A comparative analysis of the evolution of the business internationalization process: the Western Balkans and the EU member states in CEE

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Abstract

The term internationalization has been mainly used to show the expansion of economic activities of firms outside of their home country where they aim at capturing a bigger market. The Central and Eastern Europe region has gone through a process of market transition over the past few decades, yet the business internationalization process has played an important role in the states' economies. The aim of this paper is to analyze the firm internationalization process in the new member states and the Western Balkans countries and gain a better understanding of the process and its course over time. Due to different geopolitical circumstances, the Western Balkan countries did not attract as many investors as much as the EU member states in CEE did that have had a constant flow of investments once they were members of the EU.

Keywords: internationalization, foreign trade, evolution, business, CEE, EU, Western Balkans

Introduction

The internationalization of firms is a well-known topic in the business literature as it is appealing for both the academia and the business environment. The process of internationalization is a very complex strategy a company can follow as the movement firm's operations beyond the borders of the country of origin can take up significant resources and efforts to diversify economic activity. The term internationalization has been widely used to illustrate the external movement of a company's abroad operations (Turnbull, 1987), while Welch and Luostarinen (1988) explained the process of internationalization as the phenomenon of gradual involvement of international operations where due to innovation, companies respond to the challenges posed by the international surroundings. Nowadays, due to the process of globalization, the international business environment is increasingly complex, where small and medium-sized companies, as well as large multinational firms, adopt different internationalization strategies to serve global markets.

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The on-going process of globalization offers multiple business opportunities for companies when considering going international (Zain and Ng, 2006), and these opportunities usually tend to impact international growth. The International Monetary fund defines globalization as the increase in economic interdependence of countries around the world by increasing the volume and variety of goods and services traded across borders (IMF, World Economic Forum, 1997).

In the past few decades countries from Central and Eastern Europe have been going through different changes, and as it different as they may seem to be, these states do have much in common in terms of economic and social policies. Since 1989, countries in this region have been through the process of transition from centrally planned economies to market economies, and the main objective for these countries has been to be part of the European Union (EU). The evolution of the internationalization process is a main indicator of how well the countries have managed to adapt to the new political, social, economic changes and what their main advantages are in terms of foreign trade and investments.

The largest enlargement of the EU took place in 2004 when ten more countries from Central and Eastern Europe have joined: Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia, and Slovenia, followed by Romania and Bulgaria in 2007, and Croatia in 2013, therefore the boundaries of the European Union have shifted towards east. These eleven countries mentioned above are called the new member states (NMS) as they have been the latest countries to join the EU.

Although the European Union showed its commitment to enlargement, there are multiple states that have not met the set requirements yet; the EU also developed policies to grant access to the Western Balkan countries (Albania, Bosnia and Herzegovina, North Macedonia, Montenegro, and Serbia), Croatia being the first country from the area to join in 2013. Given the different paths that the two groups of countries have had after the fall of communism, the aim of this paper is to analyze the firm internationalization process in both regions of Central and Eastern Europe and gain a better understanding of how the process evolved over time.

1. Literature Review

The internationalization process has been studied in the literature through a variety of frameworks and theoretical models, however, it is a topic that was not widely covered before the 1970s. when the Uppsala model came out, written by Johanson and Vahlne (1977), and it’s currently one of the most cited models in the company internationalization literature. The two authors claim that the company's internationalization process is a gradual process of involvement in foreign markets, and the economic environment and the problems faced by the company during this process determine the pace of internationalization.

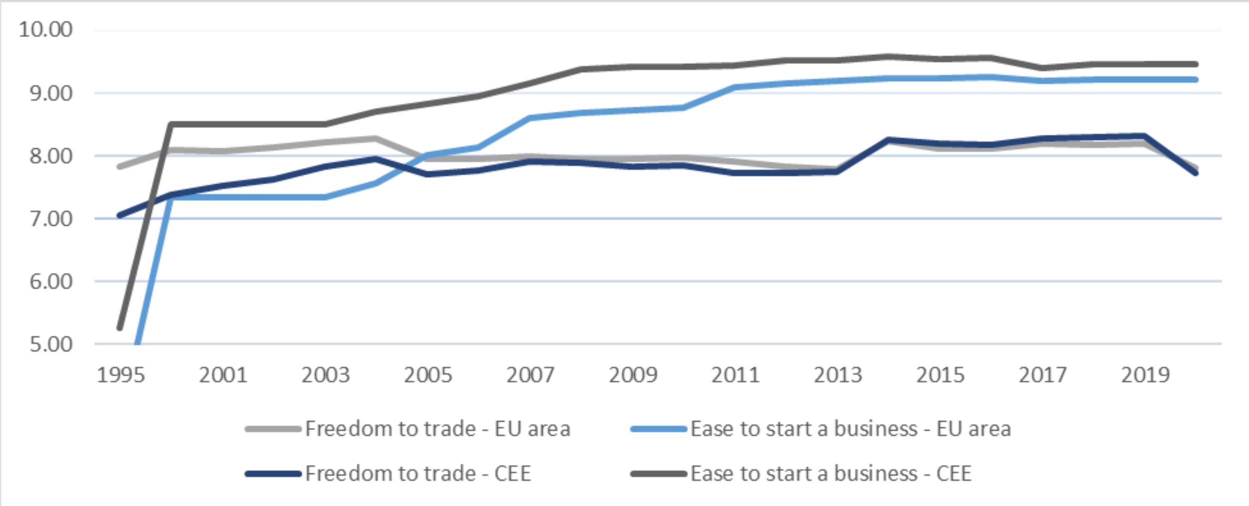
Fernandez and Nieto (2005) claim that the process of internationalization is considered the most complex strategy that a company can implement and when it comes to taking the decision whether to internationalize or not, the first question that needs to be answered is why a company would want to proceed in expanding globally. The term internationalization has been widely used to illustrate the external movement of a company's abroad operations (Turnbull, 1987). Welch and Luostarinen (1988) explained the process of internationalization as the phenomenon of gradual involvement of international operations where due to innovation, companies respond to the challenges posed by the international environment.

The technological advancements and the improved communication and transportation have led to the significant decrease of physical distance between countries, goods and services being now available to consumers in less accessible geographical areas. According to Beer *et al*. (2017), increased trade can lead to more efficiency and productivity, thus have a positive effect on economic growth. Consumers take advantage of a great product variety and lower prices, and in an interconnected world characterized by a high degree of specialization, products can no longer be produced exclusively in-country, or profitably sold only within the domestic market (Felmery *et al.*, 2020).

In Central and Eastern Europe, after the fall of communism, due to the economic transition, a significant number of companies had started participating in international markets (Ipsmiller and Dikova, 2021). Since the fall of the Iron Curtain, international business research focused on Central and Eastern Europe has received considerable academic attention (Jaklič *et al*., 2020). Meyer and Peng (2005) stated that the region is a "fascinating research laboratory", showing the high-degree of interest that the region has had over time.

Central and Eastern European countries have experienced faster changes in the last few decades than any other region in the world, as illustrated by several indicators. Using the database from the Fraser Institute, figure 1 below shows the evolution of economic freedom and the accessibility to start a business for selected CEE countries (Poland, Slovakia, Romania, Slovenia, Bulgaria, Hungary, Lithuania, Latvia, Croatia, Czech Republic, Serbia and Moldova) and the European Union countries between 1995 and 2019.

Figure 1. Freedom to trade & Ease to start a business – EU area vs CEE countries



Source: Fraser Institute, Freedom of the World: 2022 Annual Report

The freedom to trade index measures the amount of tax on international trade as a share of exports and imports, while the ease to start a business indicator measures how easy it is, in terms of resource involvement, to start a business. The data were only available for some of the CEE countries.

According to Dabic and Lamotte (2017), the two most important reasons that explain the patterns showed above are (1) the internal reforms that took place in CEE countries to reduce the cost of international trade and (2) the access of these countries to the World Trade Organization and the European Union as significant free-trade agreements have been established. After the fall of the Berlin wall, the transition phase for Central and Eastern European countries has been quite different, smoother for some countries, while a bit bumpier ride for others.

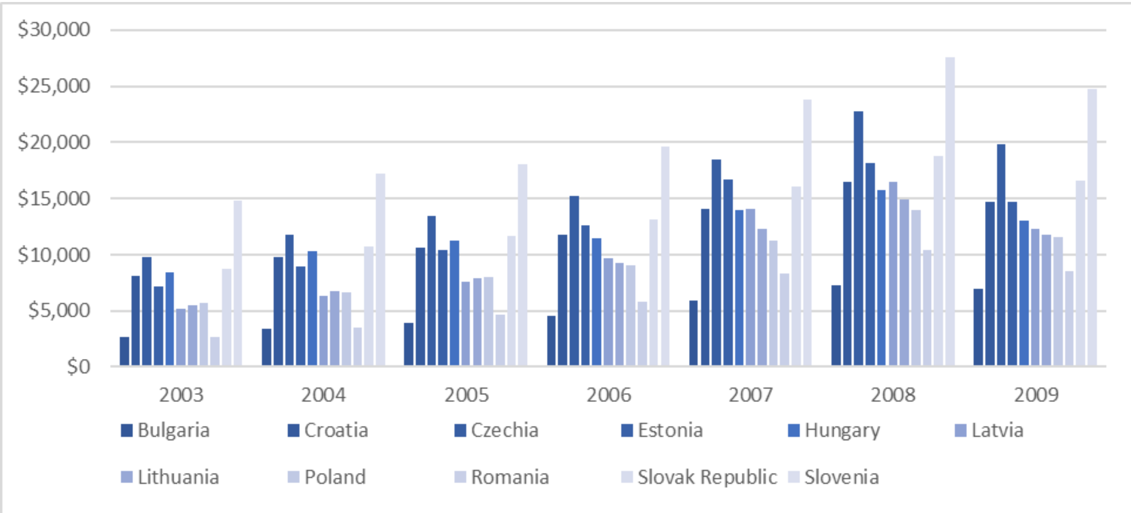
Economic transition in Central and Eastern Europe has forced a significant increase in firm internationalization, where different types of companies, from large multinational entities to small born global companies, are choosing to participate in international markets. Since the fall of the communism system in the 90s, the process of internationalization has followed an increasing path as the markets were now free and the governments were not fully in charge of the flow of products and services.

2. New member states – firm internationalization evolution

At the beginning of 2000s, a significant number of countries started to meet the fundamental set standards by the European Union and joined the western countries on both economic and institutional terms, thus, allowing the free flow of products, services, knowledge into this region. The largest enlargement of the EU took place in 2004 when ten more countries from Central and Eastern Europe have joined: Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia, and Slovenia, followed by Romania and Bulgaria in 2007, and Croatia in 2013, therefore the boundaries of the European Union have shifted towards east by adding granting access to the new member states.

The enlargements process was not only considered beneficial for Europe by creating a larger single market, but it was also seen as beneficial for the post-communist states and their democratic evolution. The addition of the new member states created uncertainty at first, for both the EU and new members, yet the inclusion created new economic circumstances, policies, and social and institutions orders. In order to join the EU, any European state must meet some set requirements that respect the union's values, and the candidate state, once accepted, is willing to promote them. Ever since 2004 when the biggest enlargement of the union took place, there have been some rough times economically taking into consideration the financial crisis starting in 2008 and the COVID worldwide crisis in 2020. The GDP per capita is an important indicator of progress considering that economic growth is driven by technical progress, skilled labor, and increased capital. In the figure below it is shown the evolution of the GDP per capita (current U.S. dollars) of all the Central and Eastern European countries that have joined the EU.

Figure 2. GDP per capita (current \$) - New Member States



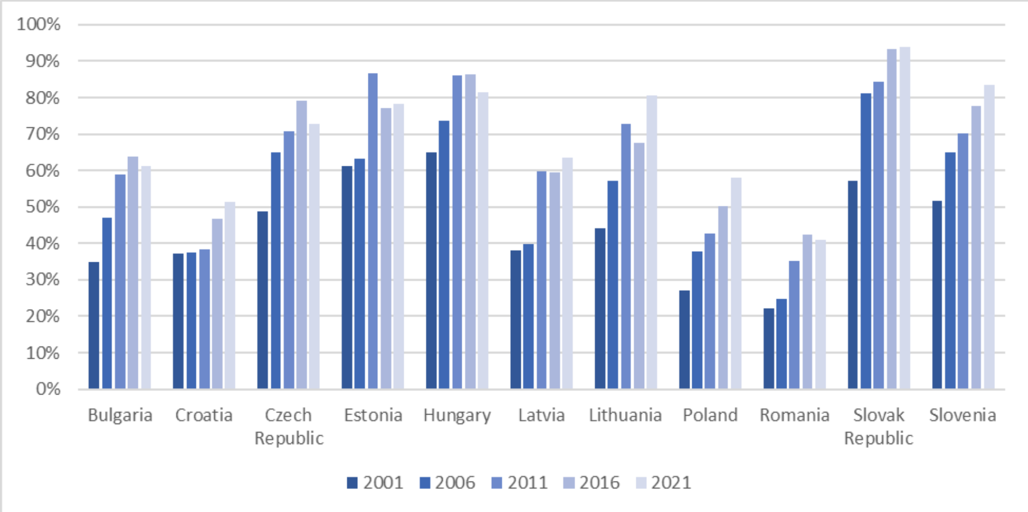
Source: World Data Bank, http://databank.worldbank.org/

In figure 2 above it is shown that in 2005, all the countries that have joined the EU a year before had an increase in absolute values of GDP per capita, with a significant impact on Czech Republic, Latvia, Lithuania, and Poland, while the same trend was followed by Romania and Bulgaria soon after their accession in 2007.

International trade is an important component of the globalization process, and countries all around the world have been making great efforts to reduce barriers to trade and open their economies to foreign competition. The European Union has trade agreements in place with various countries worldwide, and multiple agreements in focus that could increase the trade flow.

Trade openness of a country can be measured by looking at the flow of exports and imports as a percentage from total value of the gross domestic product, and in the figure below we have the evolution of the exporting flows as of GDP value for all the CEE countries that have joined the EU.

Figure 3. Evolution of Export flows as of GDP (%) 2001-2021 – New Member States



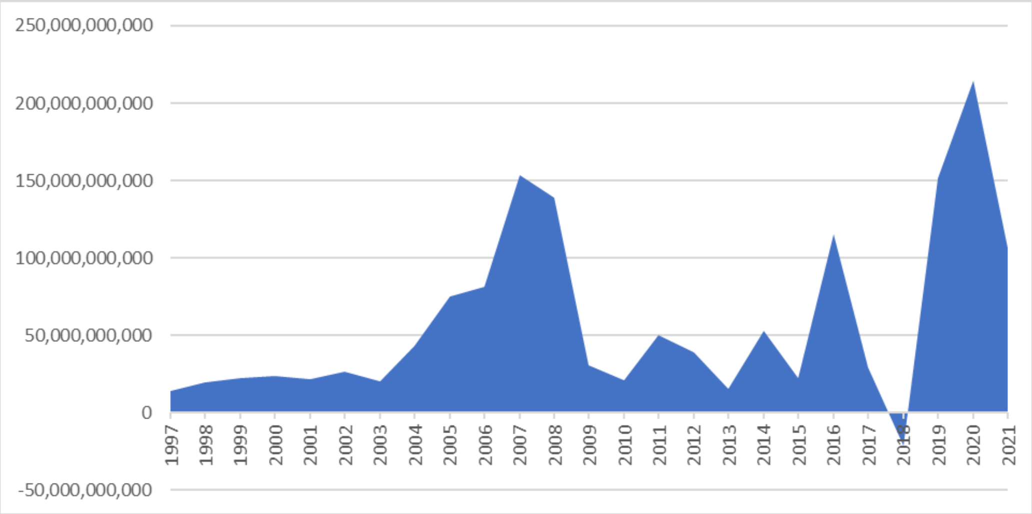
Source: World Data Bank, http://databank.worldbank.org/

As figure 3 reveals, all the countries mentioned had a steady increase in exports flows as a percentage of GDP, with a slight decrease in 2021 for Bulgaria, Czech Republic, Hungary, and Romania possibly due to COVID crisis that restricted foreign trade. It is also noticeable that Croatia had a significant increase of almost 10% soon after it was granted access to the EU, as well as Czech Republic, Hungary, Lithuania, Poland, Slovenia, and Slovak Republic as their export flows went up after the joined the EU. According to Palankai (2010), the new member states produced an exceptionally rapid integration in the last decades, some countries having the most globalized economies in the world.

Foreign direct investment can play a crucial role in making progress toward economic growth as it drives technological development, and although FDI has the potential to offer sustainable growth for a country, policy makers have to be careful as they play an important role in obtaining this goal. Foreign direct investment continues to be seen as an important source of capital, with significant contribution to the development of the economies, given the positive spillovers generated in host economies (Hayat, 2019).

Multiple multinational companies have made the decision to invest or relocate to Central and Eastern Europe as these countries have made great efforts to attract investments. Studies generally indicate a positive direct impact of FDI in terms of accumulating financial capital, technology transfer into the host economy, innovation, managerial knowledge, specialized workforce, tax payments to the national or local budge (Horobet and Popovici, 2021). The new member states of the European Union have attracted a cumulative total gross FDI of over 1 trillion dollars between 2004 and 2021 (figure 4 below). Therefore, it is a continuous desire for the new member states of the European Union to implement reforms in order to attract FDI.

Figure 4. Evolution of FDI inflows (current $) 1997-2021 – New Member States



Source: World Data Bank, http://databank.worldbank.org/

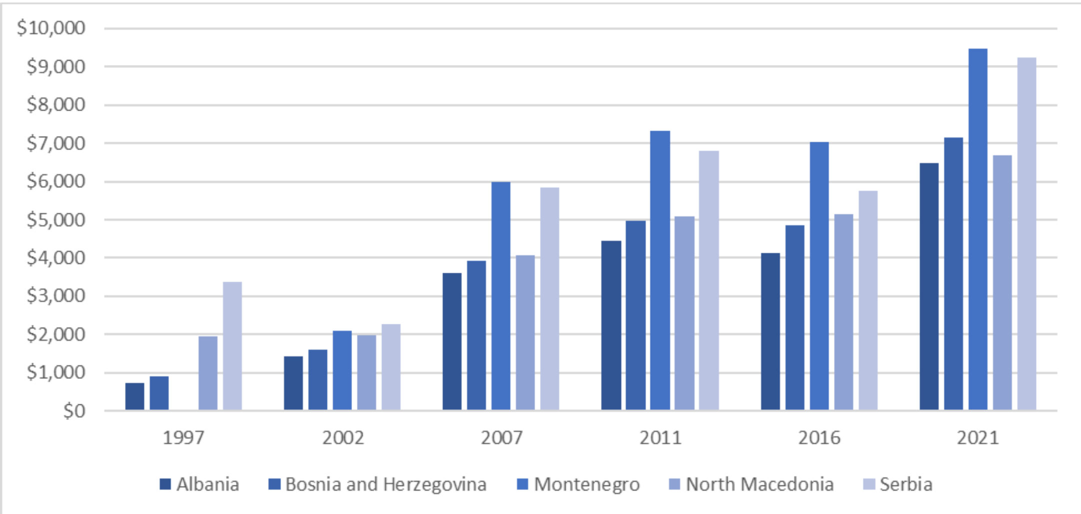
The FDI inflows saw a significant increase soon after the EU membership and foreign direct investment has also contributed to exports, employment, and productivity growth. The three largest economies in the region (Poland, Hungary, and Czech Republic) captured almost two thirds of the total FDI inflows, and the service sector dominated FDI inflows counting for almost two thirds of FDI stock invested. Large inflows into services sector were explained by privatization, development of trade, transport, and communications sectors. Together, financial services and wholesale and retail trade account for over 40 percent of total FDI stock in the new member states.

3. New Western-Balkans – firm internationalization evolution

In order to join the EU, any European state must meet a set of accession criteria, as well as to respect and promote the European values. The prospect of EU membership is a very strong incentive for change and reforms, and the Western-Balkans countries are guided by the pre-accession criteria and EU support. In 2013, Croatia was the first country to join the EU, and building off of that experience, the Commission of the European Union suggested further improvements for all the other countries in the area (Serbia, North Macedonia, Montenegro, Albania, Bosnia and Herzegovina).

The West-Balkan countries have already been making great progress in terms of political and economic development. Furthermore, when looking at some key global indicators, the countries in this region are outperforming some of the current EU countries. For instance, in the World Justice Project's Rule of Law index, North Macedonia ranks better than Hungary (Hoxha, 2022). Also, the Doing Business Ranking from the World Bank, North Macedonia is ranked 4 out of all the EU states. Moreover, in the 2021 Corruption Perception Index, Montenegro is seen as less corrupt than Romania, Hungary, and Bulgaria. However, the main factor that separates the West-Balkan countries from the EU member states is the GDP per capita. Although the region has come a long way in the last few decades in terms of economic progress, steadily increasing its GDP per capita values, all 5 countries shown in the table below have lower GDP per capita than all EU countries. The figure below shows the GDP per capita (current U.S. dollars) progress over the years.

Figure 5. GDP per capita (current $) 1997-2021 – West Balkan countries

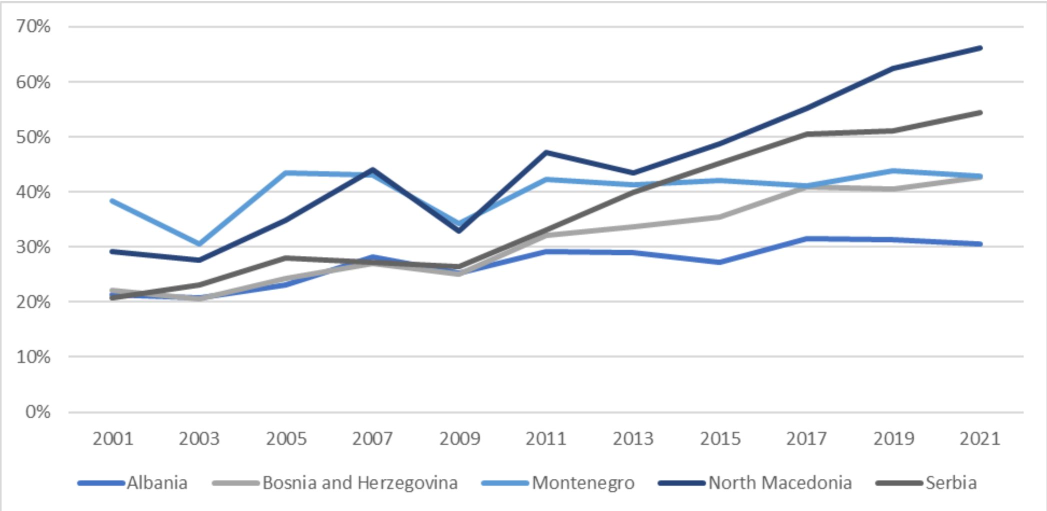


Source: World Data Bank, http://databank.worldbank.org/

It can be seen that all countries in the region have been managing to increase the GDP per capita and slowly align to the EU standards; the region's close location to other fully developed countries, its deep connections with the EU and with the help of digitalization, the West-Balkan region can become extremely attractive for future partnerships and strategic priorities. The GDP per capita values in this region are higher compared to the other countries that are not part of the EU, yet they were part of the communist bloc. During the first two decades after the fall of communism, the region managed to move away from its old negative Balkanization paradigm towards a new positive one of Europeanization (Jano, 2008).

The Western-Balkans countries have had a late start in terms of European integration and global economy due to their hectic civil war, ethnic struggle, and financial crisis, however, the countries have been making great efforts to enhance exports, foreign direct investments, and growth performance. The figure below summarizes the exporting of goods and services evolution as of percentage of GDP between 2001 and 2021.

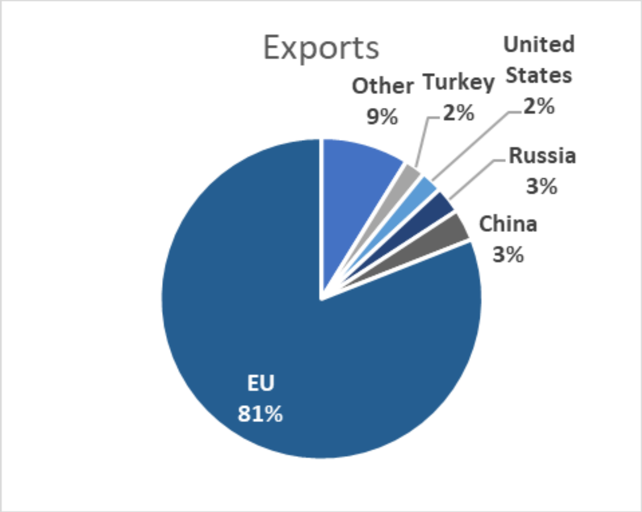
Figure 6. Evolution of exports as of percentage of GDP 2001-2021 – West Balkan countries

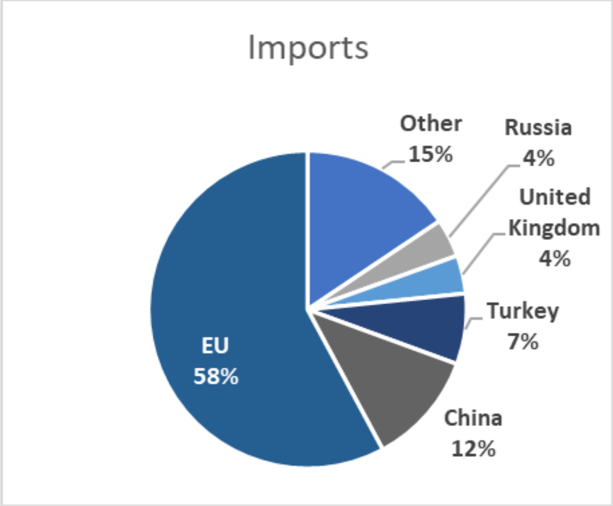


Source: World Data Bank, http://databank.worldbank.org/

The Western-Balkan countries have been having un upward trend since 2001 in terms of exports, with a small drop during the 2008-2009 financial crisis, and their percentages are not surprisingly much lower than the ones posted by the new member states. The figure below summarizes the Western Balkans Trade with the EU and other main partners.

Figure 7. Main partners exports & imports of West-Balkan countries

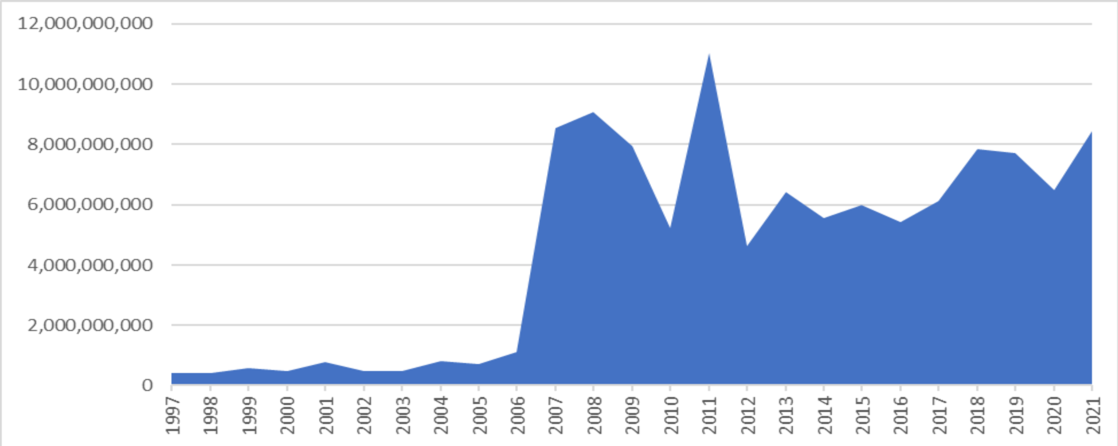




Source: World Data Bank. http://databank.worldbank.org/

The European Union is the main partner, both in exports (81%) and imports 57.9%), while China is also an important import partner (11.6%), yet it has a small share in terms of exports (3.2%).

Figure 8. Evolution of FDI inflows ($) 1997-2021 – West Balkan countries



Source: World Data Bank. http://databank.worldbank.org/

An important challenge that the region had to accomplish was to create a degree of stabilization for sustainable growth, yet, even when there was political will to create the proper environment, authorities frequently lacked the financial and administrative capabilities to implement reforms and policies (Bechev and Andreev, 2005). To attract investors, the West-Balkan countries have provided generous financial incentives in the form of investments credits, which is a common practice particularly for developing countries. Andersen (2017) stated that nearly 50% of the developing countries introduced tax benefits for investors, although studies show that they are not cost effective over time. Figure 8 shows the FDI inflows evolution from 1997 to 2021 in the West-Balkan countries.

Following the lack of interest of foreign investors at the beginning of 1990s, the region saw a significant increase in FDI during the 2000s due to the privatizations of enterprises and banks and improved economic environment. The European Union played an important role in reducing uncertainty of transition, and the target of membership status has sped up the progress and motivated the countries to implement new reforms.

Conclusions

The process of firm internationalization is a dynamic, continuously changing process where many factors play a decisive role, such as political or social changes. The business internationalization phenomenon has been mostly studied in the western countries, leaving some gaps in the literature in terms of the evolution of this process in the Central and Eastern European countries. The fall of communism brought significant changes social, economic, political changes to all countries in the region, thus, forcing them to create new paths to becoming market economies.

The EU membership has helped the new member states gain a competitive advantage in comparison to all the other former communist, non-member states by gaining access to various markets in terms of exporting and importing, and by being an interesting target for foreign investors due to the highly skilled human force, yet relative low wage. Once they were granted access, all states took advantage of the benefits of being part of the EU, managing to develop a sustainable business environment where companies could invest and grow, yet provide better working conditions for the people. The single market phenomenon also helped countries by intensifying foreign trade within the union, thus, helping the countries progress economically and socially, providing better living conditions.

The Western-Balkans countries had a slower start in terms of internationalization as the area was impacted by the effects of the war at the beginning of 1990s, thus, foreign investors were not as interested in developing their business in environments characterized by uncertainty. In order to be admitted, the aspiring countries in the region have to strictly comply with the set EU political, economic, and legal requirements. Even though the Western-Balkans had a late start, the trade agreements that the region has with the EU are helping the countries continue their upward trend in terms of foreign trade and investments, thus, they are doing great efforts to keep up with the new member states. Motivated by the potential access to the EU, authorities within the region have tried to create a safe business environment implementing various reforms that would attract investors and help intensify foreign trade. Careful consideration of the literature shows that there are many arguments and explanations as to why the two regions analyzed have evolved a certain way, yet further attention needs to be shed in order to offer a true picture of the regions as they have been impacted by many transformations and challenges within a relatively short period of time.

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