

Helsinki School of Economics / Center for Markets in Transition CEMAT: Internationalization of Finnish firms in the Baltic States in 1987-2004 and Finnish investment experiences from Estonia

SUMMARY

Finnish firms have been active in the Baltic States and especially in Estonia since the beginning of bilateral trade between Finland and the Soviet Union. It seems that the Finns have come to stay in the Baltic States. During the first few years after the re-independence of the Baltic countries, Finnish firms typically increased their shares in joint ventures and bought out the local partner entirely. Lower production costs attracted manufacturing companies while retailers were attracted by the rapidly growing consumer demand. Also the location factor played an important role. The geographic proximity has made it possible to organize Baltic operations from Finland. The entry of Finnish firms to the Baltic countries has proceeded in line with the privatization process in these countries.

The motives for Baltic operations have somewhat changed in the course of time but in general, the operations of Finnish firms have grown constantly. Companies seeking for cost advantages have often later realized also the local market potential. Finnish providers of business services that have followed their customers to the Baltic countries have later expanded their customer base to local actors. Finnish firms in the fields of information technology, textile and furniture, have been seeking for cost advantages particularly in Estonia through outsourcing or own production operations. Retailers, foodstuffs industry and construction companies have been attracted by the growing Baltic markets.

Among the Baltic countries, Estonia has been the easiest market for Finnish firms to enter. Most Finnish firms have succeeded well in Estonia, and some Finns have even gained the position of a market leader. Considering the large number of Finnish firms operating in Estonia, there seem to be relatively few firms that have clearly failed. Estonia has actually been a test market for internationalization for many Finnish firms. For example, Elcoteq, which is currently operating globally, started its internationalization from Estonia in the early 1990s. At the break of the millennium, also Finnish retail and foodstuff companies started to look for growth through internationalization and often headed to Estonia. In the future, one factor challenging foreign operations in Estonia is the lack of labor force. In certain sectors there are already major difficulties in finding professional labor force. Companies often train their employees themselves.

In Latvia, Finnish firms have encountered considerably more problems due to the unpredictability and lack of cooperation of the state or local administration. The stumbling of several Finnish firms in Latvia indicates that the Latvian business environment is clearly more difficult than e.g. in Estonia. Although there are Finnish firms active in various sectors in Latvia (e.g. telecom, foodstuff, retail), individual investments made have been relatively small in value.

As a rule, Finnish firms have entered Lithuania following their competitors. Therefore, they have faced relatively severe competition in the Lithuanian market. However, it seems that

Finnish operations in Lithuania have not witnessed any major problems as in Latvia. Finnish investments to Lithuania have been fewer in number but larger in value compared to Latvia. Investments have mainly been targeted to telecom, foodstuff, retail and energy sectors.

During the past 10 years, the business environment has undergone tremendous changes in the Baltic countries. Especially Estonia has developed rapidly, and Finnish firms have a very positive image about Estonia's business environment. The Estonian legislation and other formal institutions regulating the firms' operations are on a western level. However, being based on German and other Central European models, the Estonian legislation partly differs considerably from the Finnish one. For example, as regards issues concerning ownership of land and real estate, the knowledge of local lawyers is often indispensable. The problem is the lack of precedents and as yet unestablished legal praxis, which sometimes shows in unexpected court rulings.

Also informal institutions in Finland and Estonia are becoming more similar. This is due to the foreign investments flowing to Estonia and importing western business practices. On one hand, business practices are modernizing as the older generations are withdrawing from working life. Younger than 30-years-old-Estonians have not worked in Soviet companies. On the other hand, there are still some clear differences between Finnish and Estonian business lives. For example, the role of personal relations is emphasized in Estonia, and the personal network of a candidate may be a central factor affecting the selection of a local partner or manager. Companies try to achieve good contacts e.g. with the local administration, which may in many cases speed up and ease problem solving. Corruption was a considerable problem in Estonia especially in the beginning of the 1990s. Lately, however, corruption has clearly diminished, although there are still some regional differences. In general, the corruption situation is much better in Estonia when compared to Lithuania or Latvia, not to mention Russia.

Many Finnish firms nowadays view the Baltic countries as part of their home market, which covers the entire Baltic Sea region. Estonia alone is no longer an interesting target market. Rather, Estonia opens avenues to business opportunities in the East (Russia) and South (other Baltic countries). However, Estonia's potential as a stepping stone to Russia has so far not realized. Trade with Russia was expected to accumulate as the double tariffs were removed in conjunction with the EU membership. High expectations have been undermined e.g. by increasing import tariffs of metals from Russia. Russia has also tightened e.g. the hygiene requirements of imported Estonian foodstuffs.

Nevertheless, all the Baltic countries undoubtedly have good preconditions to compete for transit trade to/from Russia as their ports and other communication infrastructure are improving. As the cost advantages are gradually disappearing, the competitive advantage of Estonia and the other Baltic countries will most likely increasingly base on their logistic potential.

For further information contact:

HSE/CEMAT, Project manager Piia Heliste, tel. +358-9-4313 8874.