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THE IMPACT OF NETWORKS ON THE INTERNATIONALIZATION PROCESS OF ESTONIAN FIRMS

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ABSTRACT

Network membership (both through long-term relationships with foreign suppliers and buyers and joining the foreign owners' network) can facilitate the Estonian companies' foreign expansion, providing them with necessary resources and capabilities, but sometimes also inhibit it. The ownership ties might lead to extensive foreign support, but reduced strategic autonomy.

INTRODUCTION

For over the last four decades, the internationalization process has received wide attention. Consequently, different research streams have emerged. Despite the variety of concepts, there is no common theory explaining the interaction between the firms' internationalization, their network relationships and the role of managers' strategies in reaching a higher decision-making autonomy in the parent company's network. Consequently, it is important to examine this subject from a more holistic perspective.

The role of networks — sets of connected relationships between actors controlling business activities (Forsgren and Johanson 1992) — is especially important for studying the internationalization of firms from transition economies. After the dissolution of the Soviet Union, these companies needed additional resources and capabilities to compete with Western enterprises. They had relatively uncompetitive products, poor technology; lacked information, capital and other resources. New enterprises were in a similar situation. Consequently, they needed external assistance to (re) gain international competitiveness. Therefore, many firms joined cross-border business networks. Despite that, there have been only a few studies about the companies from this region. Estonia is an especially interesting country to study because of its smallness that has further increased the enterprises' need to internationalize. It also has one of the highest foreign direct investment inflows per capita in Central and Eastern Europe.

The purpose of this paper is to analyze the impact of business networks on the internationalization process of Estonian firms and the differences in autonomy-support tradeoffs of these companies in a network context. Consequently, the literature review of this paper begins with an overview of four approaches to companies' (pre-network) internationalization process. Thereafter, we will show how the firms could benefit from network membership. Then, follows a discussion of how an enterprise's role in the (parent company's) network could impact its internationalization process and how larger autonomy could be gained. Thus, by the classification of Luis Araujo and Geoffrey Easton (1996) we will examine three types of network approaches: industrial marketing and purchasing; network organizations and entrepreneurship studies. The next section includes a short discussion of the research methodology. The empirical part examines eight Estonian enterprises from different industries, of different sizes, with different owners and levels of internationalization. We will show when and how they internationalized, when they joined business networks and how it impacted their internationalization process and decision-making autonomy. The paper ends with some managerial implications and suggestions for future research.

THE THEORETICAL BACKGROUND

A large quantity of research is based on the Uppsala (or the U-) model. It states that internationalization is usually a long, slow and incremental process driven by experiential market knowledge. Companies pass through a situation of no regular export activities to export via independent representatives or agents, overseas sales subsidiaries and production/manufacturing units. They first begin to export to neighboring countries or those that are comparatively well known and similar and later enter farther regions (Johanson and Vahlne 1977). The U- model has some exceptions: large firms, those with substantial resources, stable market conditions or experience in similar markets can internationalize more easily (Johanson and Vahlne 1990). Innovation-related internationalization (or I-) models demonstrate many internal and external factors influencing enterprises' export initiation and behaviors besides knowledge (Bilkey 1978). They show that different forces influence foreign-owned firms' internationalization than that of their domestic counterparts. For example, the headquarters could take the initial decision to start exporting and organize sales through a global marketing network (Wiedersheim-Paul, Olson and Welch 1978). The I-models agree that firms internationalize step-by-step, starting from sales to the domestic market and continuing with sporadic export activity, regular exports and, later, more complicated entry modes (Leonidou and Katsikeas 1996).

The Finnish model implies that a company can increase its internationalization not only in terms of depth of operational mode as the U- and I- models suggest, but also through diversity, by using various operational forms, offering a varied product range and penetrating dissimilar markets (Luostarinen and Welch 1997). It also claims that enterprises can leapfrog some stages and speed up their internationalization (Chetty 1999); inward activities (for example, imports or foreign direct investment inflows) might precede and influence outward activities (Fletcher 2001) and the internationalization process may include de-internationalization and re-internationalization (Luostarinen 1994).

The literature on born globals agrees that in certain cases, firms may leapfrog into internationalization rather than move cautiously through a series of incremental steps (Knight and Cavusgil 1996). This happens despite the enterprises' young age, small size, and lack of resources and experience (Oviatt and McDougall 1994). Born globals are generally the companies where the top management has a desire and commitment to export, which compete on value — mainly quality, technology and product design — and have a strong customer orientation (McKinsey & Co 1993). This research stream also suggests that a critical incident — for example, takeover by another firm, acquisition of an enterprise with international connections or the internationalization of a domestic client — may lead to rapid and dedicated internationalization (Bell, McNaughton and Young 2001).

To some extent, the network approach explains leapfrogging. It claims that through relationships, companies can mobilize and use some resources controlled by the other actors (Håkansson and Snehota 1989). In addition to learning about the partner's capabilities, needs and strategies, a firm learns about their business conditions and market networks (Johanson and Johanson 1999). Thus, a typical internationalization sequence has changed from gradual expansion to expansion in leaps by joining the nets (Hertz 1996). On the other hand, the relationships could not only drive and facilitate, but also inhibit a firm's internationalization (Ford 1998).

A multinational corporation is an inter-organizational network, in which the subsidiary has multiple connections with the other entities both inside and outside the corporation's formal boundaries (Birkinshaw 1997). The role of a firm depends on its unique characteristics (Bartlett and Ghoshal 1986), managers' behavior, the head-office assignment and the local environment (Birkinshaw and Hood 1998). The managers' entrepreneurial behavior can fuel the development of value-added strategic activities in the subsidiary and these, in turn, lead to higher credibility with the parent company, commitment to a clear strategic vision, valuable organizational and managerial capabilities (Birkinshaw 1993). This, in turn, should lead to successful internationalization.

From the above, we can propose that a firm has several choices concerning its strategic autonomy and involvement in network. It can avoid network relationships, thus missing the potential support from the partners and having to follow the long internationalization path described by the U- and I-models. Alternatively, it can opt for long-term partnership ties or even use the foreign owner's intra-corporate network as a channel for knowledge and resource transfers. In these situations, foreign expansion should be faster: similar to the Finnish model and the literature on born globals. This will be examined by using case study data from Estonia.

THE RESEARCH METHODOLOGY

In this paper we use case study analysis. This method has been an essential form of research in social sciences and management (Chetty 1996). By combining previously developed theories with new empirically derived insights (Yin 1994), the case study approach is especially appropriate in new topic areas. It can transcend the local boundaries of the investigated cases; capture new layers of reality and result in developing novel, testable and empirically valid theoretical insights (Eisenhardt 1989; Tsoukas 1989). This method also allows conducting research in a country, where the small sample base means that there might not be enough firms to justify using statistical generalization (Chetty 1996).

Single case studies limit the ability to generalize from the conclusions, models or theory developed from the case. Multiple cases, in turn, may reduce the depth of study when resources are constrained, but can both augment external validity and help guard against observer bias (Voss, Tsikriktsis and Frohlich 2002). In the multiple-case approach there is no ideal number of cases, but a study of between four and ten cases usually works well. With fewer than four cases, theory is difficult to generate, and with more than ten cases, the volume of data is difficult to cope with (Eisenhardt 1989). Taking this into account and still wishing to demonstrate the impact of the foreign parent companies' networks on their affiliates' internationalization from as broad a perspective as possible, eight enterprises of different sizes, with different types of foreign owners, from different industries and on different levels of internationalization were selected (see Table 1). Each firm was chosen by replication rather than sampling logic (Chetty 1996). At first, each case was looked at as a separate entity, enabling unique patterns, which can be generalized across cases, to emerge (Eisenhardt 1989).

*** Insert Table 1 here ***

With each firm's general manager, hour-long personal interviews were conducted. Personal interviews were chosen to receive more detailed and extensive answers. The interviews were semi-structured around several open-ended questions. The managers were invited to analyze their firms' international development and the network partners' and their own role in their enterprises' international activities. All the interviews were taped, transcribed, and transcripts sent to the interviewees for necessary corrections or additional information. To further increase the validity and reliability of the results, in addition to the interviews with each firm's CEO, several other materials, like surveys, newspapers, and reports, were used.

NETWORK-SUPPORTED INTERNATIONALIZATION OF ESTONIAN FIRMS

The data from eight case companies

From the eight case firms, **Sangar Group** is the only one not having a foreign owner. Therefore, in terms of know-how and support, it benefits only from cooperative arrangements with its suppliers and buyers. The firm has retail outlets in Latvia and Lithuania. Still, most of its turnover comes from subcontracting for Swedish and Finnish partners.

Baltika Group began its internationalization from subcontracting and proceeded with exporting its own production and later, foreign sales subsidiaries, shops and franchising. It has started from nearest markets — Latvia, Lithuania, Finland, Sweden, Russia and Ukraine — and later entered farther countries. Baltika Group has not benefited considerably from the foreign owner. The latter has invested in the firm, where necessary, and supported its development — for example, tried to find a new investor or an expansion possibility in Poland — but it has not offered any technology or information, nor created any market opportunities or in-house training opportunities for the employees. On the other hand, the foreign owner seldom interferes into the firm's management.

Mootorreisi Group internationalized relatively rapidly. It started with bus lines from Tallinn and then proceeded with foreign affiliates in Latvia, Lithuania, Russia and Belarus. To some extent, it has gained from having a German partner: improved its image, minimized risks and acquired easier access to financial resources. Still, the company is very independent from it. Mootorreisi Group has also cooperated with other firms in selling tickets and developing new bus lines. CVO Group entered several CEE counties in a very short time period: from December 1999 to August 2000, it established affiliates in Latvia, Lithuania, Poland, the Czech Republic, Hungary, Russia, Bulgaria and Romania. Without the foreign owners' financing, it would not have internationalized so quickly. The company has also benefited from their know-how, ideas and assistance in finding new customers. In addition, CVO Group has cooperated with several other enterprises to develop new services and enter additional markets. The foreign owners have not interfered remarkably in the firm's management.

Hansabank Group started its internationalization from the closest markets. At first, it entered Latvia, a year later, Lithuania and after that, Russia. In Latvia and Lithuania, the bank has gradually increased its presence. From Russia, it had to back up because of the economic crisis, but it restored its activities in 2002. In general, the company has increased the share of its revenues from foreign markets steadily, while the share of Estonia has decreased. The parent enterprise has assisted it in internal audit and risk management and improved the firm's image. For example, in 2001, when buying a Lithuanian bank, Hansabank Group defined itself as a Swedish, not an Estonian bank. In addition, by sharing knowledge with its owner, the company can exploit synergies and avoid making mistakes in its business judgments. As Hansabank Group has always shown reasonable profit, the foreign owner has not interfered into its management.

Krenholm Group has followed several stages of internationalization and de-internationalization.

Up to Estonia’s independence in 1918, the firm exported to Russia and China. Then, its production was reoriented to Scandinavia and Western Europe. After World War II, Krenholm entered the Soviet market. When Estonia regained its independence, the firm was forced to find new export markets again. The Swedish owner has considerably developed the company: provided with marketing and management know-how, invested in machinery and improved the firm’s image. It has also given advice and supported some projects. Up to 2002, the owner did not interfere considerably into Krenholm’s management.

From its creation to the World War II, **Tarkon** gradually increased its production and found new export markets. Then, it was forced to reorganize its production and orient it to the Soviet market. In the beginning of 1990s, Tarkon had to enter new foreign markets again. Its export share gradually increased up to 92 per cent in 1998. After the economic slowdown following the September 11th, the export share dropped to below 60 per cent. Through know-how and capital transfer, the investor has improved Tarkon’s ability to export. Its marketing group has contacts mainly on the Swedish market, but also in Finland, Germany and the United Kingdom. On the other hand, although Tarkon has been quite active in increasing its efficiency, investing in new technology, training its employees and searching for local subcontractors, the owner sometimes makes it to do some simpler work it would not like to, or to serve certain customers.

Saint-Gobain Sekurit Estonia internationalized very quickly. Only five years after the production started, its export share had increased to over 90 per cent of its turnover. The firm has received strong support from its parent. It sells most of its production through the owner’s network and under its trademark, Saint-Gobain. The corporation also provides the company with know-how. To a smaller extent, Saint-Gobain Sekurit Estonia has acquired raw materials and assistance in product and process innovation. In most areas, it is relatively independent in decision-making.

Discussion of the results

From the case analysis, we can conclude that Hansabank Group, Sangar Group and Baltika Group have internationalized more or less gradually, while the internationalization of Saint-Gobain Sekurit Estonia, Mootorreisi Group and CVO Group has been rapid. The choice of foreign markets has also differed. Tarkon, Hansabank Group, Mootorreisi Group, Sangar Group and Baltika Group started their internationalization from neighboring markets like the U-model has suggested, while CVO Group, Saint-Gobain Sekurit Estonia and Krenholm Group quickly entered more distant markets that is more characteristic to the literature on born globals. The production companies started their foreign activities from indirect and direct exporting, but Hansabank Group, CVO Group and Mootorreisi Group established affiliates. Still, we cannot reject the hypothesis of the U-model that firms tend to start internationalization from nearest markets and simpler market operation modes and continue with farther markets and more complicated operation forms. The companies that internationalized differently were either large or had acquired considerable resources from their foreign owners. Recognizing the latter, we can also support the hypothesis of the I-models that foreign-owned companies' internationalization is dissimilar to the one of locally owned enterprises. In addition, it can be seen that two firms — CVO Group and Hansabank Group — started with purely domestic operations.

From critical incidents, mentioned in the literature on born globals, three should be mentioned: the dissolution of the Soviet Union, the September 11th and a change in foreign ownership. All of them have forced the companies to reduce their operations in certain countries — Russia and the USA, respectively — or enter new markets. Consequently, they led to de- and re-internationalization, examined in the Finnish model. The inward-outward connections, proposed in the latter, have also found support from the case enterprises. As shown below, all of them benefited from network relationships with their owners and other foreign partners.

Sangar Group acquired know-how and support from its partners. CVO Group, Mootorreisi Group and Baltika Group considered foreign ownership a useful solution to the financial or credibility problems they faced during their expansion. In the end of 1999, when CVO Group started its intensive foreign expansion, it urgently needed additional financing and involved various venture capitalists. Mootorreisi Group offered the 40 per cent minority ownership to the big German bus company to gain access to its home market and reduce risks. Hansabank Group also received a strategic investment at the key moment, when the Russian crisis left it in an urgent need for additional capital. The investment allowed the bank to proceed with its ongoing expansion. It became the regional headquarters for the region. Krenholm Group acquired capital, but also know-how and advice. Before the foreign investment, it was in a relatively unfavorable position because of underutilized production capacity.

Saint-Gobain Sekurit Estonia and Tarkon have a relatively deeper involvement in international intra-corporate network than the other companies. The manager of Saint-Gobain Sekurit Estonia pointed out that the Estonian unit is, in many ways, subordinated to Saint-Gobain Sekurit's corporate and regional headquarters. Of the exports going to Sweden, Tarkon sells about 60 per cent through its foreign owner, who provides it with subcontracting work for Swedish telecommunication and precision-mechanics companies.

Consequently, from the eight case companies, Sangar Group is involved mainly in relational networks based on long - term mutual benefits. Mootorreisi Group, CVO Group and Baltika Group have their own corporate networks with strong managerial position and some foreign ownership ties. Krenholm Group and Hansabank Group are networked intra-corporately but with extensive autonomies. Tarkon and Saint-Gobain Sekurit Estonia are deeply involved in corporate network. At the same time, while there seemed to be a link between the autonomy of the firm from the foreign owner and the extent of transfers (a higher autonomy appears to be accompanied by smaller assistance), the relationship between the owners' transfers and the companies' internationalization is not as clear as expected: for example, Tarkon has obviously gained more from being foreign-owned than CVO Group but its internationalization has not been as fast. The differences in the managers' efforts to increase their enterprises' autonomy have also not always led to a dissimilar rate of internationalization. For example, Mootorreisi Group and Saint-Gobain Sekurit Estonia have both internationalized quickly but their rate of autonomy from the foreign owners is not similar (see also Figure 1).

*** Insert Figure 1 here ***

CONCLUSIONS AND MANAGERIAL/THEORETICAL IMPLICATIONS

The multiple-case study analysis of eight Estonian companies revealed some support of (foreign owner') networks to their internationalization aspirations. The researched network relationships range from subcontracting partnerships, in case of Sangar, to the deep involvement in the multinational intra-corporate networks, as in case of Tarkon and Saint-Gobain Sekurit Estonia. Thus, the case firms differ in their level of network involvement and transfers from partners.
The internationalization process of Estonian firms prior to the inclusion into international networks has been, in terms of its speed and pattern, in accordance with the predictions of the U-, I- and the Finnish model. After involving foreign partners and owners, the case firms acquired resources and improved their knowledge base. This, in turn, facilitated their access to international markets. Still, in case of Tarkon, and somewhat less in case of Krenholm, there are

signs that network partners can also restrict firm's activities of international expansion.

Due to the network partners, Saint-Gobain Sekurit Estonia and Mootorreisi Group could be classified as 'born global' companies. In Hansabank and CVO, the outside support has reinforced their entrepreneurial posture. For the other case firms, the inclusion into network has been the critical incident revitalizing the stagnating internationalization process.

The most important implications for managers relate to the ever-increasing need to further incorporate the partnerships planning and development into the strategic as well as operational management of the firm. To benefit most from the network involvement, knowledge and resource exchange procedures have to be developed and refined. In case of involving a foreign investor, some of these transfer procedures are governed by the foreign partner, not the recipient firm. Therefore, managers have also to take into account the possibility of losing some of authority over the firm's international expansion to the foreign counterpart. Even de-internationalization is possible. In conclusion, it becomes essential to be able to foresee the main positive and negative aspects of the network involvement.

In terms of implications to the theory, our evidence suggests the need to incorporate the elements of several approaches into the research framework applicable in transition economies and developed economies alike. These synergies are paramount for the movement beyond the present comprehension of international expansion processes, because of insufficiencies (for example, too restricted explanatory power) characteristic to one single approach. The future research should also concentrate on similar network impacts in inter-country comparison, investigate the indirect or spillover effects of networks, look closer into the characteristics of foreign owners and the other determinants of network support (for example, size and industry), and scrutinize the role of differing managerial visions in network partnership. In addition, the negative aspects of network membership should be investigated more closely.

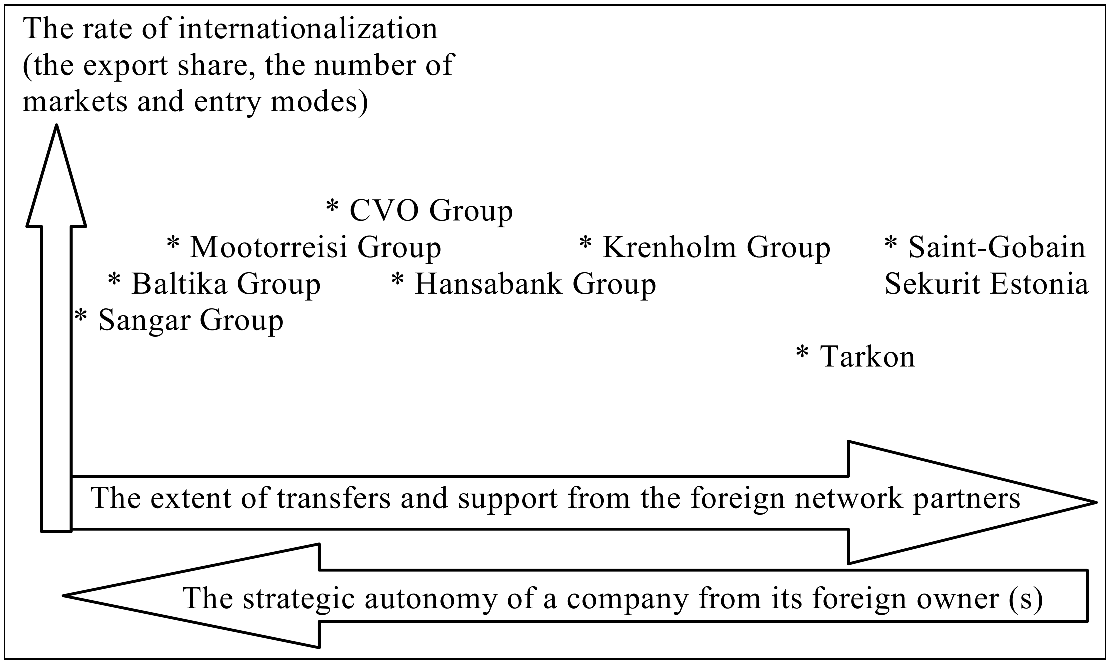
Table 1

The information about the eight case companies

	The year of			The main field of activity of		The country of origin of the foreign owners	The firm's main foreign market in 2001/ 2002	The share of foreign		The number of	
	foundation	foreign entry (after Soviet time)	the 1st inward FDI	the firm	the foreign owner (s)			capital (%)	turnover	employees	foreign affiliates abroad
Sangar Group	1944	1991	No FDI	Clothing (production and retailing)	No FDI	No FDI	Latvia	0	74	750	2
Baltika Group	1928	1991	1996	Clothing (retailing and production)	Risk capitalist	Guernsey	Finland	36	71	1500	7
Mootorreisi Group	1993	1994	1994	Bus transport	Bus transport	Germany	Germany	40	93	110	4
CVO Group	1996	1999	2000	Recruiting	Risk capitalists	USA, UK, Germany, Finland	Hungary	> 50	n.a.	110	6
Hansabank Group	1992	1995	1998	Banking	Banking	Sweden	Lithuania	60	42	5400	3
Krenholm Group	1857	1991	1994	Textiles production	Textiles production	Sweden	USA	100	86	4700	3
Tarkon	1907	1991	1996	Fine mechanics	Fine mechanics	Sweden	Sweden	85	58	600	0
Saint-Gobain Sekurit Estonia	1989	1991	1989	Car wind- and side screens (production)	Car wind- and side screens, construction glass	Sweden (France)	Holland	100	94	130	3

Figure 1

The positions of case companies as network actors



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