing plan to penetrate the target market (Root 1987).

- What kind of factors influences the strategy companies' use in the Baltic area?

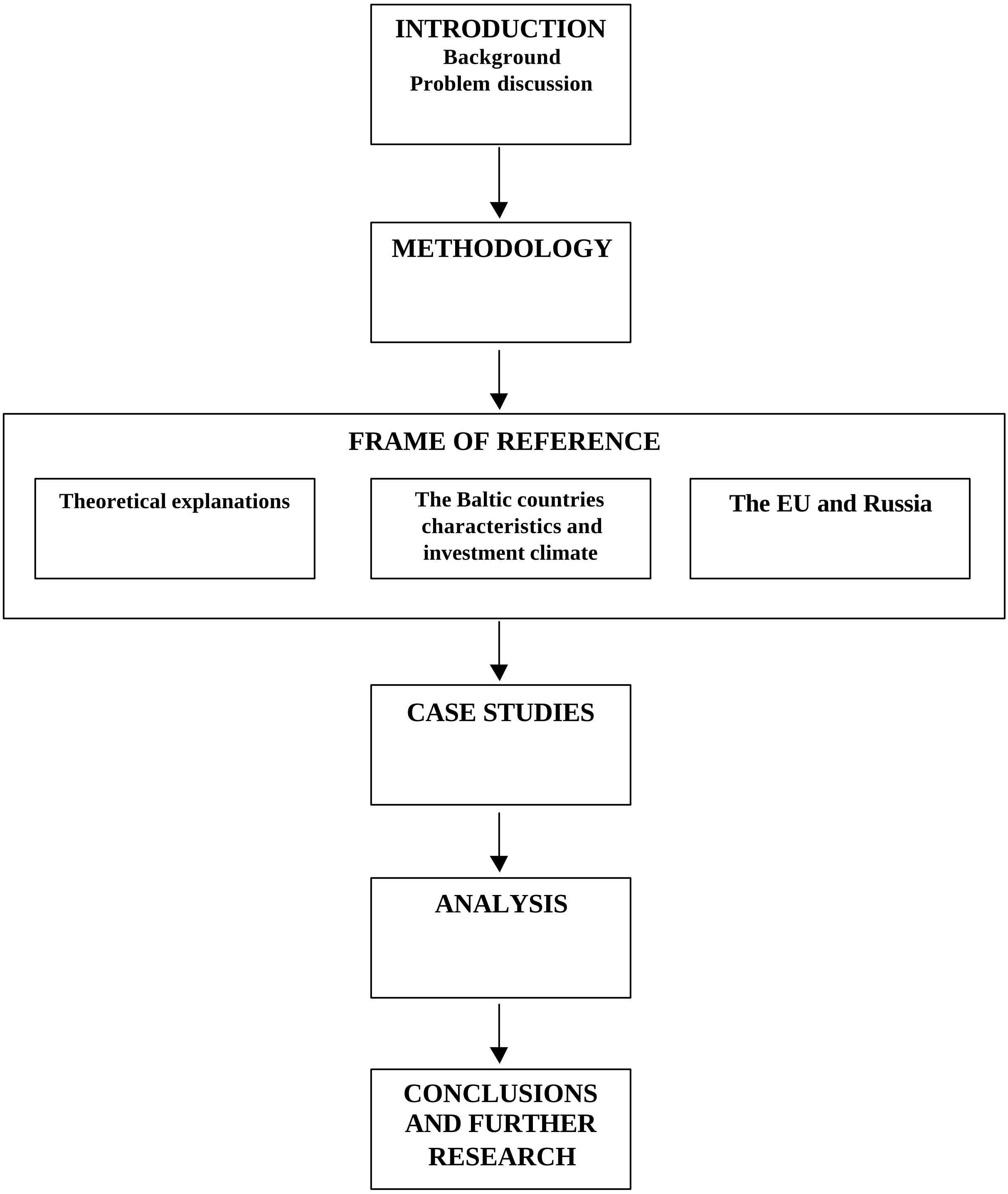
1.3 PURPOSE

The purpose of the study is to explain how foreign companies strategies theoretically match the Baltic countries strengths and weaknesses and what kind of entry modes provides a good match between the investor's strategy and the local attractiveness

1.4 LIMITATIONS

This study is done as a case study investigation on four Swedish companies with a turnover exceeding 150 million Swedish crowns. The study's focus is the Baltic region with the countries Estonia, Latvia and Lithuania. These countries are very small and dependent on their macro environment which has great influence on the whole Baltic region. I will therefore also include Russia and the EU in the report, in order to create an understanding of the impact they have on the Baltic region.

1.5 DISPOSITION



2. METHODOLOGY

In this chapter I will give you, the reader knowledge of how I keep myself to reality and science. I will first describe my view of the subject's science, knowledge and reality and at the same time I will try to clarify my thoughts of the area. The purpose with the chapter is to give an understanding of the process in writing my thesis. I think that a scientific work demands a critical check of methods and results. I will therefore finish the chapter with a description of my way of writing this thesis and criticises my methods.

2.1 THEORY OF SCIENCE AND KNOWLEDGE

People see reality in different ways and therefore people see science in different ways depending on our "luggage" that is our background and previous experiences. I therefore believe that the understanding of deeper studies is made easier throw the understanding of different scientific methods and the approaches you may choose. I have therefore chosen to acquire a deeper understanding of the theory of science and theories of knowledge (epistemology) to be able to "see" behind the scientific "truths". Reality may be described in many different ways depending on the author's personal and specific view. I therefore think it is important to highlight the factors behind which view different authors of theory of science have and how I place myself regarding those theories. To put science in a wider context may be necessary to understand why you may get different answers from one question. Hopefully these thoughts may help the reader to understand how I perceive reality.

2.1.1 What is science?

What is science and what is regarded as scientific? There are many different answers but if you see what the word science is in a lexicon you get the explanation: systematic arranged knowledge or the searching for knowledge (Bonniers lexicon, 1994).

Some scientists claim that there is only one theory of science that exist and that you ought to use it within every scientific field. Others claim that an examination may be scientific in more than one way and that there is a difference between social science and natural science. In the social science there are a lot of different opinions of what science really is and how this kind of research should be conducted and which kind of criterions should be fulfilled so that the research would be considered good (Lundahl & Skärvad 1992).

My view regarding science is the same as the one of Arbnor & Bjerke, *"To work in a scientific manner means to collect, carefully examine and arrange the material. Then you may describe, classify, explain predict and create theories that may lead to wider knowledge"* (Arbnor and Bjerke 1994). This is the kind of tools and methods we use in social science to explain political, economic and social changes in society (Lundahl & Skärvad 1992).

2.1.2 Hermeneutics vs. Positivism

To use a quantitative method means that you use systematic observations, for example questionnaires with fixed alternatives of answers. You use statistical methods to explain different phenomena and you make general conclusions from the information. This means that the scientist is doing a wider research and examines many units in his research and he knows from the start what kind of information he wants (Holme & Solvang 1991).

The positivistic ideal is a quantitative method, which means that the phenomena that are studied must be able to be measured and quantified, the result is often presented in numbers. It should also be possible to do an order of precedence of the answers. Due to Eriksson & Wiedersheim-Paul (1997) there is often only a one-way communication when you use a quantitative method. This is a result of the way the information is collected, usually by questionnaire and with standardised options of alternative answers, which are highly influenced by the researcher.

The qualitative method has been influenced by the hermeneutic approach. The advocates of the qualitative method does not see any possibilities to measure or in an interesting way quantify all phenomena as for example motivation, quality or other characteristics in the study of social science. According to Eriksson & Wiedersheim-Paul (1997) you may see the qualitative process of research as a two-way communication. The researcher put forward a question and gets an answer, which in turn influence the researcher in his further research. When you use a qualitative method you want much information in a few units of examination. In this research you go deeper in the research area throw unsystematic and unstructured observations. This view is in accordance with my view because I think that two-way communication between me as a researcher and the respondent is of vital importance for the quality of my work.

2.1.3 What is knowledge?

What kind of requirements should an opinion have to be called scientific? How should we separate knowledge from guesses and subjective convictions? Is knowledge something we are born with or do we requires it throw experience? Mankind has ever since the ancient antique tried to define what knowledge really is. During the seventeenth century this questions led to a dividing into two groups, rationalists end empiricist, this split is actual even today (Eriksson & Wiedersheim-Paul 1997).

According to rationalists the knowledge is in our inherited consciousness this means that the consciousness is the real source of knowledge. Knowledge is reached throw formulations of true starting points in the form of axioms and premises from which you draw logical conclusions, this is called deduction. The empiricists contrary to the rationalists means that knowledge comes from our experience, this is called induction. When you are born you may say that your soul is a "tabula rasa" (empty painting) which is filled with experience during time and provides us with knowledge (Arbnor & Bjerke 1992). This means that the empirical path and the rational path lead to principally two different ways of tackle problems in science, deduction or induction. Deduction is explained in the following way: from a theory we shape hypothesis, which are testable statements of reality and throw logical conclusions we find the result. Induction means that from different phenomena (experience) in reality we draw general statements, theories and models (Eriksson & Wiedersheim-Paul 1997).

An inductive approach means that you gather empirical data and from these you develop a theory, the theory comes in this approach after the empirical work. When using a deductive approach you create a theory and then you "visit" reality to see if the theory is valid or not. Reality under these circumstances is the empirical work. My opinion is therefore that it is hard to se that you could create a theory without any empirical data, from where is the theory then coming? How could you go out in real life completely free from the influence theories?

I started my research first with a literature study and then did empirical research, this means that I have chosen a deductive path. This work will of course reflect my view of knowledge and science. Therefore I see it as impossible to be "totally" objective because as an individual I am influenced by different experiences and interpretations.

2.1.4 To understand or explain

Arbnor & Bjerke (1994) say that it is important to understand the difference between an explaining way or understanding way of acquiring knowledge. They mean that the boundary is very diffuse and it is difficult to draw straight boundaries. They have done a schematically mapping of the different methods (fig 1). The researchers that reject the difference between nature science and social science is called positivists. The positivists are using the methods that are valid when analysing data in nature science and have the opinion that they are also valid in social science. Hermeneutics (interpreters) do a distinction between the methods of the nature science and social science. They mean that the way of the nature science is not suitable for the research in social science and they mean that there is a significant difference between explaining nature or understand (interpret) the culture (Lundahl & Skärvad 1992).

To try to understand a phenomenon in reality is according to Lundahl & Skärvad (1992) to strive to achieve laws and causal (cause–effect) relations. Throw controlled experiment researchers tries to find the cause to the appearance of a phenomenon, this means that the effect has got a casual explanation to the studied phenomena. The thought of causality is not central for hermeneutics they strive instead for an understanding to the studied problem instead of seeking an explanation (Arbnor & Bjerke 1994). In my opinion it must be easier to decide the cause-effect relationship in the study of nature science than in the study of social science because here we study people. People are social beings which control their behaviour with their thoughts and it must be harder to try to measure them. From my scientific view I have tried to understand my research phenomena, the process of entry into the Baltic countries.

To understand means, to find a signification or a purpose in the material you are doing in your research (Andersson, 1979). This may in my opinion demand some preunderstanding, if we for example read en economical magazine you may need certain preunderstanding in the area of economy so that we could understand the concept and increase our knowledge. Gummesson (1985) say that the understanding of the parts is a condition for the understanding of the whole picture. In the philosophy of science this iterative process is called the hermeneutic circle. Through this circle or spiral a deeper understanding is developed through the interplay of preunderstanding and understanding (Föllesdal, 1993, Gummesson, 1985, Eriksson & Wiedersheim-Paul, 1997).

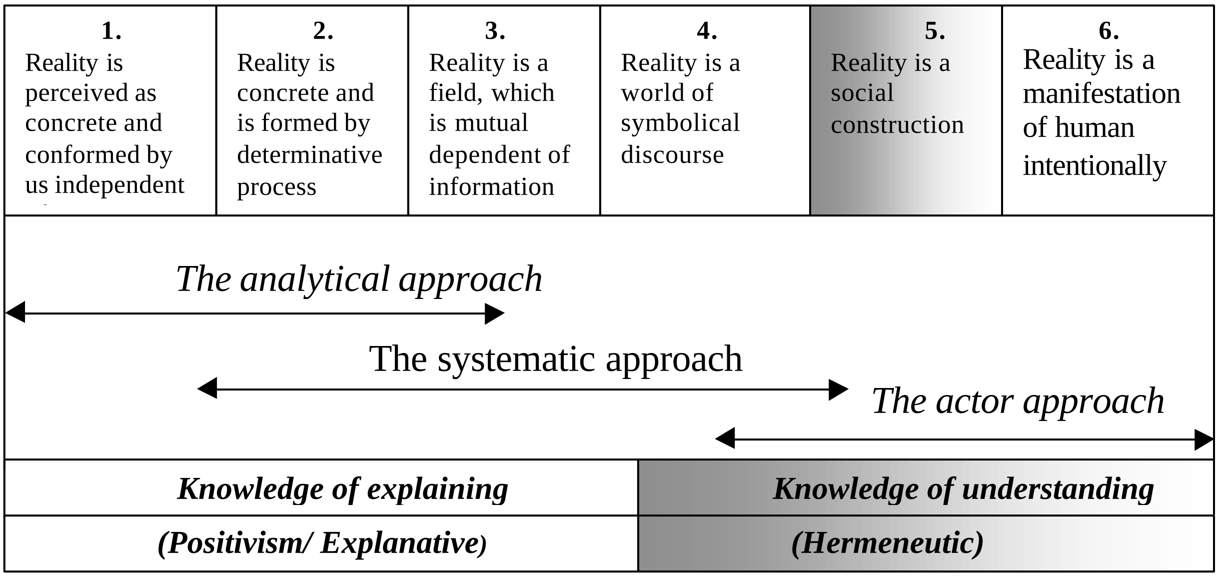
According to the interpreting way of understanding I have choose, my opinion is that social science can not be objective and devoid of value judgements. The judgements I have done and the understanding I have got will affect this reports design and result. I do not say that this thesis is total subjective because my goal was to try to have an objective approach as far as I could. To make my research valid I have great demands on my way of work, my descriptions and results (Arbnor & Bjerke 1994). The researcher must show objectivity and openness in the presentation of the research, according to Eriksson Wiedersheim-Paul (1997) you must reach credibility in the process of your research. They also believe that credibility is the performance of a good research and the transfer of results to other researcher who put up great demands on openness and honesty in the presentation of the research process and the material.

2.1.5 A summery of the researchers view on different methods

Depending how reality, science and knowledge are perceived Arbnor & Bjerke (1994) identifies three views on methods in the field of business economy methodology, 1 The analytical view, 2 The systematic view, 3 The actor view. The different views overlap each other's and the relations with positivistic way and the hermeneutic way is shown in this modified model (fig. 1).

Figure: 1. Summery of different views on methodology

Source: Own work and putting together of facts from Arbnor & Bjerke 1994



According to the figure above we can identify that an analytical researcher, an explanative researcher and a nature science researcher tries to explain with the help of a cause and effect relationship. A systematic researcher may be both explanative and a hermeneutic. The participant researcher is according to the Arbnor & Bjerke (1994) always an understanding oriented interpreting researcher, a hermeneutic. The areas in the figure that are shadowed show my view of methodology, it means that I see reality as a social construction the reality is determined by the one that is studying it. How we perceive the actual area of research will therefore effect what I will do with this thesis.

2.2 RESEARCH METHODOLOGY

The scope of the research questions, coupled with the exploratory nature of this study, made a case study methodology appropriate. I decided to study a limited number of FDI companies in the Baltic States, Estonia, Latvia and Lithuania. The decision to study these three countries meant that I could to some degree distinguish country specific issues and those issues with implications for FDI in general. Companies from the area of Östergötland and Sörmland was chosen with a turnover of minimum 150 million Swedish crowns. The process was started with a hunt for material and after that an approach was made towards the companies. Qualitative interviews were made with managers in charge of operations or managers that had driven the internationalisation process in the companies. After this a read again process started and was followed by telephone interviews to clarify specific issues.

2.2.1 The choice of the companies

My choice of companies that I have used in my report was made in a hurry and without any thought. I was supposed to go to the Baltic to do a case study of the company Baltex 2000, but for some unexplained reason my contact pursponed my visit two times and after that he ignored my e-mails that I sent him. The material that I had gathered was focused on the textile business and had an internal angle at the company. Because of this I had to find a new focus of my study, and I had to do that so I could use as much as possible of the material that I had collected. Since the Baltic still was in my focus I tried to get in touch with somebody who could get me in contact with companies that had business going in the Baltic. I found a good contact in Ove Ohlsson at the Swedish Chamber of Commerce in Oxelösund who is responsible for the matching between Swedish companies and Baltic companies. He supplied me with a couple of companies and in the middle of July I was not in the position to be very picky about which companies that I could use in my study. So finally I used the companies that had time and was interested in helping me.

The companies and the institution I made the interviews with was:

- The Swedish Chamber of Commerce
- Lamiflex Board AB
- Lundbergs produkter AB
- Stål & Plåt AB
- Nyköpings Plastprodukter AB (NPP AB)

The interviews were made face-to-face with both tape recorder and writing. I was able to go through the information after the interview without any kind of misinformation which could occur when you have left the interview situation. The interviews took place at the company headquarters and were conducted between two to four hours.

2.2.2 Criticism of methodology and sources of facts

Is my research valid? Would other researchers get the same answers that I got, if they did a similar survey? In a qualitative study the problem is how you are going to operationalize the result as it is not measurable. My research would have for sure improved a lot if I could get hold to more companies that has business in the Baltic and more companies to choose from. The research would also had improved with the qualitative study in the Baltic countries were you could see the establishment by yourself. I finally hope that my research is valid if you consider that I have interviewed persons that had driven the internationalisation process themselves and was able to ask questions during a couple of hours. You should always be aware that some sources of information could be more or less subjective and possibly could have been changed during the writing process. My aim in the whole of my writing was to be aware of the different traps that you could encounter. Hopefully I have seen them and have avoided them, but I have for sure stepped in some traps and it is then up to you the reader to see through my faults.

3. THEORETICAL EXPLANATIONS

In This chapter I will account for the data I collected and the theories I have chosen for my frame of reference. I will start with an explanation of the internationalisation process and then I will introduce you to the Cross border investment model (CBIM). I will also explain the different internal and external factors that influence the choice of strategy a company will choose. Finally I will reveal the different entry modes that are actual and there are cons and pros with each. The reader should bear in mind Hazely C & Hirvensalo I (1998) quotation if what a FDI is from chapter one.

3.1 THE INTERNATIONALISATION PROCESS

The internalisation process is manifested in a number of different ways. It can be seen in the establishment of foreign subsidiaries, in international joint ventures, in licensing agreements, in international advertising campaigns, in international trade, exhibitions and a multitude of other events and traditions (Leonidou and Katsikeas, 1996). In studies concerning the internationalisation of the firm, development is often seen as a process, in which the enterprise goes through phases of development that successively leads to increased market knowledge and knowledge of different establishment possibilities, this process is called the internationalisation process (Dombos and Ekman, 1998).

The explanations of the internationalisation process of the firm have been made from micro economic and from a macro economic point of view. Dunning´s approach called the “Eclectic approach” state that the company will do a FDI if three conditions are satisfied. 1. The firm possesses firm-specific advantages vis-à-vis firms of other nationalities in serving particular markets. This means firm-specific advantages that take the form of intangible assets, know-how of technology and management or marketing. 2. It must be beneficial for the company that possesses such assets to internalise them through the extension of its own activities rather than externalise them through licensing and similar arrangements with independent firms. 3. It must be profitable to utilise the advantages in conjunction with at least some factor inputs located outside the company's home country (Hazley C & Hirvensalo I, 1998).

3.2 ECONOMIC ENVIRONMENT: PLANNED ECONOMY vs. MARKET ECONOMY

There are two basic kinds of economic systems: planned systems and market-directed systems. There is no market that is entirely planned or market-directed, instead there is usually a mixture of the two systems. In a planned economic system the government planners have the authority to decide how much that should be produced and distributed by who, when, to whom, and why. In this type of economic environment the producers do not have the choice about what product or services they should produce, instead their main focus should be to meet assigned production quotas set by the government. Consumers in these markets usually have some freedom of choice when they select products and services, but the assortment of goods and service is more than often, quite limited. In some instances government planning may work out well as long as the economy is simple and the variety of goods and services are small. For example, under wartime, drought, or political instability it might be necessary to use government planning, but as economies become more complex the government planning becomes more difficult. If the planners cannot handle all the complex decisions, consumers may lose patience if the planners do not respond to their needs. The collapse of communism in Eastern Europe dramatically illustrates this. For instance, citizens of what used to be the former Soviet Union were not satisfied with the government's plan because the product and services they demanded were not available. Government planners tried to reduce the dissatisfaction in the population and started to focus more on making consumer goods more available to the general population, but they could not live up to the expectations of the consumers. So, the dissatisfaction of the consumers created a revolution against the planned economic system, which led to the development of a market directed economy. The differences between a planned economic market and a market economic system are quite obvious. For example the questions of what, how much, and for whom to produce are decided in an open market through competitive forces of supply and demand (Perreault, McCarthy, 1996).

3.3 PSYCHIC/CULTURAL DISTANCE

The world in general and the business community in particular has become more and more homogenous. This is due to new technology for transportation and communication and an increasing homogeneity of customer demand (Vahlne et al 1992). To be able to capitalise on the growing similarities in customer demand, companies are required to develop skills to do business in environments that are different from their own country. Beckerman used the term psychic distance the first time in 1956 to be able to explain international trade. Burenstam Linder talks in 1961 about "limitations on businessmen's knowledge about sources and markets in trying to identify factors which separate countries from each other besides the mere physical distance" (Vahlne et al 1992). As Hörnell et al (1973) in Vahlne et al (1992) showed that psychic distance as well as psychical distance was important factors when deciding on going abroad. Also Nordström (1991) described that psychic distance had great value in the choice of country in the internationalisation process but competitive considerations and country-specific characteristics were also of great importance (Vahlne et al, 1992).

Vahlne and Wiedersheim-Paul defined psychic distance in 1973 as *"factors preventing or disturbing firms learning about and understanding of a foreign environment"*. This means that companies need to learn facts about the foreign countries laws and distribution systems etc. But it also means that the company need to understand the specific culture and be able to relate to it and adjust its own behaviour in order to become successful in that country. The more the foreign market differs from the home market the more difficult will it be to understand the new environment. This means that companies have a tendency to start the internationalisation process on markets close to the home market and the internationalisation process will gradually step-wise go to more distant markets (Johanson & Vahlne (1977, 1990) in Vahlne et al (1992).

The Business community has become more homogenised. The world is becoming smaller and smaller due to technological, psychosocial and political causes. This means that the psychic distance has decreased and it has not been so easy for companies as now to learn about and understand foreign environments and markets (Vahlne et al 1992). Administrative and legal structures are becoming more harmonised with the development of the EU. The English language has taken over as the universal second language of the world. This is due to that over 400 million people have English as a mother tongue and the English spoken part of the world is driving the economic development on the globe. In 1990 over 1 billion people were speaking English (Naisbitt & Aburdene 1990). Educational systems is homogenised all over the world in order to understand and to do business with other countries (Vahlne et al, 1992). Today’s decreasing psychic distance is due to that firms are better prepared to overcome psychic distance. There are more people with experience of doing business internationally and who has knowledge of different investment environments. This comes from the increasing importance of the world economy and the must to be able to share the international trade in order to develop countries.

Vahlne and Wiedersheim-Paul developed in 1973 seven measuring indicators of psychic distance; 1. Level of economic development in the host country, 2. Level of education in the host country, 3.difference in level of economic development between home country and the host country, 4 difference in level of education between home country and the respective host country, 5. Difference in business language, 6. Difference in culture and local language, 7. Existence of previous trading channels between home country and the host country. Vahlne and Wiedersheim-Paul launched a survey there the result was that Nordic countries were closest to Sweden followed by the Northwest European countries, Anglo-Saxon non –European countries and then Latin European countries (Vahlne et al, 1992).

Nordström made a report in 1991 about psychic distance despite that there were twenty years apart between the reports the conclusions were the same and the result that one can draw from these two reports is that psychic distance is rather stable (Vahlne et al 1992). Hofstede showed in his study in 1980 (Vahle et al, 1992) of cultural differences that the culture pattern of countries has very old historical roots, sometimes as old as the Roman Empire. Culture in Hofstede´s sense *"is a phenomenon that could be expected to be stable over time"* (Vahlne et al 1992 p 10). There must therefore be mechanisms in societies which permit that stability of culture patterns across generations. Psychic distance refer to the business community and captures both culture and the factors that prevent learning and understanding, factors that create distance and the ability to cope with this factors. This means that psychic distance is not as stable as culture and it comes from the increasing travelling, lower information costs and creation of standardised markets etc, that close the psychic distance gap between countries. The studies of Hofstede 1980 was an quantitative study of cultural differences and Nordström´s study in 1991 in which he studied psychic distance shows great similarities between countries. Vahlne et al 1992 makes the conclusions that the factors that create psychic distance to large extents have their roots in cultural differences. The internationalisation is therefore not s success in changing culture it is a success in coping and overcoming the perceived psychic gap.

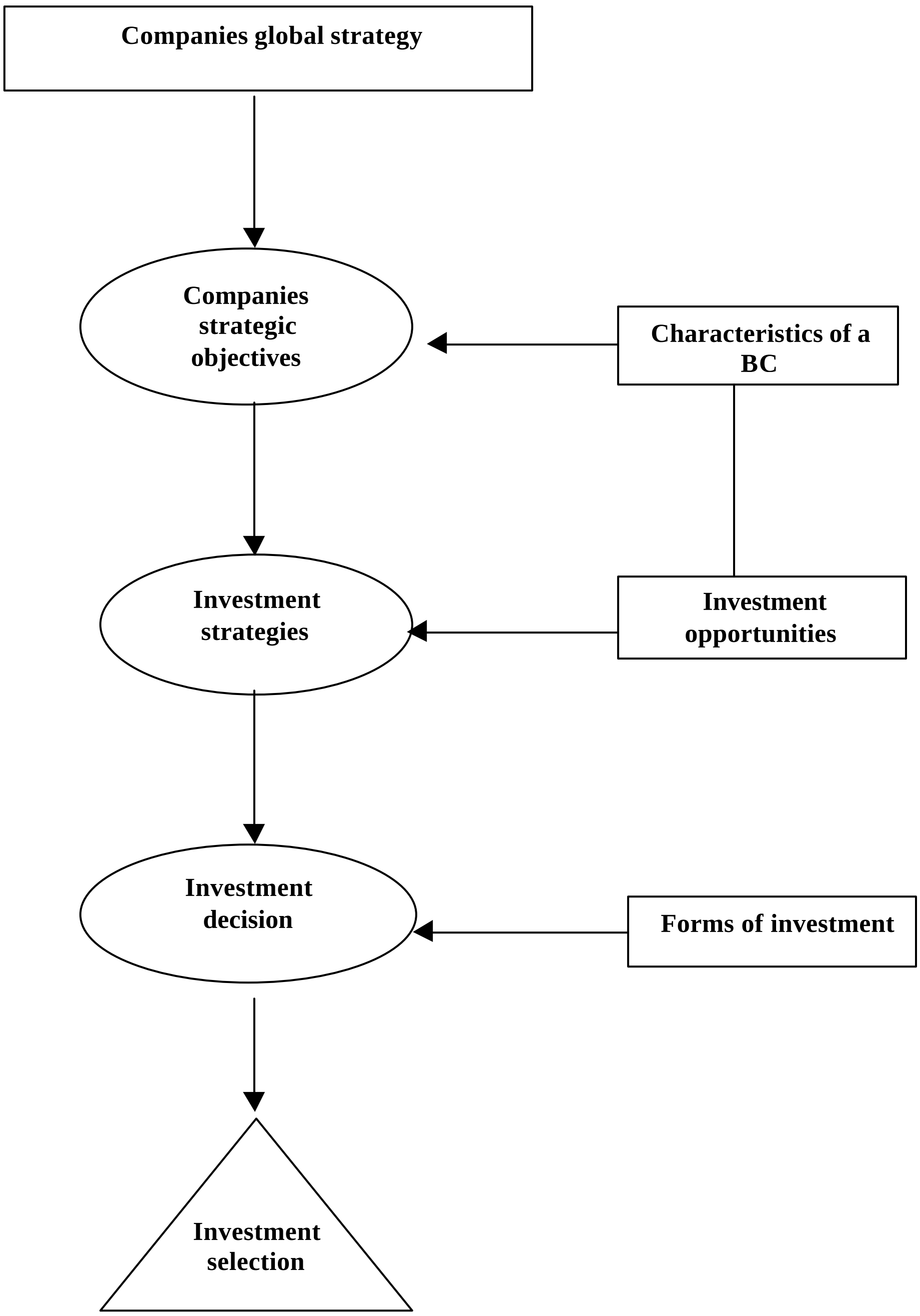
It is not only psychic distance that affects the choice of foreign investment it is also the size and growth of the economy, transport costs, tariffs etc. In a perfect neo-classical world manufacturing investments would be directed to countries where advantages complementary to those of the investor can be found. In reality psychic distance and competitive and country specific considerations factors matters. Nordström (1991) use a multiple regression model to test the influence of psychic distance as well as the market potential on the establishment sequence of Swedish firms during 1960-1986. The result of this multiple regression models was that psychic distance matters substantially and is strongly related to the establishment pattern of foreign investments (Vahlne et al 1992).

3.4 THE CROSS BORDER INVESTMENT MODEL (CBIM)

There are a lot of reasons why a company does a foreign direct investment into a Eastern Europe (EEC) country, such as the hunt for low-cost production and/or development of new markets. The cross-border investment starts with the match between the company's global strategy and the advantages and/or disadvantages of the region considered. On the basis of these considerations firms decide on the form of investment, taking full advantage of investment opportunities offered by the investment area. When companies cross the borders the main aim is to become a global market player. The crossing of borders is a result of the company's dilemma, diversify at home or expand abroad. Domestic firms gain from better match between production and local consumer needs. Global companies gain from the comparative advantages of nations and experience a sustained economy of scale, economies of scope and learning effects (Djarova, 1999).

Dunning (1993) in Djarova 1999 defines three requirements for firms to engage in FDI: 1. ownership control, 2. international advantage and 3. location advantage. The CBIM incorporates the firm's entry or expansion modes abroad and the location attractiveness within the entire investment decision chain. The Cross-border investment model (CBIM) has four decision-making inputs. 1. The western company's global strategy, 2. characteristics of the investment area, 3. investment opportunities offered by the investment area and 4. possible forms of investment. Three major decisions or outputs are being made on the basis of the input information. 1. The company's strategic objectives toward the investment area, 2. the investment strategy and 3. the investment decision, which will lead to an investment selection (Djarova, 1999).

Figure: 2. Cross-border investment model (CBIM)
Source: Djarova, 1999



3.5 CHARACTERISTICS OF A BALTIC COUNTRY (BC)

Western investors think of BC as any other investment area, in terms of comparative advantages and disadvantages that are important when shaping an investment strategy.

3.5.1 High specialisation but low efficiency

The Baltic countries offer specific advantages and disadvantages. All Baltic countries share the common characteristics from the past. These characteristics are high specialisation, often low efficiency, and low labour costs, low productivity, vertically organised and highly organised companies with a European culture and tradition. During the Soviet occupation the Baltic countries were forced to build up huge capacities in one sector, which were supposed to feed the whole former Eastern Europe with this particular goods. As an outcome from this heritage, the lost of these old markets and the “economic liberation”, the companies in Baltic countries suffer from a lack of economy of scale, lack of markets and large debts. They are often in worldwide declining industries too and are therefore unattractive to foreign investors. There are of course companies in the Baltic countries that offer reasonable production facilities, well qualified workers and engineering staffs (Djarova, 1999).

3.5.2 Low labour costs but low productivity

The most highlighted advantage of Baltic countries is the low labour costs. The problem in these countries can be that because they have low labour productivity the overall labour cost advantage diminishes. The salary of a worker in an export investment is 16 percent of the western level and productivity is about 70 percent of the western level (EBRD 1996 in Djarova, 1999). The most important question for investors nowadays are how long it will take for the Baltic countries to reach western standard in the levels of salaries. Nobody can today say how long the industries with labour-intensive industries such textiles, forestry and food processing will persist longer at the lower salary levels. The low labour cost advantage can be sustained if the Baltic countries can improve productivity but the lack of upgrading activities for the workers, inefficient labour organisations, counterproductive labour attitudes and inadequate management systems, the lack of quality controls and the necessarily logistics makes doing business in these countries hard. Investing companies that deal with these measures will extend the lifetime of the labour-cost advantage (Djarova, 1999).

3.5.3 Vertically organised and highly centralised companies

Western companies that have the intention to take control over companies in the Baltic countries have to deal with highly centralised organisational forms. The attraction of BC companies lies with their core businesses. Taking over a BC company often means restructuring processes. This could lead to differences because the of social sensitivity of such a restructuring process. The restructuring of the companies often means that the vertical dependence of the company's parts is abolished. The process is delicate because you do not want to lose the functional expertise of the employees, which is one of the advantages of functional corporate structures. The process should aim primarily at the company's human capital, if the western firm is unaware of this, they may encounter conflicts with the employees and local management. (Djarova, 1999)

3.5.3 European culture and education

It is not only the size and the potential of the newly opened BC markets that investors considers when thinking of doing business there. The companies are also very interested in social characteristics like personal life styles, working values, education and consumer behaviour. One advantage of Baltic countries is that they have a nearer psychic distance than developing countries and Far East countries. This means that it is easier for western companies to influence employees and consumers perceptions of western like products and habits. The high percentage of university graduates in the countries and western training programs make the adaptation fast and uncomplicated. According to Ove Ohlsson at The chambers of commerce in Oxelösund *“there are 100 engineers on every 1000 people in the Baltic countries, in Sweden it is 1,5 on every 1000 people”*. Economic and social differences are diminishing as EEC countries sign agreements and become members of different trade associations and of different institutions as the EU (Djarova, 1999).

3.6 COMPANIES STRATEGIC OBJECTIVES TOWARDS THE BC

Companies with a strong position in their home markets intends to retain them as primary markets will only cross borders if an attractive investment opportunity shows up. These companies are usually sensitive to country risks and their investment decision is largely defined by their requirements for high returns.

Companies may pursue cost-reduction strategies when they are going global and doing investments abroad. This strategy means mainly transfer of production from a more expensive to a less expensive place. This means that you need to find a suitable partner that you could trust in terms of quality and business loyalty and use as a subcontractor or build up local factories on the spot. The most important thing in the investment area is the legal framework that defines the investment regimes in the host country.

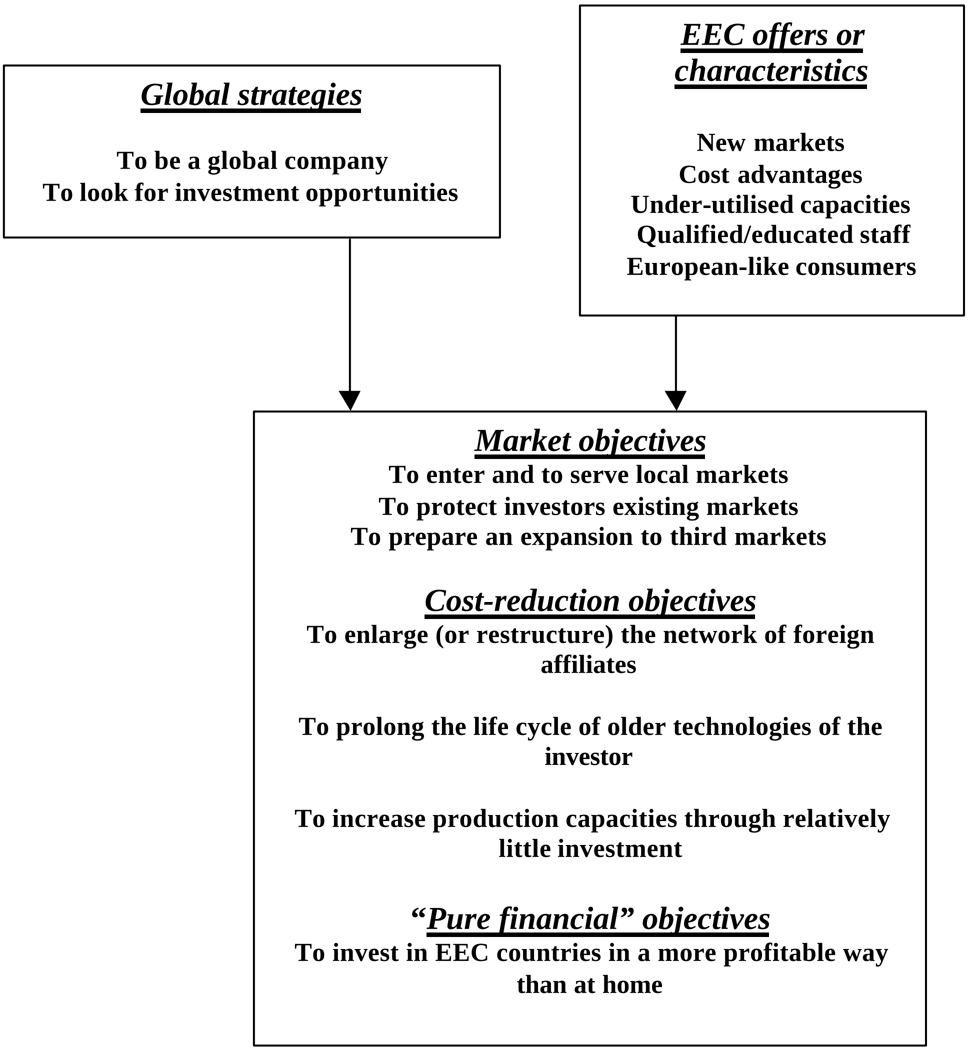
Table: 5. Companies global and investment strategies often pursue cost-reduction strategies. Source: Djarova, 1999

		Global Market-related Strategies	
		To be a global company	*To look for investment opportunity*
Global cost-Reduction strategy	*Global cost reduction is needed*	Multinationals as Coca-Cola	Machine building, textiles, metallurgical companies, ready-made clothes
	Is not needed or not applicable	Multinationals constancy companies as, Unilever	Local transport companies, services, trade companies

If the firm pursues a market strategy it needs to investigate consumer needs, prices, competitors, consumer demand, distribution channels, possible suppliers and the legal framework of the country. This strategy usually implies ownership involvement in domestic companies or establishing a subsidiary. The process often takes substantial amounts of time and has a long-term impact. Global companies often combine market-related strategies with cost-reduction strategies to be able to establish a "cheap satellite" in a country with cheaper input costs (see table 5). This company uses the old technology from the Mother Company but is still competitive due to the lower production costs (Djarova, 1999).

The strategies of western companies assume a specific meaning when combined with the above specific characteristics of BC as an investment area. Following the classification of strategies shown in table 5, three groups of objectives could identifies, market objectives, cost-reduction objectives and purely financial objectives (see figure 3).

Figure: 3. Western companies strategic objectives toward Baltic countries
Source: Djarova, 1999



3.6.1 Market objectives of western companies toward Baltic countries

Three main market objectives can be identified, to enter end serve local markets, to protect the companies existing markets and to prepare expansion to third markets.

Entering and serving local markets

This objective is intended to realise the expansion of the company's sales or production in the local markets of Baltic countries. The BC area and the rest of the east European area offers a potential market of 400 million people which have an unsatisfied demand and a low degree of competition. There are still low levels of entry barriers and companies may choose a gradual entrance starting with a simple trade using local production. Other companies may use more aggressive approaches such as the taking over a local producer or building new production facilities (Djarova, 1999).

Protecting foreign investors existing markets

Western companies are given the opportunity to maintain some of their existing markets by applying a low price strategy and by selling an old generation product profitably.

An excellent example is the Skoda car, which is produced in the Czech VW/Skoda plant and sold in Western Europe at a relatively low price. Another example is when Philips transferred a product line of outdated video recorders, which were sold at the local market until these markets became ready to accept the new generation of video recorders. Protecting the companies existing markets can also mean neutralising potential exporters to these markets. Protection can also be directed toward maintaining the quality of the exported goods. For this reason Western companies in BC have as a rule retained sole distribution rights, especially where their traditional markets are concerned. (Djarova, 1999)

Preparing the expansion to third markets

BC can be a springboard to a third markets for two main reasons. First the BC may offer the potential to recover former economic relations within the region, including the great potential market of Russia. Second, the countries of the Baltic offer manufacturing and labour capacities for lower prices, and these are reflected in the prices of products. This gives the western companies the possibility to enter third markets with a low price strategy combined with western-quality products. (Djarova, 1999)

3.6.2 Cost reduction objectives of western companies toward Baltic countries.

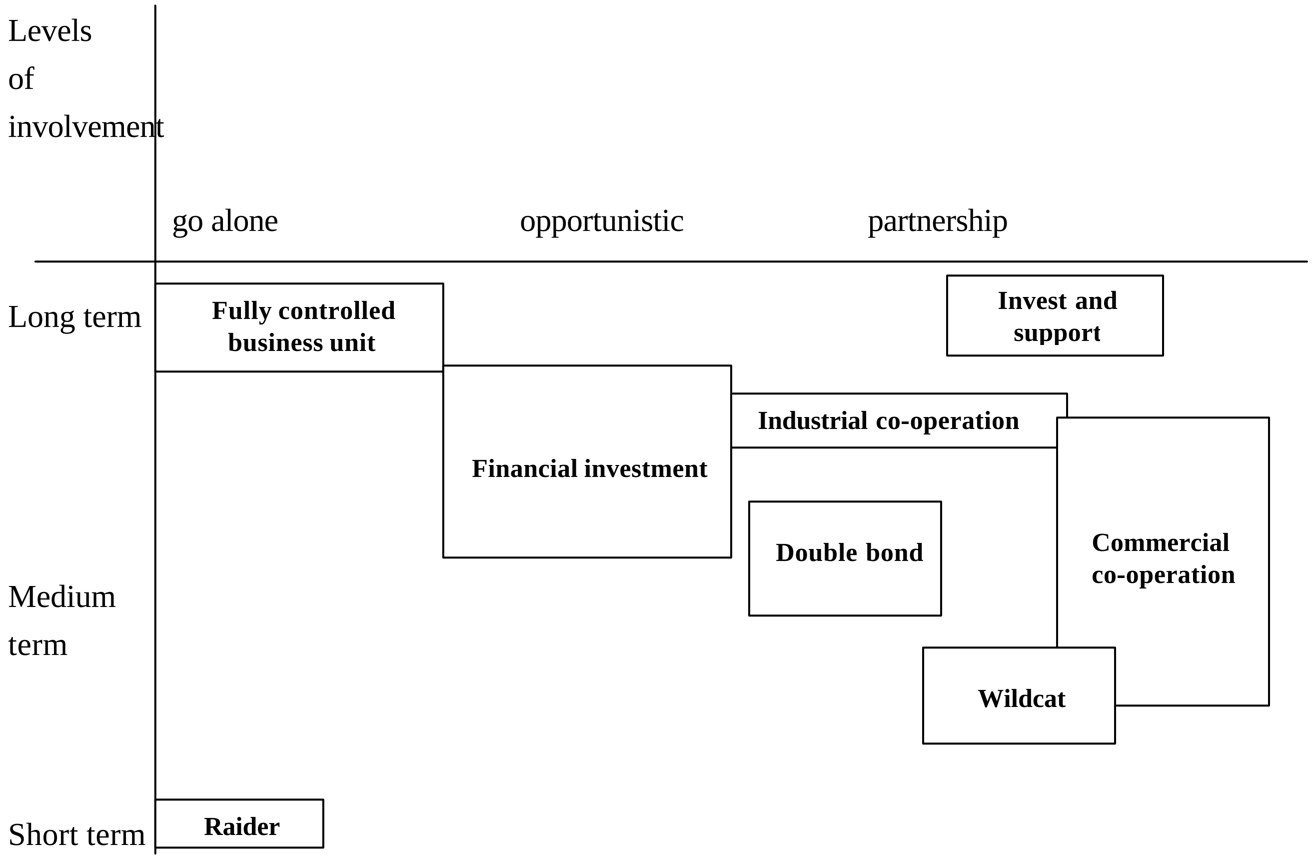
The cost-reduction objectives have been factors in the East-West business relations since 1973. The reward lay mainly in cost advantages for the western companies and technology transfer and adaptation of new products for the countries in the former Soviet republic. The transition process made the western companies consider which strategic move one should take with regard to their co production partners. Now western companies focus on the local market opportunities, they benefit from the low cost structure of the Baltic countries and stand to benefit from increased value-added products in case of they are exported to third competitive markets. (Djarova, 1999)

Western companies apply cost-reduction objectives to the BC primarily for three reasons: 1. To enlarge the network of satellite companies, 2. to prolong the life cycle of an old technology and 3. to increase production capacities for low investments. The EBRD showed in a study that Western investors *"stress the importance of production cost reduction in general and the availability of cheap skilled labour in particular"* this is the single most important motivation for their investment decision. (Djarova, 1999)

3.7 INVESTMENT STRATEGIES AND INVESTMENT OPPORTUNITIES

Foreign investors realise their strategic objectives toward the Baltic countries through entry or expansion strategies that match the objectives with the possible investment forms in the region. The investment strategies are based on two criteria's, first would the foreign investor enter the investment area alone or in co-operation with partners, local or international. The second criteria is the company's level of involvement in investments in local business and whether the company has a long-term view of its involvement. The combination of the two criteria's gives rise to several types of investment strategies. See figure 4.

Figure: 4. Investment strategies based on the criteria's level of involvement and partnership or not
Source: Djarova, 1999, Root, 1987



The highest involvement of western companies in the Baltic countries can be realised through production and/or sales subsidiaries in cases where the company want to do a “go alone “ strategy. The subsidiary can be established through three types of investments, 1. a “green-field” company set up, 2. acquisition of a local company and 3. taking over the majority ownership in a local company. The main advantages of this kind of entry are the control an investor gets over the investment in regards of production, distribution, pricing and promotion, quality, innovation and resource management. This entry mode make it possible to adapt and develop the company’s investment plans whenever necessary. The most widespread form of business forms in Eastern Europe has been joint ventures or co-production. This is due to that these two modes were the only allowed in the former Soviet Empire and they also provide an acceptable spread of risk. Joint ventures can be horizontally or vertically integrated with the main business activities of the western company. With the establishment of a horizontally integrated joint venture the western company is pursuing primarily an expansion strategy with the intention to enlarge the existing core business activities in a profitable manner. With a vertically integrated joint venture the western partner is pursuing a backward/forward integration strategy which means that the company enlarges the network of foreign affiliates. Most of the east-west joint ventures are horizontally integrated. (Djarova, 1999)

Joint ventures still seems to be preferred as an entry mode in the BC countries and the status of this entry mode has changed over the transition process. Western companies are often faced with the choice between establishing a joint venture or participating in privatisation. The choice is a critical one because in the case of privatisation the owner who usually is the BC state puts certain requirements on the potential buyers. These requirements are often additional investments in the modernising of the company, limitations of employee layoffs and preservation of core activities. Western companies often therefore face the fact that they first pay for the shares and second for the fulfilment of an investment program. But in most cases restructuring is badly needed. This could be a hard process where the foreign investors often are seen as invaders.

In the case of joint ventures the foreign partner contributes with capital and management know-how and technology. The East-European partner contributes with fixed assets and people. The payment for this transaction is made once instead of the privatisation case, there additional costs comes from the modernising and other agreements the western company made with the BC government. In the Joint venture the western partner has more freedom over the choice over which kind of employees one want and which assets to include in the deal. The negotiations are carried out directly between the partners. (Djarova, 1999) See table 6.

Table: 6. The joint venture/privatisation choice
Source: Own work of Djarova, 1999

Forms	Advantages	Disadvantages
Ownership through Participation in the Privatisation of a BC company	taking over a company in the core business taking over a Existing market Opportunity to Negotiate the price And the conditions Follow-up control Over the business	Negotiations with the state larger investment Buying the bad and the good parts of the company Follow-up obligations toward the former owner
Joint venture deal With EEC company	Negotiating directly with the partner Control over the Development of the Business plan and The investment risk Investing only once Directly into the joint Venture Influencing the Contribution of the EEC partner Decisive rights in Selecting labour and Management	the identification of a partner might take a long Time, the same applies to The negotiations Approval procedures by the state might be lengthy Changes in the ownership of the BC partner might have influence on the Joint venture conflict of interests possible with the BC partner

There is a particular risk involved in joint venture deals with BC companies that are still state owned. Sooner or later the company will be privatised which of course will have an impact on the joint venture. There are possibilities of conflicting interests. To avoid situations like this it is necessarily to have a majority ownership so that the western partner still has decisive management rights. If the western company is not interested in full ownership or majority ownership the construction of a subsidiary and an equity joint venture with a state owned enterprise is not preferred. The most advisable models in mind are therefore invest and support" and "double bond". These two constructions will assure the western company of a minority participation in a privatisation company with potential to move to more binding constructions or the possibility to withdraw more easily. (Djarova, 1999)

In the ***"invest and support"*** model the western company takes a minority share. It brings in money, know-how and commercial contacts to the Eastern European Company. It is looking for an income stream from the investment and expects the values of the shares to increase or a steady stream of income. The investment is usually not on a short notice and this arrangement is suitable for companies in the same business, where the support from the western partner could improve business and the Baltic company's value (Djarova, 1999). See fig 5.

The ***"double bond"*** strategy is a protective strategy and is not interested in investment as such. The aim is to protect the co-operation between the two companies. To ensure the strategy the western company exchange minority shares or the western company buys a small share of the Baltic company. If the western company is a significant buyer of the Baltic company's products as in the case of co-production and licensing the partners are mutually dependent and therefore vulnerable, it could be necessary to strengthen this relationship with a small investment. (Djarova, 1999) See fig 5.

The ***"wildcat"*** investment strategy is a way for the Western partner to try out the business opportunities in Baltic countries without so much risk. The strategy is to take a small share of a company and monitor its progress. At later stage if the shares act profitably the strategy moves to an invest and support strategy. The Wildcat strategy provides the Baltic company with vital amounts of money and the Western European company gets learning experience in addition and prevents a competitor from taking over the European partner. (Djarova, 1999) See fig 5.

If the western partner only brings in money we speak of a ***"financial investment"***. The wildcat strategy is usually of long-term interest from the western company's perspective and is very beneficial for potentially successful Baltic companies. This kind of investment is preferred by the Baltic companies that want to stay independent and to preserve their brand name and management control. (Djarova, 1999) See fig 5.

The ***"raider model"*** is hostile in its objective and is used when Western European companies has no long-term interest and are not involved in the business. The strategy means that the West European company takes over a Baltic company with the intention to sell it at a profit. This is done either by selling pieces or the whole company or a combination of the two possibilities. Raiders are out for a quick profit and are not interested in building and investment for the future. (Djarova, 1999) See fig 5.

"Commercial co-operation" as exporting, counter trading and franchising is used when Western companies want to be present with their products on the Baltic markets without doing any heavy investments. These kind of commercial forms are only the first step toward the entering of a new market. This form of entry may be followed by higher involvement or just be a single transaction or limited to trade. (Djarova, 1999) See fig 5.

There is close interaction between investment strategies and investment forms. A fully controlled business unit can be realised either through a Greenfield operation or by the take-over or by the majority ownership in an existing company. The *"investment and support"* strategy can be pursued by minority participation in an existing company with promising financial results and with a future option to expand ownership. *"The double bond"* strategy is based either on a protective construction of exchanged small shares between the West and the Baltic companies or on minority participation in the Baltic partner. The "*raide*r" strategy ends in a take-over of a Baltic firm with future opportunities for further profitable sale. "*The wildcat*" strategy is a tryout strategy that does not go beyond very small ownership participation in an existing company and can lead to "invest and support" as a possible follow up. *"The financial" approach* is not among the more popular investment forms in Baltic countries but is applied where a high and fast ROI is expected. "*The industrial co-operation"* strategy can be realised in several forms, the most popular of which is the joint venture. In addition to this form co-production, licensing and franchising will spread and for sure become elements of other forms. Matching an investment strategy with the corresponding investment form brings the foreign company to a particular investment decision that realises firm's strategic objectives. This decision can later be adapted to the dynamics of the investment area and the changes of its business conditions. After several years of transition one can now see a dynamic in the investment forms with which foreign companies first entered. Trade develops into equity participation or co-production and co-operation. Joint ventures are transferred to fully owned foreign subsidiaries. Some minority participation appears to have the objective of a "raider". Foreign banks and institutions invest in equity and thus increase the share of financial investment (Djarova, 1999).

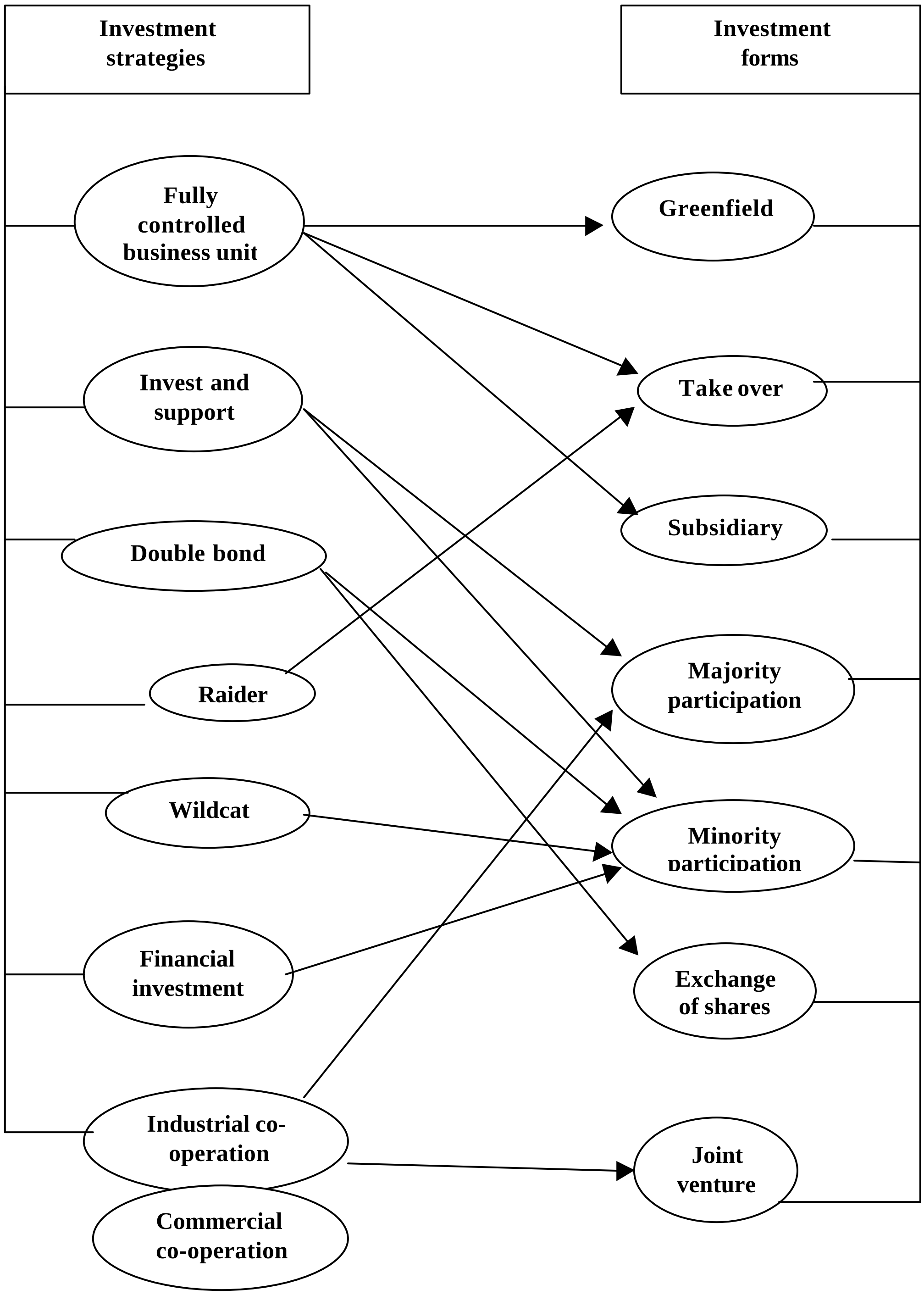
The model in figure 4 leads to a choice of an investment strategy and a form of investment. By following the model in figure 2 I have tried to uncover the investment decision process by matching a western companies global strategy and entry/expansion modes with the specific requirements of the country. The choice of investment strategies and investment forms will lead to a investment decision, but each company may adopt a different strategy according to its own objectives and capabilities, past experience and margins of risk. The strategies of investment in the Baltic countries differ depending on the individual company's investment objectives and capabilities. These differences derive from the different objectives and different experiences of the companies in cross-border investments. They also derive from the different margins of risk that companies choose to bear in cross-border deals. Large multinationals have an advantage in both experience and risk capability. They are often the first therefore to enter the Baltic markets. Small and medium sized companies need more time for feasibility studies and risk evaluation. All companies need to make decisions concerning the combination of investment strategy and investment forms. (Djarova, 1999)

Western companies study the region before investing into it. The result from this is that countries in the central Europe was chosen before the countries in the Baltic area because of the faster pace in the transition process and a more stable political environment. These countries are Hungary, The Czech Republic and Poland which are countries with more historical and cultural links with Western Europe. Investors seem to have a country or region approach. Companies with a country approach are interesting in finding a country that could be their new production or distribution foundation for the entire Eastern European area. Investors with a country approach want to enter or expand on any market where the opportunity arises. They start with fast developers among Eastern European countries and slowly widen their presence in the entire region. This is specific for producers of food and personal products, oil companies, restaurant service foreign car distributors and retailers. The primary aim of many of the foreign investors is to gain access to the new markets of Eastern Europe and their distribution channels. To benefit from the low cost structure is more a consequence than a first rank objective. The investors who entered the Eastern European market early try to achieve a high market share, by taking over or establish a joint venture with local people leading the company in the same business. A few companies got access to sometimes 80 percent of the market share because of highly specialised and centralised local production. Most companies enter Eastern European countries to serve the local market, but to be in a country may be a good basis for an expansion into other countries of the region. Market objectives have a long-term character in comparison with cost-reduction objectives, which can be applied until the cost structure of Eastern European countries is lower than that of the investor's country. Salary levels and the productivity level increase fast in the countries of Eastern Europe where the cost advantages may only last a few more years. (Djarova, 1999)

The matching between the investment strategy and investment forms has two popular cases. First the “go alone” strategy which is realised through Greenfield operations, subsidiary, take-over or majority shareholding in case a full take-over is not possible. Second is the “partnership” strategy mainly in the forms of joint ventures. The choice of form depends on the privatisation rules and conditions and on the availability of a suitable partner. Privatisation is often the only opportunity to acquire or establish a partnership with a local company, even though the joint venture would be preferred by the investor. (Djarova, 1999)

Finally I remind you the reader of Hazely C and Hirvensalo I (1998) definition of FDI. “*Co-operation agreements, subcontracting arrangements or other forms of non equity linkages cannot be considered direct investments, unless they involve capital transfers tied to voting rights from the investing company*”.

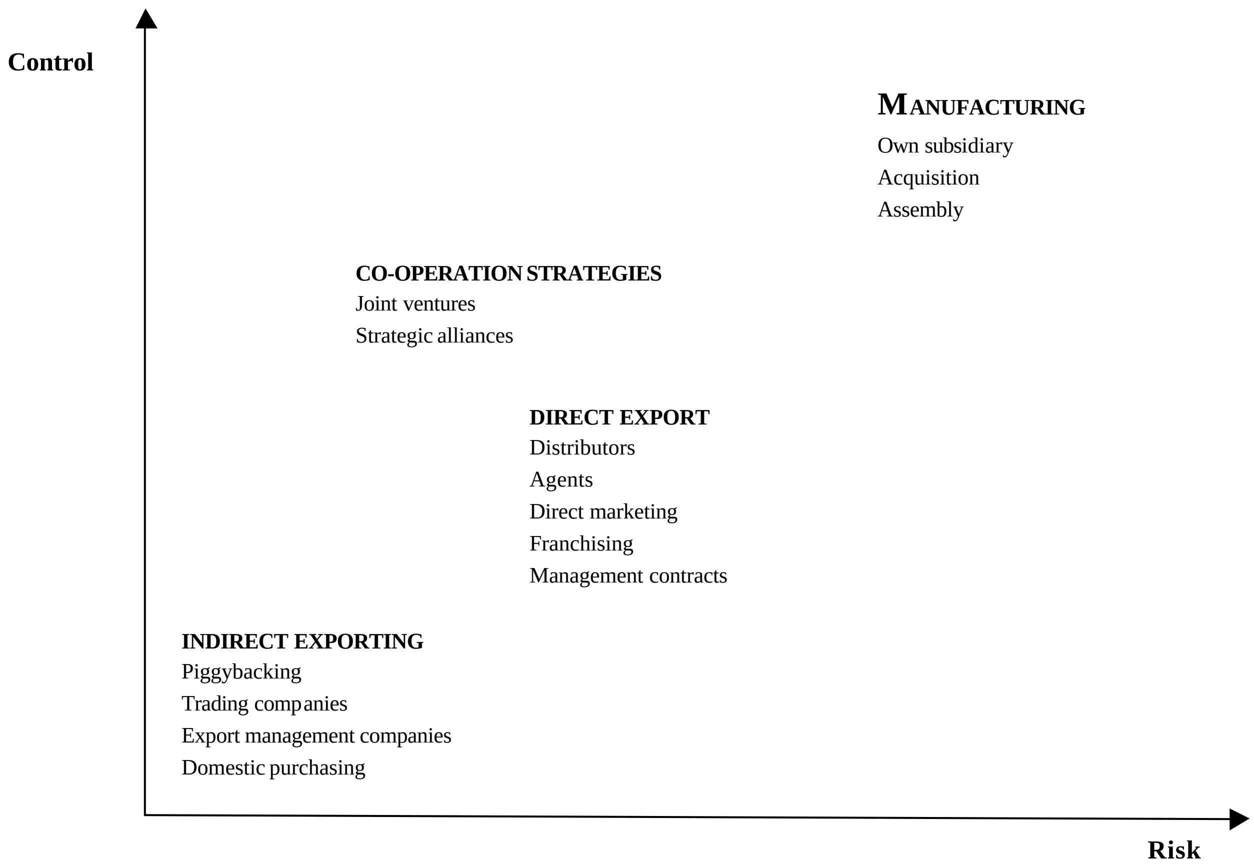
Figure: 5. Investment strategies give raise to different investment forms
Source: Djarova, 1999



3.8 FORMS OF INVESTMENT

There are advantages and disadvantages with each market entry method. The decision for which market entry method the company should choose will affect the business for many years ahead and the break into new markets need to be thought over more than once. The method the company chooses signals the company's level of engagement in that host country and its assessment of the business environment in that country. It affects the surrounding business environment in the case that a deeper engagement will signal to the domestic environment that the company believes in its new market, and it will of course be easier to do business if you have the trust of your counterparts, both economic and governmental. There is no ideal market entry strategy and it needs to be assessed for every occasion.

Figure: 6. Risk and control in market entry
Source: Dadfar, 2000



From an economists point of view a company can arrange entry into foreign countries in two ways. First it can export a product to the target market from a production base outside that country. Two it can transfer its resources in technology, capital, human skills, and enterprise to the foreign country, where they may be sold directly to users or combined with local resources (labour) to manufacture products for sale in the local market. These two entry modes can be broken down into several distinctive entry modes (Root, 1987).

Companies has over time developed new modes of doing business in foreign markets, these modes are variations of four different themes.

Table: 7. Different kinds of entry modes

Source: Root 1987, Vahlne et al 1993 from Young S et al, International marketing and development strategies and management, Harvester Wheatsheaf 1989

Export entry modes Indirect Direct agent /distributor Direct branch/subsidiary
Contractual entry modes Licensing Franchising Technical agreements Service contracts Management contracts Construction/turnkey contracts Contract manufacture Co-production agreements
Investment entry modes Sole venture: new establishment Sole venture: acquisition Joint venture: new establishment/ acquisition
Corporate coalitions and strategic alliances

3.8.1 Export entry modes

Exporting is the most traditional entry form and can change according to the change in the Baltic countries. Under the former Soviet regime the export of the companies were handled by state owned banks, which was a guarantee for the western companies. Nowadays private companies has taken over and foreign exporters face problems such as the lack of information regarding different trading companies, uncertainties about payments and financial guarantees, credit insurance and difficulties in controlling the fulfilment trade agreements. Another problem encounter firms that have strict price and promotion policies of their products may lack influence and feedback on this matter in Baltic countries. Respected foreign firms prefer therefore to establish representative offices or to transfer the distribution rights to authorised dealers (Root, 1987).

This entry mode differs from the others in that way that the final products is manufactured outside the target country and transferred to it. Firms with few resources for international marketing use the lowest level of cost method of market entry and use others who sell their products. The reasons for choosing a indirect market entry method could be to benefit from opportunities which may arise or sell-off excess capacity with the least possible convenience. Indirect exporting is often small companies first experience to international markets (Root 1987, Dadfar, 2000).

3.8.2 Contractual entry modes

This entry-mode means that it is a long-term no equity associations between an international company and an entity in a foreign target country that involve transfer of technology or human skills from the former to the latter. The difference from Export entry modes is that contractual entry modes are carrier of the transfer of technology and human skills from one part to another. They differ from investment entry modes because there is no equity investment by the company. International companies often use contractual entry-modes in combination with Export or Investment entry-modes (Root, 1987).

There are a lot of benefits for setting up oversea manufacturing. You avoid problems due to the nature of the product, such as perishability, transporting and warehousing. The cost of transporting heavy, bulky components and finished products over long distances is reduced. You get around tariff barriers/quotas, barriers to trade, which make the market inaccessible, are reduced. You get around government regulations such as entries to some markets. Local manufacture may be viewed more favourable by customers because they provide employment. Government contacts is increased, firms are likely to be viewed more favourable if they contribute to the local economy. You get first-hand information, a strong local presence improves the quality of market feedback. Local manufacture allows faster response and just in time delivery. Production, distribution and service centres can be moved to lower labour cost markets, provided there are appropriate skills and adequate information technology and infrastructure to maintain satisfactory quality. To set up an overseas manufacturer plant is more expensive than expanding the domestic plant (Root, 1987).

The advantages with this entry mode are that the company can focus on sales and marketing activities and let local manufacturers produce the product. It keeps the direct investment at a minimum level and makes it easier to withdraw from the market. It is a good mode to overcome trade-barriers and in politically unstable countries it is the best strategy for achieving market presence without having the risk of a large investment in manufacturing (Root, 1987).

The disadvantages with this mode is that the company can get quality problems because of lower wages, which comes with lower level of the employee's education and training. The local manufacturer can get the experience of the market and product and could be able to compete against your own company in the future (Root, 1987).

3.8.3 Foreign direct Investment (FDI) entry modes

Subsidiaries are established for a variety of motives, such as resource seeking, market seeking, efficiency seeking etc. This could be done throw a different variety of modes such as Greenfield, acquisition, joint venture etc (Birkenshaw J, Hood N, 1996).

Foreign manufacturing strategies with direct investment.

This entry mode involves ownership by an international company of manufacturing plants or other production units in the target country. It ranges from simple assembly plants to plants that undertake the full manufacture of a product. This entry-mode is characterised by ownership and management control. Foreign production affiliates may be classified as sole ventures with full ownership and control by the parent company or as joint ventures with ownership and control shared between the parent company and one or more local partner. The company can start from scratch by a new establishment or by acquiring a local company, an acquisition. At some point in international business development, a stage is reached when the pressure increases upon a firm to make more substantial commitment to an individual market. The reasons can be to gain new business, to defend existing business, to move with an established customer, to save costs and to avoid government restrictions (Root, 1987).

Assembly

The advantages with this entry mode are the reducing affects of tariff barriers, which are normally lower on components than on finished goods and if the product is large and transport costs high. Development skills are kept at the domestic plant. The assembly does not require so much engineering skills and you could manage with low levels of local management (Root, 1987).

Wholly-owned subsidiary

The advantages with this entry mode are that it signals to customers, competitors and government that you believe in the market in that country. You also get good control over the business and it is easier to meet the company's strategic objectives. The disadvantages are that this is the most expensive strategy and it requires great commitment from the management, time and resources. It can only be used when the demand for the market appears to be assured and success is unlikely to come instantly (Root, 1987).

Company acquisitions and mergers

Company acquisitions and mergers are effective to develop an international business. The advantages with this are a fast way of market entry and a good way to get short-term profits. You get access to a trained labour force, existing customers, recognised brands, an established distribution network and an immediate source of revenues. The disadvantages are that you could get a demotivated labour force, poor image and reputation and out of date products and processes. The government of that country might see you as hostile (Root, 1987).

International Joint Ventures

The advantages with two or more companies are that it could provide complementary competitive advantages for the new joint venture company and a good alternative when there are restrictions by governments that foreigners cannot own companies by themselves. The other part can provide with good governmental contacts if you share the venture with a domestic partner. R & D is expensive and in a joint venture the costs are shared. You also get a better understanding of how the new market works and should be able to better finance and profit from their activities, and the company can exert better control over the operation.

The disadvantages are the members aims and objectives of the joint venture could be differentiated. If one partner has a higher equity stake than the other, that one can become more dominant and the other partner resentful. Substantial commitment of investment of capital and management resources must be made in order to ensure success.

When examining the most obvious reason for planning a joint venture, the prohibition or the discouragement of sole-venture entry by governments in developing countries has shown to be the most common reason. The same reason is also true in the communist countries where sole ventures are not allowed. Therefore joint ventures are usually viewed as the most feasible type on investment entry in developing and communist countries. Even though joint ventures can be viewed as a response to the host government, a joint venture can also bring positive benefits to the foreign partner through the local partners expertise and contributions, for instance: local capital which reduces both the investment and the risk exposure of the foreign partner, knowledge of the host country environment and business practices, contacts with local suppliers, customers, banks, and government officials, management, production, and marketing skills, local prestige and other resources. The most important issue is usually the local partner’s knowledge of the local environment and their way of dealing with it. That is one reason why some companies have chosen to establish joint ventures in Japan even though there are options to start sole ventures in the Japanese market. Sometimes the combination of the foreign partner’s technology and related skills combined with the local partner’s contributions can exploit a target market more effectively than a sole venture. So, it is important to understand that companies should not just pick a local partner to satisfy the regulations of the host government and ignore the contributions that a local partner can bring to the joint venture (Root, 1987).

International joint ventures are used in wide variety of manufacturing and service industries and are frequently undertaken in conjunction with technology licensing by the firm to the joint venture. The host country may require a certain percentage (often 51%) of manufacturing or mining operations be owned by nationals of that country, thereby requiring firm to operate though joint ventures. Depending on the equity share of the international company, joint ventures can be classified as majority, minority, or 50-50 ventures. In addition to such legal requirements, firms may find it desirable to enter into a joint venture with a foreign firm to help spread the high costs and risks frequently associated with foreign operations. Moreover, the local partner may bring to the joint venture its knowledge of the customs and tastes of the people, and established distribution network and valuable business and political contracts. Having local partners also decreases the foreign status of the firm and may provide some protection against discrimination or expropriation, should condition change (Hitt, 1996)

An international company has obviously less control over a joint venture compared to a sole venture, especially when it has only a minority equity position. Sole venture will make it possible for a company to have full control to carry out its own strategy in the target country and gain all the profits. It will also automatically facilitate the management of the parent company by bringing the venture into common financial and other reporting systems. That will create safer protection of industrial property and it also encourages transactions between the venture and the parent's operations in other countries. A joint venture can also be frustrating for a foreign partner if their strategy and the local partner's interests are not similar. There are of course disadvantages to international joint ventures. A major potential drawback to joint ventures, especially in countries that limit foreign companies to 49% or less participation, is the loss of effective managerial control can result in reduced profits, increased operating costs, inferior product quality, and exposure to products liability and environmental litigation and fines. Firms that wish to retain effective managerial control will find this issue an important topic in negotiations with the prospect joint ventures partner and frequently the host government as well. Like technology licensing agreements, joint ventures can raise antitrust issues in certain circumstances, particularly when prospective joint venture partners are major existing or potential competitors in the affected national market. Because of the complex legal issues frequently raised by international joint venture agreements, it is very important, before entering into any such agreements, to seek legal advice from qualified counsel experienced in this aspect of international trade (Hitt A, 1996)

Firms contemplating international joint ventures also should consider retaining counsel in the host country. Firms can find it very disadvantageous to rely upon their potential joint venture partners to negotiate host government approvals and advise them on legal issues, since their prospective partners' interests may not always coincide with their own. Qualified foreign counsel can be very helpful in obtaining government approvals and providing ongoing advice regarding the host country's patent, trademark, copyright, tax, labour, commercial, antitrust, and exchange control laws. (Hitt A, 1996)

A crucial time for a company when entering a joint venture is to find a suitable local partner in the host country. A joint venture could be compared to marriages, since like in many marriages, joint ventures often end in divorce between the two partners when one of them conclude that they could benefit more from breaking up the relationship. When a company has decided to use a joint venture entry it is important for the company's managers to initiate a search/evaluation process, first to create a joint venture profile that will include the desired features of a candidate, second to identifying/screening candidates, and negotiating the joint venture agreement. Both partners will enter a joint venture to gain the skills resources possessed by the other partner. The international company's contributions to a joint venture will depend on both their own capabilities and those of the local partner, and also the purpose of the joint venture. The most common contributions of the international partner are technology or products and for the local partner, knowledge and skills to manage the venture in the host country are the most common contributions. There are many important questions that must be agreed on between the two partners. For example, the question of ownership shares, managers need to resolve many other issues in negotiations: the allocation of responsibilities in management, production, finance, and marketing, day-to-day operations, and planning for the future. Problems that are common between two partners usually include, profit reporting, dividend policy, capital expansion, the pricing of inputs sourced from either parent, or executive compensation. These are all important questions that the two partners have to solve otherwise they will almost certainly return to haunt them at a later time (Root, 1987).

A criticism of joint ventures by international companies is the loss of management control. From a company's point of view the importance of control to a company ultimately depends on its strategy. It is up to the managers to decide how much control a company will need to accomplish their objectives in the target country. The most direct way to gain control over a joint venture is through majority ownership, but it is usually not allowed by foreign governments. Control can still be achieved through other ways by the minority partner. One is the fact a foreign partner that is contributing with a continuing support of technical assistance has the power of the life ore death over the joint venture, therefore the minority partner has the opportunity to exert a dominant influence on its policies and operations. Another way to exercise control is through bylaws that will grant certain rights. For instance the selection of key executives or through a management contract. Another way of gaining control is through issuance of voting and nonvoting shares, where the majority of the voting stocks will be held by the foreign partner. The minority partner's interest may also be protected by holding veto rights over key decisions in the joint venture, such as dividend declarations or new capital investment. It is important for managers to understand that even if they are a minority partner in a joint venture agreement it does not necessarily mean lack of control since they can achieve a solid level of control. (Root, 1987)

3.9 EXTERNAL AND INTERNAL FACTORS INFLUENCE THE CHOICE OF ENTRY MODE

Internationalisation requires comprehensive planning, studies show that the entry strategy span for most companies is from three to five years. This time is needed for managers to raise and answer questions regarding the direction and the scope of their company's international business. Several, often conflicting forces determine a company's most effective form of participation in a foreign market and both internal and external factors is influencing the choice (Cavusgil, 1990).

External factors cannot be affected by the management but they affect the selection of a particular entry mode. Target market factors such as the present and projected size of the markets is a primary determinant for the type of entry. Small markets favour entry modes with low break-even sales volume such as exporting, licensing or contractual agreements. Large markets with high sales potential justify entry modes with high break-even sales volume, such as subsidiaries or joint ventures. Another aspect is that if it is an inadequate market infrastructure the market may only be reached by branch or subsidiary entry modes (Cavusgil, 1990).

Production factors in the target market as high costs and poor infrastructure is not advisable to manufacture locally. But is production costs low for such as labour, raw material, energy etc, it favours local manufacturing. The same situation if the infrastructure is good with good port facilities and a good road and rail network (Cavusgil, 1990).

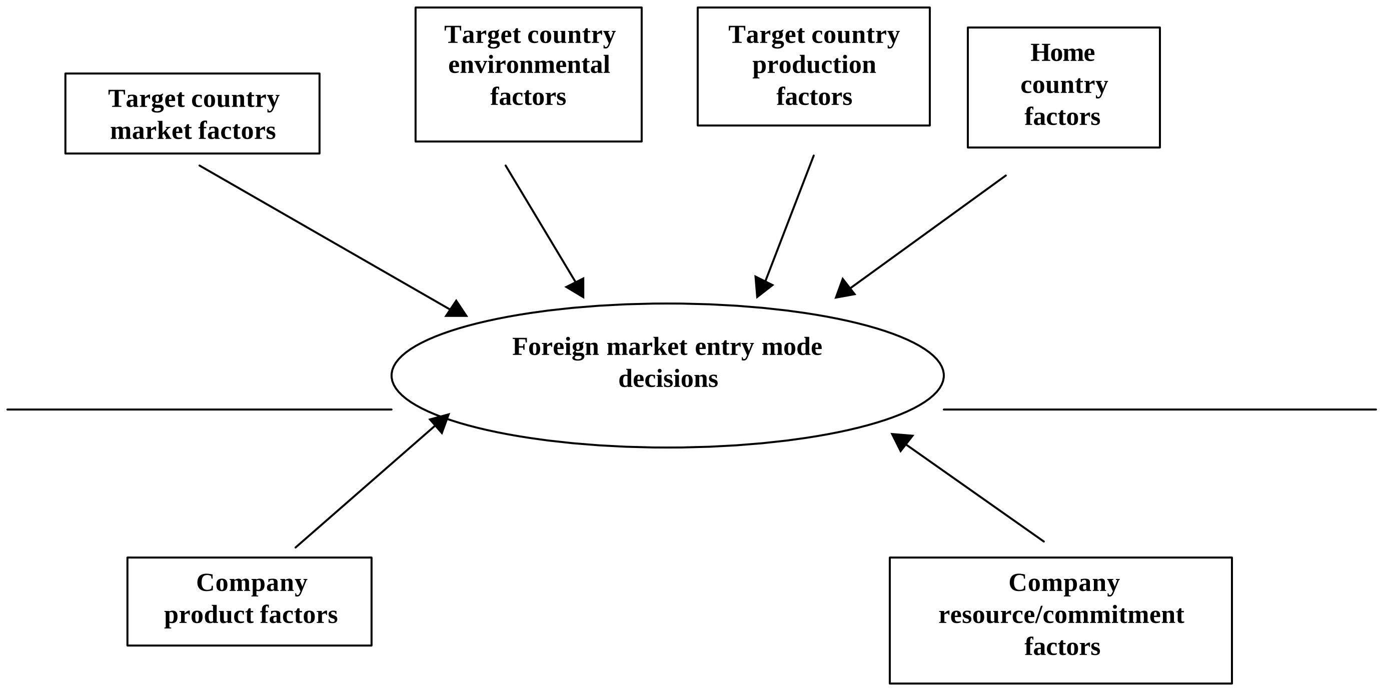
Environmental factors such as the economic, political and sociocultural character of the target market affects the choice of entry mode. A persistent weakening of a country's balance of payments could lead to import restrictions or devaluation of the exchange rate. Markets with tight government regulations such as high tariffs, quotas are more suitable for an investment entry mode as subsidiary. If the cultural values of the country is very different from the home country non-equity entry modes favours, which limits the company's commitment (Cavusgil, 1990).

Internal factors as product, resource and commitment are factors that influence firms choice regarding the establishment of foreign presence. Product factors such as highly differentiated products can be priced freely but still remain competitive in the market despite high unit transportation costs and import duties. An export strategy is favoured under these circumstances. Poorly differentiated products must compete on price basis, which pushes companies towards some sort of local production. Technology-intensive products give companies an option to license technology in the foreign market. Resource and commitment factors are factors that increase the entry modes options in the company. The more skills and resources a company has in management, capital, technology, production and marketing the more possibilities does the company have in their internationalisation. If these skills or resources are lacking in the company entry modes that requires small resource commitment are favoured. According to Cavusgil changes in internal factors are the principal forces shaping a company's international evolution, but the choice of entry mode is directly influenced by the external factors. External factors have a greater impact on the company than the internal factors and can force the company to revise its decision of entry mode (Cavusgil, 1990).

3.9.1 External factors

The external factors that the company must bear in mind are market, production and environmental factors in both the target country and it's home country. These factors cannot be affected by the management of the company and the factors can be used as parameters of the choice of market-entry decision.

Figure: 7. External and internal factors impact on the decision on FDI
Source: Root 1987



Target country market factors

The present and projected size of the target country market is an important influence on the entry mode. Of course small markets favour entry modes that have a low breakeven sales volume. Indirect and agent/distributor exporting, licensing and some contractual arrangements are good as entry-modes in small markets. In markets with high sale potential entry-modes with high breakeven sales volumes is preferred, such as branch/subsidiary exporting and equity investment in local production. The company need also to highlight the competitiveness in the foreign market, is there a lot of non-dominant competitors or are there an oligopolistic competition or perhaps monopolistic competition. An atomistic market is favourable to export entry, an oligopolistic market and monopolistic market does often require entry via equity investment in production to enable the company to compete against powerful competitors. Is the competition to strong licensing or some other form of contractual mode is preferred. The infrastructure of the foreign market is of importance too, because if the good local agents/distributors are tied to other firms or they maybe do not exist, the company may have to entry the foreign market through branch/subsidiary mode (Root, 1987).

Target country production factors

This factor is of importance because it really affects the way companies enter the foreign market. Depending on how expensive/cheep raw materials, labour, energy is and how the infrastructure of the country is built up are of importance. How are the port-facilities, railroad network, highways etc? This means that the quality and cost of the infrastructure is mayor factors when choosing entry-mode. If the labour is expensive, export is maybe a better alternative than local manufacturing (Root, 1987).

Target country environmental factors

Another mayor decisive factor is the environmental factor, which is political, economic, and the sociocultural character of the target country. Government policies and regulations have a mayor impact on which entry-mode to use because the target country may have restrictive import policies such as high tariffs and tight quotas. This may favour other entry-modes than export of some kind. There may also be encouragement from the foreign governments such as tax-reductions. There can also be restrictive foreign investment policies, which generally discourages equity investment in favour of other primary modes and may discourage sole ventures in favour of joint ventures or acquisitions in favour of new establishments. Geographical distance is another environmental factor of great importance. If the distance is great, transportation costs can make it impossible for export goods to compete with local goods. If the distance is great an investment such as an assembly operation is preferred over export because of the transportation costs (Root, 1987).

Which kind of market is the target market? Is it a centrally planned economy or is it a market economy? It could be hard to do some kind of equity-mode in a central-planned economy so for doing business in these kinds of economies no equity exporting, licensing or other contractual modes are preferred. How large is the market? How is the growth rate of gross national product and personal income? Even the countries economic relations are of importance, how is the balance of payments, does the company have a dept burden, and how is the governments exchange rate behaviour? Root says, "*Substantial one-way changes in external economic relations are indicators of probable future changes in government policies on trade and international payments.*" This can affect the company in the case of for example new import restrictions, which would discourage export entry. Exchange controls that limit the repatriation of income and capital tend to discourage equity entry more than other entry modes. If the exchange rate is allowed to depreciate, the effect is to discourage export entry and encourage equity investment entry (Root, 1987).

Sociocultural factors also influence a company's choice of entry mode. The cultural distance between the target country and the home country's societies can affect managers to feel insecure in doing business in the target country so they do not enter or enter with an entry-mode which is not as effective as another would have been. Cultural distance often has the effect of high costs when you acquire information. Cultural distance favours no equity entry modes that limit a company's commitment in the target country. Cultural distance also have a time aspect which means that companies first tend to enter countries which are culturally close to the home country (Root, 1987).

Political risk is another environmental factor and in countries with high political risk companies favour entry-modes that limit the commitment of company resources. The political risks can be general political instability or threat of expropriation (Root, 1987).

Empirical verification of the influence of external factors

One hundred countries were compared and they were divided in three separate groups, hot, moderate and cold. Hot countries were characterised by very stable governments, high market opportunity, advanced levels of economic development and performance, low legal, physiographic and geocultural barriers. This type of countries exists in west Europe, Canada, Australia, and New Zealand etc. Cold countries had opposites characteristics and they were found in almost all Africa, the middle east, south east Asia, India, South America, Greece etc. the moderate countries were found in Finland, south Korea, Spain, Malaysia etc. the moderate countries were some were in the middle of hot and the cold countries characteristics. The study proceeded with a survey of 250 American companies entry-modes. When going from a hot county to a cold country the company's dependent increasingly on export entry. For the average hot country exporting represented 47,2 percent of all entry modes, investment in local production represented 28,5 percent and all other 24,3 percent. For the average cold country exporting represented 82,6 percent of all entry-modes and investment in local production only 2,9 percent all others 14,5 percent. For the average moderate countries the profile laid somewhere between the hot and cold countries (Root 1987).

Home country factor

Market, production and environmental factors in the home country also influence a company's choice of entry mode. A large domestic market allows a company to grow large in size before it turns to foreign markets. These companies use equity modes more frequently than small companies when going abroad. Companies in small-market countries are attracted to exporting because they want to reach optimum size with economies of scale. The competitive structure in the domestic country also influences the choice of entry mode. Companies tend to imitate each other so that the competitive equilibrium does not become threatens, this is the case in markets with oligopolistic industries. If the market is atomistic companies enter foreign markets as exporters or licensors. High production costs in the home country relative to the foreign target country encourage entry modes involving local production such as licensing, contract manufacture and investment. The home country's policy toward exporting and foreign investment by domestic firms is also influencing the choice of entry-mode. The home government may offer tax and other incentives for exporting but at the same time is neutral or even restrictive on foreign investment which is a common situation then its policy is biased in favour of exporting and licensing or other contractual modes of foreign market entry (Root 1987).

3.9.2 Internal factors

How companies responds to external factors in choosing an entry mode depends on internal factors. Product factors influence the entry mode in different ways, highly differentiated products with distinct advantages over competitive products give sellers a significant degree of pricing discretion. These products can absorb high unit transportation costs and high import duties and still remain competitive in a foreign target country. Weakly differentiated products must compete on a price basis in a target market, which may only be possible through some form of local production. High product differentiation favours export entry while low differentiation pushes a company toward local production. Service-intensive products require branch/subsidiary exporting and local production modes of entry, because it is hard to market the product at a distance. By nature services cannot be produced in one country for export to another therefore local service production is necessarily. Technologically intensive products give companies an option to license technology in the foreign country rather than use alternative entry modes. Industrial-products companies are more inclined to enter licensing arrangements than consumer-products companies. Products which require considerable adoption to be marketed abroad favour entry modes that bring a company into close proximity with the foreign market such as branch/subsidiary exporting or local production (Root, 1987).

Resource/commitment factors

The more abundant a company's resources in management, capital, technology, production skills and marketing skills the more numerous its entry mode options are. Company's with little resources is forced to use entry modes that call for only a small resource commitment. This means that company size is a critical factor in the choice of an entry mode. Resources alone is not a critical factor when choosing entry modes it is the commitment to use them in a foreign market which is critical. A high degree of commitment means that managers will select the entry mode for a target country from a wider range of alternative modes than managers with low commitment will. High-commitment companies regardless of its size favours equity entry modes. How does one measure the management commitment? You look at the strategy of the company, the status of the international organisation and the attitudes of managers. Commitment is a growing process over a period of time. Success in foreign markets has encouraged more international commitment and this has led to more success. On the other side failure will have the opposite effect (Root, 1987).

3.10 THE WAY OF ENTRY

Once started in international business a company will gradually change its entry mode decisions in a fairly predictable fashion. Increasingly it will choose entry modes that provide greater control over the foreign marketing operations. This means that the company must provide more resources to the foreign markets and it means greater economic and political risks. As the companies gets more confidence in the foreign market a shift in the trade-off between risk and control is taken and deeper involvement as equity investment is taken.

Changes in internal factors such as growing commitment to foreign markets are the principal forces shaping a company's international evolution. External factors are most influential forces shaping a company's entry mode decision for a specific product or target country. It is vital that the company continually monitors external factors in the target country and need to be prepared to revise its entry mode in order to sustain or strengthen its market position (Root, 1987).

3.11 MONITORING AND CONTROL

Every organisation is concerned how to focus its resources towards attainment of organisational objectives. It is through the control system that goal congruence and goal achievement is assured, to have an effective control an efficient monitoring function is necessary. Leksell (1981) in Vahlne (1993) distinguishes between three key systems subject to monitoring and control: organisational, administrative and social systems. The organisational form is handling were responsibilities should be allocated, organisational specialisation, vertical and horizontal differentiation and formalisation. The administrative system includes matters such as budget, planning and goal reaching procedures, which is reporting and evaluation systems. The social system deals with recruitment, executive relation, development procedures and incentive systems. Companies that face environmental uncertainty adopt more flexible and adaptive organisations Leksell (1981). The Baltic area has the characteristics of performance requirements that will be higher than in comparable operations than in more stable environments. Decision making on operations will be highly decentralised and subject mainly to social monitoring and control. Any decision making matters considered to be of strategic importance will be centralised and involve top management.

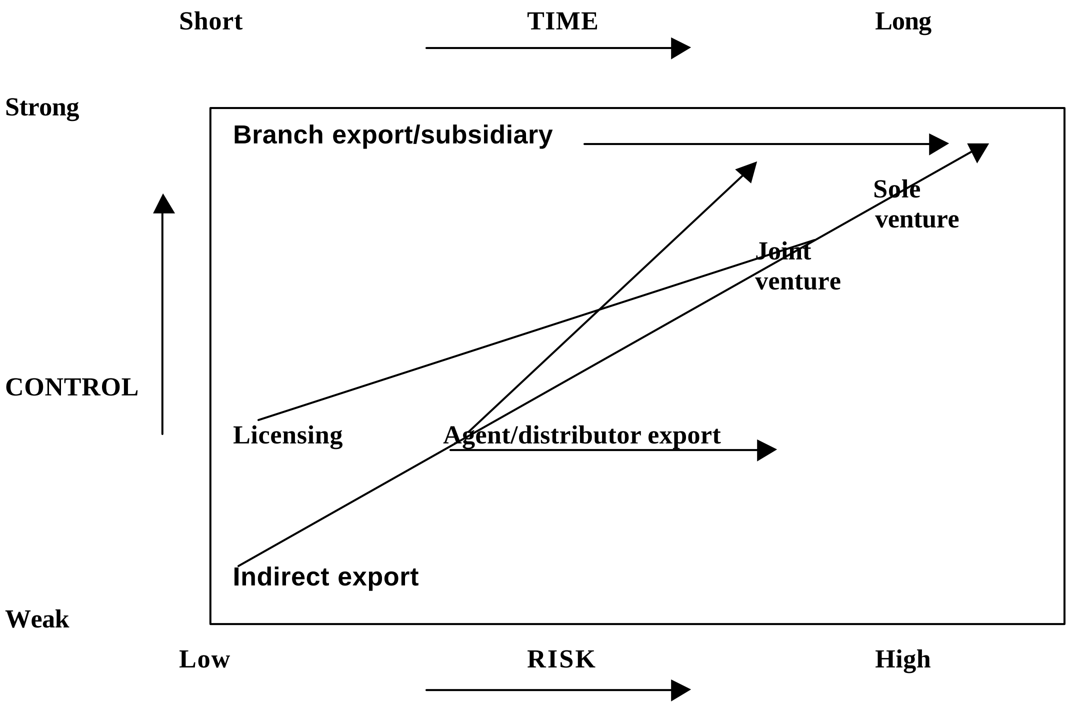
3.12 IMPACT FACTORS ON ENTRY MODES

In order to become successful when entering a new market several issues have to be considered. The market entry decision depends on the firm’s objectives and attitudes to international marketing and also what experience and skill of its managers to operate in foreign countries. One factor that has impact on a company’s new market entry success is the company objectives and expectations relating to the size and value of anticipated business. The size and financial resources and the company's existing foreign market involvement are other important factors to take in consideration when choosing entering mode. When looking at the specific foreign market, the nature and power of the competition in the market, the nature of existing and anticipated tariffs barriers, the nature of the product itself and the timing of the move in relation to the market are determining factors to consider. In this context timing is particularly important in considering entry mode. As we earlier mentioned there are pros and cons with every available entry mode and that have to be compared with the presumptions for the specific company. (Doole I & Love R, 1999)

When entering a new market companies have to ask themselves three questions:1.What level of control do we require of our foreign investment? 2. What level of risk are we willing to accept? 3. What kind of and what level of cost are the company able to bear? See figure 8. When discussing these questions and when weighting them against the pros and cons with different entry modes, it is important to consider the relative importance that the firm might place upon the different elements of its marketing activity as well as the questions themselves. For example might lack of control over certain aspects of the marketing process affect the reputation and image of a company or brand, because consumers more often blame the manufacturer rather than the distributor or retailer for poor quality (Doole, I & Love, R. 1999).

The internationalisation process can start by two ways, import or export. It is though more frequent that the internationalisation process start with export. There is one famous company that started their internationalisation with import and that is IKEA. The foreign entry modes have different characteristics in the dimensions of risk, (size of investment), potential for learning and controllability including control of proprietary knowledge. There is a trade-off between these characteristics because the more you invest the higher are the risk but you gain more control of the operation. This leads companies to start the internationalisation process with less risky and potentially less rewarding entry modes. After more knowledge and experience are gained firms adapt more risky entry modes. When the market potential is high more risky modes are preferred because of the performance is usually superior from a profit point of view (Johanson and Vahlne, 1977,1990, 1993).

Figure: 8. Risk and control with the time aspect
Source: Root, 1987



4. THE BALTIC COUNTRIES CHARACTERISTICS AND INVESTMENT CLIMATE

The macro and microenvironment are different between the three Baltic countries. Foreign companies may encounter different problems or opportunities in different countries due to the fact that the Baltic countries have chosen different ways in their transition. Even in the macro environment there are differences due to different policies towards the EU and Russia and the different internal problems of the Baltic countries.

4.1 MACRO AND MICRO ENVIRONMENT IN THE BALTIC

When companies considers the Baltic countries they often define their strategic objectives after that they have analysed what the country has to offer. The objectives act therefore as strategic investment criteria's. The comparative advantages or disadvantages a Baltic country can offer is analysed from three different angels. 1. A regional and national macro analysis from which an investor chooses an area for investment, 2. a microanalysis of the area and 3. specific investment opportunities. The regional and national macro analysis involves macroeconomic, political and social indicators that serve as input to a country's risk analysis. Also factors such as democratic governments, clear moves toward a market economy, resolution of foreign exchange, convertibility and profit repatriation issues. The microanalysis covers specific market considerations, economic policies such as privatisation and foreign investment, legislative and regulatory environment, and business infrastructure. The Baltic countries are characterised by the transition process that started 1989. The microanalysis is determined by the outcomes of the transition process, which of course differs from country to country. For example a raise in The European Bank for Reconstruction and Development (EBRD) index by one point raises the probability for the success of the investment by 2,7 times (Djarova, 1999). ALMI, Swedish council of trade and Chamber of commerce provide companies with different risk analysis but often companies conduct own research and sends investigating missions to the area. Firms with little experience of international activities often relies on published materials (Djarova, 1999).

4.2 TRANSITION PROCESS IN ESTONIA, LATVIA AND LITHUANIA

In the early stage of the transition process Estonia introduced its own currency, the Kroon. It was done in order to escape from the post-Soviet inflationary development. The Kroon was introduced in June 1992 and is based on a currency board arrangement which means that base money issue has to be fully covered by gold and foreign currency reserves. The Bank of Estonia is obliged to buy and sell Estonian Kroons at a fixed exchange rate. The Kroon was tied to the German mark but is now tied to the Euro (Tiusanen, 1997).

Latvia's move towards a national currency was done in two steps. Latvia introduced the Latvian rouble in 1992 and moved to stage two with the introduction of the national currency the Lat in 1993. The Lat was first allowed to float free and was later pegged to a currency basket of the IMF.

Lithuania was a bit slower in the start of the transition process and introduced its own currency board on April 1994. The Litas is pegged to the dollar and the amount of money in circulation is limited to the market value of gold and hard currencies maintained in the bank of Lithuania (Tiusanen, 1997).

The reasons for that the Baltic states have chosen fixed exchange rate regimes are that the fixed exchange rate is a policy tool used to stabilise the financial environment and to be an anchor for the economic system under the transition from a centrally planned to a market economy. Second, by using the stability of the currency they can more easily introduce world market prices to their domestic economy and this results in that they can give adequate and predictable price signals in investment decisions. All the three countries currencies are undervalued in order to keep imports expensive, this is a method of protectionism. The problem with this advantage is that all three countries have relatively high inflation (higher than its trading partners), this under valuation diminishes under the fixed exchange rate regime. This means that the real exchange rate appreciates and the under valuation advantage erodes. If they cannot control the inflation they are facing current account problems and modifications of the exchange rate must take place before the current account problem becomes insurmountable (Tiusanen, 1997).

Because the countries size and the lack of natural resources they are very dependent on foreign trade. The share of exports in gross domestic product (GDP) was in 1994, 70 percent for Estonia, 72 percent for Latvia and for 71 percent Lithuania. Compared with Poland 24 percent and the for Nordic countries about 30 percent (Tiusanen, 1997)

The Baltic States has a living standard, which is approximately one third of the EU average, there Estonia has the highest, Latvia the second best and Lithuania the worse of the Baltic countries (Tiusanen, 1997).

4.2.1 ESTONIA

Estonia is the smallest of the Baltic republics and is approximately as big as Denmark and has 1,5 million inhabitants. Estonia lies on the Eastern Shore of the Baltic Sea and shares borders with Latvia in the south and the Russian federation to the east. The capital of Estonia is Tallinn with 408.000 inhabitants

(29 % of total population) and lies on the north coast of Estonia. Tallinn lies about 85 kilometres from Helsinki, 750 kilometres from Moscow, 310 kilometres from St Petersburg, 307 kilometres from Riga, 580 kilometres from Vilnius, 880 kilometres from Warsaw and 405 kilometres from Stockholm. The country consists of 40 percent forests and 30 percent is cultivated. Main natural resources are timber, oil shale and limestone. The Independence Day is 24 of February 1918 and Estonia's reindependence day is 20 of august 1991. (http://www.stat.ee/wwwstst/content/I_S_UL/1.html 2000-08-22 I_S_UL), (Tiusanen, 1997), http://www.vm.ee/svenska/right_ie.html 2000-08-22, Bonniers nya världsatlas 1997.

The ethnic composition of Estonia has changed dramatically since the soviet occupation. The transformation of Estonia to a country with heavy industries made it possible for the leaders of the former Soviet Union to transfer ethnic Russians to the country and in the same time transfer ethnic Estonians to Siberia. This meant that under the Soviet occupation Estonians nationals fell from 95 percent to 62 percent, leaving a big ethnic Russian minority behind (28 %). The non-Estonian population mainly inhabits the cities while the rural population remains Estonian. The Estonians is only giving citizenship to those whom is born after 1991in the country or pass a test in the Estonian language. This is a cause to political unrest in Estonia and the country's future with a depressed ethnic Russian minority has to be solved (Tiusanen, 1997, (http://www.stat.ee/wwwstst/content/I_S_UL/1.html I_S_UL).

Before the Soviet occupation Germany and Great Britain was the most important trading partners and investors, nowadays it is Sweden and Finland. Estonia still has 20 percent exports to Russia and is dependable of resources, which make Estonia vulnerable of Russia's development. Foodstuffs are the main export articles of Estonia followed by clothing and labour goods and other labour-intensive branches (Tiusanen, 1997).

The first year of independence was an economic disaster with an inflation, which was almost 1000 percent, and economic activity decreased with 20 percent. In 1993-1994 a recession took place and a sustained hyperinflation was avoided. A modest economic growth was achieved in 1995 but with an inflation of almost 30 percent. The inflation combined with the fixed exchange rate caused erosion of the price competitiveness (Tiusanen, 1997).

Wages in Estonia is higher than in the other Baltic countries and in 1996 the wages was approximately 240 US$ and is increasing with 25 percent per year. The economic growth is planned to be 3,5 percent per annum and the inflation is planned to decrease, but not very rapidly. Estonia wants to be a "Tiger economy" and this means an annually growth of at minimum 5 percent (Tiusanen, 1997).

After a couple of years with a strong GDP growth the growth is decreasing a bit and this is due to that IMF suggested that Estonia should cool down its economy. The Russian crises has affected the economy negatively, even if the Russian trade only accounts for 10 percent. It was in the food sector the crises struck hardest, the Russian demand diminished and a lot of Estonian enterprises went into bankruptcy (wysiwyg://infoframe.352/http//www.swedi….se//utlandet/landrapporter/estland .htm 2000-08-22).

The unemployment is increasing due to the restructuring of enterprises and will hit the roof at 11 percent. Estonia has regional differences in unemployment, in the Tallinn area there is no unemployment, but in the southeast the unemployment is an increasing problem. The Estonian currency has been pegged to the D-mark to the rate 8:1 and this means that it is indirectly pegged to the Euro. Estonia is facing the problem with increasing wages which will decrease the FDI, who are primarily after the country's low-cost production. The bad account of trade is also a problem but the inflation is still decreasing, which is a good sign.

Estonia path towards a membership in the EU is affecting the willingness to invest positively and since 1997 when Estonia negotiated its membership with the EU the willingness to invest in Estonia has increased.

Table: 8. The distribution of Gross domestic product in Estonia 1994
Source. Liutho, 1997 p. 19

Agriculture	8,6 %
Industry	21,4 %
Construction	5,5 %
Transport	9 %
Service	55,5 %

The main economic question in the beginning of the next millennium will be whether it is in the country's best interest to stick with the fixed exchange rate. The relatively high inflation is eating up the under valuation advantage of the currency if the economic growth could not be speeded up. The risk is that the trade balance will deteriorate, the current account will show deficits, which cannot be financed. Therefore the option to devaluation cannot be excluded (Tiusanen, 1997).

Table: 9. Main economic indicators of Estonia
Source: Liuhto, 1997, wysiwyg://infoframe.352/http://www.swedi….se/I_utlandet/landrapporter/estland.htm 2000-08-22, www.odiiici.gov/cia/publications/factbock/index.html 2000-12-16

	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP growth	-19,3 %	-2,1 %	-1,8 %	+4,3 %	4 %	11,7 %	4 %	-1,1 %	4 % ?
Inflation	+950 %	+89,4 %	+47,7 %	+29 %	23,1 %	11,4 %	8,2 %	3,6 %	4,9 %
Trade balance % of GNP			-7,4 %	-4,4 %	-9,2 %	-12 %	-9,7 %		

The estimated growth for 2000 is 5,2 percent and the inflation 4,1 percent

Firms operating in Estonia

The predominant factor for companies who did FDI in Estonia was to get access to new markets according to Hazley C & Hirvensalo I (1997) survey. Additional motivation was the access to raw materials, low cost levels and strategic considerations of following the clients and strengthening of market positions. Over 80 percent of the FDI were made as wholly owned subsidiaries and shows in this way that they are taking a long-term commitment and most of the companies reached profitability within two years. Managers of the subsidiaries were predominately expatriate managers (60 percent).

4.2.2 LATVIA

Latvia is located on the eastern shores of the Baltic Sea and the Gulf of Riga. The country borders with Estonia in the north, Russia and Belarus in the east and Lithuania in the south. The country consists mostly of undulating plains, half the country is arable and about two fifths is covered by forests. The country has three ice free ports, Riga Ventspils and Liepaja.
The capital of Latvia is Riga and the country has a population of 2,5 million. Riga is situated 400 kilometres from Helsinki, 300 kilometres from Tallinn, 770 kilometres from Moscow, 290 kilometres from Vilnius and 430 kilometres from Stockholm. Almost one million of the country's population is concentrated around Riga. The ethnic composition are 57 percent ethnic Latvian and 30 percent Russians, the other's are Belo Russians, Ukrainians, Poles, Lithuanians. The history of the population is dramatic with an increase of Russian from 9 percent 1935 to 34 percent in 1989. The ethnic Latvians decreased from 77 percent to 52 percent in 1989. Before the occupation the economy was predominantly agriculture, under the occupation large enterprises was established in heavy industry which focused on output to the military in the former Soviet Union. The Latvian currency the Lat is stabile after the result of a tight monetary policy (Bonniers världsatlas, 1997, Tiusanen, 1997).

The Latvian economy has started to grow again after the external chock the Russian crises in 1998 did on the economy and especially the weakening of the Russian Rubel and the cancelled payments from Russia. A result from the Russian crises was that the industry production suffered because of lack of demand in Russia and other Eastern European countries. The crises had the effect that more of the export (62,5 %) and more of the import (54 %) now goes to the West European countries. This means that Latvia is not as vulnerable as before if yet another crises in Russia should come (Tiusanen, 1997).

The unemployment is a regional problem in Latvia. Unemployment can be as high as 20-30 percent in the eastern parts of the country, this is due to that the industrial structure totally has collapsed due to obsolent factories. In the Riga area unemployment is not a problem, the problem is to find well-educated personnel, but overall the unemployment percentage is around 10 percent (Tiusanen, 1997).

The problem that the country is wrestling with is the deficit in the trade balance which is still not improving and the problem to keep the budget in balance.

Table: 10. The distribution of gross domestic product of Latvia
Source: Liutho, 1997, http://www.csb.lv/basic/pril.htm

Agriculture	10,1 %
Manufacturing	21,1 %
Services	56,1 %
Construction	6,1 %
Electricity, gas & water supply	6,6 %

The economic development has followed the trend from the other Eastern European countries with an initial high inflation followed by a negative economic growth. Bank crises in 1994 halted the economic growth with a failure to pay wages and debts.

Table: 11. Main economic indicators of Latvia
Source: Liuhto, 1997, http://www.csb.lv/basic/gdp.htm gdp 2000-08-22

	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP growth	-33,8 %	-11,7 %	+2 %	-1,6 %	+4,1 %	+5,3 %	-5,3 %	+6,2 %	+4 % ?
Inflation	+958 %	+109,2 %	+35,9 %	+25 %	+17,6 %	+8,4 %	+4,7 %	+2,4 %	?
Trade balance			-10,4 %	-10,5 %	-10,3 %	-9,6 %	-8,7 %	?	?

This table forecasts a development which is in line with Estonia, a moderate but sustainable growth period. Trade balance deficits and current account deficits are likely to increase but not in a dramatic manner.

Firms operating in Latvia

Companies that invested in Latvia did the investment soon after those companies did investments in Estonia. The main goal for the investors was to gain market shares, to penetrate the local market and to study and learn the market. Almost 75 percent of the FDI were made as wholly owned subsidiaries and they reached profitability after 4-5 years. Managers of the subsidiaries were predominately local (60 percent) (Liuhto, 1997).

4.2.3 LITHUANIA

Over the past few years, Lithuania has become a leading location for foreign investors and a competitive centre for product sourcing in the region. The main reasons are a high skilled and low cost alternative to production in the west along with a stable and strong production springboard to the huge markets to the east. Impressive growth, a stable currency and good business environment is in Lithuania’s favour in it’s aim to become the premier investment location in the region.

Lithuania is the largest of the three Baltic countries and is bigger than both Denmark, the Netherlands and Switzerland. Lithuania is celebrating its independence day on 11 of March 1990. Lithuania is situated on the Eastern Shore of the Baltic Sea and is approximately of the size of Ireland. Latvia borders Lithuania on the north, Belarus on the east and Poland to the Southeast and to the south. The Russian enclave of Kaliningrad is situated to the Southwest. The country consists of predominantly lowlands with almost 3000 lakes and a widespread network of rivers and streams. Lithuania has 3,7 million inhabitants and the capital of Lithuania is Vilnius with 600 000 inhabitants. Vilnius lays 580 kilometres From Tallinn, 640 kilometres from Helsinki, 640 kilometres from Moscow, 380 kilometres from Warsaw and 720 kilometres from Stockholm. The major cities in Lithuania are Vilnius which is the capital (578200 inhabitants), Kaunas (414500) and Klaipeda (202100). Lithuania's currency the Litas is pegged to the dollar under a currency board system to the rate US $ of 4:1.
(Tiusanen, 1997, http.//www.lda.lt/invest.cp.bassiccountrydata.html 2000-08-22, Bonniers nya världsatlas 1997).

The ethnic composition of Lithuania is Russians 9 percent, Poles 7 percent and the rest is Lithuanian. (80 percent of the people are speaking Russian but Lithuanian is the state language (Tiusanen, 1997).
The country has few natural resources, two thirds of the country is agricultural and one forth of the country is forest. Because of the lack of natural resources and indigenous supplies of energy Lithuania's industrial sector is heavily dependent on imports of primary products. Under the Soviet regime the country was forced to transform from agriculture to a heavily industrialised structure with emphasis on large-scale, highly specialised enterprises. Lithuania's energy-producing sector consists of the famous nuclear plant Ignalina that produces half the country's need for electric power. Lithuania has also an oil refinery in Mazeikiai which is dependant on oil from Russia and the refinery exports its refined products through the port of Klaipeda (Tiusanen, 1997).

Lithuania’s first years of transition were more dramatic than the other Baltic countries. After the independence the industry sector collapsed because of the lost of the main market and the lost of the access for cheap fuel and raw materials. The industry sector accounted for 40 percent of the economic activity and the deepest decline happened therefore in Lithuania compared to the other Baltic countries (Tiusanen, 19979).

The average wages in Lithuania increased by 12,7 percent 1998 and is now 1152 Litas, and the inflation was lower in Lithuania than in Estonia and Latvia. FDI´s in Lithuania came from the USA, Sweden, Finland, and Germany in 1999. Most of the investments went to the manufacturing industry (32 %) (http://www.ekm.lt/muitai/EKMIN/AP98_A.HTM).

Table: 12. The distribution of gross domestic product in Lithuania 1994
Source: Liuhto, 1997

Agriculture	8,1 %
Manufacturing	23,2 %
Electricity, gas & water supply	2,8 %
Construction	8,7 %
Transport	8,1 5
Services	51,9 %

The decrease of GDP by 35 percent and consumer price index increase of over 1000 percent in 1992 was done by the shortfall of energy supplies from Russia and the rising prices of Russian fuel (Tiusanen 1997).

Table: 13. Main economic indicators of Lithuania
Source: Liutho, 1997, http.//www.lda.lt/invest.cp.basiseconomicdata.html Advantage Lithuania – Lithuanian Develop… -Country Profile – Basic economic Data 2000-08-22

	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP growth	-35 %	-16,5 %	+1 %	3,3 %	4,7 %	7,3 %	5,1 %	-4,1 %	+2 % ?
Inflation	+1162 %	+189 %	+45,1 %	+35,7 %	7,1 %	5,9 %	2,4 %	0,3 %	+3 % ?
Trade balance			-4,7 %	-3,5 %	-2,7 %	-3,2 %	-4 %	?	?

Lithuania succeeded in attracting FDI´s 16,3 percent from Sweden, the USA 14,5 percent, Finland 10,3 percent, Denmark 9,9 percent, and Germany 7,2 percent in 1999. (http://www.urm.lt/economic/lek.htm Economics 2000-08-22)

After rock bottom during 1992-1993 the economy experienced a relative consolidation with some economic growth 1994-1995. The growth was halted by a bank crises and rumours of an impending currency devaluation that caused extensive withdrawing of hard currency from the banking system. As this happened inter-enterprise debt built up and there were delays in wage and other payments which created disorder in the economy. The monthly earning in Lithuania is about 170 US $ and is increasing with almost 30 percent each year, so the inflation caused by increases in wages is not under control. The forecast for Lithuania is that it is slower than Estonia in the GDP growth and will have an inflation that will probably go under 10 percent. This slow advancing economic growth will increase the trade deficits and there will be a current account problem. This means that Lithuania cannot keep its fixed exchange rate and there will be speculation of devaluation (Tiusanen 1997).

The effect from the Russian crises has now hit rock bottom and the effects have hit Lithuania hard due to the lost export to the East European countries. The growth in the country is hindered by a low demand in Lithuania as an answer from the crises. A protectionist trade policy together with different compensations programmes that struck wrong have also had a bad impact on the economy. This has meant that the FDI´s to the country have decreased and the privatisation process has declined and the companies in Lithuania are not as attractive as before the crises. The agriculture sector and the energy sectors are also two young cuckoo’s that is unreformed and non-privatised and is slowly draining the government finances. Twenty percent of the population is working in the agriculture sector and is only generating 10 percent of the GNP. One EU farmer is producing what 30 Lithuanian farmers do. The energy sector in Lithuania is very dominant due to the nuclear power plant Ignalina and the oil refinery Mazeikiai that is the only one in the Baltic. The Russian crises reformed the export in Lithuania and are now more directed towards the EU. The best companies that restructured and had the best survivor capabilities survived (Tiusanen 1997).

Before the crises the East European countries had 40 percent of the export, now they have 20 percent. The export to Russia alone has decreased from 24 percent to 7 percent. The EU countries part has increased from 35 percent to over 50 percent. The biggest import countries are Germany and then Latvia, this is due to the import of cars that have Russia as a destination. The EU has 45 percent of Lithuania’s import and the East European countries 25 percent and Russia alone has 20 percent and it is predominantly gas and oil which is imported. The crises have struck hard against Lithuania’s economy but the integration towards the EU has been speeded up (Tiusanen, 1997).

The productivity in the industry has increased 30 percent the last three years. The textile and wood industries that survive on Lithuania’s cheap labour are going to have problem because the wages are increasing fast. If these industries build its competitive capabilities on low labour costs they are going to face big trouble in the near future.

The biggest investors in Lithuania today are Sweden (18 %), The USA (15 %), Finland (10 %). 32 % of the FDI went to the manufacturer industry.

A couple of protectionist policies have been implemented to protect the domestic producers from the Russian crises and minimum prices were introduced. This threatened the Baltic agreements of free trade.

Firms operating in Lithuania

Firms invested in Lithuania at the same time as the investments were done in Latvia. The reasons for investing were to get market shares and to get access to local markets and to follow clients from Scandinavia. Over 80 percent of the companies were wholly owned subsidiaries. Profitability was reached after 3-4 years and the management was 50 percent expatriates the other part local .

4.3 FOREIGN TRADE OF THE BALTIC STATES

After the independence the Baltic States restructured their trade but Russia (19,8 %) is still Lithuania's main destination of exports, while in Estonia it is Finland (22,8 %) then Russia (17,8 %). In Latvia Russia has 28,1 percent of the export. In table 14-19 one can see in which direction the trade is concentrated because of the countries different ties to neighbouring countries and their geographical position (Tiusanen, 1997).

Table: 14. Main destination of **Estonia's** export
Source: Own creation of Liuhto, 1997, http://ww.stat.ee/wwwstat/content/I_S_VK_IR/1.html

	1995	1999
Finland	22,8 %	19,4 %
Russia	17,8 %	9,2 %
Sweden	10,7 %	18,8 %
Germany	9,2 %	7,5 %
Latvia	7,1 %	8,7 %

Table: 15. Main origins of imports to **Estonia**

Source: Own creation of Liutho, 1997, http://ww.stat.ee/wwwstat/content/I_S_VK_IR/1.html

	1995	1999
Finland	38,6 %	22,8 %
Russia	13,4 %	13,5 %
Sweden	9,1 %	9,3 %
Germany	7,1 %	9,3 %

Table: 16. Main Destination of **Latvia's** export 1995

Source: Own creation of Liutho, 1997, wysiwyg://infoframe.352/http://www.swedi…se/I_utlandet/landrapporter/lettland.htm

Russia	28,1 %
Germany	10,5 %
Sweden	6,9 %

Table: 17. Main origins of imports to **Latvia** 1995

Source: Own creation of Liutho, 1997, wysiwyg://infoframe.352/http://www.swedi…se/I_utlandet/landrapporter/lettland.htm

Russia	23,6 %
Germany	13,5 %
Sweden	6,4 %

Table: 18. Main Destination of **Lithuania's** export

Source: Own creation of Liutho, 1997, http://.ekm.lt/muitai/EKMIN/AP98_A.HTM 2000-08-22

	1995	1999
Russia	19,1 %	16,7 %
Germany	15 %	12,9 %
Latvia	7,5 %	11,2 %
Belarus	11,1 %	8,8 %
Ukraine	7 %	8 %

Table: 19. Main origins of import to **Lithuania**
Source: Own creation of Liutho, 1997, http://.ekm.lt/muitai/EKMIN/AP98_A.HTM 2000-08-22

	1995	1999
Russia	30 %	21,1 %
Germany	16,2 %	18,1 %
Ukraine	4,1 %	1,9 %
Poland	4,2 %	
Belarus	3,3 %	2,2 %
Latvia		1,8 %

You can draw the conclusion from the above tables that Lithuania and Latvia has a much higher eastern orientation than Estonia.

As mentioned before natural preconditions for farming are very good in the three countries and they ought to have an advantage in foodstuff production. The living standard and the wages are compared to European standard low and this means that the countries have an advantage in labour intensive industries. See table 20-25 (Tiusanen, 1997).

Table: 20. Principal exports of **Estonia** 1995
Source: Own creation of Liutho, 1997, http://www.vm.ee/svenska/right_ie.html

Foodstuffs	16,4 %
Clothing	16,3 %
Timber products	14,2 5
Machinery & equipment	9,3 %
Metals	7,2 %
Transport equipment	6,5 %

Table: 21. Principal imports of **Estonia** 1995

Source: Own creation of Liutho, 1997, http://www.vm.ee/svenska/right_ie.html

Machinery & equipment	21,2 %
Foodstuffs	13,4 %
Minerals	12,6 %
Clothing	12,8 %
Metals	11,5 %
Transport equipment	8,2 %

Table: 22. Principal exports of **Latvia** 1995

Source: Own creation of Liutho, 1997, http://www.csb.lv/basic/pri.lhtm

Wood & wood products	21,3 %
Textiles	13,2 %
Foodstuffs	12,8 %
Metals	10,1 %
Transport equipment	10,0 %
Mechanical equipment	9,2 %

Table: 23. Principal imports of **Latvia** 1995

Source: Own creation of Liutho, 1997, http://www.csb.lv/basic/pri.lhtm

Mineral products	29,4 %
Machinery & equipment	16,1 %
Chemicals	10,2 %
Agriculture & food products	8,4 %
Textiles	5,9 %
Base metals	5 %

Table: 24. Principal exports of **Lithuania** 1995
Source: Own creation of Liutho, 1997, http://www.lda.lt/invest.reasons.html

Textiles	14,8 %
Agricultural & food	14 %
Chemicals	12,3 %
Fuels	11,9 %
Machinery	10,8 %
Non-precious metals	8,7 %

Table: 25. Principal imports of **Lithuania** 1995
Source: Own creation of Liutho, 1997, http://www.lda.lt/invest.reasons.html

Fuels	25 %
Machinery & metalworking equipment	17 %
Textiles	10%
Chemicals	9 %
Non-precious metals	7 %
Foodstuffs	5 %

As one can read from the graphs Clothing has a very high percentage of the export of Estonia and textiles has a very high percentage of the Lithuanians export. Also wood has a high percentage of Latvia's export. All three countries have poor natural resources and primary goods are imported extensively. Estonia is self-sufficient in the energy-sector but Lithuania is dependent on imported fuels (Tiusanen, 1997)).

The main trading partner of the Baltic states is Russia and there has been a lot of tension between the Baltic States and Russia. The main cause of friction has been the minority issue of ethnic Russians. The problem is greatest in Estonia and Latvia and minor in Lithuania (Tiusanen, 1997).

All the Baltic countries have signed Europe agreements with the EU which means that they have the same trade-conditions as the EFTA-countries (central European Free Trade Area). The Baltic States has free trade among them (Tiusanen 1997).

The living standard in Estonia is three times lower than in Finland. Lithuania has a living standard, which is one third lower than in Estonia. Latvia has a living standard somewhere between Estonia and Lithuania. Estonia's living standard is half that of the Czech Republic which comes on second place after Hungary in the transition race. Hungary has attracted most of the FDI. Both Estonia's and Lithuania's economic situation ought to be able to attract foreign direct investments (FDI) (Tiusanen, 1997).
Estonia, Latvia and Lithuania has a disadvantage, they have small home markets. Their advantage is their geographical position, which offers a natural bridgehead to the east European countries. The tension between the Baltic States and the former republics of the Soviet Union makes this advantage vulnerable. Another disadvantage is that the population is relatively old and is decreasing which could end in a shortage of labour. Strong wage inflation seems impossible to avoid in a fast growing economy so the price competitiveness is deteriorating and they need to compete in quality instead (Tiusanen, 1997).

The World Bank has developed a special index to measure the relative position of countries, this index is called the Human Development Index (HDI). In this index one can see how far the Transition Economies (TE) has come in their process. It is a composite index of achievements in basic human capabilities in three fundamental dimensions, a long healthy life, knowledge and a decent standard of living. Three variables have been chosen to represent these three dimensions. Life expectancy, educational attainments and income (Tiusanen, 1997).

Table: 26. Human development index of the World Bank 1996
Source: Own creating of Liuhto, 1997

Country	**HDI value**	**HDI rank**
Canada	0,951	1
Sweden	0,933	9
Czech Republic	0,872	37
Latvia	0,820	55
Russia	0,804	57
Estonia	0,749	68
Lithuania	0,719	81

In table 27 one can see the distance a country has to travel to reach the maximum possible value of 1 and the HDI index allows good inter country comparisons. The Czech republic is the best-ranked TE-country and twelve of EU-member states are among the top twenty.

The European Bank of Restruction and Development (EBRD) has also a way of ranking TE´s. See table 28. For a fully market-oriented economy the value is 4,5 and the lowest possible is 1.

Table: 27. EBRD ranking 1996
Source: Own creation of Liutho, 1997

Country	***Ranking***
Czech republic	3,56
Estonia	3,39
Latvia	3,11
Lithuania	2,89

Also Ernst & Young give points to various TE´s by assessing the business climate, the best score is 5 and the worse is 30. See table 29.

Table: 28. Ernst & Young ranking 1996
Source: Own creation of Liuhto, 1997

Country	***Points***
Czech republic	10
Estonia	16
Lithuania	16
Latvia	17

One more possibility to measure the “health” of TE´s is to take FDI inflow or stock and see which countries have been able to attract risk capital. See table 30.

Table: 29. Foreign direct investments in transition economies 1995
Source. Own creation of Liuhto, 1997

Country	**FDI´s as a percentage of GDP**	**FDI´s per capita US$**
Hungary	10,2 %	1113 US$
Estonia	5,8 %	413 US$
Czech republic	5,6 %	532 US$
Latvia	3,5	164 US$
Lithuania	0,8	61 US$

There is no exact way of measuring the relative success of TE´s in transitional process, but one can make some conclusions of the “ranking lists”. Estonia has been most successful of attracting foreign investors while Latvia and Lithuania has not been as successful.

4.4 INVESTMENT BARRIERS

A study by the OECD in 1994 assessed the investment opportunity barriers in the Baltic States. The main external barriers were; central bureaucratic, administrative and legislative, protracted and complex negotiations or approval procedures, frequent change of government officials and difficulties in finding the decisions makers who would accept responsibility and inconsistent policy changes and conflicting information from different ministries. Other barriers were slowly developing business infrastructure and varying degrees of inadequacy in the areas of communications, distributions and banking were also significant barriers. But all of the interviewed managers said that administrative and establishment barriers were the most significant problem (Hirvensalo I & Hazely C, 1998).

4.4.1 Investment barriers in Estonia

The Foreign Investment Advisory Service of the International Finance Corporation and the World Bank did a diagnostic study of the environment for directs investment in Estonia in 1997. The foreign investors were generally pleased with the investment climate in Estonia but there were some problems to. See table 30. Access to land was perceived as a bottleneck as well as access to residence and work permits. The legal requirement of the members of the board should be 50 percent residents of Estonia. There are also problems with the overall policy framework as the interpretation of the law, conflicts between the legislation and lack of consistency in the application of the law, for example concerning tax accounting and reporting. The major problem in Estonia is in the human resource area. More than 90 percent of the interviewed companies had experienced difficulties in obtaining work or residence permits, recruitment of functional management, trained personnel and loyalty and attitude of employees. Another problem is the lack of skilled and trained middle managers and personnel in trained in functional management. This means that a lot of time is spent on supervising mundane tasks, which take time from the “real business”. Another issue is that the danger of hiring older middle managers is that you may inherit the old soviet mentality. Tax problems seem to be another issue with problems concerning consistency and uncertainties about legislation. This problem arises more problems when arbitration does not work, bankruptcy laws do not protect creditors, implementation is unfair and the general lack of overall consistency in implementation is widespread. Some 40 percent of the companies had experienced some type of entry restriction or protectionism, in some cases foreign companies were not permitted to have access to extract raw materials or the license to operate with collusion between local companies and authorities to prevent them from entering. There have also been problems in the start up process with the interpretations of legislation as to the rights and restrictions modus operandi. This causes extra costs and problems for the company in purchasing and operations when in fact this set up is the accepted norm in many EU countries. Another problem is bad debt problems from customers and difficulties with the interference with the Estonian banking system and currency with banks suffering with liquidity problems. Credit information was unreliable, unavailable or very subjective. Other problems are the high level of illegal activity. Other problems are the poor infrastructure. On the supplier side the problems are that there are a lot of young start up companies with no or little information about the history of credibility. Loopholes in the bankruptcy law enable assets to be diverted into spouse names instead of being left to creditor claims. Quality standards and after sale care and warrants are not as you would expect from a western European country (Hirvensalo I & Hazley C, 1998).

4.4.2 Investment barriers in Latvia

Latvia suffers from the tough competition it faces from other Baltic countries and the rest of the region. The World Bank estimated that neither the government nor the private sector could ensure the volume of investments necessary for the development of the national economy. This means that FDI will play a significant role in the development of the Latvian Economy the coming years. One of the problems facing investors in Latvia is related to acquisition of information about new legislative acts. Translation of legislation is not ensured in Latvia and available sources are quite expensive and irregular. Municipal regulations are not available in foreign languages at all. A shadow economy is established due to long processes in courts with low quality of the judge. Firms that had used local firms for activities such as setting up a subsidiary, custom clearance and transportation had fewer problems in these areas. The major problem in Latvia is implementation of legislation, which lagged behind, is unfair, does not function and changes unpredictably. Product certification and registration was also a problem that conducive to facilitate nor enhance the business environment and it restricts business activity. Human resources are an area of problem to with difficulties in the recreation of personnel with functional management skills. This shortage is widespread in all areas of specialisation such as accounting, marketing and sales and management in general. This shortage of trained management in both the middle management and functional management holds the development of business back. Customers that stretch credit limits beyond normally acceptable thresholds are also of concern. The problems which would appear to be stifling economic activity and growth stems more from the bottleneck at the client or customer end which is often state owned enterprises rather than at the customer end. Customs is another problem area with unsatisfied procedures and officials. Rules and procedures are implemented inconsistently and decision making of customs officials is a major difficulty. The custom procedures are rather an ad-hoc procedure rather than a predictable routine which management then could delegate to subordinates. These problems divert management's attention to more important business issues to the mundane functional problems. The result is that firms loose the momentum and the potential economic activity is being restricted. More than 60 percent of the companies were aware of the corrupt activities or that they recognise crime as an extra cost of doing business utilising local security "firms" Hazely C & Hirvensalo I, 1998).

4.4.3 Investment barriers in Lithuania

Lithuania has lagged behind Estonia and Latvia in attracting foreign investments. As in the case with Latvia the companies that had used local specialist firms for activities such as setting up a subsidiary, customs clearance or transportation of goods had encounter fewer problems. Lithuania's legislative environment restricts foreign investment at the levels of both establishment and operation. The tax regulations are burdensome due to the bookkeeping requirements, unclear, unfair or sometimes stupid. The legislation is inconsistent, unclear, and poorly thought out with little effort to speak to all the main business groups concerned. On the operating side the constantly changing taxation system breeds substantial uncertainty and is exacerbated by inconsistency in its implementation. In areas of establishment there were problems with procedures or protectionist policies of the government. Lithuania has many complicated, detailed and bureaucratic procedures requiring many stages of approval before establishing a company. At customs the tariffs is illogical and discriminatory against foreign companies. Also some problems with the banking system such as the lack of venture capital and limited access to capital due to small capital base and the lack of credit information. The labour flexibility is unlike Latvia spread around three major cities with educational establishments also being dispersed. Potentially good employees own their homes and it is difficult to find personnel trained and educated who are prepared to relocate (Hazely C & Hirvensalo I, 1998).

5. THE EU AND RUSSIA

The Baltic region is in the middle between the Western world and the East European world. That means that the Baltic countries have two important factors that have a great impact on their economy, the EU and Russia. Since they have different connections and trade with both these worlds it is therefore important to know how these major markets influence the Baltic countries.

5.1 THE EU

The European Union has developed since 1950s and consists of fifteen countries today. The EU has moved from a free market area to a customs union, a common market with an economic and monetary union. The most important question of today in the EU is the enlargement eastward. East European countries have got green light in terms of accession. Everyone agrees on that EU must be economically strong and politically stable and the question with the EU enlargement are speed, timing and cost (Pautola, 1997).

Estonia, Latvia and Lithuania applied for EU membership in 1995 and as a steppingstone to the membership they signed Europe Agreements (Association agreements) with the EU. Association agreements acknowledge the interest of a partner country in becoming a full member of the EU. The Association agreements are signed in order to establish a close, long-term association between the EU and individual BC's. The agreement differs from Estonia and Latvia and Lithuania because Lithuania and Latvia had a transitional period, which ended 1999, because Lithuania and Latvia had some protectionist economic measures they needed to take away (Pautola, 1997).

The key words are transition and stabilisation. *"Transition means a movement from a centrally-planned economy to a market one, involving changes and creation of institutions, enterprises and legal structures"* (Nina Pautola, 1997 Bank of Finland in Liutho 1997 p 60). Stabilisation aims to achieve a low and predictable rate of inflation. Through the use of fiscal and monetary policy instruments the stabilisation policy aims to prevent dramatic fluctuations in output and employment. The stabilisation and transition are complementary, to succeed in the transition process you need stabilisation (Pautola, 1997).

The Baltic countries have done a lot to liberalise its economy but there is still a long way to go in enterprise structuring, strengthening financial institutions, commercialisation of infrastructure and environmental protection. Enterprise restructuring should be carried out together with privatisation. Often large-scale privatisation involves high financial returns to management insiders and those with political power. Company's has been privatised without restructuring the corporate governance, which has led to inefficiency and failure. Many banks are still government owned and have bad loans after the banking crises (Pautola, 1997).

The main task for the transition economies is to build a new role for itself, from state control to state support. To do this, the government need to have a tax-system and a tax-administration that is working and that is the problem in the Baltic. Corruption and public distrust for the government have negatively affected people's wiliness to pay taxes. As long as the Transition economy's (TE) grow faster than the EU their economies have good possibilities to converge and catch up with the EU (Pautola, 1997).

Table: 33. Real GDP change in the EU countries
Source: European union, 1996, Liutho 1997 p.66, Veckans affärer, no 51/52, 18 Dec 2000

	1993	1994	1995	1996	1997	1998	1999	2000
EU-15	-0,6 %	+2,7 %	+3,1 %	+1,3 %	+2,2 %	+2,8 %	+3,1 %	+3,6 %

According to the EU foreign affairs commissioner, Hans van den Broek the biggest challenge of the Baltic States before they can join the Union is harmonisation of legislation with that of the EU. This process needs to be speeded up in the areas of competition, customs, lifting of foreign trade barriers and banking. Another issue is the rights of minorities and non-citizens. The Baltic countries need to solve issues among themselves as Latvia’s and Lithuania’s disagreements over oil drilling in the gulf of Riga. Estonia has not reached a border agreement with Russia and these factors need to be solved before a membership. A membership in the EU requires membership in the World trade organisation (WTO) and OECD and the Baltic States membership is under preparations. In October 1997 Estonia introduced protective tariffs to support the agricultural sector, but this contradicts with Estonia’s own liberal trade policy and the principles of WTO and EU. This show the Baltic countries interest in becoming members of the EU but their actions sometimes tell otherwise (Pautola, 1997).

Latest statement by Baltic politicians stress the fact that no matter what, EU membership remains number one priority and the required changes will be made in order to reach that goal (Baltic News Service 1997: The Baltic Times 1997 In Liutho, 1997).

If price stability reflects a successful and strict monetary policy, the exchange rate regime choices made in the Baltic States have positively contributed to economic stabilisation, inflation have slowed down in all the Baltic states. On the other hand growing trade and current account deficits, real appreciation of national currencies against western currencies and weaker competitiveness may create strong enough pressures to alter the exchange rate regime in the future (Pautola, 1997).

Due to a practised tight fiscal policy from the beginning of independence government subsidies has been kept low and social security benefits has remained stable. Taxation has been rationalised, new taxes introduced and tax collection and co-ordination between central and local authorities improved. The results from these measures are that the general government deficits have been smaller than in the other countries of the former Soviet Union. Still the central banks of the Baltic States need more experience in practising monetary and fiscal policies. They need to do financial sector reforms and liberalise capital movements. The countries still have more work in restructuring ineffective corporate governments in the fiscal end enterprise sector and lack of adequate regulations conducting business as well as a lack of competition still hinder development (Pautola, 1997).

The impact of the European union on the Baltic area

A EU membership will have very positive impact on foreign investment according to a study, which incorporated 500 Baltic companies of large-scale. The Estonian managers believed more strongly of the increase of investments than their neighbours. By 1995 FDI´s grew in Estonia to 650 million US$, in Latvia 550 million US $ and in Lithuania 150 US$. As Lithuania and Latvia has more than twice the population of Estonia the FDI´s in Lithuania is poor, but good in Latvia. The FDI in Estonia is only ten percent of that of Hungary, which was the country in Eastern Europe, which attracted most investments. Baltic membership in the EU would add interest of both EU and non-EU countries into the region. For EU- countries it is an interesting investment target due to their low labour costs and close location to Russia. For non-EU companies the Baltic region might be an excellent springboard for the intra-EU market (Liutho, 1997).

A EU membership would also increase Russian investments into the Baltic States. The fact that they share the language and have prior experience in the Baltic’s also attracts the Russians. The Russian FDI in1995 in Estonia was 6 percent, in Latvia 19 percent and in Lithuania 7 percent (Liutho, 1997).

There are two views of the Russian investments. One is that the Baltic becomes more financially dependent and tied more close to the neighbour both economically and politically. The second view is that it would improve the relations with the Great neighbour (Liutho 1997).

Managers in both Latvia and Lithuania fear that EU membership will weaken relations with Russia. Because of the more dependent situation they have of the The Commonwealth of Independent States (CIS) than Estonia has. The CIS trade into Latvian and Lithuanian trade with CIS countries amounts approximately 40 percent and in Estonia some 20 percent. The trade with EU is larger in Estonia, which is more west directed, the EU accounted for 60 percent (Liutho, 1997).

The membership will also improve the living conditions in the Baltic. It will also secure the territory of the Baltic States from Russia. The foreign competition in the Baltic's will force their companies to increase their efficiency and become more integrated with international markets (Liutho, 1997).

The Baltic officials will get training from EU in the judicial system, police and customs. The EU will support the development of small to medium sized companies. Small and medium sized enterprises will adept better to the size of the Baltic's than the large post-soviet ones. These companies are very flexible and dynamic and could easily adept to changes in the economic environment. They would also be an employment potential and the entrepreneurship of these companies may be a good way of strengthen the middle-class and enhance social stability (Liutho, 1997).

If Estonia gets a membership in the EU before Latvia and Lithuania it will not affect the trade between the Baltic countries, because Estonia's trade with Latvia is 8 percent in export and 2 percent in import and with Lithuania it is 5 percent in export and 2 percent in imports. They have signed the so called Europe agreements which brings the Baltic countries closer to EU. Latvia and Lithuania expects to become members of the EU before 2004.

In the case that Estonia would become a member of the EU before Lithuania the thought of the managers interviewed is that Estonia could be used as a foothold for other Baltic enterprises on their way to the EU market.

The Baltic managers do not think that EU membership will affect the competitiveness of their products because of the present liberal customs policy of Estonia, which enables a free flow of foreign goods into Estonia.

One important factor in Lithuania's environment is how the Kaliningrad area develops and how the relations between the Russian enclave and Russia will develop. If this region would pursue to increase its autonomic position this might have an impact on Lithuania.
In 1995 the EU represented only 37 percent of Lithuanian foreign trade while for Estonia the percentage was 61 percent and for Latvia 42 percent. Russia is a very important trading partner for Lithuania and will probably always be. Russia stood for 20 percent of the export and 31 percent of the import in 1995. Same figures are for Estonia 18 percent of the export and 14 percent of the import. For Latvia export was 28 percent and import were 24 percent. This is a surprise as Russia does not border Lithuania, but the majority of the trade with Russia goes through Kaliningrad. In Lithuania foreign companies plays a smaller role in Lithuania than in Estonia. In Lithuania the foreign companies stood for 1 percent and in Estonia about 6 percent and in Latvia 4 percent. The most striking thing of the findings of the survey is that the managers of the companies do not believe in the justice system in the Baltic countries (Liutho, 1997).

5.2 RUSSIA

Russia, the big eastern neighbour has an area that constitutes over 76 % of the former Soviet Union area. The country has a lack in the infrastructure, which makes it difficult to transport goods in the country as well as in and out of the country. The transformation from a planned economy to a market economy has caused high unemployment. This has resulted in corruption among public authorities. For a company who is entering the Russian market these are issues to consider in the daily activity. It has become the Russian way of doing business and all companies depend on a liable connection that can guide them through the bureaucratic jungle. The Russian market is in European matter of speaking a large market with growth opportunities. This is one of the reasons it's worth the trouble entering the Russian market (wysiwyg//:infoframe.352/http://www.swedi….se/I_utlandet/landrapporter/Russia.htm).

Russia has started to overcome the crises in 1998 sooner than expected and GNP increased with 3,2 percent in 1999. This year the prognosis is more than 5 percent and the drive comes from the weak Rubel and the high market price in oil. This means that the balance of trade is going to have a big surplus. The inflation is expected to be nearly 20 percent and the growth in the economy is predominantly in petrochemical industry (21,1 %), Wood products (17,1 %) and steel (14,4 %). The Russian domestic market has been strengthen due to the more expensive import due to the weak Rubel. Russian main export products are energy (42,2 %), metals (15,1 %) and the main Russian import is machinery and transportation products (32 %). The FDI ´s in to Russia increased by 25 percent 1999 and most investments were done in the energy sector (28 %), food sector (23 %). The household's economy has also improved and the demand is increasing because the pensions and salaries are paid (wysiwyg//:infoframe.352/http://www.swedi….se/I_utlandet/landrapporter/Russia.htm).

Politically the Russia is becoming more stabile and that means better economy and more FDI´s. The main structural problem Russia has is still not dealt with as for example that banks are in a bad condition, the enterprises do not have a transparent accounting system and this means that taxation is hard to control. This has a negatively impact on the growth in the economy wysiwyg//:infoframe.352/http://www.swedi….se/I_utlandet/landrapporter/Russia.htm.

Table: 34. Main economical indicators of Russia
Source: wysiwyg//:infoframe.352/http://www.swedi….se/I_utlandet/landrapporter/Russia.htm

	1996	1997	1998	1999	2000
GNP growth	-3,4 %	+0,9 %	-4,6 %	+3,2 %	+5 % ?
Inflation	21,8 %	11 %	84,4 %	36,5 %	12 % ?

Political environment in Russia

When we talk about political environment in Russia we have to distinguish between the cities and the countryside. For example in St Petersburg, there is the political environment in the structure more like it in the West European countries and political parties have more influence than particular members. In the regions on the countryside the political parties have not so much influence except from the communist party. Remaining parties are bad organised and it is hard to see where they are on a scale from right to left according to western tradition. Instead there are individual candidates as acting in the political system. (http://www.isn-inc.com/html/article_5.html 2000-08-08)

The emerging markets of Russia are attracting attention among foreign investors in the West. Russia hoped that western companies would provide the technology and capital to tap the regions abundant natural and human resources. But so far the amount of foreign direct investment has not come close to the levels anticipated. There are many reasons to this, for example large bureaucracy and poor infrastructure. The possibility of violence and civil war associated with political and economic instability in the country are other important factors that can explain why foreign direct investments not has increased so much as expected. (http://www.isn-inc.com/html/article_5.html 2000-08-08)

Western companies have to face a number of risks, both political and otherwise when they should enter the Russian market. Some of these risks can be eliminated by conducting basic due diligence to determine the validity of all parties involved. Other risks fall outside the control of the western company for

example political risks as war, terrorism, currency inconvertibility and other forms of government interference.
(http://www.isn-inc.com/html/article_5.html 2000-08-08)

The Russian Economy

From an economic point of view Russia has been facing a rapid decline in investor confidence, which has led to a detouriation in general economic conditions. The major crisis in Russia has taken place due to the weak Russian economy struggling to restructure and rebuild after the collapse of the Soviet system. The current crisis is due to financial and economic indicators, both domestic and external. Furthermore, the trends in most cases are indicating future concerns about Russia's ability to improve its financial condition (wysiwyg//:infoframe.352/http://www.swedi….se/I_utlandet/landrapporter/Russia.htm).

Ever since the Russian reform back in 1991 high inflation has been a major challenge to Russian economic policy makers. Examining the consumer price index, the Russian economy sustained a manageable inflation of 11% in 1997, but in 1998 the inflation rate his 84.4%, which was a significant setback for the Russian economy. High inflation will have an impact on the ruble holders since it will reduce their potential purchasing power and lead to a decline in the living standard. Inflation will also be debilitating financially to pensioners and other fixed incomes. The economic constructions in Russia have led to an increase in unemployment, in 1994 the Russian unemployment rate was 7% but by the end of 1998 the unemployment rate had reached close to 12%. Even though the current crisis cannot be blamed entirely on for the unemployment problem, the decline in economic growth has set back attempt to reduce it.
(wysiwyg//:infoframe.352/http://www.swedi….se/I_utlandet/landrapporter/Russia.htm).

Russia faced a critical time period in 1998 where the interest rates increased dramatically as a sign of loss of investor confidence. While rates have decreased some, they nevertheless remain high and it will continue to affect Russia's ability to finance its government budget deficits and have stifled investment in the non-government sector as will. Russia's financial problems center on its fiscal situation. The Russian government has persistently high budget deficits while general government expenditure (expenditures of the federal and regional government, plus extra budget expenditures) have declined, some areas of public spending have not been adequately controlled. The government has not been able to cove its expenditures with revenues (wysiwyg//:infoframe.352/http://www.swedi….se/I_utlandet/landrapporter/Russia.htm).

The crisis in Russia has already had an immediate economic impact on Russia and will have longer-term implications for the Russian economy and its efforts to become a market economy. Ruble depreciation has caused prices of Russia imports including some consumer goods to raise feeding inflation and greater economic instability. It has also caused buyers and ban depositors to panic and buy goods in stores and withdraws deposits for banks as the currency loses value. As the crisis continues, the impact on the Russian economy might become greater, the economy needs new investments, both foreign and domestic, to replace outdated and worn-out capital assets to build new infrastructure. But so far the crisis has undermined investor's confidence setting back prospects for economic growth. (wysiwyg//:infoframe.352/http://www.swedi….se/I_utlandet/landrapporter/Russia.htm)

6. CASE STUDIES OF THE INTERNATIONALISATION PROCESS

I will now account for the information I gathered in the research on my four case companies. The cases are built up on interviews with employees of the companies who participated in the internationalisation process into the Baltic countries. The cases are built up on interviews with employees and owners at the companies, where nothing else is stated.

6.1 LAMIFLEX EESTI AS

6.1.1 Company background

Lamiflex is a group of companies in the packing industry. Lamiflex Eesti AS in Estonia has a turnover of twenty million Swedish crowns and which mother company is Lamiflex Board AB in Norrköping, which has a turnover of 70 million Swedish crowns. Lamiflex Board AB is a daughter company to Lamiflex AB in Nyköping and which has a turnover of 150 million Swedish crowns. The Lamiflex group has also subsidiaries in Germany and England.

6.1.2 Preparations

Thomas Jacoby is the managing director of Lamiflex Eesti AS. He has Estonian roots and speaks the language fluently. This has according to Thomas made the whole process possible. Thomas used to work for STORA with almost the same tasks that he now works with. Thomas saw the possibilities in the Baltic early after the independence and wanted STORA to invest in Estonia. STORA did not want to take such a risk so Thomas and the executive director of the today’s

Lamiflex Eesti AS quit and presented the idea of an establishment to Lamiflex in Nyköping. Thomas laughs at this because now they get credit from STORA of what they have achieved and they sell the Estonian products to them more expensive than before, because now they are an external producer to STORA not an internal as they were before.

6.1.3 The establishment – motives

The primarily reason for the establishment in the Baltic area is according to Thomas Jacoby *"always to make money". "Russia has very cheap raw materials, which makes Estonia very suitable to set up a manufacturing in. You do not get the same high quality as you would have in a western country but you can sell the product in larger quantities and make more money that way.*

Most of the production goes back to Sweden so the establishment's aim was not to penetrate the Eastern Europe markets. The goal was to get access to low input costs in the manufacturing and lower production costs. Lamiflex Eesti AS has about twenty competitors in Russia but these companies has antidumping tariffs of 40 percent on their products, which makes the product not profitable in the EU.

"Estonia is a good country for investment today because they have pushed their economy further towards market economy than Sweden" says Thomas Jacoby. The country also has agreements with the EU and the trade is custom free. Estonia also has custom free trade with Russia, which makes the import of raw materials cheap.

"The closeness to Estonia is good because if there are some problems you could be there in a few hours to deal with them yourself". Thomas Jacoby says, *"that this is a little European Asia, but nearer so that you can take advantages of low labour costs and well educated personnel"*. The product that Lamiflex is manufacturing in Estonia becomes unprofitable if the transportation exceeds 500

kilometres in road transports. If the transportation to the customer were longer a factory in the neighbourhood would become more economically.

One important thing when companies are planning on starting a business in the Baltic's or other parts of Eastern Europe are to quote Thomas to get a *"jävligt bra partner"*, because that is a requirement if you want to succeed in the region.

"The Estonian psychic distance does not differ very much from the Swedish so the Estonians are easier to do business with than the Russians, which are living in Estonia". The way of doing business does not differ from the Swedish way of doing it. But "*you should always have a party with your partner, if not, it is not considered a partnership"*.

6.1.4 Market entry modes

Lamiflex decided to go for a joint venture in Estonia. They got help from The Swedish chamber of commerce in Oxelösund in finding a business partner. They got a partnership with a factory which had been bought from the state by the management and they were looking for a foreign investor. This meant that Lamiflex contributed with capital and some machinery and the Estonian part with the factory and employees. This was the best solution because of the amounts of money a green-field subsidiary would cost. If any external or internal problems would show up, no fixed assets could be lost.

6.1.5 Other

Thomas has not perceived any problems with the bureaucracy in Estonia and has not bribed any official to get necessarily documents.

He can not see that there could be politically unrest in Estonia due to the Russian minority, the Russian will over the years become more integrated in the country. *"He thinks that the Estonians have been very generous in the ethnic issue and take Yugoslavia as an example were the people never forgets an injustice"*.

"The wages differ in the three countries for a worker. In Estonia the salary is 2500 scr, in Latvia 1500 scr and in Lithuania 1300 scr".

It takes time for the employees to trust the western way of doing business and to trust the employees. Thomas has often suggested thing for improvement but they have almost refused. But after they have seen the effects of the change they adopted the concept with their hearts.

6.2 NYKÖPINGS PLASTPRODUKTER AB (NPP AB)

6.2.1 Company background

NPP AB makes all kind of plastic moulds and a large product technical form material of plastics to the mobile telephone industry. The company was founded by Kjell Karlsson which was to recently the only owner but have now sold a minority part of the company to investors.

6.2.2 Preparations

Before the establishment in Latvia the company had production in Portugal which at that time was a low cost country. The choice of changing production sites came when Kjell discovered that a monthly wage was 7000 Swedish crowns in Portugal and only 1500 Swedish crowns in Latvia. The experience from the entry into Portugal was good to have done when the entry in Latvia was proceeding.

The company made own trips to the Baltic in the hunt for low cost production sites but did not find any. They got help from the chambers of commerce in Oxelösund and found four presumptive partners. Three of these companies were colossus with feet of clay. Three of the companies did not have any realistic idea of how business should be done. They found one factory which had a ” management rent out” which had potential.

6.2.3 The establishment

NPP AB was forced to look for other countries for production due to fierce competition and the hunt for reducing costs to become more competitive. If you are a sub-contractor to Nokia and other large companies they have though requirements on cost effectiveness on you. If you are not cost competitive they will give the contract to somebody else.

6.2.4 Market entry modes

NPP AB did the entry in the form of a joint venture with a local factory. During 1993-1995 the factory did not perform well so bankruptcy was near and the taxes to the government could not be paid. NPP AB did a new construction of the business in Latvia and bought the whole company. As a struck of luck the company got a couple of huge orders which financed the take-over completely.

6.2.5 Other

Today the company is recognised as one of the best managed and the problem of a to big suit has become acute. The strategy for the company is to grow and to be able to do that Kjell have sold a part of the company.

The process from an economically planned factory to a market oriented one has been like a roller coaster. It took time to get the management to trust western procedures. The fortunate thing with the factory is that under the Soviet regime the factory constructed data chips to all of The Soviet Union and the employees in the factory is very well educated.

The only control the mother company in Nyköping have over the daughter company in Latvia is the balance account and the invoices the company send to Nyköping.

Kjell Karlsson answer the question: why Latvia? Why not any other country in the Eastern Europe? He answered,*" If I cannot get milk in ICA, I will go to Konsum".* He will go to the country were the psychic distance is not so huge and were the production costs are low.

The distance to a market or a production facilitate does not differ according to Kjell Karlsson because of today's communication possibilities. As Kjell Karlsson says "*had China been closer they had established the company there*".

Russia is both a possibility and a threat but the country is far behind the Baltic region and Western Europe. There is a demand in the Moscow area which stands for almost 80 percent, St Petersburg stands for 10 percent and the rest of the great country for the rest. Latvia is a springboard to the St Petersburg market because the Latvians are speaking the Russian language and are used to deal with Russians. He thinks that Russia is a to dangerous country to do an entry into and therefore is the Baltic a good investment area. His opinion is that the Finnish businessmen have more advantages than the Swedish because they have been used to do business with Russia before the Glasnost and Perestroika.

Latvia has an unnecessary heavy bureaucracy and he has encountered problems with officials and has been forced to bribe bureaucrats in order to make things happen. "*This just naturally because of the low living standards they have*". If Latvia would become to expensive, Poland and The Czech Republic are very interesting investment areas.

The key to success is that you got good people that you could trust in the host country who are managing your business.

The Baltic countries have a lot of cultural differences so if you are doing business in the whole of the Baltic region you need to be aware of that the differences exist.

6.3 LUNDBERGS

6.3.1 Company background

Lundbergs is a family company, which is established in the construction business. They have spearheaded their business towards the make it self market and is selling to wholesalers as BEIJER. In 1999 the company had a turnover of 150 million Swedish crowns. The company's strategy is to expand and take more market shares or other competitors will overrun the company instead. They see expansion as a must strategy otherwise they will loose market shares. The company has no production of their own and buys products from producers and sells them in their turn to wholesalers. 55 percent of Lundbergs products are exported to the Nordic countries, 20 percent are exported to Germany 20 percent to Holland and 5 percent to Russia.

6.3.2 Preparations

The idea to the establishment in the Baltic came when a supplier in Sweden did not supply Lundbergs with a specific product. The supplier introduced Lundbergs to his Baltic producers and it showed that they were 40 percent cheaper than another Swedish producer. Lundberg did a test order and their requirements of quality were satisfied.

Through The Chamber of commerce in Oxelösund a matching trip was done in order to find producers in the Baltic. ALMI and the Swedish trade council also contributed with material. A contact with the Swedish NUTEC which helped the Baltic to improve their economy was taken in the Baltic which provided experience.

Fredrik Toftemo became in charge of the operations in the Baltic and an office was established in Riga in Latvia to be able to control the operations.

6.3.3 The establishment – motives

"Lundbergs has been successful because they have found new and cheap ways of producing their goods and the Baltic was interesting because of their cheap resources and the operations in the Baltic could be a good experience before the entry into Russia", says Fredrik Toftemo. This is vital because Lundbergs has no production of their own.

Lundbergs is constantly seeking for cheaper resources more and more eastward. He sees the Baltic as a European China were Hong Kong and Taiwan puts order to be able to use the low costs of labour.

6.3.4 Market entry modes

Since Lundbergs is a wholesaler there was no motives for establishing a manufacturing plant. Their fundamental idea in the business concept is that they should not have any production of their own. Sales office was the alternative that was used in order to control quality and delivery.

6.3.5 Other

"It is crucial to find a reliable partner when doing business in Eastern Europe".

The company have had one incident were the Russian Mafia was involved.

They feel that the Baltic in general have a heavy bureaucratzy.

An EU membership would affect the price level in the Baltic and an entry into the neighbouring countries is considered.

The businesses is done trough a "gentlemen's agreement" to great extent.

Estonia is the most expensive country of the Baltic's. This is due to that the country is small so Tallinn is affecting the price level in the whole country. The other countries have lower labour costs due to that they are bigger and have lower labour costs outside the cities. Latvia has become the financial centre in the region and Lithuania has the best infrastructure, but the country has not been successful in attracting risk capital. Lithuania has tighter bonds to Russia, so Russia is affecting g Lithuania to greater extent. Lithuania has not recovered from the crisis during 1998 in Russia. Estonia is the country which has come the longest in the transition process much due to the Finnish investment in the country

"It will take for sure 10-15 years before the Baltic countries are on a Western European level".

"The Russian minority is ill treated but will over time become more assimilated in the country. Russia has forever lost the control over the Baltic's and with a EU membership this bond is tightened".

Many of the Balts are university graduates.

6.4 THE SWEDISH CHAMBER OF COMMERCE IN OXELÖSUND

Ove Ohlsson is a consult working at the Chamber of commerce in Oxelösund. He has been responsible for the matching between Baltic companies and Swedish companies for several years. "*It is more going on in Latvia than in the other Baltic countries today and most investments are done there*". All countries suffer from their bad balance of trade which is continually very low. The country which has come the longest towards market economy is Estonia which is very corporate friendly. Estonia has no taxation of companies which makes investors more interested. When an entry is considered into the Baltic the legal part is important. A membership in the European Union would probably increase living conditions and threaten the low labour costs in the Baltic. The education system is working better than the Swedish and they have a higher grade of engineers. According to Ove Ohlsson "*they have 100 engineers on every 1000 citizen and Sweden has 1,5. Latvia has done as Sweden and has invested a lot in the peoples IT-education and they have a higher density of computers than Germany and the Internet is used more than the EU average*". The problems companies encounter the most is register of ownership is not as tight that you could expect to be sure that you are buying what you are buying and that you own it afterwards. "*Ove Ohlsson advice to companies that want to do business in the Baltic is to go the Joint venture way and this is the most common mode of entry*". The most significant errors companies do when they have established themselves in The Baltic is that they do not invest in automation of the production. They use cheap labour, which in the long run will do the company less competitive.

6.5 STÅL & PLÅT AB

This company will for competitive reasons be anonymous because their biggest competitor is following behind and anything that could decrease the distance in the entry process will cost money in the future.

6.5.1 Background

Stål & Plåt is a wholesaler that have the whole Sweden as a marketplace and they are a daughter company in the Trelleborg group. They distribute steel products and alumni products to entrepreneurs so that they do not need to have any storages, the company is purchasing almost 72 percent of the steel outside Sweden. The turnover of the company exceeds 1 billion Swedish crowns.

6.5.2 Preparations

Stål & Plåt did a study in the Baltic countries, which included customer contacts, meeting of officials and an assessment of the countries current position. Head of the study was the head of the sales and of the export. The chamber of commerce and the Swedish trade council in all three countries helped with different contacts.

The preparations started in 1997 and the establishment in all three countries ended in the beginning of the year 2000.

The thought was to buy a Baltic wholesaler to get an access to the market fast.

"Stora Kopparbergs another Swedish company had business there and they had done business with Stål & Plåt earlier and now they helped us in the establishment process".

6.5.3 The establishment –motives

The Baltic is becoming a Swedish home market and you need to be there in order to be the first who takes the advantage over the area.

“Because of the free competition in the market of steel an establishment in the Baltic seemed necessarily to endure market performance over long time of period. The operations in the Baltic with its nearness to Sweden allowed the company to enlarge its volumes pretty easy. To be a good alternative to other importers in the future Stål & Plåt needs to establish in a low cost country with a good market potential”.

“The Baltic region has a market as the size of Sweden”.

6.5.4 Market entry modes

The entry was chosen in Estonia because of its more “friendlier business climate”. An Estonian manager was hired for advice and smooth contacts with officials. Then operations in Lithuania was established and then in Latvia.

The entry mode that was chosen was a sales office with the intention to be a full wholesaler in the region. This mode was chosen after the strategy was clear and to show customers that Stål & Plåt AB intention was to stay in the region and grow.

An acquisition was considered in order to get access to market shares more quickly than a green-field operation.

Due to the increase sales in the Baltic three daughter companies was established, Stål & Plåt AB Teras & Metall AS in Estonia, Stål & Plåt Terauds un Metäli SIA in Latvia and Stål & Plåt Plienas ir Metalai SIA in Lithuania.

6.5.5 Other

“There is a constantly changing among laws”.

“In Estonia the question of the Russian minority is very “hot”.

Stål & Plåt has no contact with the Mafia. The Mafia contacts only companies with business that is illegal.

“The markets in Russia are 150 million and The Ukraine is 50 million people”.

Stål & Plåt sees the Baltic as a springboard to the markets in Russia. Russia is a hard and dangerous country to do business in due to the Mafia and insufficient laws and psychic distance. Ahlsell which is another company in the Trelleborg group has operations in St Petersburg and are going to be used as a smooth way into the Russian market. *“If you are going to survive in Eastern Europe you need to be in Moscow because there is what everything is happening”*.

Stål & Plåt employs only managers that are maximum 35 years otherwise they are to dug into the old planned system of economics. *“You should never have a Swedish executive manager in the Baltic”*.

The next establishment is going to be in Poland because of the growth in the country and the huge construction market.

“Practical experience is a must in an establishment process”.

“It is very important to have as much information as possible when an entry in another country is under consideration”.

The customers are picking up deliveries by themselves to 70 percent, because there are no transport firms as in Sweden.
They are trying to have the same system as in Sweden, but it is impossible due to the different thinking of how to do business.

The steel comes from Russia to a large extent and with the Russian financial roller coaster you cannot trust them as suppliers. As during the crises in 1998 they got no deliveries and needed to take more expensive steel from Sweden to the Baltic. *“The threats are coming from Russia both financially and economically”.*

“The Balts are very nationalistic concerning business and this is due to the former Soviet occupation”.

“The Baltic countries have an agreement with the EU of free trade”.

“The Baltic regions nearest surroundings have 125 million presumptive customers”.

“An establishment in Russia and Ukraine is seen as necessary to be able to survive in Eastern Europe due to competition from these countries”.

“Personal relations are very important and a handshake is more important than a contract”.

7. ANALYSIS

In this chapter I will analyse the information I collected during my interviews using the theories in the Frame of Reference as a tool and the background facts in chapter 4-6. As we connect the theories and the results from the field study, I will try to answer the purpose of the study. I have chosen to divide the analysis into different headlines and follow Djarova´s Cross border investment model (CBIM).

7.1 INTERNATIONALISATION

Following Dunning thoughts of internationalisation three conditions must be satisfied, the firm need specific advantages, it must be more beneficial to internalise them by the company themselves and it must be profitable to use these advantages in conjunction with factor inputs in the target country. All my interviewed companies were trying to increase profits by hunting for low costs or try to get a competitive advantage in the growing Baltic markets. The Baltic has an outstanding nearness to the huge markets of Europe and closeness to the source of cheap factor inputs from Eastern Europe.

Foreign direct investments are done to exert significant influence on the management of the enterprise in the foreign country. These investments are done in two different ways, a green-field investment or the acquiring of existing companies. As Thomas Jacoby at Lamiflex Eesti AS says, *"you do a foreign direct investment in order to earn money. Can you not earn them in the home country, earn them in the host country"*.

7.2 PSYCHIC/CULTURAL DISTANCE

As the world is becoming more homogenous and especially the Eastern European countries who wants to be more Western European alike the psychic distance is closing in to Western European levels in the Baltic area. This has not come as a lightning from clear sky, it is from the heritage that the countries has from Western Europe. The Soviet era has left some traces as Kjell Karlsson at NPP AB says, "*when you suggest improvements you must bear in mind that it will take a while before they test your ideas. This could be a frustrating time but you cannot force them, if you do not want to turn them against you*". Thomas Jacoby in Lamiflex Eesti AS says, *"the hierarchical system in ordinarily life in the Baltic and in the business community can be of a problem. To avoid this problem you hire younger people not above the age of 35, because they are not so indoctrinated with the "old ways of doing business""*. All of the interviewed companies favoured the Baltic due to the psychic distance. Russia is on a different level of psychic distance than Sweden and is therefore harder to do business in, this is the reason for choosing the Baltic area. The way of thinking is almost the same as in Sweden and the mentality alike. This follows Johnson & Vahlnes´s theories (Psychic distance) about the internationalisation process. Companies have a tendency to start the internationalisation process on markets close to the home market and the internationalisation process will gradually step-wise go to more distant markets. Fredrik Toftemo at Lundbergs AB has the whole Baltic as an field of interest but has now learnt how these markets is working and is now preparing to look at the more Eastern countries for new suppliers of cheap input factors. The Baltic countries psychic distance can be measured with Vahlne and Wiederheim-Paul´s seven measuring indicators of psychic distance. 1. The level of economic development in the country, 2. the level of education in the country, 3. difference in level of economic development between home country and the host country, 4. difference in level of education between the home and host country, 5. difference in the business language, 6. difference in local language and culture and finally 7.the existence of previous trading channels between the home and host country. All the interviewed companies and my own findings about the increasing GNP and the development of the countries suggest that the gap in economic development is decreasing rapidly. As Ove Ohlsson at the Swedish Trade Council says that *“their school has a higher standard than ours and that they have more engineers per 1000 inhabitants than Sweden, they have also a fast increasing knowledge in IT”*. The economic development is faster in the Baltic than in Sweden but this is due to that Sweden is more developed than the Baltic and it is harder to develop further and the Baltic has it easier because of their low level of development. There are still differences in the business language but the business culture is very close to western style says Thomas Jacoby at Lamiflex Eesti AS. The culture and local language is different. The culture in the Baltic has a lot of common with Sweden due to the history and the English language is spoken by the young generation. “*If you know German or Russia you will manage really well, the Russian language in Eastern Europe is like the English language in Western Europe”* says Fredrik Toftemo. The existence of trade channels is supported strongly by the Swedish government through the Swedish Trade Council, the ALMI, the NUTEC and the Chamber of Swedish Commerce. We should not forget as Thomas Jacoby says that the Vikings have been trading the Baltic since the 800-century so there must be something in common between us.

7.3 THE CROSS BORDER INVESTMENT MODEL

The cross-border investment model figure 2 at 3.4 is constructed to take full advantage of the investment opportunities in the investment area. By breaking down the companies’ global strategy into smaller pieces one gets an investment decision that is based on the companies strengths and weaknesses and the specific characteristics of the target country. The model has four input factors, the companies’ global strategy, characteristics of the target country, investment opportunities in the target country and forms of investment. From these inputs the company do three major decisions, the strategic objectives toward the target country, the companies investment strategies and the investment decision. If these decisions are in favour of investment, an investment selection is being made.

7.3.1 The companies global strategy

Companies’ global strategies

The companies’ global strategies can be analysed from table 5. at 3.6 there a combination of market-related strategies are matched with cost-reduction strategies. As one can understand there is no single strategy, often the companies’ strategy is a mix of these strategies. If we combine these global strategies with the specific characteristics of the Baltic area we get three different objectives, these are market objectives, cost-reduction objectives and financial objectives. The companies that I interviewed had a cost reduction strategy as NPP AB and Lamiflex AB. Stål & Plåt had the strategy according to table 5 to be a global company, if not somebody else might establish a foothold in the Baltic and penetrate Sweden from there. If you want to be a domestic competitive firm today you also need to be a global one.

7.3.2 Companies strategic objectives towards the Baltic

Companies’ strategic objectives towards the Baltic

<u>Market objectives</u>

Market objectives are to enter and to serve local markets, to protect investors existing markets or to prepare an expansion to third markets. Lamiflex Eesti AS is exporting its products back mainly to Sweden and did the establishment due to competitive reasons. The product that is manufactured in Estonia is of lower quality but can be sold at larger quantities and is therefore much profitable. If they have not exploit the opportunity somebody else may have filled that niche. NPP AB was searching for a cheap production site with low input costs to stay competitive and because they produce plastic solutions for example Nokia mobile phones, they have a constant pressure of reducing costs. Lundbergs AB strategy is to expand their business to the profitable German and Dutch markets. In order to do that they needed to be more cost competitive if they would succeed with their expansion so they needed to find cheap products in the Baltic. Stål & Plåt states, *"if you do not have a good offer to the customer they will go to those who could give them what they want and the Baltic is our home market and if we do not see the opportunity the Finnish companies that are our competitor will"*. Stål & Plåt did its establishment solely of this reason. They think of the Baltic as a wider home market were it is important to grab market shares and be there among the first to become successful. So the answer of these objectives was to enlarge their network of affiliates. "If you do not see to your neighbour, the neighbour will come and see you". The market of the Baltic is of approximately the size of Sweden and Stål & Plåt products fills a niche in the reconstruction of the Baltic.

<u>Cost-reduction objectives</u>

You may say that Lamiflex Eesti AS did the investment to prolong the lifecycle of older technology. You do not need new machines to produce their product profitable. They fairly easy increased production capacities through little investment and got access to cheap input factors.

NPP AB had manufacturing experience from the 1980`s low cost production country Portugal, but when wages and the input factors increased NPP AB looked for other opportunities. *"If you cannot find milk in Konsum, you go to ICA*" Kjell Karlsson says. This means that companies are always after cheaper input factors and will place manufacturing where it is most competitive and cost effective.

Pure financial objectives

This objective is true for every company that I interviewed. Thomas Jacoby said that if one could not do more money in the Baltic area than in the home market no one would invest a penny due to the increased risk and there are a lot of companies who just put in their money in order to close the way for competitors or be a gambler in the race.

7.3.3 Characteristics of the Baltic area

Characteristics of the Baltic area

All the Baltic countries share the common history of occupation from the former Soviet Union. This is almost the only thing these countries share. They have different, history, culture and language. Estonia's language is of the Finno-Ugric heritage and is very close to the Finnish language. Latvian's and Lithuanian's are the only surviving nationalities of the Baltic people, which was an ancient group of people that extended from Hungary to Siberia. The Estonians and Latvians are Protestants and Lithuania is catholic. In the religion one can trace from where the heritage is coming, Poland has had a big influence on Lithuania and it shows in that they share the same religion. Latvia and Estonia has more influence from Germany and the Nordic countries. All three countries was a part of the Russian empire under the nineteenth century and have a great amount of Russian influences.

All three countries have a high specialisation of industry due to the former Soviet regime that made different countries specialise in different fields and then should see to that the whole Soviet empire got their product. The companies are therefore very hierarchical and highly organized. This means that productivity is low even if the workers are skilled. The positive about the Baltic region is that they have a European culture and tradition and therefore it is easy to reshape them as Thomas Jacoby says. Lamiflex Eesti AS has been fortunate to have Thomas Jacoby because he is of Estonian roots, this means that he has been able to look for the right people and manufacturing sites and avoid some problems the ones who cannot the culture and language would have.

Estonia

Estonia is the smallest of the Baltic countries and the country in the Baltic that have come the longest in the transition. As all other transition countries it had a huge decrease in the GNP after independence but has since 1985 had an increasing GNP. The aim for the country is according to Tisuanen 1997 to be a tiger economy, that means a continuously increase in GNP of minimum five percent. As systems need times to adept to the new environment, inflation was almost 1000 percent in the beginning of the transition period but has steadily decreased to around 10 percent. Ove Ohlsson from the Swedish chamber of Commerce predicts that the inflation is going to decrease even more when Estonia joins the EU. One dangerous outcome of the EU is the now steadily increasing wages which will raise the costs in the country and drive up inflation. The trade balance deficit of ten percent need to be financed in the future and as the industry is adapting to Western European standard this will for sure improve, but Estonia has few natural resources so it will be dependent on import from other countries (see table 8 at 4.3.1 and 21 at 4.4). Estonia has also an under valuation advantage due to the fixed exchange rate regime but this is eaten up by the inflation. The problem that Estonia is facing in the near future is a lack of labour since they have a very small population and therefore a small home market, this will hinder the economic growth in the country. Lamiflex Eesti AS who has a joint venture in Estonia has not met any bureaucratic problems or problems of illegal kind. Thomas Jacoby does not see that there could be politically unrest in the country due to the Russian minority. He sees no internal threats of other kind either, but as he says he has the advantage of knowing the language, the culture and the people. He cannot se that there could be external threats from Russia and the more integrated the country gets into the Western Europe the safer is the countries in the Baltic. The Russians is doing enormous investments into the whole Baltic and that is good. The more channels of interest the more trust could be built into relations between the countries. Russia is a large neighbour and its economy will always influence Estonia. Estonia has turned around its trade so that Russia has 13,5 percent of Estonia's import and 9,2 percent of the export. This means that the country is not as dependent of Russia economically as before and hopefully a crises such as the one in 1998 in Russia would not strike as hard next time.

Latvia

Latvia is the second largest of the Baltic countries and has according to Ove Ohlsson taken over the role as the leading investment country among the Baltic countries. Latvia as Estonia has had bad experience of the Soviet occupation and over 25 percent of the population was moved or killed during the occupation. They also have a big Russian minority which is discriminated as in Estonia and is a source of unrest in the country. Kjell Karlsson at NPP AB sees no problems with political unrest from this situation and he is confident that it will be solved when Latvia joins the EU. Latvia was hit hard by the Russian crises in 1998 due to cancelled payments and has as Estonia turned around its trade. Now Western Europe has 62,5 percent of the export and 54 percent of the import. 1995 Latvia exported 28,1 percent to Russia and imported 23,6 percent this figures has decreased, so that next financial crises in Russia would not strike Latvia as hard. It has taken Latvia almost two years to manage to get back on tracks after the chock of 1998. Latvia as Estonia had a decrease in GDP in the beginning of the transition process and has the opportunity to go past Estonia in economical growth. Latvia is the country with most push today and will attract more investments than the others. Latvia has been able to reduce its inflation more than the other and has an inflation of approximately 2,4 percent. Because Latvia is a small country with little natural resources it is dependent on import and it shows in the trade balance (see table 10 at 4.2.2 and 23 at 4.3). The inflation can be a future problem due to budget and trade balance problems.

Lithuania

Lithuania is the country in the Baltic that has attracted the least investments but has good potential to a rapid economical growth due to the large population. Lithuania has also a fixed exchange rate regime that has decreased the inflation and has had an under valuation effect which the domestic producers has benefited from. In the long run the fixed exchange rate regime cannot endure and there is rumours of devaluation of the currency. Lithuania is also dependent of resources from outside the country because Lithuania’s lack of own natural resources (see table 12 at 4.2.3 and 25 at 4.3). Lithuania has a big energy sector with the nuclear plant Ignalina and the oil refinery Mazeikiai. This means that Lithuania is dependent on primarily Russia to get access to these raw materials and Lithuania was badly wounded by the Russian crises in 1998. Lithuania has as the other Baltic countries directed their trade towards the EU to be able to avoid future Russian crises. The export to Russia is now 7 percent and the import is 20 percent. In the beginning of the transition the markets in the former Soviet Union collapsed and these markets accounted for 40 percent of the economic activity. Lithuania is behind the rest of the Baltic in economic growth due to the highly industrialised and specialized industry sector which markets was lost after the collapsed of the Soviet system. As the rest of the Baltic’s the GNP decreased in the beginning of the transition but the lack of FDI makes the country slip after the others. One reason for this is that Lithuania has handled protectionist during the transition period and have made FDI unnecessarily hard to do. Inflation was also huge in the beginning but has now stabilized on 3 percent. The trade balance is not as high as the rest of the Baltic countries but need financing in the future. Two problem areas that are draining the budget are the Energy sector and agriculture sector which do not function properly. As the other Baltic countries the wages are increasing fast and this could mean high inflation in the future and that the low cost advantage will diminish.

The EU influence

All the Baltic counties have signed association agreements and Estonia is the one that is going to become a member first in the EU enlargement eastward. Latvia and Lithuania has not come as far in the transition process as Estonia and therefore has to wait until next membership opportunity. EU is the tool to catch up with the rest of Western Europe in living standard etc. One important issue is that the small conflicts with Russia must be solved before a membership could be possible, Estonia for example has a border problems with Russia. An EU membership will increase western FDI into the Baltic region and become a good springboard to the more eastern markets and the Russian FDI will also increase. Russian investments are good because it strengthen the bounds between the countries but it also means that the Baltic becomes financially dependent of Russia which they tried to avoid due to the unstable economy. The EU will also secure the territory and the military threat from Russia would decrease. Kaliningrad in Lithuania can maybe become a problem for Lithuania and EU in the longer run because it is "situated" in Lithuania and wants to become more independent. This may give Russia an excuse for interfering in the Kaliningrad territory and the only way is through Lithuania. Finally the Baltic politicians statement is that EU membership is number one priority for all three Baltic countries.

Russia's influence

Russia is the big neighbour who will always have an influence on life both politically and economical in the Baltic. Russia's infrastructure is falling apart due to the lack of resources and transportation of raw materials could become a problem. Russia's transition has been tougher than the Baltic's and a huge corruption is spread among officials. This is the effect of that no wages or insufficient wages are not paid. Russia is also a bureaucratic jungle which will make every attempt to do business a nightmare. Russia’s other side is that it is an enormous market with good economic growth opportunities. The fact is that Moscow has 80 percent, St Petersburg 10 percent and the rest of the country 10 percent of the economic activity. This means that the huge country has been divided into poor areas and areas which are on western standard and this could according to Ove Ohlsson at the Swedish Chamber of Commerce *“be a source to unrest in Russia in the future”*. Russia’s fortune is the oil and with increasing world market prices Russia has a trade balance surplus. Russia is seemed as a dangerous investment country and this developed the crises in 1998 and interest rates became sky high. Russia has plentiful problems of financial character as non-sufficient fiscal situation, the budget is overexpenditured and has not been controlled adequately. In short terms the government cannot cove expenditures with revenues. The important saving for economic growth has diminished since nobody can trust the Rubel. Russia’s future is hard to predict and with not enough fair play on the market Russia is seen as a hazardous place to invest into.

7.3.4 Invest opportunities

Investment opportunities

Joint venture / privatisation

Companies which do foreign direct investments in the Baltic region have the possibility to choose if they want to be a part of the privatisation process. No one of my interviewed companies considered privatisation as a possibility because of the hooks the government gets on the company. It was not a choice of our Kjell Karlsson at NPP AB says, *“when you do business you want free* *strings to do it your way"*. If you participate in a privatisation of a company you have to deal with the government, you maybe have to pay little less for the company but you are involved with the government and cannot manage the company as you wishes. To be able to join a privatisation process you may have to promise that employees should stay even if they are to many and unproductive and you end up with a company that is hard to do effective. The biggest disadvantage is that you cannot just buy the good parts, you get the lot and need to insure the government of keeping personnel and such. The most important advantages is that you may take over existing markets but these industries as Thomas Jacoby at Lamiflex Eesti AS says, "*was made to do one kind of product in large quantities and feed the whole former Soviet block with the product"*. So today there may be no market to take over because of the lack of money in the Baltic countries and Russia. Both Lamiflex Eesti AS and NPP AB choose the joint venture because of the fact that you directly could identify the partner. The joint venture form of investment enabled them to decisive rights in selecting labour and management which meant that they had control over the business and the risk. Both companies found a good partner through the Swedish Chamber of Commerce in Oxelösund.

7.3.5 Investment strategies

To realise the companies strategic objectives toward the Baltic countries they needed to choose entry strategies that match their objectives. Is it best to go alone or in co-operation with somebody else and how much involvement would the company like to have? The deeper involvement the higher is the risk. As we can see in figure 4 at 3.7 the different forms are shown. Lamiflex Eesti AS, NPP

AB and Stål & Plåt chose the fully controlled business unit because it enabled them good control over the management of the company.

7.3.6 Forms of investment

Forms of investment

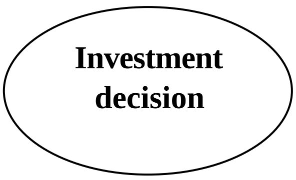
As figure 5 at 3.7 suggests if you want to have a fully controlled business unit there are three investment forms to choose, greenfield, take over, or a subsidiary. Lamiflex Eesti AS and NPP AB made the entry into the Baltic through the joint venture. Both Lamiflex Eesti AS and NPP AB thought that showing a long-term interest is important to get support from both the government and from the factory employees. Both companies have with this kind of investment control over the whole production chain. Lamiflex Eesti AS is a subsidiary to Lamiflex Board AB in Norrköping and NPP AB has the same construction in Latvia as Lamiflex. Lundbergs AB has no manufacturing in the countries because they are a wholesaler and have therefore a sales office in Riga to be able to control quality and that shipments are done in time. Stål & Plåt AB has one subsidiary in each Baltic country of the same reasons that Lamiflex Eesti AS and NPP AB have. In figure 6 at 3.8 the form of investment is shown in a diagram of risk and control and the more control one wants the more risk you need to take.

<u>External & internal factors</u>

External factors cannot be influenced by the company but they affect the selection of entry mode. Target market factors such as the size of the market is a determinant for the type of entry. Cavusgil (1990) means that large markets favour entry modes with high break-even sale volumes such as subsidiary and joint venture. If you use my interviewed companies this is the opposite, the markets in the Baltic is small but the companies chooses entry modes with high break even sales instead of low break even sales as exporting etc. This is interesting because doing business in transition economies is not as doing business in the western world. It can be that these markets together are enough or the companies are after a stronghold near the enormous Russian market. The production factors in the Baltic is good, they have low production costs and a fairly good infrastructure. The environmental factors such as economic, political and sociocultural also affects the choice of entry mode. The Baltic countries problem is that they say one thing and do another. The politicians say that there should be free trade among the states but often they have some kind of regulation which the term free trade agreements is not happy with. The cultural values are like the European values but they suffer from nationalistic feelings as a consequence of the Soviet occupation. All three countries have problems with the trade balance and they have fixed exchange rates. This could in the future lead to devaluation and import restrictions. The last external factor is the home country factor which you could say is the EU home country factor. The problem in Western Europe is that certain things is too expensive to produce due to wages, taxation etc. This means that you need to look for new places for producing and the Baltic is in the neighbourhood.

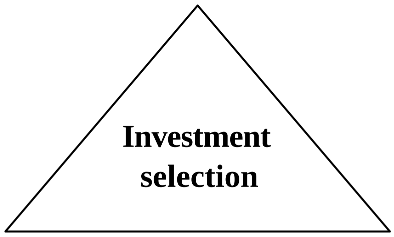
Internal factors such as product, resource and commitment influences the companies' choice of entry. The more skills and resources a company has in management, capital, technology, production and marketing the more possibilities does the company have in their internationalisation (Cavusgil 1990). Companies with small resources will according to Cavusgil choose entry modes that call for small resource commitment. This is another fact which is different in doing business in the Baltic countries. Now companies has the possibility to invest in companies pretty cheap so even small companies could afford to take the risk with deeper commitment. My interviewed companies had a turnover of 150 million Swedish crowns and is assessed to be small to medium sized companies. All the companies with manufacturing choose the subsidiary way of entry mode in the form of joint venture. Companies need commitment to do a FDI and Lamiflex Eesti AS had Thomas Jacoby as a spearhead and with great knowledge of the area. Also Kjell Karlsson at NPP AB has commitment to find cheap places for manufacturing. He says, *“if China had been closer I had been manufacturing there”*. Lundbergs AB has Fredrik Toftemo who is really committed to take all opportunities in the Baltic to find cheaper resources. Stål & Plåt AB sees the Baltic area as a home market and the company need to be there of competitive reasons. This is according to Cavusgil´s (1990) opinion that management with great commitment favours equity entry modes. All the interviewed companies have been successful and Cavusgil says that successful companies will be encouraged to more international commitment. All companies are looking at the potential markets in Russia and the other Eastern European countries in the hunt for cheaper input factors.

7.3.7 Investment decision



The decisions to investment in the Baltic area was done after that the Chamber of Commerce helped with all kind of information, government contacts and matching Baltic companies with the Swedish. All companies see the Baltic as a home market and the total market of the whole Baltic region is of the same size as the Swedish. Sooner or later the companies had to exploit the Baltic opportunities if they would stay competitive or let other companies use the Baltic market for a springboard into the Nordic markets.

7.3.8 Investment selection



Lamiflex Board AB in Norrköping choose Estonia as their entry point because of Thomas Jacoby´s knowledge and contacts in the country and decided to have a joint venture with an Estonian partner. NPP AB chose Latvia because they found the “right” production facilitate with the right kind of management. Lundbergs chose Riga because of the central spot between the two other Baltic countries. Stål & Plåt AB needed to be in all three countries due to competitive and storage reasons.

8. CONCLUSIONS AND RECOMMENDATIONS

In this chapter I want to highlight the factors I have found to be most important for companies entering the Baltic and answer my purpose of the study. I will conclude the chapter and the report by giving suggestions for further research in the area.

8.1 IMPLICATIONS OF THE STUDY

I will recall the purpose of the study. The purpose of the study is to explain how foreign companies strategies theoretically match the Baltic countries strengths and weaknesses and what kind of entry modes provides a good match between the investor’s strategy and the local attractiveness

To be able to fulfil the purpose of the study I have divided my problem into sub problems:

- Why does companies do a Foreign Direct investment (FDI) in the Baltic area?

The Baltic area has come to be a new market in Sweden’s neighbourhood. The Baltic consists of three markets but which together is of the size of Sweden. The Baltic area is also a good step towards the markets in Russia and the rest of Eastern Europe. To be first means that you gain competitive advantages and the costs for companies that is too late is higher for establishing. The Baltic have a huge demand of western products of all kind and have an unsatisfied demand. On the other hand the country provides the investor with a cheap input factor costs and well educated employees. The Baltic is of strategic importance since it is in the middle of Eastern Europe and Western Europe. The countries have the opportunity to become transit countries for products both eastwards and westwards. If Swedish companies do no exploit the opportunity other European companies will and as the Baltic is our home market Sweden is the Baltic home market. This means that the Baltic could be used as a stronghold for a push into the Swedish market.

- What form of foreign direct investment was used when entering the Baltic area and was that the best form?

The best form or the most used entry mode seems to be joint venture. This may be of historical roots since the communist regime did not allowed acquisition of their companies. Today companies use joint venture to get the Balts to feel participated in the business and to use their contacts with the government and other bureaucratic. Often Swedish companies still have a Baltic management who is managing the company because they are the grease that smoothens the machinery. The joint venture was soon after the establishment made to a subsidiary because of the profitability.

- What kind of problems arises for an investor when entering the Baltic area?

First is the problem of finding a good partner that you could trust and now after almost ten years of transition the best companies has already been privatised so suitable production facilitates may be hard to acquire. If you do not now the language you will have a disadvantage but this could be overcome easily. The bureaucratic systems will not stay the same and will constantly change and the rules of the business game will sometimes be unfair. This will become better as the transition goes along and when the countries join the EU.

- What kind of factors influences the strategy companies' use in the Baltic area?

There is always the cost and risk factors but the Baltic is seen as a save investment area so the risk factor is not so huge and the cost of establishing is small, compared to an establishment in Western Europe. Other factors are if you should go alone or co-operate with someone. The best thing seems to be to co-operate with a local partner to be able to exploit the contacts they have

8.2 Further research

This area of study is barely touched upon and there is much more to be done. The overall view on internationalisation and market entry in the Baltic or in the whole former Soviet sphere is going through rapid development and there are much more research to do. I will give some suggestions for further research.

The most important thing when entering a new country is to get access to information and knowledge of the specific market conditions of the area. The best way of doing that seems to be through the finding of a good and reliable local partner. The local partner is often the one who means failure or success. An interesting research seems to be how to find a good partner and what criteria's they should be chosen from.

Another interesting research would a large empirical study of how the enter processes be in different companies and companies with different sizes be. Is there differences in the way of entry due to size or which product the companies manufacture or markets?

There are a lot of internal and external factors influencing the choice of country for internationalisation and also modes of entry is relying on which factors is the most important. Which factors are most important and are there different factors in different kinds of companies?

There seems to be a huge research field in the area of culture. This would for sure be an interesting research to do when western standards met a mix of East European and Western European ways of thinking and acting.

Djarova´s CBIM model is one way of doing things right in an internationalisation process. It could be very interesting to compare this theory with for example the Uppsala model. Companies do not see to theories so much when they establish, they often do as every body else or follow advices from different consults. I think that it would be very interesting to se how a lot of theories have influenced the internationalisation process. This is a larger research and would take a lot of time but it would be interesting to see which theory which is influencing mostly or which theory which is the one most connected to the real way of doing business.

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APPENDIX 1

Table: 30. Summery of problems for FDI in **Estonia**
Source: Hazely C & Hirvensalo I, 1998, p 154-155

Problem	**Estonia**
Legislation	**80 %**
Inconsistencies / uncertainty in implementation	73 %
Restricting business operations	27 %
Land reforms / restitutions – too slow	33 %
Establishment barriers	
Entry restrictions / protectionism	47 %
Customs / Tariffs	**47 %**
Delays / Relations	33 %
VAT problems	20 %
Finances	**73 %**
Access to capital	20 %
Bad debt / payment for goods	33 %
Banking / liquidity if system	40 %
Interest rates / currency risk	20 %
Information	
Access to reliable credit info	33 %
Human resources	**93 %**
Shortage of functional management skills	80 %
Obtaining work or residence permits	33 %
Mindset / loyalty	40 %
Illegal activities	**67 %**
Crime / corruption	53 %
Collusion between locals and authorities	33 %
Reliability of local supplier	**27 %**
Distribution / infrastructure	
Technology lag	40 %
Other issues	
Attitudinal differences	27 %

APPENDIX 2

Table: 31. Summery of problems for FDI in **Latvia**
Source: Hazely C & Hirvensalo I, 1998, p 154-155

Problem	**Latvia**
Legislation	**83 %**
Implementation / change	75 %
Certification	33 %
Establishment barriers	
Obtaining good premises	33 %
Customs / Tariffs	**58 %**
Procedures vary	58 %
Problems with officials	42 %
Finances	
Payments for goods	67 %
Information	
Human resources	**93 %**
Shortage of functional management skills	75 %
Illegal activities	**67 %**
Corruption	33 %
Crime / security	33 %
Reliability of local supplier	
Distribution / infrastructure	
Inadequate infrastructure	67 %
Other issues	
Poor attitude of investors	17 %

APPENDIX 3

Table: 32. Summery of problems for FDI in **Lithuania**
Source: Hazely C & Hirvensalo I, 1998, p 154-155

Problem	**Lithuania**
Legislation	**83 %**
Implementation inconsistent or unclear	58 %
Tax regulations	58 %
Certification	25 %
Establishment barriers	**67 %**
Procedures complicated	50 %
Protectionism	17 %
Customs / Tariffs	**58 %**
Delays / Rules vary	42 %
Tariffs unfair	42 %
Finances	**50 %**
Obtaining loans / credit	50 %
Banks	20 %
Information	
Human resources	
Lack of functional management skills	25 %
Illegal activities	**50 %**
Corruption	25 %
Crime	17 %
Discrimination	17 %
Reliability of local supplier	
Distribution / infrastructure	
Infrastructure	25 %
Other issues	

APPENDIX 4

Table: 35. Summery of problems for FDI in **Russia**
Source: Hazely C & Hirvensalo I, 1998, p 154-155

Problem	**Russia**
Legislation	**91 %**
Inconsistent tax regulations and accounting rules	73 %
Uncertainty about authorities	82 %
Immaterial rights violated	9 %
Establishment barriers	**82 %**
Bureaucracy	45 %
Protectionism	27 %
Land ownership	9 %
Customs / Tariffs	**73 %**
High tariffs, long delays, problem with certification, bribes	
Finances	
Access to capital and payments for goods	82 %
Banking system	36 %
No local credit	18 %
High credit risk	18 %
Information	**64 %**
Limited, biased information concerning regulations	
Human resources	**91 %**
Lack of management skills	91 %
Language problems	18 %
Illegal activities	**65 %**
Security problems	27 %
Bribery	27 %
Reliability of local supplier	**65 %**
No local supply or insufficient quality	65 %
Distribution / infrastructure / logistics	**45 %**
Access to distribution networks	18 %
Infrastructure Technology	27 %
Other issues	**55 %**
Hostility towards investors	35 %
Non.acceptance of good of Russian origin	18 %

INTERVIEWS APPENDIX 5

The Swedish Chamber of Commerce
Oxelösund
Ove Ohlsson, responsible for advising and matching Swedish companies establishment in the Baltic with the right kind of company.
000704

Lamiflex Board AB
Norrköping
Thomas Jacoby, managing director of Lamiflex Eesti AS in Estonia and responsible for the establishment.
000705

Lundbergs produkter AB
Oxelösund
Fredrik Toftemo, responsible for the Baltic establishment, and head of the office in Riga, Latvia
000710

Stål & Plåt AB
Linköping
Roger Byström, responsible for the company's establishing in Estonia, Latvia and Lithuania.
000712

Nyköpings Plastprodukter AB (NPP AB)
Oxelösund
Kjell Karlsson, owner and responsible for managing the internationalisation in Latvia.
000707

Appendix 6

Interview guide

The respondent

1. What kind of position do you have in the company?
2. What kind of position did you have when you entered the Baltic?
3. Did you have earlier experience of internationalisation? In which countries did you have experience?

The company

Would you like to describe your company and it´s current status.

1. Which country did you enter and why?
2. What kind of motives did the company have for the internationalisation?
3. What kind of objectives does/did the company have in the Baltic's?
4. What kind of strategy did or does the company have in the Baltic?
5. What factor or Which factors was/were the most important when the company decided to internationalise?

Internationalisation

1. What kind of preparation did the company do before the entry?
2. What level of involvement did the company want to have in the Baltic?
3. How long did the internationalisation take?
4. Did you consider to cooperate in a privatisation process in the Baltic?
5. For how long did / does the company plan to be in the Baltic?
6. Did the company get help from any organisation in the internationalisation process?
7. Did you do any analysis of the Baltic before the entry?
8. Did the company analyse it´s strength's and weaknesses before the entry?
9. Did the company do a sole entry or did it join another company in the process?
10. Which advantages/disadvantages did you encounter in your process?
11. What kind of entry mode did the company use when entering?
12. What kind of risk were the company willing to take in the internationalisation process?
13. Which external factors influenced the process?
    - Target country market factors
    - Target country environmental factors
    - Target country production factors
    - Home country factors
14. Which internal factors influenced the process?
    -Company product factors
    -Company resource/commitment factors

Country specific questions

15. What do you know of the Baltic?
    - Laws, tariffs, customs and other trade barriers
    - The governments attitude towards foreign investors

- Social status in the country
- Political status in the country
- Other
- Infrastructure

Technology

16. How far have the countries come in the transition process?
17. Is there any similarities/differences between the countries?
18. Which country gives the best investment opportunities?
19. Do you have any competitors in the Baltic?
20. Is there any problems in doing business in the countries?
21. What do you know about doing business in Russia?
22. What kind of problems/opportunities are there in Russia?
23. How much is Russia influencing the Baltic?

Other influencing factors

24. Do you know any other influencing factor that have impact on the Baltic?
25. Do you think that the EU has impact or will have impact on the Baltic?
26. Do you think that the Russia has impact or will have impact on the Baltic?

Psychic/cultural distance

1. Is there differences between the Baltic and Swedish way of doing business?
2. Is there differences between the Baltic and Swedish management and labour, in education, quality and responsibility?
3. Is the Baltic still influenced by the Soviet union and the planned economy?
4. Which language is the dominating in businesslife, English or Russian?
5. Is there risk for social unrest in the Baltic's?
6. How is the Russian minority treated?
7. Can you see any other cultural aspects that could be threats or opportunities for the Baltic?

Finally

1. Is there something else that You think is of interest for my research?