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EU Membership's Impact on Business in a New Member Country – Experiences of Finnish Firms

ABSTRACT

Membership in the European Union poses various changes in the operating environment of firms in the new member country. This study set out to determine the key areas of change and the possible measures by firms and authorities to facilitate the transfer into the changed operating environment. Through a survey with 184 Finnish responding firms this study found that after three years of membership the experiences have been mainly positive – much thanks to early preparations and sufficient support from the national government and the EU. New membership for a country appears to spell opportunities, challenges and problems of strategic and tactical level for firms. Conducting business with partners within the EU has become easier, and the country image of Finland has improved, but the EU legislation is often seen as a new burden. Pointing out the critical elements for managing integration, such as training and securing management capacity, the lessons from the Finnish experience may help managers and authorities in the countries aspiring to become EU members in the future.

Key words: *European Union – New membership – Firm experiences – Finnish firms*

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INTRODUCTION

Becoming a member in the European Union (EU) has consequences primarily in the economic activities of a nation and her citizens. A significant change in the operating environment is bound to have an effect on the operations of firms in the new member country, too. Finland joined the European Union along with Austria and Sweden in the beginning of 1995. Finland's membership in the EU did not come as a surprise but was seen as quite likely a development for some years before 1995. Nevertheless, the question arises whether the Finnish companies were prepared for the changing environment, and if not, what could have been done in order to prepare better for the change. This study takes a look at the impact of a country's new membership in the EU on her firms and their business, using Finland as a case country.

The post-war economic regime in Finland relied much on recurrent devaluations. As the membership in the EMU is making it impossible to use the devaluation tool for international price competitiveness enhancement, Finnish companies obviously have to prepare for competition in other, conventional ways. The issue of firms adapting to the environment of integrated economy must be seen as a gradual process. In Finland this process started when the country became an associate member in EFTA and continued with the EC/EFTA cooperation later. Finnish firms' readiness to adapt to the integrated European market was discussed vividly as early as in September 1988. Then, for example, the Ministry of Trade and Industry organized a seminar where Ilkka Suominen, Minister of Trade and Industry, and various experts from institutions and firms presented views concerning the measures that Finnish firms should take in order to prepare for the future integration development. (Kotimaisen Työn Liitto 1988). In 1988 the tone of discussion was that if firms have not started to prepare for harder competition due to integration development, they are hopelessly too late; this has later turned out to have been a rather exaggerated view. On the other hand, there was strong optimism in the air and the changes to come were not seen as insurmountably difficult.

Building on this background, this study sets out to address the following question:

How is economic integration experienced in firms?

Here, for example, the effects of economic integration on various functions of firms are assessed. From these issues this study moves on to address the following question of a more general nature:

What are the major changes in the operating environment for firms when their home country becomes a member in a major economic bloc?

Further, this study will take a look at issues of a more applied nature, such as:

How could a national government ease firms' transition into operations as part of an integrated economic bloc?
What can firms in countries aspiring to become members in the EU (e.g. Poland, Hungary, Czech Republic and Estonia) learn from the Finnish firms' experiences?

The objective of the study is to determine the key areas of change affecting firm operations when a firm's home country joins an economic bloc. In addition, this study will give suggestions to firms on how to prepare for the economic integration. Moreover, this study aims at giving some suggestions to authorities on how to facilitate firms' adaptation to the changing operating environment.

EUROPEAN UNION'S SIGNIFICANCE TO THE FINNISH ECONOMY

Europe is very important to the Finnish economy and the Finnish firms, as evidenced by selected foreign trade figures. In 1997 the share of exports into the EU were 53 per cent of all Finnish exports; in absolute terms this means some USD 23 billion annually. The relative share of the EU exports has decreased during the last few years due to the strongly increased exports to Asia – in 1995 and 1996 the EU shares were 58 and 55 per cent, respectively. However, due to the economic recession in Asia the relative importance of European export markets may again increase. On the imports side, the share of EU imports of all imports into Finland in 1997 was 60 per cent.

Foreign investments from Finland have been targeted mainly into the EU countries and former EFTA countries. During 1985–96 some 60 per cent of foreign investments were made into the EU-15 area. In the mid-1990's there were more than 3000 Finnish subsidiaries in Western Europe. More than two-thirds of those were in the manufacturing sector, where in turn subsidiaries in the area of machines, appliances, electrical products and instruments and simple metal products represented about forty per cent of the units. Nearly fifty per cent of the three thousand or so Western European subsidiaries are sales units – production units (30%) and holding units (10%) are the other major categories. Nearly 80 per cent of the Finnish subsidiaries in the Western Europe were 100-per-cent-owned in the mid-1990s. (Karila & Maunuksela-Malinen 1996)

PAST RESEARCH ON THE TOPIC

A key aspect of firms' operations in an integrated economic area is that of investment behaviour. A question arises whether firms will change their targets of direct investment after their home country has joined an integrated economic area, and whether firms will invest more inside or outside the integrated area. Further, it would be interesting to know to what extent firms' investment moves are driven, firstly, by market factors and, secondly, by production cost factors. In other words it is worth studying whether the investment motivations in the changed economic environment are either horizontal or vertical, or perhaps both. Earlier studies have pointed to determinants of investments such as relative market size, trade barriers, exchange rate movements, trade intensity between the two countries, costs of production and profitability of firms in the host country, and the intensity of R&D in the host country. (Culem 1988, Karppinen 1991, Kinnunen 1993, Lunn 1980, Morsink & Molle 1991, Scaperlanda & Mauer 1969). Bajo-Rubio and Sosvilla-Rivero (1994) found that Spain's joining in the EC in 1986 partly explained the increased Spanish FDIs into the EC; the authors suggested that the main driver of increased investments would be the expectations of a larger market for the Spanish companies.

Larimo (1994) studied the investment behaviour of Finnish firms in the European Community countries, and emphasized the roles of cultural distance, target country size in terms of economy and the timing aspect of the investment. Finnish firms' investment behaviour in developing countries has been studied by Larimo and Mäkelä (1995). Erkkilä (1997) studied the determining factors of Finnish outward investment flows into 14 European countries between 1975–94, and particularly the implications for Finland participating in the third stage of Economic and Monetary Union (EMU), where the participant countries' currency exchange rates are irrevocably fixed, the common currency euro is adopted, and the European Central Bank is to take a central role in economic policy-making. The study was based on the statistics of the Bank of Finland, building an econometric model for Finnish FDIs; firm-level behaviour was not dealt with in the study. The study suggested that the drivers for Finnish direct investments in a foreign country are the host country GDP, the Single Market, the host country export share in total Finnish exports and the degree of structural similarity in economies. It was concluded in the study that Finnish investments into the EMU area would increase if the third stage of EMU increased the participating countries' GDP and if the common currency increased competition in the same way as the Single Market programme has done. To use the terms given above in this study, the study by Erkkilä concerned and consequently suggested horizontal motives for Finnish investments in European countries.

What comes to the different functions of a firm and the effects that a change in the operating environment would have on these functions, it would appear that the effects are not equally significant to different functions. In earlier studies it has been suggested that it is marketing which is most directly affected by the economic integration. (Daser and Hylton 1991, 45).

Taking an interesting perspective, Schmidt (1996) has looked at the integration's longerterm effect on the government – business relationship, using France as a case. In the study it was found that the dependence of French business on the French government has decreased due to the European economic integration. Another study touching the sphere of the present study has been that by Mäkelä et al. (1995), where the implications of EU membership on the development assistance of Nordic countries, including Finland, were examined.

Opportunities and threats brought about by the economic integration to the Finnish firms were studied by Tuulenmäki and Virtanen (1990). The purpose was to determine the strategic options of Finnish SMEs to prepare for the challenge posed by the year 1992 in the European economy; at the time of the study Finland's membership was by no means assured. The study comprised a survey and interviews among 125 Finnish firms representing a range of manufacturing sectors.

The study indicated that Finnish SMEs expected only small changes in their business environment, and believed that the changes will have only slight impact on their operations. Growing export market opportunities was the most common positive expectation. As to negative expectations, it was feared that the cost development in Finland would be unfavourable when compared to that in EC member countries, meaning that costs in Finland would rise but costs in other EC countries would decrease. This expectation by the respondent firms is somewhat difficult to interpret and it also raises the issue of how capable SMEs are to assess such rather complex matters as the implications of economic integration. No differences between firms of different size were found in the expected impact of the European integration on business environment. However, the study indicated that the already internationalized firms anticipated more both new opportunities and threats than those firms which operated mainly domestically. It was found out in the study that on average SMEs expected a slight increase in their internationalization due to the Internal Market. Also, it was concluded that the Finnish SMEs considered their position good or fairly good in relation to the European integration.

RESEARCH METHOD

The purpose of the study was to get a rather representative picture of the Finnish firms' experiences of the Finnish membership in the European Union and thus a broad survey method with a large sample appeared to suit the purposes of the study best.

In the selection of firms into the survey attention was paid to the relative shares of industrial sectors in Finland. It was felt important that the service sector is included in the study as it represents 61.2 per cent of the GDP in Finland (1996), manufacturing representing 34.3 per cent. Similarly, services employed in 1996 about 65 per cent of the work force in Finland, manufacturing having another 28 per cent.

Within manufacturing the metal, equipment and machinery sectors represented in 1996 about 32 per cent of the gross value of production, some 40 per cent of the work force, and some 42 per cent of the total exports of goods from Finland. In exports to the EU the share of this sector was about 34 per cent.

Within the service sector it was seen relevant to separate the trade, both wholesale and retail, from other service sectors, as it was assumed that firms in the trade sector would have experienced many changes due to Finland joining the EU. Another factor was that trade, as perhaps services in general, have not always received the attention they deserve in discussion concerning economic integration. Moreover, the share of trade firms out of the total number of firms is significant.

There were some 218 000 firms in Finland in the beginning of 1996. About 13 per cent of those were manufacturing firms and about 26 per cent were wholesale or retail trade firms. However, it was seen necessary to weight the sample first towards manufacturing and secondly towards trade sector firms because they are typically larger in size, have more international exposure and are more relevant e.g. in terms of the balance of payments of the national economy of Finland. In other words small service firms – such as barber shops, laundries, petrol and service stations, which form a large portion of all firms in Finland but are typically purely domestic in their operations – were purposefully left out in the sample. A sample of firms were selected from the industry data base according to the industrial sector classification by the Statistics Finland, and consequently the following aggregate industrial sectors and sample sizes were chosen:

- metal, equipment and machinery manufacturing 534 firms
- other manufacturing 138 firms
- wholesale and retail trade 314 firms
- service sector other than trade 132 firms

Within each sector firms were randomly selected from a data base listing all Finnish commercial enterprises. Sales of at least FIM 5 million (USD 1 million) and engagement in either export or import activities or both were used as screening criteria in the selection of sample firms. At the outset a response target of 30 per cent was set, which would have yielded some 330 responses. That was seen as very much sufficient for the purposes of the study, provided that the firms represent the different sectors in a balanced way.

After two rounds of questionnaire mailing a total of 184 completed responses had been received. Metal industry firms represented 38 per cent of the sample, other manufacturing 41 per cent, wholesale and retail trade 13 per cent, and other services 8 per cent. As to the size of the respondent firms, 30 firms had a turnover below FIM 10 million, 87 firms had a turnover between FIM 10–49 million, 25 had a turnover between FIM 50–99 million, 31 between FIM 100–999 million, and 11 firms had a turnover of more than FIM 1 billion.

Respondent firms in metal industry had an average turnover of nearly FIM 500 million, and in other manufacturing nearly FIM 1000 million. In trade and other services the average turnover was significantly smaller, about FIM 100 million and about FIM 140 million, respectively. The share of international business varied by sector from some 10 per cent in trade to some 80 per cent in metal industry.

As to the positions of the respondents in the firms, more than two thirds were managing directors or general directors, the rest being mainly sales or marketing or export directors or managers and finance directors or managers. Nearly all respondents were male.

FINDINGS OF THE SURVEY

First, as to how important the EU is as a market area for the respondent firms, overall the EU represented about 30 per cent of the firms' turnover. This is more or less in line with the overall share of the EU market in Finland's exports of goods and services. The EU share was highest for the category "other services" (35%) and lowest for trade (6%). The larger the firm, the larger the EU's share in its turnover; for firms with less than FIM 10 million turnover the EU represented a share of 21 per cent, and for the firms with more than FIM 1 billion turnover it represented a share of 44 per cent. The natural and perhaps self-evident conclusions are, first, that larger firms have been seeking growth in foreign markets, and second, that there is potential for small firms to grow through exports.

It was asked in which markets do the firms see it possible to increase sales within the next five years. Overall only six firms saw sales growth potential only in the Finnish markets; 34 per cent of the respondents saw sales growth potential in the Finnish, other European and extra-European markets. By firm size the general feature was quite understandably that the larger the firm, the more extensive its international coverage; larger firms typically saw sales growth potential in the Finnish, other European and extra-European markets. Smaller firms rather typically looked at only Finnish and other European markets. In the manufacturing sector about one-third of the firms saw growth potential only outside Finland. In the trade sector half of the firms saw growth potential in the combined Finnish and the rest of Europe markets.

In the questionnaire a set of statements concerning Finland's membership in the European Union was given, to which the firms had to respond on a scale *fully agree(1) – agree(2) – disagree(3) – fully disagree (4)*, complemented with a *cannot say* option. The statements were:

1. Business management has become easier in Europe with Finland's membership in the EU
2. The EU membership has increased cooperation with European partners
3. The EU membership has increased bureaucracy in Finland affecting our operations
4. The EU membership has increased bureaucracy in Europe affecting our operations
5. The EU membership has had a positive effect on our sales
6. The EU membership has decreased our material and operational costs
7. The EU membership has had a positive effect on our profitability
8. The EU membership has increased the need for training in our firm
9. The EU membership has increased the need for support (e.g. from the Govt.) in our firm
10. The EU membership has significantly affected the operations of our firm
11. The overall effect of the EU membership on our firm is positive
12. Finland should join the EMU 3rd phase among the first group of countries
13. Membership in the EMU would benefit our firm's operations
14. Membership in the EMU would entail significant risks for our firm

The response profiles by industry sector were perhaps surprisingly similar (see Figure 1). Large differences are notable only as to the statements number 3, 4 and 8:

- trade firms have experienced more bureaucracy in Finland than firms in manufacturing or particularly in other services than trade
- as to bureaucracy abroad the same as above applies, but with a smaller differences between industrial sectors
- as to the growing needs for training, it is the trade sector that appears to have them most, while the other services sector would appear to have less.

The response profiles by firm size were even more uniform. Perhaps the only meaningful differences were in responses concerning the training needs in firms due to Finland's membership in the EU; quite evidently due to the larger role of international business it was the larger firms that appeared to have more training needs than smaller firms did.

What comes to the changes experienced in the respondent firms' business, the answers were somewhat mixed. Overall about 25 per cent said that bureaucracy has decreased whereas some 20 per cent said that it has increased. Other changes mentioned were decreased material costs (10%), the internationalisation of business activities (5%) and the hardening of competition (4%). Interestingly, it appears that the smaller the firm, the more they see bureaucracy being decreased. A possible explanation for this is that smaller firms may experience de-

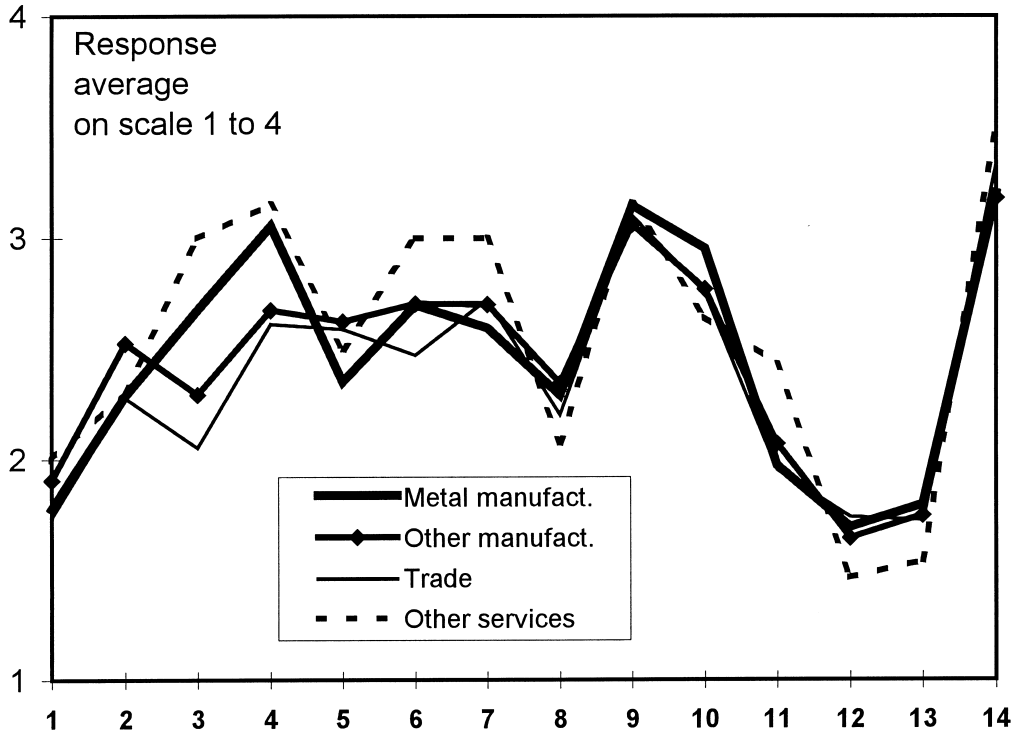

FIGURE 1. Response profiles to statements 1–14. By industry sector.

creased bureaucracy due to the smaller number of documents needed in trade within the EU, but larger firms are likely to experience EU related bureaucracy e.g. due to needs to conform to EU legislation, an issue that small firms perhaps have to confront less frequently. For the largest firms the hardening of competition and the increased mobility of personnel appeared as rather significant changes. Differences between industrial sectors are small; however, it appears that firms representing "other services" had experienced most strongly the hardening competition.

As to Finland joining the EU and its effects on the foreign operations of the firms, 80 per cent of all the respondents said that there had been no effect. About 5 per cent of the manufacturing firms said that they had increased their exports, whereas some 5 per cent of the trade firms said that their imports had grown. Among other services firms one in five said that cooperation with foreign firms has increased. When the effects on foreign operations are assessed by the firm size, the main findings are that among the largest firms cooperation with foreign firms and foreign investments have increased, but in the smallest firms – with turnover less than FIM 10 million – nearly 90 per cent of the firms had experienced no effect. As for the future, it could be hypothesized that as the European common market develops and smaller Finnish firms get to know it better, the effects of the membership on the small firms' operations might increase; namely, larger firms may now have an advantage over the smaller ones in using new opportunities to alter operations, thanks to better resources and typically internationally more experienced personnel.

Concerning benefits experienced by the respondent firms, due to Finland's membership in the EU, more than 40 per cent of the firms saw that it has become easier to conduct business, some 15 per cent felt that the awareness and image of Finland has improved thus helping business; some 20 per cent of the firms had experienced no benefits. Sectoral differences concerning the benefits were small, with the exception that the manufacturing firms had experienced the more stable prices as a benefit. Assessed by firm size, it appears that the smaller firms had experienced the easier business conduct as a benefit, reflecting, of course, the fact that large firms have more experience in operating in different and also in more demanding business environments. Also, some of the larger firms felt that better access to foreign public procurement has been a benefit.

Concerning problems experienced by the respondent firms due to Finland's membership in the EU, overall one third of the firms had experienced no problems, but some 30 per cent of the firms saw EU legislation and directives as a problem in their operations. Most problems had been encountered by firms in trade, where the EU legislation (33% of the firms) and the increased cost of imports from outside the EU (20 % of the firms) were given as experienced problems. As to the size of firms, quite interestingly it was the smallest firms which had experienced least problems.

Firms were asked about their needs for training in order to manage European Union business better. Overall 80 per cent of the respondent firms said that they have training needs, languages (30 per cent of the firms) and legal issues (25 per cent of the firms) being the key topics. Other training needs expressed were for issues concerning government and other support, taxation, cultural issues and lobbying. Sectoral differences were small, with perhaps the only distinctive finding that for the trade the various support systems were an area where training was needed quite much. It appears that the larger firms have more training needs for legislative matters and lobbying.

Overall more than 90 per cent of the firms had language training needs. The order of importance for training was English, German, French, and surprisingly Russian, even though the question had specified the language training needs to be for operations in the EU. Differences between firms of different size and of different industry were small.

Firms were also asked about the needs they have for support from the authorities in order to facilitate operations in the EU. Some 40 per cent of the respondent firms had no needs, whereas some 30 per cent had needs for export promotion support. Other support needs mentioned were training, research and development, and financing. Sectoral differences were small, but differences between firms of different size were quite significant. Smaller firms had significant needs concerning export promotion, whereas one third of the largest firms had needs for financing but had no training needs. The largest firms also needed guarantee support from the authorities.

The firms were also asked whether they expected any benefits from the common currency to be introduced. Overall only 10 per cent expected no benefits, but nearly half of the firms saw the smaller foreign currency risks as a benefit. Other, less significant benefits mentioned by the firms were decreases in foreign exchange cost, easier payments, simpler pricing, easier cost comparison, stabilization of interest rates, and the availability of alternative financing possibilities. Sectoral differences were not very significant, with the exception that trade appeared to emphasize decreasing foreign exchange risks. For the largest firms the benefits of decreasing foreign exchange risks were not of great significance, but they saw the easier cost comparison as a benefit more often than medium-sized and small firms.

As to the expected problems due to the common currency, overall more than 40 per cent of the firms expected no problems. Nearly one third of the firms mentioned the costs of transferring from Finnish markka into euro as a problem, and one in ten firms saw the consequent harder competition as a problem. Another problem mentioned was the decreasing cost competitiveness. Again, sectoral differences were small; services emphasized the decreasing cost competitiveness, whereas firms from the "other manufacturing" sector emphasized the harder competition. Rather interestingly but perhaps quite understandably the smallest firms saw the transfer costs as problem less often than larger firms did.

CONCLUSIONS

The overall conclusion from the survey is that firms seem to have experienced more benefits than problems due to Finland joining the European Union; the key benefits and problems are presented in Figure 2.

The findings of the survey can be summarized as in Table 1, where key issues have been presented by firm size, which seemed to be a relevant distinguishing factor between firms in terms of the experienced changes, benefits, problems, training and support needs due to the home country becoming a member in the European Union. The purpose of the table is not to be an extensive summary but to simplify the findings in order to highlight the key points.

It appeared that firms of different size have experienced the environmental change in different ways. Even if in overall terms benefits outweigh problems both in small and large firms,

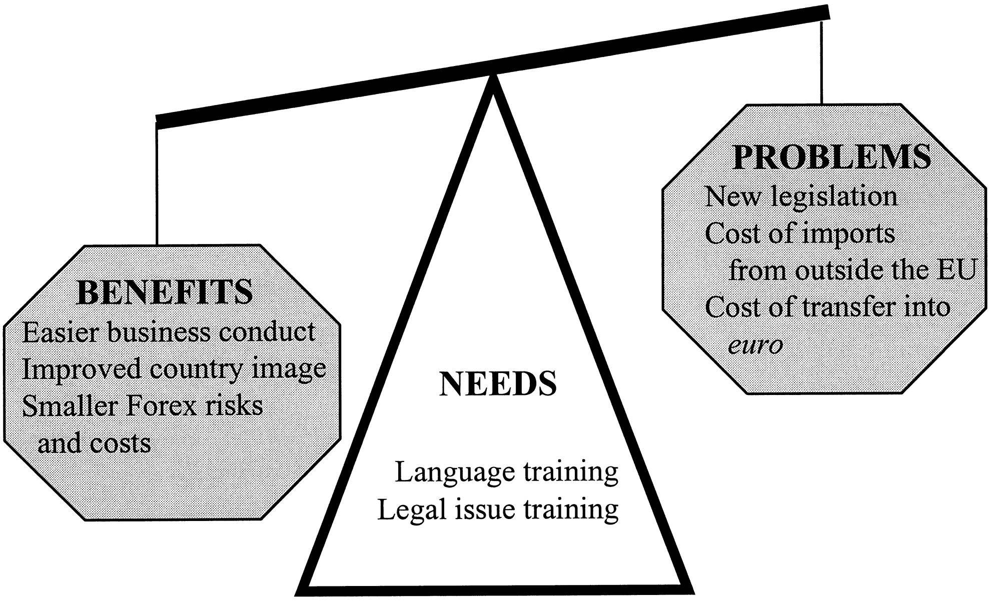

FIGURE 2. Key benefits, problems and needs.

there appears to be a difference as to the level of critical issues. In small firms the benefits and challenges appear to be more on a tactical level, whereas in larger firm they would appear to be more on a strategic level. However, it is to be noted that "smaller" issues – i.e. issues that are of tactical nature to large firms – can be of strategic importance to small firms. Also, the support needs experienced in firms seem to differ; in small firms training and export promotion needs prevail, whereas in larger firms these areas are evidently well taken care of, but there are needs concerning financial and guarantee support.

As to firms being able to respond successfully to the changes brought about by the economic integration, it seems that for smaller firms it is mainly an issue of training and the challenges are perhaps more on a tactical level. However, as the firms get larger, and typically get involved in more versatile, more complex and more internationalized business operations, thus typically having a more extensive arsenal of skills, then the successful response to economic integration would appear to be more a question of management capacity. In other words it is not primarily a training issue anymore, but that of executive capacity and executive recruitment. Figure 3 summarizes the generalized conclusions of the study.

As to the question whether the experiences have been different from expectations, the comments from the respondents would appear to convey a message that firms have had a fairly good picture of the changes to come. Apparently the preparatory information provided e.g.

TABLE 1. Key findings by firm size

Issues & general findings	Small firms	Large firms
Changes experienced • overall changes have been modest	Less bureaucracy; e.g. through fewer forms to fill	Harder competition Personnel mobility Foreign investments and foreign cooperation
Benefits experienced • business conduct has become easier • country image has improved	Easier business conduct; less barriers	Better access to public procurement abroad
Problems experienced • legislation seen as a problem	Legal issues in trade sector	Legal issues a challenge
Benefits from common currency • smaller foreign exchange risks	Foreign exchange costs down	Cost comparisons easier
Problems from common currency • nearly half expect no problems • transfer costs	Cost of transfer	Cost of transfer can be significant
Support needs	Export promotion	Financing and guarantees
Training needs	Languages	Legal issues

by the Ministry of Trade and Industry and the industry associations has been paid close attention to, and the various training programs offered for firms have not been in vain.

Concerning the Government's actions to ease firms' adaptation to the changing environment, it would appear that the authorities have done a good job by providing information and supporting training programs. Perhaps what could be done better is the provision of export promotion support, but that is such a wish from the industry that is always there, regardless of whether there is a change in the environment or not; firms always would like to get more export promotion support, but at some stage it becomes a matter of drawing the line between the responsibilities of firms and those of the authorities. Similarly, the larger firms' wishes for more financing and guarantee support is understandable, but has to be put, for example, in the framework of European Union competition policy; the consequent question is how far governments can go in supporting their national industries and firms.

Taking into account not only the relatively small size of the Finnish economy and her geographic location, but also the different economic histories of Finland and the potential new

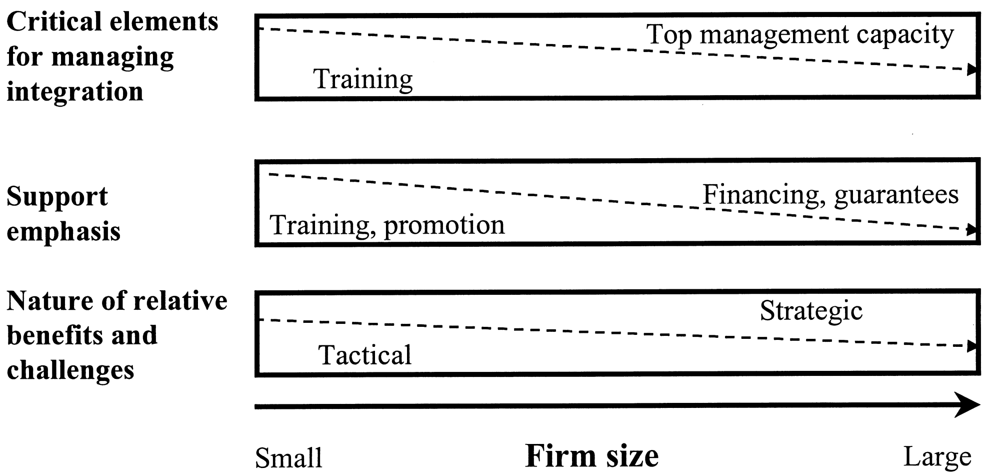

FIGURE 3. Relative significance of key components as to critical elements, support emphasis, and benefits and challenges.

EU members, it appears reasonable to suggest that many of the experiences of Finnish firms after Finland joining the EU are worth paying attention to in those countries that are likely to become new EU members in the future.

As for the governments of potential EU members, the key challenge appears to be the provision of sufficient education and training opportunities for people, and user-friendly information for the firms. The tasks are made ever more challenging due to the fact that e.g. the legislation in most of these countries is still under development. However, the lack of firmly established economic legislation can be seen as an opportunity, as well: now the governments can push for legislation that is compatible with the EU legislation from the very beginning.

Then, what could firms in those countries that aspire to become members in the EU learn from the experiences of Finnish firms? The inevitable starting point is that the integration will most often mean intensified competition and therefore the basis of business should be in good condition; product offering and quality, production and its costs, understanding of distribution structures, and understanding of the role of promotion in one's business. The first lesson from the Finnish experience then would be that the benefits can outweigh problems if the firms have done preparatory work duly: training of personnel concerning EU legislation, selection of management which is familiar with working in the EU environment, and providing essential supportive training such as that in languages and business cultures of European countries. Proper preparation for the challenges of economic integration requires investments, but such investments are likely to bear fruit. ■

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