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INTERNATIONALIZATION OF ESTONIAN ENTERPRISES: THE MARKET DIMENSION

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INTERNATIONALIZATION OF ESTONIAN ENTERPRISES: THE MARKET DIMENSION

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Abstract

The main aim of this working paper is to analyze the target market patterns of Estonian internationalizing companies. Since foreign direct investments are believed to have significantly influenced the internationalization process of Estonian enterprises, the study tries to ascertain whether these processes differ in case of enterprises based on Estonian capital and those with foreign participation. The data of four surveys that were carried out among Estonian exporters and foreign investors, and firms involving foreign investments were used for testing the hypotheses proposed. It can be said that inward foreign direct investments have not contributed much to the internationalization of Estonian companies in the sense that they have mostly concentrated their activities on the Baltic markets or exported their production to the home market of the foreign parent. Additional knowledge of foreign markets gained owing to such international activities is often marginal. Somewhat unexpected was the result that there are no clear differences in target market patterns between firms with differing shares of export in their turnover. Two case studies presented in the last part of the paper suggest the existence of some inter-firm differences that are determined by the motivation of foreign expansion. As Sylvester has been internationalized step by step, but has not followed all the principles suggested by the previous empirical studies. Namely, it did not set up its foreign subsidiary in the market to which it exported the largest share of its production, but selected the market, proceeding from the availability of suitable resources and the distance to the target market. The internationalization of As Baltika

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has been carried out mostly in line with the ideas of incremental internationalization processes, but the expansion has been faster and the spectrum of foreign market entry modes has been wider than those of As Sylvester.

Keywords: internationalization, target market selection, transition economies, Estonia

CONTENTS

Introduction

Extensive research into the issue of internationalization of enterprises started with the rapid growth of foreign trade and foreign direct investments in the 1960s. Since that time a large number of researchers have analyzed the factors that have influenced the internationalization process and pattern, its threats and opportunities, the impact of internationalization on the parent company and host economy, and several other problems related to international activities of firms.

At the beginning of the 1970s, an extensive research into the internationalization processes of enterprises started in the Nordic countries. Over three decades in a considerable number of research papers discussed these issues. The original idea of sequential development of international operations was suggested almost simultaneously in Sweden by Johanson and Wiedersheim-Paul (1975), and Johanson and Vahlne (1977), and in Finland by Luostarinen (1979). Most of the research thus far has concentrated on analyzing the internationalization processes of enterprises in developed countries.

The emergence of new attractive markets in Central and Eastern Europe (CEE) at the beginning of the 1990s was a great chance for several enterprises in developed countries to expand their international activities. However, due to their lack of experience and competitive advantages only a few firms in CEE countries were interested in entry to foreign markets. By now the situation has completely changed as many enterprises in these countries are increasingly engaged in export activities and their foreign direct investment outflows are growing each year.

It could be expected that the internationalization process of enterprises in the transition countries would be somewhat dissimilar to the traditional processes suggested by some Scandinavian researchers. For example, the size of the local market and the low level of purchasing power might force enterprises to speed up internationalization. At the same time, in the small (transition) countries the average size of companies tends to be smaller than in bigger markets, their R&D expenditures are low and their production is relatively primitive — thus their organizational capabilities set limits to their use of foreign direct investments when entering new markets. In addition, some differences in selecting target markets are also to be expected, since firms' competitive advantages are quite often based on inward foreign direct investments. So the companies would carry out their foreign owners' internationalization strategies, not their own.

Estonia is a small transition country with extremely liberal economic policy. As compared to the other Central and Eastern European countries, Estonia has been relatively competitive in attracting foreign direct investments (Varblane, 2001). These have been instrumental in accelerating the transition processes and building up competitive advantages of the local enterprises. On the other hand, because of the limited local market, for the sake of further growth, internationalization is inevitable for enterprises. Thus, deeper understanding about the experience of Estonian internationalizing firms is needed in order to avoid errors, to promote international expansion and implement supportive policy measures.

Until now the subject has been nearly unexplored in Estonia (only Varblane *et al.* 2001 and Roolaht 2002 have provided some insight into the subject) and so the analysis made in the present working paper is an attempt to facilitate deeper understanding of the internationalization processes undergone by Estonian enterprises.

As internationalization has many dimensions (product, operational mode, market), it is not possible to present a thorough analysis of all of them in one paper. Therefore, in what follows only one part of the internationalization process — analysis of the target market — will be addressed.

The main purpose of this paper is to analyze the target market patterns of Estonian internationalizing companies. Since foreign direct investments are expected to have had a significant impact on the internationalization of Estonian enterprises, the existence of differences in the internationalization processes between the enterprises based on Estonian capital and those with foreign participation is going to be tested.

In view of its aim, the paper is divided into three parts:

At first, the theoretical foundations and the results of previous empirical studies about target market patterns of internationalizing enterprises are presented and the hypotheses about the internationalization pattern of Estonian firms are formulated.

Next, the market dimension of internationalization of Estonian enterprises is studied.

Finally, two case studies are presented to illustrate the target market pattern of Estonian enterprises.

The data drawn from the surveys "Exporter 1997", "Foreign Investor 1997" and "Foreign Investor 2000" is going to be used for analyzing the internationalization tendencies of Estonian enterprises. The results of the survey "Outward Foreign Direct Investment in Estonia 2001" are used to provide additional information about the internationalizing firms.

1. Overview of previous research on the market dimension of internationalization

Research into internationalization of enterprises started several decades ago. By now a considerable number of studies have addressed this issue. Several researchers have suggested that internationalization should be viewed as a sequential process. This approach has been especially popular among Nordic scholars.

Luostarinen (1979) distinguished between three dimensions of the internationalization process — product (P), operational mode (O) and market (M). Afterwards he added an additional dimension — organizational capacity — to the POM-pattern. (Luostarinen 1989; Luostarinen *et al.*, 1997).

Johanson and Vahlne (1977) described internationalization as a sequential process, in which market commitment decisions depend on market knowledge and current commitment in this particular market (see Figure 1). They suggest that the incremental nature of internationalization has resulted from lack of knowledge about foreign markets. Lack of information and experience increases the risk level that is related to operating abroad. (Johanson *et al.*, 1977)

Uncertainty about foreign markets is greater in the case of distant markets. Since geographical distance alone does not provide sufficient information about inter-country differences, the concept of psychic distance was introduced. The psychic distance between two countries depends on differences in their languages, education, business practices, culture and industrial development. The uncertainty related to foreign markets and the impact of psychic distance can be reduced by means of interaction and integration with the market environment (Johanson *et al.*, 1977).

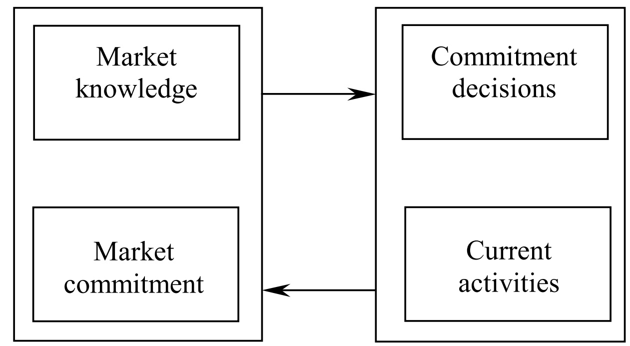


Figure 1. The basic mechanism of internationalization — state and change aspects (Johanson *et al.*, 1977).

Firms prefer entry to similar markets because it enables them to reduce uncertainty, facilitates transfer of both technology and managerial resources, and assures demand for their products (Erramilli, 1991). Companies that are in the early stages of internationalization are usually interested in entering the markets that are more familiar and less costly to penetrate (Luostarinen classifies these as 'hot' markets). Usually these are the markets which are closest in psychic and cultural terms. Market selection, dominated by concerns of uncertainty in the early phases of international expansion, will increasingly become a function of economic opportunity (organizational capabilities) as the firm gains experience. Thus, a company's shift to more distant markets (towards 'cold' markets, according to the classification suggested by Luostarinen) indicates greater maturation of its internationalization process. (Erramilli, 1991; Luostarinen, 1989; Welch *et al.*, 1988)

The validity of the above-mentioned relationships between international experience and target markets was supported by an analysis made by Erramilli on the basis of US service firms' internationalization. He discovered that firms would choose culturally similar foreign markets when they are at a low level of experience, expanding their activities to unfamiliar territories as soon as they have reached higher levels of experience. He also suggested that the geographic scope of a firm's experience influences its market selection more than the length of experience. Consequently, the diversity of experience is more important than its intensity. (Erramilli, 1991)

In their comprehensive overview of empirical studies in the field of export development, Leonidou and Katsikeas briefly describe the issue of market expansion by exporting firms, suggesting that firms undergo three stages of export development — pre-engagement, initial, and advanced export. In the first stage, firms are likely to expand extraregionally (that is, within regions of their own country base). Then, in the initial stage of export activities, limited corporate resources, fear of the unknown and other barriers are responsible for the firm adopting a concentrated foreign focus. Finally, as the firm acquires more resources, seeks to exploit more foreign opportunities and gains expertise in handling export problems, it spreads to a large number of markets in the advanced stage of export development. (Leonidou *et al.*, 1996)

In comparison with developed Western European countries, the differences in the internationalization processes in the transition countries derive from their enterprises' own experience and knowledge. Western European enterprises have developed sequentially and have had time to get used to the globalization processes of the world economy. Their knowledge of foreign markets and commitment to international markets has accumulated gradually during a relatively long period of time. Conversely, until lately most of the Central and Eastern European countries had neither private ownership nor knowledge of the business routines characteristic of market economies.

There were differences between the transition countries themselves, too, so the starting positions of the CEE economies were far from equal. For example, while several countries (e.g. Poland and Hungary) allowed private entrepreneurship, others had absolutely no practical market economy experience.

The internationalization of Estonian enterprises started in the early 1990s. Compared to several other countries, this process has been somewhat more accelerated in Estonia. There are several reasons for this. Firstly, the local market is limited (both in terms of population and purchasing power), therefore offering few prospects for expansion. Secondly, Estonia has a liberal foreign trade policy, which is why local firms have been under intensive pressure to increase their competitiveness in order to survive. This has forced them to introduce new products, technologies and routines. Thirdly, there has been a remarkable inflow of foreign direct investment to Estonia which has facilitated Estonian enterprises' entry to foreign markets, since foreign investors have well-established contacts and distribution channels in foreign markets. An additional advantage is that foreign owners already have experience of operating in foreign markets which they can at least partly convey to the Estonian subsidiary and exploit in combination with the local capabilities in expanding to new target markets. On the basis of the preceding discussion, the following hypotheses were formulated.

H1: Foreign investment has a significant impact of on the internationalization process of Estonian enterprises — foreign-owned firms are entering more distant markets than local capital based ones.

H2: Compared to firms with a smaller share of exports in their turnover, enterprises with a larger share of exports in their turnover have more export activities in markets whose psychic and geographical distance is greater.

Besides the psychic and geographical distance between countries, the size of the target market has also to be considered when taking decisions about internationalization. For example, Galan, Galende and Gonzalez-Benito concluded on the basis of their analysis of Spanish internationalizing companies that the potential of the host market is the most important determinant in selecting the target market (Galan *et al.*, 1999). Firms can start their foreign operations either in large markets or small countries – there is no clear rule about that. However, using the example of Sweden, Johanson and Wiedersheim-Paul suggest that firms with a small local market might prefer to start their foreign operations in smaller target markets, because these are more similar to the local market and either require a smaller initial resource commitment or have less competitive domestic industries. (Johanson *et al.*, 1975) The same approach might also be applicable in the case of Estonian internationalizing firms.

Johanson and Vahlne propose that commitment decisions should be made in small steps, unless the firm in question has very large resources at its disposal, its markets are stable or homogeneous, or the firm has earlier experience from similar markets (Johanson *et al.*, 1977). Stray, Bridgewater and Murray argue that reduced barriers between markets enable simultaneous entry to several foreign markets (Stray *et al.*, 2001) and initiate the emergence of "born international".

Mascarenhas suggests that if the target markets are small, the firm may simultaneously enter multiple markets to exploit economies of scale. This pattern of international development is especially likely in the case of industrial products and relatively homogeneous international needs (Mascarenhas 1992). The same tendency may also appear in the internationalization of Estonian enterprises, since several main target markets (for example, Latvia and Lithuania) are relatively small.

Oviatt and McDougall define a new international venture as "a business organization that, from inception, seeks to derive a significant competitive advantage from the use of resources and the sale of outputs in multiple countries" (Oviatt *et al.* 1994, p. 49). Taking into account the number of countries involved and the coordination of value chain activities, they distinguished between four different types of new international ventures (see Figure 2).

Coordination of value chain activities	Few activities coordinated across countries (primarily logistics)	Export/Import Start-up	Multinational Trader
	Many activities coordinated across countries	Geographically Focused Start-up	Global Start-up
		Few	Many
		Number of countries involved	

Figure 2. Types of new international ventures (Oviatt *et al.*, 1994).

The results of the analysis of small technology-based firms in the UK made by Stray, Bridgewater and Murray suggest that young and small companies have entered many countries, beginning to do so very soon after incorporation. Older and larger companies have waited for some time before internationalizing, but then have also entered many countries. The third group of firms — young, small and low export-intensity companies — have entered relatively few countries. (Stray *et al.*, 2001)

Kwon and Hu studied internationalization processes in Korean firms. Among other aspects they analyzed the average number of markets targeted by different groups of firms, finding that the firms exporting via foreign intermediaries were on average active in 6.46 foreign markets, while the firms using distributors and/or agents had operations in 7.05 markets. The average number of target markets was significantly higher if the firm had made foreign direct investments. In the case of creation of a foreign sales office and branch, the respective number was 10.87, whereas the creation of foreign production units presumed operations in 18.24 different countries (Kwon *et al.*, 2001).

It is reasonable to suppose that firms based on local capital have fewer export markets than foreign-owned enterprises. In the first place, local firms have not got enough expertise and experience in foreign activities, because of this their expansion to foreign markets proceeds rather slowly and they prefer to concentrate their activities on a small number of foreign markets. Secondly, in Estonia most local capital based firms are small and their resources are inadequate to permit simultaneous entry to several foreign markets.

H3: The number of export markets and foreign subsidiaries is larger in case of foreign-owned firms than local capital based firms.

2. Analysis of the target market pattern of internationalization of Estonian firms

2.1. The data

For analyzing the validity of the hypotheses presented in the previous section, we use the data drawn from four surveys. Three surveys ("Exporter 1997", "Foreign Investor 1997", "Foreign Investor 2000") were carried out by the Faculty of Economics and Business Administration of the University of Tartu in co-operation with the Estonian Investment Agency and the Estonian Trade Promotion Agency in 1997 and 2000. The number of enterprises covered by the surveys and their average export share in turnover are presented in Table 1. The total number of foreign investors who responded to our surveys "Foreign Investor" was actually higher than indicated in the table, but for the purposes of the present working paper only those foreign owned firms are analyzed which have exporting activities abroad.

The survey "Outward Foreign Direct Investment in Estonia 2001" was completed in 2001. The Faculty of Economics and Business Administration of the University of Tartu carried it out in the framework of ACE-Phare project P98–1162–R. The number of respondents was 70. As the stock of outward foreign direct investments is relatively low in all the transition countries, Estonia being no exception, this sample represents 46.3% of all Estonian outward foreign direct investments.

Table 1

Number of exporters in three samples (%)

	Exporter 1997				
Export share in turnover	**All**	**0–25**	**25–50**	**50–75**	**75–100**
Number of enterprises	49	7	9	20	29
	Foreign investor 1997				
Export share in turnover	**All**	**0–25**	**25–50**	**50–75**	**75–100**
Number of enterprises	44	14	7	6	18
	Foreign investor 2000				
Export share in turnover	**All**	**0–25**	**25–50**	**50–75**	**75–100**
Number of enterprises	51	15	3	10	23

Source: author's calculations on the basis of the surveys "Foreign Investor 1997", "Foreign Investor 2000", "Exporter 1997".

All the four surveys followed the same procedures. First a list of enterprises was obtained either from the Estonian Investment Agency or the Estonian Trade Promotion Agency. Then the firms were contacted by phone for getting their consent, after which a questionnaire was sent to them by mail, fax, or e-mail. The firms that failed to return the questionnaire were contacted again in two weeks' time.

2.2. Hypotheses testing

In the following analysis we will distinguish between three different groups of enterprises — foreign-owned companies both in 1997 and 2000, and local capital based firms in 1997. This will enable us to reveal whether there are any ownership-related differences and to observe the changes that have taken place during the years.

H1: Foreign investment has a significant impact of on the internationalization process of Estonian enterprises — foreign-owned firms are entering more distant markets than local capital based ones.

The differences between the export target markets of Estonian capital based and foreign-owned firms are presented in Figure 3. In the case of foreign-owned enterprises, it was possible to analyze the results both in 1997 and 2001. As can be seen from the figure, in 1997 the foreign-owned enterprises were mainly interested in servicing the market of the Baltic States. The share of firms exporting to other markets was considerably lower. At the same time, the export activities of local capital based firms were more diversified and besides the Latvian and Lithuanian markets more than 50% of all the exporting firms also exported some of their production to Finland, Sweden, other EU countries, Russia, the Ukraine and other countries. Compared to 1997, foreign-owned firms had also intensified their activities in several markets (namely, Finland, Sweden and other EU countries) by 2000. However, the presence of foreign-owned enterprises in Russia, the Ukraine and other markets was significantly lower than that of Estonian local companies; what is more, it had even decreased in comparison with 1997.

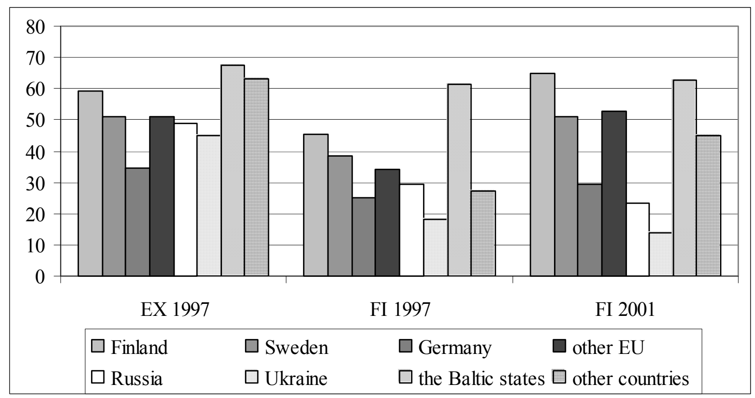


Figure 3. The share of firms (% of all exporters) exporting to different target markets (author's calculations on the basis of surveys "Foreign Investor 1997", "Foreign Investor 2000", "Exporter 1997").

It can be concluded that foreign investors have mainly been interested in servicing the Baltic States' markets which are both geographically, psychologically and economically close to Estonia. This result suggests that foreign direct investments into Estonia have mostly been of market-seeking nature, the share of investors with other motives (for example, efficiency-seeking) was rather low in 1997. Afterwards the foreign-owned firms expanded their activities to economically more distant countries — Finland and Sweden. At the same time, locally-owned firms were already in 1997 represented in both geographically close and relatively distant countries. Thus, in the case of export activities carried out by the Estonian firms, hypothesis 1 is not supported.

Outward foreign direct investments have increased and several enterprises have founded foreign subsidiaries during the last few years. There are 64 firms in our sample (22 of them are based on local capital and 42 are foreign-owned) that have made foreign investments. Table 2 shows that 81% of the enterprises in the sample have made investments to the other CEE countries. Most of their subsidiaries are founded in Latvia and Lithuania (as detailed information is available only about two most important subsidiaries, it is not possible to provide it about foreign direst investment host countries). Thus, Estonian foreign direct investments are also primarily oriented to geographically and economically close markets.

Table 2

The share of firms (% of all investors in the group) that have subsidiaries in different regions, in the year 2000

	EU	CEEC	CIS
All	12.5	81.3	14.1
Local capital based	13.6	77.3	4.5
Foreign owned	11.9	83.3	19
Manufacturing firms	31.6	63.2	10.5
Service firms	4.2	85.4	14.6

Source: Author's calculations on the basis of the survey "Outward Foreign Direct Investment in Estonia 2001".

The number of firms that have founded subsidiaries in the CIS or EU markets is almost equal. However, there is a noticeable difference between the local and foreign-owned firms in their orientation to the CIS markets. The results suggest that foreign-owned enterprises have used the Estonian subsidiary as a base for entering CIS markets. Apparently foreign investors from Finland and Sweden intended to use both the expertise of Estonian employees accumulated in the eastern markets and the experience gathered through operations in Estonia for successful expansion to the CIS region. On the other hand, local capital based firms have either not enough resources for these markets, are pessimistic about these markets, or have other priorities for foreign expansion.

Selection of target markets depends, among several other factors, on the nature and existence of competitive advantage(s). While most of the Estonian manufacturers rely on cost-advantages in competing abroad, service firms have to develop superior technology and create specific assets for the same purpose. Table 2 indicates that service firms mostly concentrate on the markets of the other transition countries, while manufacturing enterprises target their activities to a broader spectrum of markets. These results suggest that the technological advantages possessed by service firms favour expansion to economically closer markets.

If we divide the host regions of Estonian outward foreign direct investments into two groups — economically and geographically close markets (the CEE countries) and distant countries (the CIS and EU countries) — we can conclude that there are no considerable differences between the activities of local capital based and foreign-owned firms. Thus, hypothesis 1 is not supported in the case of foreign investments either.

To sum up, there is no evidence, either in the case of export target markets or foreign direct investment host countries, that foreign-owned firms enter more readily to geographically and economically more distant countries than enterprises based on local capital. Thus, hypothesis 1 is not supported.

H2: Compared to firms with a smaller share of exports in their turnover, enterprises with a larger share of exports in their

turnover have more export activities in markets whose psychic and geographical distance is greater.

Figure 4 presents an overview of the main export markets possessed by different groups of exporters among foreign-owned firms in 1997. The firms whose focus is mainly on servicing the Estonian market, also export some of their production to the neighbouring countries. Most of this export is targeted to Latvia and Lithuania, while a number of enterprises are also interested in the Russian, Finnish, Swedish and Ukrainian markets.

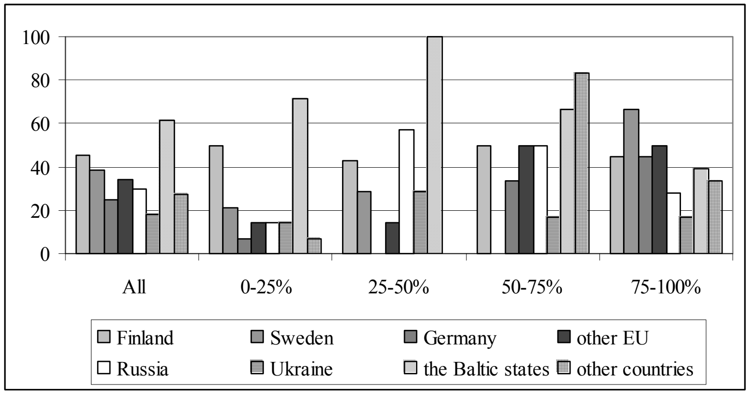


Figure 4. The share of foreign-owned Estonian firms (% of all exporters), grouped by the share of exports in their turnover, exporting to different target markets in 1997 (author's calculations on the basis of the survey "Foreign Investor 1997").

The export markets of the firms exporting over 50% of their production are somewhat different — most of their export is targeted to developed markets. The share of firms exporting to the Ukraine, Finland, Germany and the other EU countries is similar in both high-export groups. The biggest differences between these two groups lie in their operations on the Swedish and other countries' markets. The difference from the Swedish market is especially interesting, the latter being the most important export market for the firms exporting 75–100% of their production. On the other hand, the group of firms exporting 50–75% is not particularly interested in servicing this market.

If we compare the structures of foreign-owned companies' export markets in 1997 and 2000, we can notice that several changes have taken place (see Figure 5). Firstly, all the groups have diversified their activities. Secondly, export activities in economically, geographically and psychologically distant markets have intensified. Thirdly, differences between the groups have diminished.

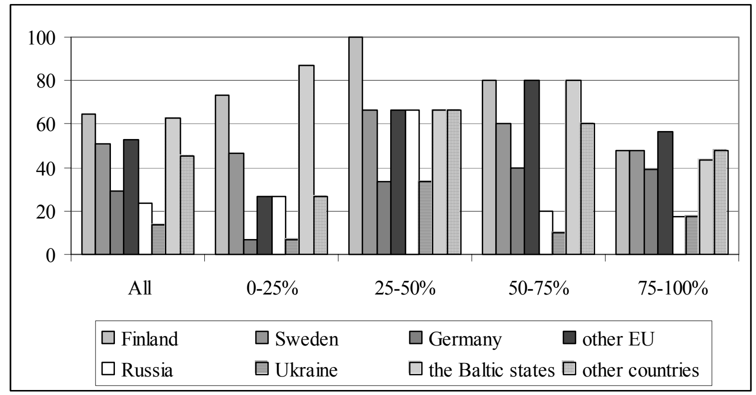


Figure 5. The share of foreign-owned Estonian firms (% of all exporters), grouped by the share of export in turnover, exporting to different target markets in 2000 (author's calculations on the basis of the survey "Foreign Investor 2000").

Firms with a smaller share of exports in their turnover (under 25%) have concentrated their activities on the Baltic States, Finland and Sweden. The share of firms operating in other markets is rather low. The next group of exporters is also active in these markets but is additionally quite actively seeking export opportunities in all other markets. As compared to all the other groups of exporters, the firms belonging to this group have the most diversified export activities. Their goal is to get as many foreign customers as possible at the cost of limited foreign marketing efforts. The main advantage of this approach is that these firms do not depend on the developments enfolding in particular countries and regions. Additionally, it enables them to gain experience of operating in different markets and cultures and allows them to select foreign markets with a higher potential.

Two groups of firms exporting more than 50% of their production are exporting much of their production to the neighbouring countries (Latvia, Lithuania, Finland, and Sweden) and are not servicing the Russian and Ukrainian markets now. While the group that has the highest share of exports in its turnover has concentrated its activities only on the less distant markets, these firms that export 50–75% of their production are also active in Germany, other EU and other markets. Thus, those firms whose share of exports is highest have the most concentrated activities. This suggests that these foreign-owned enterprises are carrying out their parent company's strategy — these investors are either of market seeking (export is targeted to Latvia and Lithuania) or of efficiency-seeking nature (an Estonian firm is integrated to its parent's production network, its production being marketed either in the parent's home market or by the parent company in other markets). The decisions about selecting markets for export and about market commitment are often made by the parent company. Thus, as a rule, the principles of sequential internationalization are not followed.

While firms with foreign participation are often not free to formulate their own internationalization strategy, companies based on local capital have been guided by their own ideas and have been forced to make more efforts towards entering foreign markets. If we compare the main export markets of locally owned firms (see Figure 6) with those possessed by foreign owners (Figures 4 and 5), we can notice differences in the target markets. Firstly, the firms exporting less than a half of their production are relatively active in eastern markets (namely, Russia and the Ukraine). This means that local businessmen are trying to use the relationships and experience that they had accumulated already before the transition process began. The same approach is also applicable in the case of Latvia and Lithuania. Naturally, the small geographical and economic distance between the Baltic States has also affected the selection of these target markets. At the same time, as we can see from the figure, only 60% of the firms exporting 25–50% of their production have operations in the Latvian or Lithuanian market (this share was almost 100% in foreign-owned firms in 1997). It is possible that Estonian enterprises do not perceive the potential of other Central and Eastern European countries yet. But it is also possible that the CEE markets are relatively similar to the local Estonian market and thus firms have no competitive edge there. Other factors that may have impeded entry to these markets are several tariff and non-tariff barriers that these countries have introduced.

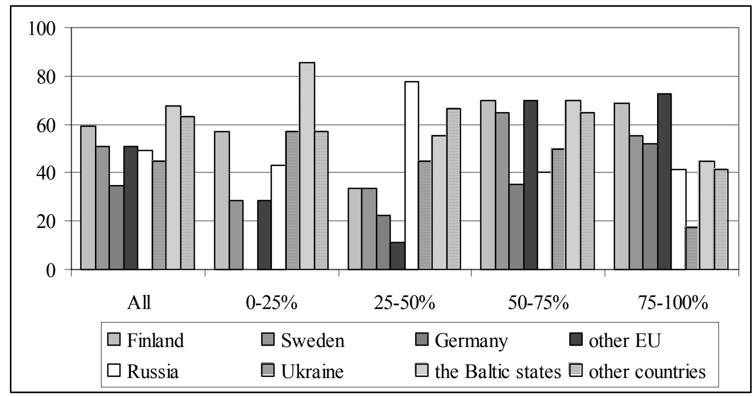


Figure 6. The share of local capital based Estonian firms (% of all exporters), grouped by the share of export in turnover, exporting to different target markets in 1997 (author's calculations on the basis of survey "Exporter 1997").

Compared to foreign-owned firms, companies based on local capital had more diversified export activities in 1997 (see Figures 4 and 6). It is possible that this difference in the results is due to the fact that local firms have to find possible target markets by themselves and cannot rely on the parent companies' contacts and distribution channels. At the same time, as they usually do not have enough resources for investing into distribution channels and aggressive expansion in the target markets, the need for diversification of activities is self-evident.

An interesting tendency is that those firms that export up to 50% of their production have concentrated in less developed markets, their activities in the highly developed neighbouring markets Finland and Sweden being really limited. On the other hand, companies exporting more than a half of their production are mainly interested in servicing markets with a high income level (for example, Finland, Sweden, Germany and other EU countries) and therefore do not pay much attention to other markets (this is especially obvious in the group with the highest share of exports).

As the preceding analysis showed, there is no direct relationship between the export target markets and the share of exports in production. Therefore, a clear answer about the validity of hypothesis 2 cannot be given.

H3: The number of export markets and foreign subsidiaries is larger in case of foreign-owned firms than local capital based firms.

Figure 7 presents an overview of the average number of export markets in three differing groups of firms. The firms are divided into four groups according to the share of exports in their turnover. As can be seen from the figure, there are quite significant differences between the groups. Comparing the number of export markets of foreign-owned and local capital based firms in 1997 we see that local firms have diversified their activities to a greater degree and the number of their target markets is twice as high as that of firms with foreign owners. The most diversified are the export activities of those firms that export 50–75% of their production.

During the period 1997–2000 most foreign-owned firms likewise started to pay attention to searching for new export markets and diversifying their activities. However, firms with foreign ownership still possessed fewer export markets than locally owned firms in 1997. The only exception is the group of firms exporting 25–50% of their production, these firms' average number of target markets being 5, which is much larger than that of the two other groups of firms.

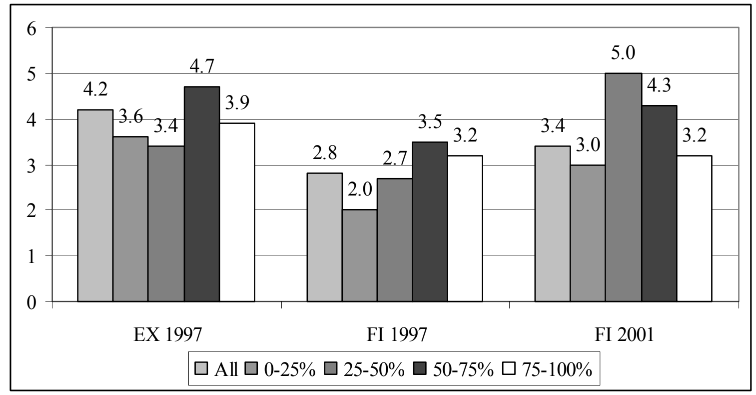


Figure 7. The average number of export markets targeted by different groups of firms (author's calculations on the basis of the surveys "Foreign Investor 1997", "Foreign Investor 2000", "Exporter 1997").

The analysis revealed that there are relatively significant differences in the amount of export markets targeted by different groups of firms. The export activities of local capital based enterprises are more diversified than those of foreign-owned firms. Thus, in the case of exporting firms, hypothesis 3 is not confirmed.

Also, there are some differences between different groups of firms in the number of foreign affiliates (see Figure 8). The number is slightly bigger in case of foreign-owned firms compared to local capital based ones. An interesting result is that the number of locally owned firms' affiliates has remained the same, while in the case of firms with foreign ownership the average number of subsidiaries has decreased. Taking into consideration the fact that during the period 1997–2000 the stock of outward foreign direct investments in Estonia increased, it can be suggested that firms have mostly concentrated on developing and expanding their existing subsidiaries. Decrease in the number of subsidiaries may be due to the fact that during the Russian crisis several foreign operations ceased (this applies especially to subsidiaries in Russia and the other CIS markets). Such an interpretation is supported by the data of Table 2 — firms with foreign ownership are more interested in entering eastern markets than the local ones.

To sum up, since the number of foreign affiliates is larger in the case of foreign-owned firms, we can conclude that in the case of Estonian foreign investments abroad hypothesis 3 is supported.

Analyzing the number of target markets of Estonian internationalizing firms one cannot spot any clearly distinguishable differences between firms representing different ownerships. Locally owned exporting firms have more diversified activities than firms having foreign owners. Looking at the number of foreign subsidiaries, however, we see the opposite picture. Thus, no clear answer can be given about the validity of hypothesis 3.

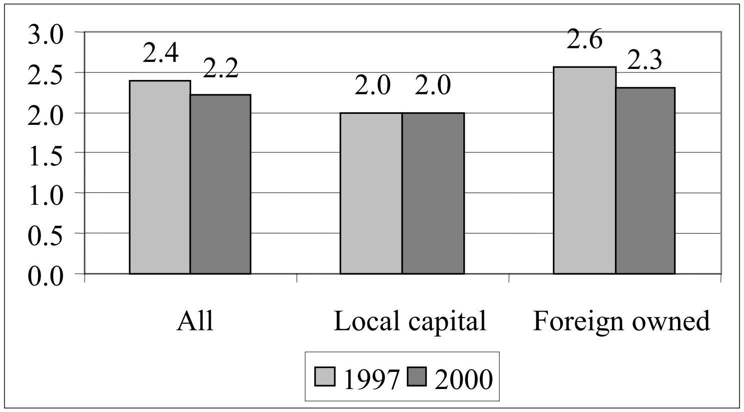


Figure 8. The average number of foreign affiliates in different groups of firms (author's calculations on the basis of the survey "Outward Foreign Direct Investment in Estonia 2001").

3. Case studies of Estonian internationalizing enterprises

3.1. Market- and resources-seeking internationalization — AS Sylvester

As Sylvester is currently the largest domestic capital based forestry company in Estonia. It has grown from a timber procurement company into a forest industry concern. AS Sylvester is one of the biggest forestry enterprises in Estonia both by its turnover and investments.

Figure 9 gives an overview of the net sales of As Sylvester in 1999 and 2000. The share of the local market dropped from 31.8% in 1999 to 28.2% in 2000. The main export markets for As Sylvester have been Finland, Egypt and Algeria, Sweden, the Netherlands, and Portugal (see Table 3). Such a structure of export markets suggests that As Sylvester is already at a developed stage of internationalization, having a number of activities in economically, geographically and culturally distant markets (for example, Egypt and Algeria, Portugal, the USA, Australia, Japan). At the same time, its activities in nearby markets (for example, Latvia and Lithuania), on the contrary, have been quite limited.

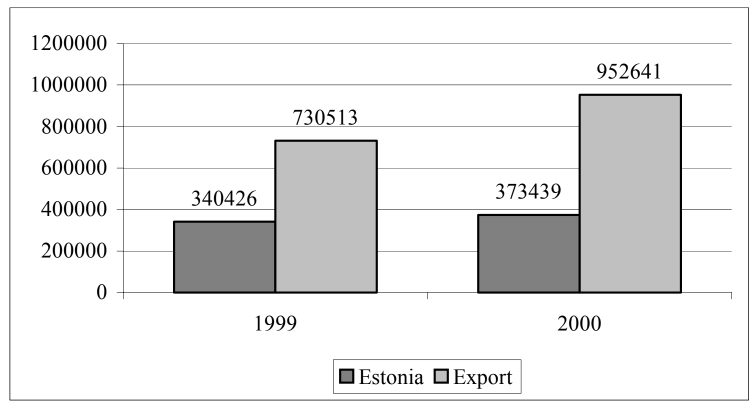


Figure 9. Net sales of As Sylvester in 1999 and 2000 (thousand EEK) (www.sylvester.ee).

Table 3

Export markets of As Sylvester in 1999 and 2000

	1999		**2000**
Finland	157 592	Finland	240 529
The Netherlands	92 057	Egypt/Algeria	131 637
Sweden	86 957	Sweden	126 939
Egypt/Algeria	79 466	Portugal	111 046
Portugal	71 437	Netherlands	95 754
Germany	69 546	Norway	73 590
Norway	58 873	Germany	49 470
Great Britain	33 350	Great Britain	37 186
Denmark	29 160	France	26 186
Spain	28 333	Spain	17 612
France	17 146	Latvia/Lithuania	12 324
Latvia/Lithuania	4 972	USA/Australia	11 044
Turkey	3 794	Denmark	9 014
USA/Australia	704	Japan	3 590
other countries	9 128	other countries	6 720

Source: www.sylvester.ee

Before 2001 As Sylvester did not pay much attention to servicing the Latvian and Lithuanian markets — the share of export in its turnover constituted 0.6% in 1999 and 1.3% in 2000. The reasons for this choice are obvious. Firstly, there are no significant price differences between the Estonian, Latvian and Lithuanian markets and thus Estonian timber has no significant competitive advantages over local producers. On the other hand, timber prices in the developed markets are much higher and Estonian producers have a competitive edge in these markets. Secondly, the transition process started in all the Baltic countries at the same time. This means that Estonian, Latvian and Lithuanian companies are developmentally at almost the same level; consequently, Estonian firms would enjoy no ownership advantages in Latvia or Lithuania.

Because of the intensive competition in the Estonian market and rising timber prices, As Sylvester decided to invest into a new softwood sawmill in Latvia in 2001. One very important reason for making the first foreign investment was also the limited Estonian market and timber resources. Therefore, this foreign direct investment in Latvia can be classified as a resource-seeking one and the selection of the target market is based on the availability of suitable resources.

As Sylvester's fully owned subsidiary in Latvia started its activities in March 2002. The investment made was 280 million Estonian kroons, which is also one of the biggest foreign investments made to the Latvian timber sector. The technology used in the sawmill is up-to-date and has been tested in Estonia. As Sylvester's main competitive advantages in Latvia are modern technology, relatively high prices and fast payment to suppliers, location in North-Latvia where there are no big competitors present, and use of timber with a smaller diameter than the main competitors are used to.

As Sylvester has expanded its foreign activities step by step. The experience gained from its export activities on the one hand, and limited local resources on the other have led the company to the next stage of internationalization — setting up a foreign subsidiary. In selecting its target market for outward investment, the company has considered both availability of timber and the distance of the target market. Thus, the internationalization process has not precisely proceeded in accordance with the principles suggested in the theoretical part of the present working paper. Namely, instead of increasing its commitment in the foreign market to which the firm is exporting most of its production, other motives have played a decisive role in selecting the suitable location for outward foreign investments. However, such a way to select a target market is in line with the idea that firms tend to be more committed to nearby markets.

As Sylvester's future plans constitute expansion into the Lithuanian and Russian markets. These plans comply with the ideas of incremental internationalization since As Sylvester is planning to move to geographically (Lithuania) and economically (Russia) more distant markets.

3.2. Market-seeking internationalization — As Baltika

The history of the Baltika Group dates back to the year 1928 when the clothes factory "Gentleman" was founded in Tallinn. To-date, the Baltika Group has become one of the leading enterprises in the Estonian clothing industry. The volume of sales of its own trademarks forms 75% of the turnover now. The Baltika Group possesses 7 different trademarks and a retail chain, Baltman. There are 51 shops in this chain at the moment (30 of which belong to the Baltika Group). The average number of employees in the Baltika Group in 2000 was 1 410.

The Baltika Group is active in 13 markets — Estonia, Latvia, Lithuania, Sweden, Finland, Norway, Denmark, Great Britain, Germany, Poland, Russia, the Ukraine and the USA. In 2000, export sales formed 66% of the Group's total turnover. The structure of the Group's turnover and share of different markets in 1999 and 2000 are shown in Table 4. The biggest change during these two years has been in the share of the Russian market. Before the Russian crisis in 1998 the share of this market was relatively high (28% of the total turnover in 1996) and now Baltika is busy regaining its position in this market.

Figure 10 presents the internationalization pattern of the Baltika Group. Baltika started its internationalization activities from geographically closer markets and has expanded to more distant markets. The international activities of the Baltika Group could be divided into three waves:

1993–1994 — first experience in foreign markets, export is used for servicing the markets;

1996 — expansion of foreign activities, entry to four new markets, sales subsidiaries are mainly used for servicing the markets;

1999–2000 — entry to five new markets through export and sales subsidiaries, franchising activities in Russia and Latvia.

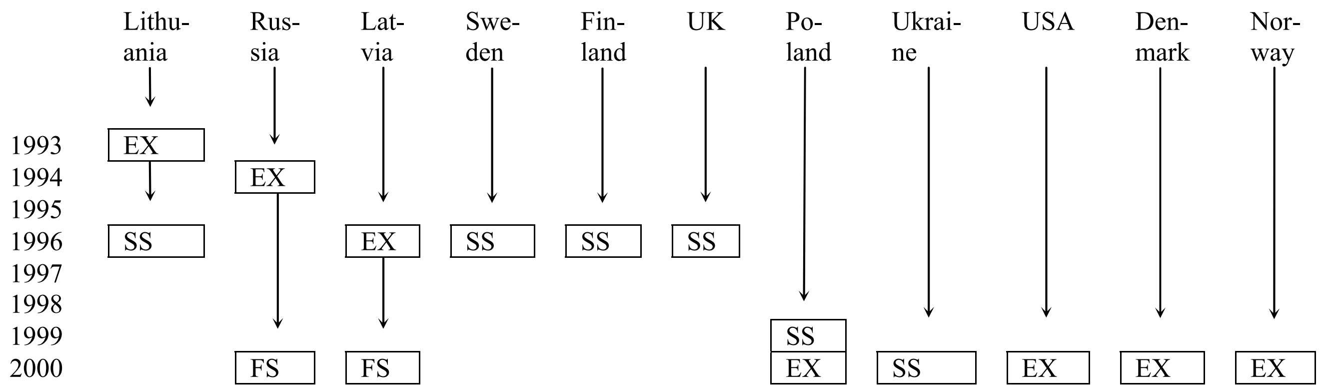
It can be suggested that the different nature of the activities of the two above firms has determined that As Baltika's foreign activities have expanded faster and the spectrum of its foreign market entry modes has been wider than those of As Sylvester. At the same time, the idea of incremental internationalization processes is supported to a large extent.

Table 4

The Baltika Group's turnover (thousand EEK) and shares of different markets

Country	1999		2000	
	turnover	%	turnover	%
Estonia	102 573	35.5	116 404	34.2
Latvia	28 402	9.8	31 569	9.3
Lithuania	33 401	11.5	39 728	11.7
Russia	7 515	2.6	25 172	7.4
Ukraine	1 025	0.4	2 589	0.7
Finland	49 844	17.3	51 024	15.0
Sweden	38 098	13.2	35 914	10.5
Great Britain	25 090	8.7	26 225	7.7
Germany	2 121	0.7	3 725	1.1
Poland	856	0.3	4 163	1.2
Norway	0	0	2 303	0.7
Denmark	0	0	86	0.0
USA	0	0	1 853	0.5
Total	288 926	100.0	340 756	100.0

Source: The Baltika Group's homepage (www.baltika.ee).



EX — export, SS — sales subsidiary, FS — franchise.

Figure 10. The internationalization pattern of the Baltika Group (author's figure on the basis of Baltika ... 2002).

Conclusions

Over the past few years, the international activities of enterprises in the transition economies have expanded considerably. Companies that were interested in servicing their home market and getting acquainted with the business customs of a market economy at the beginning of the transition period, are now looking for new markets and challenges.

The present paper analyzes the international activities of Estonian enterprises. This being a fairly broad subject, only one dimension — the target market pattern — is addressed. The data of four different surveys is used for analyzing the number and distance of foreign markets where Estonian markets are represented with their production. Both the existence of differences between local capital based and foreign-owned firms, and also differences between firms with different shares of export in their turnover are studied.

The analysis made in the paper suggests that Estonian firms have not followed a clear target market pattern in their internationalization process. The main target market(s) tends to be Latvia and/or Lithuania. It can be said that inward foreign direct investments have not contributed much to the internationalization of Estonian companies in the sense that the latter have either mostly concentrated their activities on the Baltic markets or exported their production to the home market of their foreign parent. The additional knowledge gained thanks to such international activities is often marginal. The foreign activities of locally owned enterprises, on the other hand, are in many cases more diversified. Thus, local firms tend to possess more extensive knowledge of different foreign markets, which might serve as a competitive advantage in expanding their foreign activities. Somewhat unexpected was the finding that there are no clear differences in target market patterns between firms with different shares of export in their turnover.

Two case studies that were presented in the paper illustrate two different approaches. While we can say that in principle As Baltika has followed the market pattern suggested by earlier studies, this conclusion is not valid in the case of As Sylvester. Namely, As Sylvester did not set up its foreign subsidiary in the market to which it exported the largest share of its production, but selected the market, taking into consideration its distance and the availability of suitable resources. Thus, the differences in the target market patterns are likely to be determined by the nature of marketed products.

The present study does not by any means pretend to be a comprehensive overview of the internationalization pattern of Estonian companies. The emphasis was set on analyzing the main target markets and differences between foreign-owned and local capital based firms. All the other dimensions of internationalization were excluded; these questions should be addressed in further studies. It is only on the basis of an analysis covering all the dimensions of the internationalization process that detailed suggestions can be made to the Estonian governmental organizations about how to increase the effectiveness of supporting policy measures in facilitating companies' entry to new markets.

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KOKKUVÕTE

Eesti ettevõtete rahvusvahelistumine — sihtturu dimensioon

Kesk- ja Ida-Euroopa üleminekuriikide ettevõtted on viimaste aastate jooksul hakanud pöörama suurt tähelepanu uute võimaluste otsimisele oma toodangu turustamiseks. Kui transformatsiooni algperioodil pöörati peamiselt tähelepanu koduturu teenindamisele ning turumajanduse põhimõtete tundmaõppimisele, siis nüüd sunnib ettevõtte arengu kindlustamine ettevõtteid pöörama senisest suuremat tähelepanu välisturgude ja sealt tulenevate võimaluste põhjalikule analüüsile.

Käesolevas artiklis keskenduti Eesti ettevõtete rahvusvahelistumise analüüsimisele. Kuna rahvusvahelistumine hõlmab laia teemaderingi, keskenduti vaid sihtturu dimensiooni käsitlemisele. Artikli eesmärgiks oli uurida seaduspärasuste olemasolu Eesti ettevõtete sihtturgude valikul. Analüüsi teostamisel kasutati Tartu Ülikooli majandusteaduskonna rahvusvahelise ettevõtluse õppetooli osalusel teostatud küsitluste "Eksportöör 1997", "Välisinvestor 1997", "Välisinvestor 2000" ja "Outward Foreign Direct Investment 2001" tulemusi. Selleks, et anda põhjalikum ülevaade Eesti ettevõtete sihtturgude arvust ja kaugusest, uuriti erinevuste olemasolu välisosaluses ja kohalikul kapitalil baseeruvates ettevõtetes ning lisaks sellele jagati ettevõtted gruppidesse lähtuvalt sellest, kui suure osa moodustas eksport ettevõtte käibest. Artikli lõpus esitati ka kahe ettevõtte sihtturgude valiku põhjalikum käsitlus, et süvendatult uurida rahvusvaheliste turgude valiku põhimõtteid erineva motivatsiooniga (loodusressursse otsiv *versus* turu teenindamisele orienteeritud laienemine) ettevõtetes.

Analüüsi tulemusel võib öelda, et Eesti ettevõtete rahvusvahelistumise puhul ei saa sihtturgude valikul tuua välja väga selgeid seaduspärasusi. Siiski võib öelda, et sageli on ettevõtted keskendunud Baltikumi turu teenindamisele. Huvitav tulemus oli, et ei saa tuua välja Eestisse tehtud otseste välisinvesteeringute selget positiivset mõju rahvusvahelistumise protsessile. Täiendavad teadmised välisturgude ja välisturgudel tegutsemise kohta tunduvad paljudes välisosalusega ettevõtetes olevat marginaalse tähtsusega. Kodumaisel kapitalil põhinevate ettevõtete tegevus on oluliselt rohkem diversifitseeritud (turgude arv, kus ollakse esindatud, on suurem). Seega võib arvata, et vastupidiselt ootustele on rahvusvahelise tegevusega kaasnevad täiendavad teadmised suuremad kodumaistel ettevõtetel ja edaspidisel välisturgudel tegutsemisel peaks neil seega olema välisosalusega ettevõtete ees konkurentsieelis. Mõnevõrra ootamatu oli ka see tulemus, et ettevõtete vahel puudusid selged erinevused ekspordi osakaalust lähtudes.

Artiklis toodi lühidalt ära ka tutvustus kahe Eesti ettevõtte rahvusvahelistumise protsessi kohta. Kui As Baltika rahvusvahelistumise kohta võib öelda, et see on üldjoontes kooskõlas varasemate uurimuste tulemustega, siis As Sylvesteri otsese välisinvesteeringu sihtriigi valik erines mõningal määral sellest, mida pakutakse välja rahvusvahelistumise teoreetilistes kontseptsioonides. Nimelt ei valinud ettevõtete välisinvesteeringu tegemise kohaks riiki, kuhu eksportis kõige rohkem, vaid tegi valiku lähtuvalt vajalike ressursside olemasolust ning sihtturu kaugusest. Tõenäoliselt tulenevad erinevused ettevõtte tegevusalast ning turustatava toote iseloomust.

Käesolevas artiklis käsitleti vaid ühte ettevõtete rahvusvahelistumise aspekti. Selleks, et teha põhjalikumaid järeldusi ning anda Eesti valitsusasutustele soovitusi ekspordi tugisüsteemide tegevuse efektiivistamiseks, oleks vaja uurida ka teisi ettevõtete rahvusvahelistumise dimensioone ning välisturgudele tungimise võimalikke eripärasid Eesti ettevõtetes.