Exporting as a strategy to enter Eastern European markets, taking Hungary, the Czech Republic, and the Slovak Republic as examples

Study Paper

University of Cooperative Education Mannheim
Field of Studies “International Business”

Handed in by:
Michael Heilmann
Kastanienring 33
63654 Büdingen

and

Stefan Ruh
Röntgenstraße 3
68642 Bürstadt

Tutor: Prof. Dr. Martin Kommeier
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Abstract

The following study paper focuses on the evaluation of the appropriateness of different market entry modes available to businesses willing to enter the Central Eastern European markets of the Czech Republic, Hungary and the Slovak Republic.

The fall of the Iron Curtain and the Eastern European expansion of the EU meant major changes for both people and companies located on the “old” continent. People from the Eastern European Area are granted access to the Western variety of goods by now, which in turn presents the creation of new market opportunities for Western firms. As many of those firms are confronted with saturated home markets and ever decreasing margins, presence in those “new” markets appears to be crucial to the growth objectives of many of them.

Nevertheless, when approaching a new market, one major determinant of future success for any business is the identification of the right entry mode strategy to match the internal capabilities and resources to the given environment in the target country. Still, in many companies the decision of entry mode is taken intuitively without proper evaluation of the given situation at hand. In general companies need to decide, if they want to serve a market by exports or if they are willing to show a stronger commitment by setting up own facilities locally. Still, this decision is to be made individually per country with respect to differences in the general, competitive and internal environment faced by the respective company.

This study paper addresses the question of how to evaluate the general environment in the Czech Republic, Hungary and the Slovak Republic by introducing a structured framework, which comprises of an extended PEST analysis, and applying it to the three Central Eastern European markets. By utilizing three parameters each to evaluate the political, economical, socio-cultural, technological and logistics situation in each of the three countries the framework presents a holistic analysis of the general environment to base the entry mode decision for each market upon. Findings are based on the data source of the European Commission (Eurostat) and consolidated by integrating the data into a graphical decision matrix.

As a result, it can be said that especially the general environment of the Slovak Republic as well as of the Czech Republic are well suited for an exporting strategy with both displaying a liberal
political situation supporting free trade flows, high labor costs and a well-established logistics infrastructure. The general environment of Hungary, in contrast, does not support any of the two possible market entry modes. On the one hand it displays an evenly liberal political situation and high labor costs, which rather promote an exporting strategy. On the other hand high subsidies and a significant exchange rate risk favor a local production strategy.

Concluding it can be said that this framework is a helpful tool to analyze the general environment of any country as a starting point in finding the right entry mode. Still, to finally identify the appropriate entry mode further analysis of the competitive and internal environment is indicated.
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<th>Description</th>
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<tr>
<td>CB</td>
<td>Central Bank</td>
</tr>
<tr>
<td>CIA</td>
<td>Central Intelligence Agency</td>
</tr>
<tr>
<td>CEE</td>
<td>Central and Eastern European</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>Exp.</td>
<td>Expenditure</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>PPS</td>
<td>Purchasing Power Standard</td>
</tr>
<tr>
<td>Q3</td>
<td>3rd Quarter</td>
</tr>
<tr>
<td>Q4</td>
<td>4th Quarter</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
</tr>
<tr>
<td>S&amp;P</td>
<td>Standard &amp; Poor’s</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium-Sized Enterprise</td>
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1 Business Environment in Central and Eastern Europe

The Czech Republic, Hungary and Slovakia experienced two major political changes during the last 25 years. First, there was the fall of the Iron Curtain in 1989 - which affected only Hungary because Slovakia and the Czech Republic didn't exist then. Second, there was the entry to the European Union [EU] in 2004. Both events followed major political and economic changes in those countries, resulting in new challenges and opportunities. The countries became democratized, and their economies have grown on average by an extraordinary 22.5% since 2004 - a growth rate much higher than that of the former EU-countries (8.3%) or Germany's (7.7%) (cf. exhibit). Therefore the prosperity gap between Western and Central and Eastern European [CEE] countries has become smaller during the past five years.

Central and Eastern European countries have been westernized since the fall of the Iron Curtain, trying to veer off communism and planned economy towards Western free market economy and Western values. Events like the entry to the European Union and the common currency Euro
substantiate this development, extending the existing area by an additional 750,000 km² and a population of 75 million persons, an increase of 20%. For the former economies of the European Union, also known as the EU15-countries, this extension has brought with it a further liberalization of trade barriers and has opened new doors for business in Eastern Europe. 75 million persons can make up to 75 million new customers. Many firms find saturated domestic markets, but have the potential and capabilities to keep growing. For a German company, the geographic closeness to the new EU member countries can be a contributing factor to reach this goal. However, the knowledge about the Central and Eastern European markets is sometimes very limited and many corporations lack experience when dealing with these economies. Approximately 62% of all German exports stay within the EU (see Exhibit 2), and only one of the 2008 top ten trading partners in exports was from outside Europe (USA, rank 2, source: Destatis). Historically, Central and Eastern European economies are rather open economies, dependent on imports and foreign direct investment [FDI].

Exhibit 2: German Exports to Regions 2008 (Source: Statistisches Bundesamt 2009)
Furthermore, according to Hungary Investment and Trade Development Agency, Germany holds an average of 25% of the stock of all Foreign Direct Investment in Poland, the Czech Republic, Hungary, Slovenia and the Slovak Republic (cf. ITD Hungary 2009, p.3). The three focus countries have shown a constant FDI inflow for the past four years (see Exhibit 3), i.e. since their entry to the European Union. This means that countries from all over the world have been investing in these countries for years, seeking for new opportunities in order to establish new business activities abroad.

There is further empirical analysis on factors that contribute positively to successful bilateral trade. Pankaj Ghemawat, a global strategist and professor for globalization and strategy at Harvard Business School, states in his book "Redefining Global Strategy" that four kinds of distances influence a company's success when going to other markets: The cultural distance, the administrative distance, the geographic distance, and the economic distance. These distances, or
better: one's own distances to new markets, give important insight into the exogenous chances of having success in a specific foreign market. As a consequence, there are markets that are very well suited, but on the other hand there exist markets very badly suited for a company’s operations (cf. Ghemawat 2007, p.33). Ghemawat furthermore subdivides these distances into five factors and shows their effects on bilateral trade, demonstrating the possible outcomes with the failure of two multinational corporations in foreign markets, Coca Cola and Wal Mart. These factors developing successful business abroad are (see Exhibit 4):

- Common Language
- Common Regional Trading Bloc
- Colony/Colonizer Relationship
- Common Currency, and
- Common Land Border

### Exhibit 4: Effects on Bilateral Trade (Source: Ghemawat 2003)
Given this reasonable analysis and the facts and figures about already existing German exporting and FDI, there are very good opportunities for German companies to expand their business activities to the countries in focus: the Czech Republic, Slovakia, and Hungary. All of these countries are part of a regional trading bloc (the EU), partly share a land border, as well as the same currency. A lot of companies have already invested successfully in these markets. This study paper focuses on how to explore the opportunities and threats that wait in Central and Eastern European markets, using the Czech Republic, Hungary and Slovakia as examples. It discusses possible market entry strategies from interdependent standpoints, as well as factors favoring these modes. It concludes with recommendations about how to enter the focus markets.

2 Entering Foreign Markets
After having explored the business environment and the big opportunities to do business in Central and Eastern European countries, especially in the target countries, i.e. the Czech Republic, the Slovak Republic and Hungary, the second chapter explores modes of how to enter these markets. Chapter 2.1 discusses why companies decide to expand their business to foreign markets, whereas chapters 2.2 and 2.3 focus on the different entry modes and on factors that favor one or another mode as the appropriate one. The second chapter closes with a summary of the findings.

2.1 Why Enter Foreign Markets?
This chapter illustrates the fact that the supply of foreign markets is a crucial factor for many companies. Foreign markets can be supplied by exporting to the market, or by production in those markets. Both ways will be discussed briefly in the following.
Considering the members of the Fortune 500 list of the largest multinational companies, about 50 percent of their worldwide sales were generated in foreign markets in 2006 (cf. Ball et al. 2008, p.31). Many of these companies wouldn’t be as competitive as they are without the activities in
foreign markets, and some of them might be unable to remain in business. But why do companies decide to invest in one country, and to export to another? A logical approach would be that small and medium-size enterprises [SME] rather export to foreign markets because of a lack of experience and financial or human resources and big corporations rather move to foreign markets by investing there through foreign direct investment. But giving a generalized statement like this can easily lead to mistakes. Apparently, it wouldn’t make sense for neither a big nor a small or medium company to supply each and every foreign market by producing locally. Many of the Standard & Poor [S&P] 500 list sell to 100 countries or more. Nor does it always make sense to export to all target markets due to factors such as high tariff or non-tariff trade barriers. Therefore, a company must find a strategic fit between exporting and FDI when making important choices such as the one of how to enter a foreign market. In the following chapter, different entry modes and their respective advantages and disadvantages are presented. Factors that influence the choice for the entry mode are identified.

2.2 Entry Modes

The decision of how to enter an attractive target market has a significant impact on the results. Different modes of market entry bring along different degrees of risk, effort and input of financial and human resources. Furthermore, the political stability of the country and the cultural distance, as well as sales potential and the legal framework play a crucial role when assessing and finding the accurate entry mode.

Four entry modes are discussed in this study paper: exporting and contractual agreements as non-equity-based modes of entry, joint venture and direct investment in the form of a wholly owned subsidiary as equity-based modes of entry. The exhibit on the following page shows the various market entry modes that a firm can choose from. The ones in blue are to be examined in this study paper.
The non-equity modes of entry, namely exporting and contractual agreements require little investment and are relatively free of risks, whereas the equity-based modes of entry imply an expensive and resource-intensive long-term investment in the specific country (cf. Klug 2006, p.
In the following section, four entry modes are examined according to the exhibit above. Each of the entry modes is shortly presented. Advantages and disadvantages are outlined. Since the focus of this paper is on exporting, this entry mode will be presented in a more detailed manner.

2.2.1 Exporting
Exporting means that a company sells some of its goods or services abroad. This is usually how firms begin their foreign operations, since this method of market entry requires very little investment because it exploits existing production capacities of the firm and is therefore relatively free of risks. Markets can be entered with ease and speed. However, free trade is not always given and tariff (taxes on imports) and non-tariff barriers that increase the cost of the product, as well as transportation costs may appear. For a company, exporting might be the right choice when it takes its first steps into foreign business in order to gain experience, since exporting is relatively free of risks and the company faces a minimized investment. Another factor contributing to exporting as the right entry mode can be the fact that import policies in the target country are very favorable (i.e. within free trade areas). Or the target market might not be attractive enough for a greater effort or investment (i.e. limited sales potential, high rivalry among competitors). In this case, exporting remains as the only reasonable entry mode (cf. Mercado et al. 2004, p.343). A company can usually choose between direct exporting and indirect exporting.

Indirect exporting stands for the exporting of goods and services through a third party that coordinates the entry and assumes the risk. There’s a variety of alternatives available for indirect exporting. The most common way is through export management companies whose primary purpose is to sell and market products internationally. They perform the international sale of a company’s products and take away the burden of going abroad. Another possibility to export indirectly is called piggyback exporting. Piggyback exporters manufacture and export their own products, but since they have the expertise, the distribution network and the resources to sell in a foreign market, they also export products of other companies. A manufacturer who lacks capacities to export directly can piggyback on the success of another company (cf. Albaum et al. 2008, p. 318). A third method of indirect exporting is through domestic distributors. Products are
sold to distributors or dealers who re-direct them to foreign customers. Advantages of indirect exporting are the following: firstly, there is no international experience required because no additional resources or networks are needed. Secondly, the management can focus on the core business in the domestic market and is not distracted by international issues. This is essential especially if domestic goals are more important than international ones. Thirdly, the speed of entry to the target market because strengths and experiences of the exporting partner are utilized. No staff has to be acquired and trained. Fourthly, the financial commitment is minimized, since the export partner covers most of the costs such as marketing expenditures or additional employees. Lastly, there is a very low risk - a consequence of the minimized investments. However, indirect exporting brings along some disadvantages as well, such as poor control of the export activities. All decision-making will be done by the export partner and influence to be taken will be limited. Furthermore, the market feedback to be received will be very poor because the exporting partner will not share much information on the foreign markets in order not to lose the business. A second disadvantage represents the risk of choosing a wrong partner, since an exporting partner will focus on the markets that have been successful for him in the past - which does not mean automatically that these markets are adequate for the manufacturer’s products. This stems particularly true if a company has only one exclusive exporting partner for worldwide sales. This can and will lead to potentially lower sales and missed sales opportunities (cf. Foley 1999, pp. 95-102).

As the advantages and disadvantages show, finding the right export partner is crucial for a company’s success and international sales. It is the partner who carries out business abroad and who represents a lot of benefits if he acts intelligently, but lots of risks if he acts badly on the international target markets.

When exporting directly, on the other hand, a company forgoes an intermediary in the domestic market and links its activities directly to the target market. The foreign entity can be a sales representative, an agent, a distributor, or even a subsidiary. There is a direct link between the domestic and the foreign trading partner which is an advantage, since activities can be better controlled and influenced. Direct exporting overcomes the problems of control and feedback that appear with indirect exporting. There is no export partner who avoids giving too much specific information. Close contact and therefore excellent feedback is possible and achievable. A higher
number of sales than by indirect exporting seem to be a logical consequence. However, market selection poorly executed or a search of agent poorly conducted can also lead to lower sales. Disadvantages of direct exporting relative to indirect exporting are firstly to be found in the greater investment that is required, because the manufacturer is in control of the whole export process, i.e. that more resources and more commitment are needed in order to fulfill all the relevant tasks. Consequently, there is a higher risk involved in the direct method because it involves higher financial and non-financial resources, such as a high employee commitment and management time. Lastly, the time-to-market will increase significantly depending on a firm’s experience and network in the target market. Launching products into foreign markets does always need time, especially without contacts or expertise (cf. Doole et al. 2008, p. 239).

2.2.2 Contractual Agreements: Licensing

If a company decides not to serve a market via exporting, it has to produce its goods or services in the target market abroad. The easiest way to do so – easy in this way means little risk and low investment – is licensing. By producing in the target market, a company circumvents existing trade barriers and overcomes a possible cultural distance which might be unfavorable for exporting goods, since the company is viewed as an outsider (which does play a role in many countries). When licensing, a company (the licensor) does not produce its goods or services itself, but grants access to its patents, trade secrets, or technology for a fee to its partner (the licensee). It is a contractual arrangement between two parties (cf. Dunning et al. 2008, p. 262). The framework for an agreement has to be fixed. There can be restrictions on geographical areas or the validation time of the right to use the licensor’s expertise. However, this entry mode represents some possible disadvantages. A licensor always has to give away his know-how and his expertise, meaning that there is the probability of lack of control over the use of assets. In addition, if the licensee performs well, why shouldn’t he exploit his newly gained knowledge in order to become your competitor after the licensing-period? Certainly, this specific risk grows bigger the farther East a company goes. But it has to be taken into account when making the decision of how to enter a foreign market. On the other hand, if the licensor knows that the licensee lacks the ability to become a competitor in the future, this is a very favorable factor for licensing (cf. Albaum et al. 2008, p. 380).
2.2.3 Joint Venture

A joint venture is a cooperative effort among two or more organizations that share a common interest in a business enterprise or undertaking. Thereby, the organizations involved do not have to be local. A joint venture can also consist of two international companies from two different countries that want to explore a third market. A government can also be involved as one of the trading partners. Joint ventures make sense when the target market has high sales potential and the cultural distance is high, meaning that a company needs the local staff and their know-how in order to gain sustainable market share. The new company is viewed as an insider of the market. High import barriers that make exporting unattractive are another factor contributing to the decision to form a joint venture. Naturally, the investment involved in a joint venture is much higher than that in exporting or licensing. But risk is spread among the cooperating organizations. Another advantage is that economies of scale and scope, as well as synergies can be achieved through the exchange of know-how and cooperation. Disadvantages can be seen in the spillover of know-how and the overcome independency of each organization involved. Coordination of activities with the partners might become very difficult to manage as well as the different corporate cultures of the firms that have to be merged. Successful activities might be difficult to allocate among the participating organizations (cf. Buckley et al. 1999, p. 363).

2.2.4 Direct Investment

When talking about direct investment in a foreign market, we speak of a wholly owned affiliate (according to the shown exhibit). Owning an affiliate in the target market implies a hundred percent control over the assets abroad. A company that wants to own an affiliate may start from the ground up by building a new plant (Greenfield investment) or acquire a going concern like an existing distributor with a network familiar with the company’s products. Naturally, this entry mode represents the highest risk and requires most commitment and effort of the growing company. However, greater market knowledge and a more direct contact to the customer are guaranteed. This might increasingly be important if the target market has high sales potential and
low cultural distance so that local resources can be exploited easily and efficiently (cf. Svensson 1998, p. 157).

The following exhibit concludes chapter 2.2, providing a summary of the advantages and the disadvantages of the presented entry modes. The following chapter 2.3 focuses on concrete factors that have to be taken into account when choosing an entry mode. The factors that are going to be discussed are on political, economical, socio-cultural, technological, and logistics level.

<table>
<thead>
<tr>
<th>Mode</th>
<th>Advantages</th>
<th>Disadvantages</th>
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<tbody>
<tr>
<td>Exporting</td>
<td>Minimizes risk</td>
<td>Trade barriers and tariffs add costs</td>
</tr>
<tr>
<td></td>
<td>Minimizes investment</td>
<td>Transport costs</td>
</tr>
<tr>
<td></td>
<td>Speed of entry</td>
<td>Limits access to local information</td>
</tr>
<tr>
<td></td>
<td>Maximizes scale; uses existing facilities</td>
<td>Company viewed as an outsider</td>
</tr>
<tr>
<td>Licensing</td>
<td>Minimizes risk</td>
<td>Lack of control over use of assets</td>
</tr>
<tr>
<td></td>
<td>Minimizes investment</td>
<td>Licensee may become a competitor</td>
</tr>
<tr>
<td></td>
<td>Speed of entry</td>
<td>Knowledge spillovers</td>
</tr>
<tr>
<td></td>
<td>Ability to circumvent trade barriers</td>
<td>License period is limited</td>
</tr>
<tr>
<td></td>
<td>High ROI</td>
<td></td>
</tr>
<tr>
<td>Joint Ventures</td>
<td>Overcomes ownership restrictions and cultural distance</td>
<td>Difficult to manage</td>
</tr>
<tr>
<td></td>
<td>Combines the resources of two companies (synergies)</td>
<td>Dilution of control</td>
</tr>
<tr>
<td></td>
<td>Potential for learning</td>
<td>Greater risk than exporting or licensing</td>
</tr>
<tr>
<td></td>
<td>Company is viewed as an insider</td>
<td>Knowledge spillovers</td>
</tr>
<tr>
<td></td>
<td>Less investment is required</td>
<td>Partner may become a competitor</td>
</tr>
<tr>
<td>Direct Investment</td>
<td>Greater knowledge of local market</td>
<td>Higher risk than other entry modes</td>
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### 2.3 Factors Influencing the Exporting Decision

After having explored the four entry modes, a company has to choose one, if it wants to extend its business to a foreign market. In the next chapter, factors that define the optimal entry mode for a company are assessed and a definition of the optimal specifications, supporting the different entry modes, is given. Still, a diverse number of factors influence the success of any chosen market entry strategy. To profit from the advantages and opportunities linked to any of them, a strategic fit between the entry mode and the given environment is crucial. The environment thereby can be sectioned into three different areas exerting influence on each other in many ways (see also Exhibit 7 on p. 14):

- General environment
- Competitive environment
- Internal environment

| Can better apply specialized skills | Requires more resources and more commitment |
| Minimizes knowledge spillover | It may be difficult to manage the local resources |
| Company can be viewed as an insider | |

**Exhibit 6: Summary of Advantages and Disadvantages (Source: Own figure based on chapters 2.2.1 to 2.2.4)**
Whereas the general business environment comprises of relatively stable factors such as the political, economical, socio-cultural and technological situation in a given market and therefore is rather fixed, the competitive and the internal environment are dependent on rather dynamic factors such as a company’s respective industry and its internal business situation. Hence it seems appropriate for the purpose of this paper to focus on the general business environment to establish a framework which is valid not only to a large portion of the businesses facing the decision of how to enter those markets, but which remains valid for a certain period of time. Therefore the factors to be taken into consideration are exclusively found on political, economical, socio-cultural, technological, and logistics level. Additionally the assessment is exclusively done between exporting and foreign production without distinguishing between the different sub-forms, as those are rather determined by the competitive and the internal environment. Three relevant parameters per area have been identified and analyzed for each country individually (An overview of this framework is provided in Exhibit 8 on p. 15). Section 2.3 describes both, the optimal specification of each parameter to favor an exporting strategy, as well as the most advantageous conditions supporting a local production strategy. Geographically the analysis is based on a German corporation’s view.
Political Factors

Political factors are important in order to analyze to what degree government intervenes into the economy of a given country. Three ways to analyze governmental behavior will be examined in this study paper: subsidies, trade barriers, and the role of the federal trade commission. Exporting is the optimal entry mode if the government provides low subsidies to foreign companies, if there are no trade barriers that artificially make the exported products more expensive and therefore less competitive, and if there are liberal trade policies by a federal trade commission. However, a government supports FDI by providing high subsidies, making free trade difficult through many bureaucratic trade barriers and therefore protecting the foreign industry (cf. Rugman, Collinson 2006).

**Exhibit 9: Political Factors**

- **Subsidies:** In terms of this parameter a situation where it seems to be appropriate to apply an exporting strategy is given, when the share of subsidy expenditure provided by the respective government does not exceed 0.4 % of the country’s annual GDP, as this in general indicates that liberal competition is supported by the government with only little or no measures taken by the administration to increase the competitiveness.
of locally manufactured products. On the other side, a foreign production strategy is recommended, when a country’s expenditure on subsidies goes beyond 1.0 % of its annual GDP, as this indicates a relatively strong intervention into the given competitive situation impeding access possibilities for foreign businesses.

- **Trade barriers / Federal trade commission:** To facilitate an export strategy for foreign companies a situation in the target country with no or few trade barriers (tariffs, quotas …) imposed by a liberal and internationally oriented federal trade commission is required. Additionally, membership to the respective trading bloc, in which a company’s home country is participating in, seems to be beneficial. Not being member of this trading bloc, as well as a fragmentary and bureaucratic import policy seem to be indicators for a foreign production strategy.

**Economical Factors**

Economical Factors define the stability of a country’s economy and its prospects for the future. If a country’s economy faces a golden future with high growth rates and cheap factors of production (land, labor, capital) a company should produce in that country due to the own possibilities to grow and prosper. On the other hand, few natural resources and expensive labor costs will hamper a company’s possibilities to grow and expand in the future; so do high interest rates and a low GDP growth rate (cf. Thompson, Martin 2005, p.158).

- **GDP Growth:** When focusing on economical factors influencing the strategic entry decision GDP growth seems to be a central determinant. As all three countries assessed in this paper rank amongst the lower half of the European geographic area (2008; cf. Eurostat 2009) in terms of total GDP those countries need to display an above-average economic growth to indicate future potential to foreign marketers. If one of those countries only displays a low GDP growth (below 2.0 % / yr) over several periods it seems to lack the required future potential to justify large investments. Hence an exporting strategy seems to be appropriate to serve this rather
stagnating market. If one of them presents strong economic growth (above 6.0 % / yr) marketers should think about stronger commitment to this market by building own facilities to be ready to harvest the future potential accurately.

- **Currency / Interest Rate:** Two other factors determining the right entry mode are the respective country’s currency as well as its interest rate. If the country in focus presents a stable currency and a high interest rate (Central bank rate above 7.0 %) an exporting strategy seems to be suitable, as a stable currency eliminates exchange rate risks in international transactions and a high interest rate indicates that external financing for local business operations in the country of interest is rather expensive. On the opposite, a rather unstable currency combined with a low interest rate (Central bank rate below 3.5 %) indicates the fit of a foreign production strategy, as there is a high risk of losses due to exchange rate fluctuations as well as a relative abundance of debt capital at low prices.

- **Labor Costs:** To decide upon the right entry mode labor costs is another economical factor that needs to be taken into consideration. A country that provides cheap labor (Labor cost index in Q4 2008 below 100.5 % compared to Germany – Q3 2008) seems to provide opportunities for corporations to manufacture its goods at relatively low prices. In order to be competitive in such a market, companies might apply a local production strategy to profit from those low labor costs. If a country displays relatively expensive labor costs (Labor cost index in Q4 2008 above 102.5 %) then a company might profit from exporting products from plants using less costly labor inputs.

**Socio-Cultural Factors**

Social and cultural factors affect the demand for a company’s product and define whether or not a company’s products are accepted and bought. They are a crucial factor for the market potential and therefore for the entry mode decision-making. Socio-cultural factors to influence that decision are income distribution, education and the cultural distance to the target country. Exporting is optimally promoted if income is distributed unevenly and the education level is low.
Cultural distance also plays a crucial role, since a distant culture might need product adaptation to local tastes and customs, whereas no or little product adaptation is required when dealing with countries of low cultural distance. Product adaptation is best done in the target country having the expertise and the work style at hand (cf. Armstrong 2001, p. 37ff).

Exhibit 11: Socio-Cultural Factors

- **Income Distribution:** To analyze the fairness of income distribution in this context, the Gini coefficient seems to be the appropriate parameter. An uneven income distribution is indicated, when a country’s Gini coefficient lies above 0.31. In this case it seems that a relatively small share of the country’s population owns the majority of capital and therefore market potential seems limited. Hence an exporting strategy is supported. On the contrary, an even income distribution is implied, when it lies below 0.27. In this case, market potential seems to be relatively higher, which backs a local production sight.

- **Education:** The educational level of the three target countries in this paper is analyzed by the parameter of share of 18-yr-olds in school to total 18-yr-olds. A low educational standard is given, if less than 65.0% are still in school, indicating that there is a lack of sufficiently skilled work force. In this case, an exporting strategy seems appropriate. If more than 85.0% are still in school at the age of 18, then establishment of local manufacturing sites is supported, especially in a low-labor-cost country.

- **Cultural Distance:** The parameters used to analyze the cultural distance of the target countries are the 4 cultural dimensions of Hofstede (Power Distance Index, Individualism, Masculinity, and Uncertainty Avoidance Index). If only few or no deviations to the German results are given, a similarity of needs and wants is indicated. Consequently only few or no adaptation of product specifications is required, giving support to an exporting strategy. Huge deviations in the four dimensions, on the other side, indicate that the domestically designed product will not
fit the foreign market. Hence a closer market observation and commitment is needed, favoring a foreign production strategy as the right entry mode.

**Technological Factors**

Technological factors include environmental as well as ecological aspects, such as Research & Development or access to the worldwide web. High Research and Development [R&D] funds signify further growth possibilities for the firm. Physical presence in form of FDI is therefore appropriate in that case. Presence is also required when the access to mass media is very low. Potential customers have to be reached by other, more traditional channels. On the other hand, if there are little funds for R&D and high access to mass media, exporting can be the right choice to enter the market (cf. Applegate, Johnson 2007, p. 28).

**Exhibit 12: Technological Factors**

- **Public Funds R&D:** The parameter of public funds in % of annual GDP is used in this context. An exporting strategy is indicated, if those public funds do not exceed 0.5 % of a country’s annual GDP, as this - in comparison to the other countries belonging to the European geographic area - would indicate insufficient governmental support for economical innovativeness. Thus companies rather could not profit from local operations in terms of participating in research projects. On the opposite, if public funds go beyond 0.8 % of the annual GDP, a local production sight is supported as this indicates a dynamic technological environment resulting in state-of-the-art products and production methods.

- **Access to Web Technology:** Concerning this aspect the parameter of web accounts / households was applied in this analysis. To support an exporting strategy at least 70.0 % of the respective households should have an own web account, as this indicates a relative good information availability, facilitating the marketing from abroad. A rate below 20.0 %, on the contrary, indicates that sufficient information diffusion using new technologies is impossible. For this reason more traditional marketing approaches
need to be applied, requiring a higher physical closeness to the respective market (local production strategy).

- **Patent Applications at the EPA:** In this context the parameter of patent applications per Mio inhabitants is analyzed. To support local production sights a level of at least 200 applications is required, as this indicates a sufficient level of dynamics in the technological environment to actively take part in and profit from such developments. A country with less than 85 applications apparently does not provide such an environment. So businesses should serve this market by exports.

### Logistics Factors

Logistics systems and infrastructure are important to consider when it comes to accessibility of customers and clients. Indicators for a developed logistics system that favor exporting as the optimal entry mode are high expenditures on infrastructure by the government, a high number of airports and an easy accessibility of customers and distributors.

#### Public Expenditure on Transport Infrastructure:
The annual public expenditure on transport infrastructure in % of GDP seems to be a viable parameter. If public expenditure exceeds 1.0 % of GDP an exporting strategy is indicated, as it suggests a well-established transport infrastructure facilitating the accessibility of local markets from outside the country. If public expenditure does not exceed 0.5 % of GDP this hints at difficulties in reaching at least sub-areas of the market from outside the country, supporting a local facility strategy.

#### Number of Airports:
Additionally, to analyze the logistics environment the parameter of “number of airports per 1,000 sq km” is used. A country should at least provide 1.5 airports to support foreign companies with sufficient facilities to ship goods from outside the country. A ratio of less than 0.7 airports indicates that there is
a lack of transport facilities in the respective market. Therefore companies need to establish own facilities locally to adequately serve the local demand.

- **Location / Accessibility**: In this context the geographical site of a country is examined. Optimal accessibility to support an exporting strategy is given, when a country displays multiple transportation possibilities, such as access to the sea, a well-established highway-network, sufficient number and spread of airports and a modern rail network. A country lacking most of those aspects mentioned above seems to rather support a local production strategy.

All the factors presented in this chapter influence the market potential of a firm facing the decision for an entry mode. The market potential directly depends on population (how many potential customers will there be?) and wealth (how many of them can afford the products?), but indirectly it depends on much more: the political, economical, socio-cultural, technological and logistics factors discussed above. In general, one can state that firms tend to export to markets with a rather low potential for sales and invest in a market with a high sales potential. Given a high sales potential, transportation costs and tariffs - which would arise when exporting - are saved and full control over the assets is given (cf. Brassington et al. 2007, p.434).

In the following third chapter the respective factors will be applied to the target countries of concern - the Czech Republic, the Slovak Republic, and Hungary - in order to come to a meaningful conclusion.
3 Extended PEST-Framework Defining the Optimal Entry Mode

After having discussed the relevance of this study paper (Chapter 1) and having built the theoretical foundation to this study paper’s topic (Chapter 2) this chapter is going to deliver a holistic approach to analyze the general environment of the countries in the center of this work (Czech Republic, Hungary, Slovak Republic). Recent developments, giving rise to the importance of those markets especially to European corporations, have been outlined in the course of this paper. Different entry modes have been analyzed in terms of their advantages and disadvantages as well as related risks and opportunities. A framework on the proper entry mode decision, using parameters from the general environment, has been introduced and the optimal specifications, favoring any of the two possible entry strategies, have been defined. At this point, after having applied this framework to the three countries in center of this work, the authors of this paper will present the results to demonstrate trends in the respective countries’ general environment that support any type of entry mode. The analysis thereby is subdivided into the five different fields of study described in the last chapter, explaining and comparing the results for each parameter and each country. The chapter will close with a graphical summary of the actual findings.

3.1 Political Factors in the Selected Countries

As in terms of the political factors the three Eastern European countries in general show strong similarities, it seems appropriate to present the particular outcomes in context (Exhibit 14 on p. 23 provides a first overview).
Concerning subsidies the given results indicate differences between the three countries in terms of governmental intervention into free market competition. Whereas the Slovak republic presents a relatively low share of subsidies to total GDP over the analyzed period (0.50 % in 2007; Ranking 18th in Europe), Hungary displays a comparatively high rate of 1.42 % in 2007 (Ranking 1st in Europe). Especially subsidies in the agricultural sector, used to artificially increase the competitiveness of such products, seem to be the reason for this. Those subsidies already led to an international dispute filed by the world trade organization against the Balkan state and they still reside on an above-average level compared to the other European countries (cf. World Trade Organization 2009). Nevertheless, both countries show a positive tendency in lowering the share of subsidies by having reduced governmental supports over the last years significantly, probably due to pressure by the European legislative to a certain extent (see Exhibit 14). Still, as the figures in Exhibit 14 indicate, this parameter supports an export strategy in the Slovak Republic, as foreign businesses in general do not have to fear price and profitability disadvantages compared to local products. In Hungary, on the contrary, a local production strategy seems to be encouraged to profit from potential applicable subsidies in order to be competitive in this particular market.

Regarding the situation in the Czech Republic, a relatively average level of applied subsidies is indicated, as the Czech Republic is to be found in the middle of the European subsidies ranking in 2007, occupying the 9th rank. Hence according to the defined optimal specifications for this parameter no evidence for any of the two strategies is to be found at this point. However, when analyzing the development of those governmental supportive activities, startling movement can be detected with the share of subsidies increasing from 0.60 % in 2005 to 0.73 % in 2007 (see Exhibit 14): Political Factors - Results for the Selected Countries
Exhibit 15). When including the increase in absolute real GDP in the Czech Republic this indicates a tendency of the Czech government to follow a protective strategy in certain economic areas. Therefore, in this point, companies should monitor the actual development closely, as subsidies in the near future might reach a level favoring a local production strategy.

Regarding the federal trade commission in each of the three nations of interest the historical developments described above had a major impact. After having joined the European Union on May 1st, 2004 the Czech Republic, Hungary and the Slovak Republic not only were allowed to benefit from all the amenities linked to this real common market, but as well had to adjust their own national legislative to fit the requirements regulated by the officials in Brussels concerning trade barriers in international trade. Hence, having largely implemented the EU’s external trade policy, those three countries can be classified as having a relatively liberal federal trade commission and only few trade barriers for imports, especially when focusing trade partners within the Union. An exporting strategy, in this context, therefore seems to be supported for all three countries. Nevertheless, as the European Union, from an external point of view, is a customs union, each member state has to apply mandatory tariffs and duties for certain goods entering the European Union from outside. Thus, the result of this analysis for the three countries concerning these factors might not be valid for companies based outside the European Union. In summary, all three countries show a similar tendency for the entry mode decision in evaluation of

Exhibit 15: Subsidies in % of GDP per Year in the Czech Republic

Regarding the federal trade commission in each of the three nations of interest the historical developments described above had a major impact. After having joined the European Union on May 1st, 2004 the Czech Republic, Hungary and the Slovak Republic not only were allowed to benefit from all the amenities linked to this real common market, but as well had to adjust their own national legislative to fit the requirements regulated by the officials in Brussels concerning trade barriers in international trade. Hence, having largely implemented the EU’s external trade policy, those three countries can be classified as having a relatively liberal federal trade commission and only few trade barriers for imports, especially when focusing trade partners within the Union. An exporting strategy, in this context, therefore seems to be supported for all three countries. Nevertheless, as the European Union, from an external point of view, is a customs union, each member state has to apply mandatory tariffs and duties for certain goods entering the European Union from outside. Thus, the result of this analysis for the three countries concerning these factors might not be valid for companies based outside the European Union. In summary, all three countries show a similar tendency for the entry mode decision in evaluation of

Exhibit 15: Subsidies in % of GDP per Year in the Czech Republic
the political parameters as described above. As Exhibit 16 shows, in all three cases political factors seem to rather back an exporting than a local production strategy.

**Exhibit 16: Framework on Entry Mode - Political Factors**

### 3.2 Economical Factors in the Selected Countries

While the political factors considered in this analysis draw a relatively similar picture for all three countries concerning the right entry mode, an examination of the economical parameters used shows different results. When focusing on the **GDP growth per year** as an indicator for the favorable entry mode, the figures reveal that the Czech as well as the Slovak Republic show enormous future market potential, even though they rank within the lower third of the European countries in terms of GDP per capita in PPS (see Exhibit 17).

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<td></td>
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<td>CZK / 3.5%</td>
<td>CZK / 4.5%</td>
<td>CZK / 3.25%</td>
<td></td>
</tr>
<tr>
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<td>94.3</td>
<td>102.7</td>
<td></td>
</tr>
<tr>
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<td></td>
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<td></td>
</tr>
<tr>
<td>GDP Growth</td>
<td>3.50%</td>
<td>4.00%</td>
<td>1.00%</td>
<td>0.60%</td>
<td>64.4 (25th)</td>
</tr>
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<td>HUF / 9.0%</td>
<td>HUF / 8.5%</td>
<td>HUF / 10.5%</td>
<td></td>
</tr>
<tr>
<td>Labor Costs**</td>
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<td>99.3</td>
<td>97.1</td>
<td>102.1</td>
<td></td>
</tr>
<tr>
<td><strong>Slovak Republic</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP Growth</td>
<td>6.70%</td>
<td>8.50%</td>
<td>10.60%</td>
<td>6.20%</td>
<td>72.2 (23rd)</td>
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<tr>
<td>Currency / Interest Rate*</td>
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<td>€ / 5.75%</td>
<td>€ / 3.5%</td>
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<tr>
<td>Labor Costs**</td>
<td>n/a</td>
<td>90.1</td>
<td>97.0</td>
<td>102.0</td>
<td></td>
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</table>

*Interest Rate of Central Banks - Annual Basis
*Q4 - Index: Germany Q3 2008 = 100.0 (Ω Labor Costs / Hour)

**Exhibit 17: Economical Factors – Results for the Selected Countries**

When excluding the year 2008, as it was the year of the financial crisis, both countries display a GDP growth rate significantly above 6.0 %, suggesting that both countries will continue to advance rapidly. Thus, due to this supposable positive development, in both countries a local...
production strategy seems to be supported. From this point of view companies thinking about entering these markets should think of establishing own sights locally to gain rapid awareness for their brands and products to forestall competition and reach a state of market domination in their respective industry.

In contrast, the situation in Hungary appears different. GDP growth in the Central Eastern European state declined sharply in 2007 to 1.0% after ranging at an above-average level in the antecedent years. In the first year of the financial crisis its growth rate even declined to 0.6%, indicating that Hungary’s economy almost stagnated (see Exhibit 17 on p. 25). This low growth rate is mainly owed to the high leverage and public expenditure in the past, forcing the Hungarian government to implement a restrictive economical and financial policy by increasing taxes, cutting subsidies and modifying infrastructure investments. For this reason private and corporate consumption dropped significantly, especially in 2007 (cf. FAZ.net 2008). When additionally considering the low GDP per capita in PPS (Rank 25 in Europe 2008) the relatively small market potential available to foreign companies gets obvious. Therefore, an exporting strategy seems to be supportive for companies to serve this rather small market as larger investments will not deliver a satisfactory return.

Using the second economical parameter, “Currency / Interest Rate” and focusing on businesses within the European Union, there is no exchange rate fluctuation to be found in the Slovak
Republic, as it is a member of the European Currency Union. Thus, the criterion of a stable currency (in a European context) is met. When including the relatively high interest rate set by the National Central Bank of the Slovak Republic (see Exhibit 18 on p. 26), hinting at a relative expensiveness of capital in this country, it can be reasoned that an exporting strategy is rather supported by this factor. In Hungary the results to this parameter do not support any of the two strategies. On the one hand, displaying a steady high central bank interest rate over the last four years, it seems that debt capital is too expensive in this country to build own facilities locally, as this terminates the benefits from a possible leverage effect (see Exhibit 18 on p. 26). On the other hand, a local production strategy is supported by a moderate exchange rate fluctuation over the last few years, which might stress a company’s profitability situation by incurring additional costs of currency losses (for exchange rates cf. European Central Bank 2009). In case of the Czech Republic a local production strategy is backed by this parameter. A steady low interest rate level indicates the relative cheapness of debt capital, indicating that the benefits of a possible leverage effect can be realized by businesses re-financing themselves locally (see Exhibit 18 on p. 26). Additionally, the relative fluctuation of the Czech Koruna suggests that serving the market by exports might contain possible significant currency losses.

When considering the last of the three chosen economical indicators, the labor costs, all three countries again display similar results. Comparing the relative labor costs per hour in the fourth quarter of 2008 to those of Germany in the third quarter of 2008, a relative expensiveness of labor in all three countries is presented (see Exhibit 19 on p. 28).
With the Czech Republic (7th), Hungary (9th) and the Slovak Republic (13th) ranking amongst the upper half of all European countries in terms of this parameter, it gets apparent that a local production strategy does not seem appropriate, as there is high probability that companies might be able to produce their products relatively cheaper in other locations. Consequently for all three Eastern European countries an exporting strategy is supported in this point.

In conclusion it can be said that the economical parameters show different results for the three countries. Whereas for the two countries of Hungary and the Slovak Republic, with deductions, an exporting strategy rather is supported by the parameters used, in the Czech Republic the conditions described before rather seem to favor local production, especially in terms of GDP growth, currency stability and interest rate (see Exhibit 20).
3.3 Socio-Cultural Factors in the Selected Countries

Regarding the socio-cultural parameters analyzed in the course of this work, again a relatively analogous development in all three countries can be observed. When evaluating the income distribution of the respective countries by using the Gini coefficient as an indicator of the possible market size, all three countries display a very even distribution of wealth. With the Czech Republic (7th in 2008), Hungary (5th) and the Slovak Republic (3rd) all ranking amongst the top quarter of all European countries, it can be said that a relatively large share of the respective population earns the majority of income (see Exhibit 21). With this relatively large portion of people having a similar purchasing power, it becomes clear that any product meeting the needs of those people has a fairly high market potential. For this reason producers might favor a local production strategy in order to utilize this potential in an optimal way through physical closeness to those customers.

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<tbody>
<tr>
<td>Czech Republic</td>
<td>Income Distribution*</td>
<td>0.26</td>
<td>0.25</td>
<td>0.25</td>
</tr>
<tr>
<td></td>
<td>Education**</td>
<td>87.9%</td>
<td>86.9%</td>
<td>87.0% (Low)</td>
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<td></td>
<td>Cultural Distance</td>
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<td></td>
</tr>
<tr>
<td>Hungary</td>
<td>Income Distribution*</td>
<td>0.28</td>
<td>0.33</td>
<td>0.26</td>
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<td></td>
<td>Education**</td>
<td>79.3%</td>
<td>82.2%</td>
<td>83.0% (Medium)</td>
</tr>
<tr>
<td></td>
<td>Cultural Distance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>Income Distribution*</td>
<td>0.26</td>
<td>0.28</td>
<td>0.24</td>
</tr>
<tr>
<td></td>
<td>Education**</td>
<td>81.4%</td>
<td>82.4%</td>
<td>83.2% (n/a)</td>
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<tr>
<td></td>
<td>Cultural Distance</td>
<td></td>
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*Income Distribution = Gini Coefficient
**Education = Share of 18 yr-old in school to Total 18 yr-old

Exhibit 21: Socio-cultural Factors – Results for the Selected Countries

This tendency to favor a local production strategy by employing the parameter of income distribution is backed by the findings of this work concerning the educational level of the three Central Eastern European countries. Applying the share of 18-year-olds being in school to total 18-year-olds as the appropriate indicator to this, it can be said that the Czech Republic displays a high share (87.0 % in 2008) with Hungary and the Slovak Republic showing a marginally lower, but still decent share at around 83.0 % (see Exhibit 21). As these parameters point towards a
probable high supply of skilled labor in the respective countries, they rather encourage a local production strategy, as companies might be interested in exploiting those available skills.

Having been stated before, cultural distance is another important socio-cultural factor to be considered while searching for the right entry mode strategy. Unfortunately, the research work of G. Hofstede did not include the Slovak Republic. Therefore this country is not incorporated in our analysis of cultural distance in this work. Concerning the two remaining countries the results in this context are fairly unlike.

Whereas the Czech Republic only shows significant deviations to the German results in terms of the acceptance of power being distributed unevenly and thus displays a relatively low cultural distance to the Western European country, the results for Hungary indicate noteworthy differences. Especially when considering the Masculinity Index, Hungary seems to be far more dominated by a male world view (see Exhibit 22). Due to those differences, there seems to appear the need for businesses willing to serve the Hungarian market with their products to establish sufficient physical closeness, as there is a high probability that products need to be adapted to the differing needs of the local population. So a local production strategy for Hungary should be favored in this context. In contrast, as the Czech Republic and its population appears relatively similar to Germany, no or only little product adaptation is needed. Therefore companies might rather choose to serve this market by exports as they can expect its products to be accepted and appreciated in the foreign country as well.
In terms of the results to the socio-cultural factors influencing the decision on the optimal entry mode terminally it can be said that for all three countries the parameters used rather support a foreign production strategy (see Exhibit 23): In all countries income appears to be distributed evenly and a high standard of education is given. The only parameter behaving conflictive is that of cultural distance that might make marketers think about an exporting strategy regarding the Czech Republic.

### 3.4 Technological Factors in the Selected Countries

Another important field of the general environment driving the entry mode decision for corporations is the technological situation to be found in the market of interest. When focusing on the chosen nations, the three parameters analyzed indicate conditions supporting different entry mode decisions for each. Using the first parameter, the **public funds** allocated by the national governments to research and development projects, Hungary (1.0 % in 2008) and the Czech Republic (1.47 %) present a relatively high share of those funds in the annual total GDP, which appears comparatively stable historically (see Exhibit 24 on p. 32). Thus, when applying the defined specifications favoring one or the other market entry strategy, it can be said that with both countries displaying a share above 0.8 % of total annual GDP over the period of interest a local production strategy is indicated. Companies trying to utilize state-of-the-art technology, processes and products should monitor those markets closely, where there are relatively high subsidies in this area to be found, as this financial aid suggests that scientific leaders seem to apply the latest methods and technology to improve the quality of their research projects.
### Exhibit 24: Technological Factors – Results for the Selected Countries

In contrast, the Slovak Republic displays a relatively stable low share of public funds for R&D granted by the national government below 0.5% of total GDP (see Exhibit 24). Thus an exporting strategy seems to fit because only little governmental support for innovative research projects is to be found, suggesting that probably no pioneering inventions will be made in this country in the near future.

When considering the second parameter in this field, i.e. the annual number of **patent applications** per Mio inhabitants at the **European Patent Office**, the results of this analysis draw a contradictory picture in the case of Hungary and the Czech Republic. With all three countries presenting a rate significantly lower than 85.0 patents per year in 2005 and 2006 and therefore residing amongst the lower third of all European countries seen from this angle, a direct relation between funds, granted by the government for R&D projects, and innovative outcomes on a national basis seems to be disproved (see Exhibit 24). When applying the specifications defined for this parameter, hence, an exporting strategy seems to be supported in all three countries, as only very few innovative results can be expected, when participating in R&D projects locally. Therefore, a stronger commitment to one of these markets does not seem to deliver sufficient strategic benefits.

A third parameter in this field, important to marketers when deciding about the right market entry mode, is the **accessibility of consumers via World Wide Web** as it implies whether modern advertising tools, such as website ads, or rather traditional approaches to advertising, which require deeper insights into consumer behavior patterns, produce the desired outcomes. When analyzing the resulting values for the three Central Eastern European countries for this parameter,
using the defined specifications, all three obviously support neither a local production nor an exporting strategy. With all three presenting values between 45.0 % and 60.0 % in 2008 they are to be found in the medium range of the axis (see Exhibit 24 on p. 32). Still, with the Slovak Republic displaying a value of 58.0 % in 2008 and thus having the highest share of web users, this market apparently is the relatively most appropriate for modern advertising tools in the context of our analysis.

Taking into consideration the positive development in this parameter, all three countries have run through in the period of interest, one can see that it will only take a few more years until they reach a level of above 70.0 % (see Exhibit 25). Then, applying the before defined specifications for this parameter, an exporting strategy seems to be supported, as consumers can be approached efficiently, when using modern advertising tools.

Summing up the findings concerning the technological situation given in the countries of interest, one can say that, even though the parameter of public funds for R&D supports a local production strategy in the Czech Republic as well as in Hungary, in general an exporting strategy for all three seems supported, especially when considering the low number of patents resulting from this relatively high financial aid granted and the positive development in terms of web access for consumers.
3.5 Logistics Factors in the Selected Countries

Being the last field of interest in the context of this framework this section provides the results for the logistics factors in the selected countries in terms of the right entry mode decision. Unfortunately, when focusing on the first parameter used, i.e. the public expenditure on transport infrastructure in % of GDP, no information is to be found for the Slovak Republic, when using the database of the European statistical office. For the remaining two countries similar outcomes can be observed. Both, the Czech Republic as well as Hungary, display a relatively high share of infrastructure expenditure of more than 1.0 %, having them rank amongst the top five European countries in this aspect in 2007 (See Exhibit 26). Assuming that these steady high investments result in a well-established transport network, it can be said that for both countries an exporting strategy seems supported, as there should appear no or only few barriers to any logistics process, when shipping products from foreign manufacturers to end-consumers.

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<tr>
<td><strong>Czech Republic</strong></td>
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</tr>
<tr>
<td>Public Expenditure Transport Infrastructure (in % of GDP)*</td>
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<td>2.5%</td>
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<td><strong>Hungary</strong></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Public Expenditure Transport Infrastructure (in % of GDP)*</td>
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</tr>
<tr>
<td><strong>Slovak Republic</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public Expenditure Transport Infrastructure (in % of GDP)*</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td># of Airports / 1,000 sq km**</td>
<td>n/a</td>
<td>n/a</td>
<td>0.9 (2009)</td>
<td>n/a</td>
</tr>
<tr>
<td>Location / Accessibility</td>
<td>Easy (on an EU base)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: Eurostat  
**Source: CIA - The World Factbook

Applying the second parameter, i.e. the number of airports per 1,000 square kilometers, the findings for Hungary seem to be contradictory to those when applying the parameter of public infrastructure expenditure. Whereas the infrastructure expenditure parameter suggests a well-established transport network and thus supports an exporting strategy, this second parameter appears to be only 0.5 airports per 1,000 sq km in 2009 (see Exhibit 26). As this value is below the before specified 0.7 airports, this factor supports a local production strategy. Hungary does not offer enough airports to serve all different regions of the country using air cargo. Thus companies, dependant on rather short lead times, seemingly have few opportunities to design
distribution processes in this country properly. Nevertheless, as Hungary displays this high public expenditure on infrastructure, it is indicated that other areas of transport, such as highway and rail networks, receive a higher share. Companies, not dependant on short lead times, thus seem to find a rather sophisticated transport network in Hungary. Concerning the number of airports per 1,000 sq km the Slovak Republic shows a similar tendency. With a rate of 0.9 airports this country also lacks the capacities to provide short lead times for all its regions. Hence, again, a local production strategy is indicated. In the Czech Republic the situation appears different. With a rate of 1.6 airports per 1,000 sq km in 2009 this country is similarly endowed with air transportation facilities as Germany (1.5 airports; cf. CIA World Factbook 2009). No difficulties in guaranteeing short lead times, when depending on air cargo, should appear in this respective country. When applying the decision framework, thus an exporting strategy is backed by this factor.

The last factor in terms of logistics is “Location / Accessibility”. This factor is rather a qualitative measure of the ease of entering and transporting to a certain market, comprising of several factors, which in part were already discussed before. Taking the European view to this factor, the results for all three countries appear similar (see Exhibit 26 on p. 34). Being located in Central Europe with several adjoining countries to each, optimal preconditions for accessibility seem to be given not only to the respective countries but as a bridge stone to the Eastern part of Europe and Asia. When including the membership of all three to the European Union this fact gets even more obvious, as a common legislative for transport methods and facilities is shared, guaranteeing a certain set of rules and standards. Additionally, the relatively high share of public transport expenditure of those countries described before facilitates their accessibility. Regarding Hungary and the Slovak Republic slight deductions to this factor are indicated by the relatively low endowment with airports.

In summary it can be stated that the logistics factors again rather support an exporting strategy, as all three countries display a relative ease of accessibility, backed in the Czech Republic and Hungary by a high share of public expenditure on infrastructure investments (see Exhibit 27 on p. 36). In terms of endowment with air cargo facilities some deductions to this have to be conceded in Hungary as well as the Slovak Republic. Still, in general, their location in Central Europe and membership to the European Union confirm these findings.
Having examined the complete framework on entry mode decision by analyzing the defined factors of the prevailing general environment to be observed in the three countries, chapter 4 is going to finally present the results of this analysis in a consolidated manner. Additionally, recommendations on the right entry mode for all three countries will be provided as well as a moderate forecast on future developments.
4 The Extended PEST-Framework as a Starting Point to Define the Proper Entry Mode

Having discussed all five fields of the extended PEST framework on the entry mode decision in detail, somewhat different conclusions can be drawn concerning the right entry mode for the three countries in center of this analysis (as can be seen in Exhibit 28 as well). On the one hand, the Slovak Republic appears to be perfectly suited for companies thinking of serving this market by an exporting strategy. Especially in terms of the political situation given in this country, with a relatively low share of subsidies, few trade barriers and a liberal federal trade commission, this strategy of market entry seems to be promoted. Additionally, when taking the European view, the implementation of the Euro currency, a relatively easy accessibility and comparably high labor costs tighten this opinion. Finally, a relatively low governmental commitment to and professional work on innovations in the technology sector does not support any stronger market commitment in this particular market.

Exhibit 28: Summary Framework on Entry Mode

The second market, which rather promotes an exporting strategy in the context of its general environment, turns out to be the Czech Republic. Displaying a political situation similar to the Slovak Republic, as being member of the European Union combined with high public
expenditure on logistics infrastructure and an easily accessible geographical location, the accuracy of this evaluation gets obvious. Relatively high labor costs and a very low cultural distance add to this, as it is suggested that no or very little product adaptation is necessary to meet the underlying consumer needs in this market. Therefore products should be manufactured in relatively cheap locations - especially when those products are labor-intensive - and then be shipped to the Czech Republic. Particularly economical factors, nevertheless, contradict to this market entry mode, as the Czech Republic displays a continuous high GDP growth rate and a relatively even distribution of income, which indicates that there will be huge market potential in this particular state future wise. Being present in this market by setting up own facilities might give a company certain advantages, such as brand awareness and higher market share in an ever growing market. Additionally, the fact of having its own currency, which has developed somewhat instable in the past four years, might incur additional costs of currency losses, when applying an exporting strategy. As the majority of factors in this analysis support the entry mode of exports, it still seems appropriate in this context to state that rather an exporting strategy is backed by the general environment in the Czech Republic.

In case of Hungary the situation is rather unsettled. On the one hand, Hungary is a member of the European Union. Thus, only few regulatory interventions in terms of international trade can be observed. After having implemented the trade policy, which has been developed by the European officials, one can say that the liberality of Hungary’s federal trade commission increased substantially, especially in terms of tariffs and customs. When adding the low annual GDP growth rate as well as the comparatively high labor costs in the Central European state, it gets obvious that many important aspects seem to favor an exporting strategy for Hungary as well. But a significant number of the parameters used in this particular framework rather contradict this interpretation. Hungary still ranks amongst the European countries with the highest share of subsidies to annual GDP, indicating that its trade commission still lacks liberality compared to the other countries of the “old” continent. Additionally, the Hungarian Forint lacks stability, which might cause a significant loss on foreign exchange, when using exports to serve this market. Most notably, the socio-cultural factors in Hungary seem to conflict an exporting strategy. A relatively low Gini coefficient indicates a very even distribution of income amongst the inhabitants of this region, suggesting a relatively large, possible future market size and thus
supporting a higher market commitment and investment. A high rate of 18-yr-olds still in school hints at an abundance of highly-skilled labor, which might be utilized by setting up own facilities locally. A significant dissimilarity in terms of cultural distance between Hungarians and Germans as well hints at the fact that deeper market insight through physical closeness might be required to be successful in it. Finally, high public funds for R&D and an insufficient number of airports in this country reveal chances in the technological sector, waiting in this country, as well as weaknesses to be faced within distribution processes that might require local production facilities to keep short lead times.

As the situation in the general environment of Hungary already indicates, the framework established in this paper cannot ultimately answer the question of which entry mode to choose. As said before, other factors besides those included in our framework can be major determinants of the fitting entry mode. Those additional factors are to be found both in the external environment, when analyzing the competitive environment given in the particular country of interest, and inside the company itself, when analyzing the internal conditions and capabilities (see Exhibit 29 on p. 40; cf. Hollensen 2007, p. 298).
Concerning the competitive environment a diverse number of factors need to be included in a holistic analysis to come to a deliberate decision about which market entry mode is the appropriate one. Especially the factor of the intensity of rivalry amongst competitors in any industry in a given country appears to be a central determinant to any company. Hence, parameters like the speed of industry growth, the importance of fixed costs and economies of scale and the degree of differentiation amongst different competitive products in a particular market need to be assessed by marketers to understand the dynamics in a given industry, which largely decide about the profitability of any entry mode decision (cf. Henry 2008, p. 76).

Additionally, other forces besides the industry rivalry should be included to assess the competitive environment. The situation of relevant local suppliers in a certain industry as well as their relative position in terms of bargaining power might support any of the given entry modes. The bargaining power of consumers in a given country might be so high that this particular market appears to be unattractive to enter it by setting up own facilities, as prices are very low and therefore do not provide any sufficient level of profitability justifying high investments.
Scarcity or abundance of substitute products as well might hint at a certain entry mode to be favored. In general, companies that face intense competition, powerful suppliers as well as consumers and a large number of substitutes available tend to avoid internalization, as entry modes that involve low resource commitment promise a higher profitability level. On the other hand, factors such as a relative scarcity of export intermediaries might force a company to set up own facilities locally, if it wants to serve the market with its products (cf. Hollensen 2007, p. 301).

In terms of the internal environment faced by any company factors to be used to decide upon the right entry mode for a given market might include the actual firm size as well as its financial and resource situation, the international experience of the company’s labor force and the actual characteristics of the product, which is to be marketed internationally (cf. Hollensen 2007, pp. 298-299). Companies, even when willing to exert a high degree of control on its foreign operations, might be hindered by an insufficient endowment with both, financial and physical resources and thus might be forced to rather apply an exporting strategy to serve international markets. Low international experience as well seems rather to support an export entry mode, as a high degree of uncertainty and risk of failure appears to be associated with it. Therefore companies will tend to use entry modes with lower resource commitment in the beginning of the internationalization process to reduce possible costs of failure. The physical characteristics and the complexity of the firm’s product itself also can influence the decision on the right entry mode significantly. Even when facing a general and competitive environment, which is clearly supporting an exporting strategy, the particular product characteristics might force the company to decide differently, for example when shipping costs for a certain type of product are too high to provide sufficient profitability, when exporting. As well, a product, which appears to be very complex in terms of its handling and construction, might force a manufacturer to set up own plants and service centers in the respective destination country to provide a high service level and customer satisfaction.

As indicated by the above mentioned factors, to evaluate the business situation in any of the three countries - the Czech Republic, Hungary and the Slovak Republic - correctly and to minimize the risk of market failure, all three different environments (General, Competitive and Internal) need to be considered and assessed. As company- and industry-specific factors are relevant in the
course of such an evaluation, results will vary across different companies, depending on factors such as its particular product as well as the degree of rivalry given in the respective local industry. Nevertheless, as has been stated before, the general environment in any given country appears to be rather stable in contrast to the other two environments. This means that the specifications found in this area in a country will not change when assessing different companies from different industries. Hence, the extended PEST framework, established in this study paper, can be utilized as a starting point for any business in evaluating the attractiveness of a given market and to decide upon the right way of entering it.

Still, considering the application of the framework created in this paper, it needs to be clarified again that the findings and parameters have been assessed from the European point of view. Thus, the results and interpretations of the different parameters in the context of this work might not appear to be valid for companies from outside Europe, as for example a different tariffs structure, set by the European Union, might be applicable. Also the accessibility and location of the three countries might be interpreted differently by a Chinese corporation analyzing the attractiveness of those three markets. Nevertheless, companies from outside Europe might utilize this framework to come to a conclusion from their point of view.
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Declaration of Authorship

We, Stefan Ruh and Michael Heilmann, declare that the thesis entitled

Exporting as a Strategy to Enter Eastern European Markets, taking Hungary, the Czech Republic, and the Slovak Republic as examples

and the work presented in the thesis are both our own, and have been generated by us as the result of our own original research. We confirm that:

- this work was done wholly or mainly while in candidature for a research degree at this University;
- where any part of this thesis has previously been submitted for a degree or any other qualification at this University or any other institution, this has been clearly stated;
- where we have consulted the published work of others, this is always clearly attributed;
- where we have quoted from the work of others, the source is always given. With the exception of such quotations, this thesis is entirely our own work;
- we have acknowledged all main sources of help;
- Where the thesis is based on work done by ourselves jointly with others, we have made clear exactly what was done by others and what we have contributed ourselves;
- None of this work has been published

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(Michael Heilmann) (Stefan Ruh)