

## **7. THE ROLE OF ENTREPRENEURIAL ACTIONS IN THE DE-INTERNATIONALIZATION OF ESTONIAN ENTERPRISES: ENTREPRENEURS' PERCEPTIONS<sup>1</sup>**

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### **Abstract**

The purpose of this chapter is to identify the role of entrepreneurial actions in the de-internationalization of Estonian manufacturing enterprises. There are three main groups of reasons behind de-internationalization – lack of international experience, a change of strategy, and an increase in production costs or poor performance –, and the influence of entrepreneurial activities varies for each case. The results of three case studies that are employed in the chapter suggest that in the case of Estonian manufacturing firms the focus has shifted from those reasons of de-internationalization where entrepreneurial actions are influential towards the one where strategic actions dominate. The case studies also indicated that the relationship between entrepreneurial actions and de-internationalization is not unidirectional since de-internationalization can often lead to intensified entrepreneurial activities.

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<sup>1</sup> This chapter has been prepared with financial support from the Estonian Ministry of Education (Grant TMJR10107) and Estonian Science Foundation (Grant 5840).

## Introduction and theoretical foundations

Entrepreneurship and internationalization have both enjoyed considerable research attention but until the 1990s there were only a few contributions that integrated these two approaches. By now globalization processes have fostered integration of these two strands of literature and research in the field of international entrepreneurship (Fletcher, 2004; Giamartino *et al.*, 1993).

The definition of entrepreneurship suggests that this is a context-specific social process that leads to creating wealth by exploiting marketplace opportunities with unique packages of resources (Ireland *et al.*, 2001). Some authors stress the importance of innovation, proactiveness and risk-taking in explaining the nature of entrepreneurship (Kreiser *et al.*, 2002). In this context, international entrepreneurship can be defined as “a combination of innovative, proactive, and risk-seeking behaviors that crosses national borders and is intended to create value in organizations” (McDougall and Oviatt, 2000).

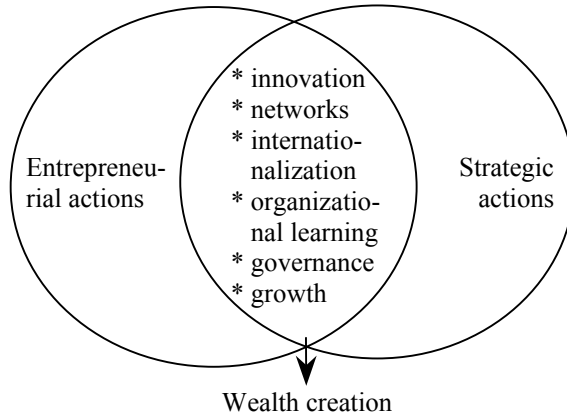
Opportunities for wealth creation are influenced by entrepreneurial and strategic actions. There are six domains that are all dependent on entrepreneurial and strategic actions and can contribute to a firm’s growth (see Figure 1). Strategic actions are related with establishing and exploiting competitive advantages within a particular environmental context, while entrepreneurial actions comprise search for new advantages (Ireland *et al.*, 2001).

Most of the research on international entrepreneurship concentrates on positive developments in internationalization when a firm increases its commitment to international markets (Fletcher, 2004; Geursen and Dana, 2001). However, the objective of wealth creation can also lead to de-internationalization<sup>2</sup> activities in order

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<sup>2</sup> Benito and Welch have suggested that de-internationalization is “any voluntary or forced action that reduces a company’s engagement in or exposure to current cross-border activities” (Benito and Welch, 1997).

to close down these operations that are not profitable or show poor operating results. Moreover, globalization processes have forced enterprises to re-evaluate their internationalization strategies and activities, having thus in many cases caused de-internationalization activities.



**Figure 1.** Creating wealth through entrepreneurial and strategic actions (Ireland *et al.*, 2001).

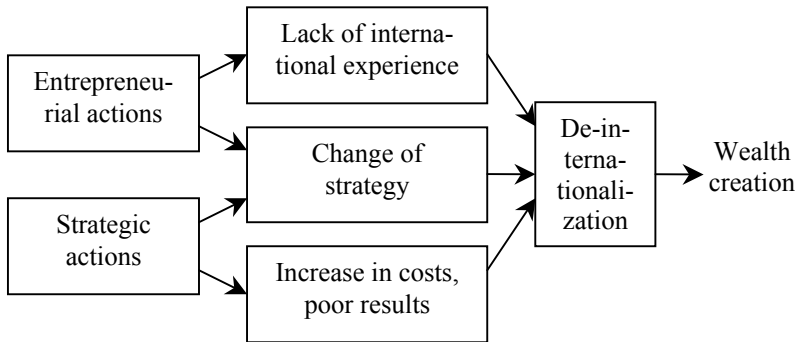
Estonia is a small transition country that has relatively modest experience in the fields of both internationalization and entrepreneurship. In the case of Estonia, before 1991 all foreign trade was coordinated by Moscow and so knowledge of foreign activities was absent in this newly independent republic at the beginning of the 1990s. Moreover, there was not only lack of foreign market experience, but also lack of knowledge of the local market and tradition of entrepreneurship. At the same time, due to globalization and integration, most firms in transition economies are experiencing pressure to internationalize (Svetličič and Rojec, 2003). However, lack of experience and pressure to find markets for their products abroad may easily result in wrong decisions, causing de-internationalization.

This chapter attempts to identify the role of entrepreneurial actions in the de-internationalization activities of Estonian manufacturing firms. The analysis is based on three interviews that were completed in 2004.

Previous research has identified three main groups of reasons behind de-internationalization, namely, lack of international experience, a change of strategy, and an increase in production costs and/or poor performance (see Reiljan 2004 for a thorough discussion).

De-internationalization due to the lack of international experience is likely to be the result of entrepreneurial actions (see also Figure 2). It is claimed that entrepreneurial actions comprise those that are related to exploitation of the new opportunities in terms of markets, customers or resources, and these can be often viewed as experiments (Ireland *et al.*, 2001). On the basis of the research of export withdrawals Welch and Wiedersheim-Paul (1980) argue that there is clear evidence that first export attempts are often experimental in their nature and thus a failure or withdrawal from exporting after having made a start is in many cases inevitable. Therefore, experimental behavior and sporadic export activities that are the results of entrepreneurial actions at the international level may cause de-internationalization.

Entrepreneurial actions likewise have an influential role in the case of those de-internationalization activities where a change of strategy can be identified as the main reason. In this case, an entrepreneur has found new opportunities in the foreign markets (Benito, 1997) or in the home market (Elango, 1998) and is eager to exploit them instead of the existing ones. This, in turn, will lead to changes in strategy and strategic actions, since the present operations have to be re-evaluated and some of them have to be closed down in order to enhance wealth creation and effective use of resources. Therefore, a combination of entrepreneurial and strategic activities needs to be applied in the case of de-internationalization activities that are caused by a change of strategy.



**Figure 2.** Linkages between entrepreneurial and strategic actions, reasons for de-internationalization, and wealth creation (compiled by the author).

Besides insufficient international experience and strategic considerations, poor performance is often mentioned as the most decisive determinant of divestments and export withdrawals (see, for example, Lindgren and Spångberg, 1981; Pauwels and Matthyssens, 1999; Tornedon and Boddewyn, 1974). In this case strategic activities lead to de-internationalization and entrepreneurial actions are not likely to be highly influential.

The following section of this chapter concentrates on analyzing the importance of entrepreneurial and strategic activities in the case of de-internationalization of three Estonian manufacturing companies. The case study method was selected since it enables us to provide in-depth information and the managers' opinions about their main motivations behind withdrawals from foreign markets.

## **Analysis of the reasons behind de-internationalization of Estonian enterprises**

This section of the chapter presents the results of three interviews that were conducted in 2004. Here Klementi represents the Estonian clothing industry that has targeted most of its production to the Baltic States and the Nordic countries. The second case company, Tarmeko, is a furniture manufacturer with huge production facilities inherited from the Soviet period that has redirected its foreign sales from Eastern to Western European markets. Finally, Tarkon is a manufacturer of fine mechanical components, its sales being highly dependent on long-term contracts and its activities tightly integrated with its customers.

In all the above cases the interviews were arranged with the persons who had been CEOs at the time of setbacks in foreign markets, had an ownership in the company and therefore knew the developments and main motivations behind the changes in international strategy. All the interviews were taped. The duration of the interviews was approximately one hour.

### **Klementi**

Klementi has a history that dates back to the year 1944 when it was established. It continued operation throughout the whole Soviet period. The privatization of the enterprise started in 1994 and was completed in 1997. Klementi has three main fields of activity – design, manufacture, and sale of ladies' wear. Besides its own production, it also provides subcontracting services. The firm started its international activities already before privatization. Its first trials were carried out in the Finnish and Swedish markets. It was apparent that the Estonian local market is too small and therefore, besides the Nordic direction, Klementi was also interested in entering Latvia and Lithuania. (Klementi Annual ..., 2001)

In the first stages of its international activities, Klementi faced problems due to its lack of experience. Especially difficult was the selection of distributors in foreign countries:

*The most difficult process is finding the right sales representatives for each market. For example, in Finland only the fourth distributor remained and we had good cooperation with him. In Sweden we had a friendly agreement to terminate the contract before deadline with one of our distributors. Of course, we had to pay quite a high compensation for that. With another one we had a lawsuit and had to drop it since the lawyer's fees would have been too high.*

Madis Võõras, Klementi

Thus, new possibilities were identified and entrepreneurial actions were taken but due to the lack of international experience, several short-term drawbacks occurred. Active search for new opportunities and clear dominance of entrepreneurial actions is also illustrated in the case of Klementi's experiences in Germany and Austria. In these markets the main problem has been that Klementi's production capacity is too small and its resources quite inadequate for product promotion. Therefore, entrepreneurial actions are not in accordance with the resources that the company possesses and this leads to de-internationalization:

*Germans said 3 years ago at a seminar that an Eastern European producer has to consider at least half a million euros, that is about 8 million kroons, per season per brand if it is interested in entering the German market. At the same time, Klementi's marketing budget was around 5 million kroons a year for promotion and all kinds of other things. /.../ We tried our luck in a number of places. We participated in fairs both in Germany and Austria. All our German sales were actually carried out via Austria. /.../ We had very good contacts with one married couple in Austria and they were very interested in selling our products and therefore we tried to enter the*

*German market, but regrettably it appeared that our capacity was too small. They also say clearly – if you are interested in selling, you have to promote. /.../ A wise businessman would not go and try the thing the potential success rate of which is relatively low, but at the same time, we had nobody to learn from. Experienced Finnish businessmen had an opinion that we wouldn't succeed, but we did not believe them.*

Madis Võõras, Klementi

The previously described incidents took place in the early stages of Klementi's international activities. On the other hand, Klementi has experienced de-internationalization in the later stages as well. First, due to the bankruptcy of its foreign owner, it was forced to withdraw from the Nordic markets for two seasons and re-entering was rather difficult. Secondly, in 2003 Klementi closed down its own retail outlet in Lithuania and switched to cooperation with the retail chain Apranga. Thus, de-internationalization because of change in strategy and therefore a combined effect of entrepreneurial and strategic actions is characteristic for Klementi's later international activities.

The importance of poor performance as a reason for de-internationalization has been modest so far; only a few withdrawals have taken place because of it. Madis Võõras from Klementi mentioned that they had to terminate one contract in Finland because of overly high provision and therefore low profitability of a contract.

To conclude, there have been different reasons for Klementi's withdrawals from foreign markets. In the earlier period, lack of experience and sporadic export activities were dominant and therefore the main motive seems to be inexperience. In the later stages, the influence of foreign ownership and changes in strategy prevailed. Therefore, if in the initial stages de-internationalization was caused by entrepreneurial actions, then in the later stages of Klementi's international operations it happened due to these reasons that are determined by strategic considerations.

## Tarkon

Tarkon was established in Tartu in 1907. During the Soviet period, “black boxes” or flight recorders for both civil and military aircraft were its main products. The privatization of Tarkon started in 1994 and was completed in 1996. (History of the ..., 2004)

Tarkon started its international activities after the dissolution of the Soviet Union with a few partners and simple production and has developed step-by-step. Its internationalization process has been relatively stable and changes have been mainly determined by external factors. For instance, export to Ireland was withdrawn since the production of a particular printer was transferred to America. The efforts to develop a new printer and all the incurring costs over two years turned out to be losses that both parties had to cover themselves.

Now there has been a major shift in Tarkon’s production portfolio since the company was forced to diversify its activities due to the recession in the world’s telecommunications sector. Before the crisis, they were tempted to enter the fast growing US telecommunications market. The plans to enter it were not entirely affected by the terrorist attacks as Americans had already decided that they were not going to switch to third-generation solutions. Due to the loss of the US market and a crisis in the telecommunications sector, Tarkon was forced to find new markets and competitive advantages within a short period of time:

*In a sense, there has been a change in strategy. In the beginning we were concentrating our efforts on the telecommunications sector and tried to develop this side. Changes in 2000 indicated that we had to diversify our activities in order to guarantee stability.*

Toomas Noorem, Tarkon

Hence changes in the world economy forced Tarkon to intensify entrepreneurial actions and find new opportunities in the other markets in order to guarantee wealth creation. This approach emphasizes that on the one hand, de-internationalization can be the result of entrepreneurial activities but on the other hand, it may induce entrepreneurial actions.

Lack of international experience and increase in production costs have had no significant impact on shaping the internationalization pattern of Tarkon yet. Therefore de-internationalization has not been due to purely entrepreneurial or strategic activities. However, increase in the importance of strategic activities is foreseen:

*The profitability of our activities is an important issue. I believe that we will restructure our activities in the future in order to guarantee sufficient and stable profitability.*

Toomas Noorem, Tarkon

To sum up, Tarkon's de-internationalization activities have been caused by a change in strategy. Therefore, both entrepreneurial and strategic actions have been taken. It is likely that in the future strategic actions will dominate over the entrepreneurial ones in Tarkon in deciding about de-internationalization.

## **Tarmeko**

Tarmeko is a furniture producer established in Tartu in 1947. It has 900 employees and belongs among the biggest manufacturing enterprises in Estonia. It produces solid pine furniture, office furniture, upholstered furniture, and form-pressed veneer. (Tarmeko, 2004) The enterprise was privatized in 1994 when 66.6% of the shares were sold to Estonian owners. This process was completed in 1997, when the remaining 33.4% of its shares were sold. (Lühiudised, 1997)

In the case of Tarmeko, there have been de-internationalization incidents both in the earlier and later stages of its international activities. The first wave of de-internationalization was definitely

not caused by lack of experience. Namely, withdrawals from the Russian and other CIS countries' markets were the result of low purchasing power and the influence of the Russian crisis on these markets was also apparent:

*In the Soviet time, we produced office furniture. There were three big producers and from our factory five railway carriages of furniture were sent out every day. After losing this market, we had to decide where to put this furniture. There were interested buyers in Russia but the terms of payment and bookkeeping in Russia was a total mess. They came here, put their dollars on the table and carried the furniture away. This was the only way to sell. /.../ During the Russian crisis only 10% of our production was sold in Estonia, all the rest went to other former member states of the Soviet Union. Suddenly, in two years this market just disappeared. /.../ It was difficult to find new markets so promptly. High instability, no experience ...*

Olev Nigul, Tarmeko

Here again, like in the previously described case of Tarkon, changes in market environment caused de-internationalization due to a change in strategy and therefore both entrepreneurial and strategic actions have been apparent. It has to be noted that the entrepreneurial actions were taken later, not prior to the de-internationalization. In search of new markets Tarmeko has had experiential export activities in a number of countries. From some of them it has de-internationalized due to its lack of international experience in selecting clients and the limited capacity of the firm:

*Dishonest clients often realize that we are not able to fight with them. In such cases we prefer termination of a contract. /.../ The other reason for terminating contracts has been that we do not have enough capacity to provide such big volumes as the client needs.*

Olev Nigul, Tarmeko

In the case of Tarmeko, low profitability and loss of competitive advantage based on low production costs can easily be considered the main reasons behind its withdrawal from some markets in the near future. In the case of Germany, there has already been a pressure to reduce the prices. Since 51% of Tarmeko's sales came from Germany in 2003, this will significantly influence the company's future strategic actions.

In conclusion, the first wave of Tarmeko's de-internationalization activities was caused by a change of strategy. This led to intensified entrepreneurial activities in order to find new possibilities in other foreign markets. This, in turn, caused the second wave of Tarmeko's withdrawals from foreign markets during which lack of international activities dominated as the main reason behind de-internationalization. It can be expected that in the future those de-internationalization activities that are caused by entrepreneurial actions will be supplanted by those caused by strategic activities.

## **Conclusion**

In the case of Estonian firms, the analyses of entrepreneurship and internationalization cannot be separated since both of them evolved simultaneously at the beginning of the 1990s, after the country-regained independence. Usually this kind of approach applies in the case of born globals, while in the case of other firms entrepreneurship leads to internationalization in the later stages of a firm's activities (see Fletcher, 2004).

Besides promoting wealth creation through internationalization, entrepreneurial activities can also lead to de-internationalization of companies. The role of entrepreneurial activities is likely to be most significant in the case of these de-internationalization incidents, in which lack of international experience is the main reason for withdrawals. It has the combined effect with strategic actions also in the case of de-internationalization due to a change in strat-

egy. In the case of withdrawals because of poor performance, strategic actions are likely to dominate.

The three case studies that were discussed in the previous part of this chapter indicated that both strategic and entrepreneurial activities have been apparent in the case of the de-internationalization of Estonian manufacturing companies. All three cases illustrate that a shift from these reasons of de-internationalization that are caused by entrepreneurial activities towards those ones where strategic considerations have the main role have taken place in the later stages of a firm's international activities. Therefore, the influence of entrepreneurial actions on de-internationalization of enterprises has a tendency to decrease over time.

The results of the discussion also suggest that de-internationalization activities can induce intensified entrepreneurial actions for detecting new possibilities in other markets or segments in order to promote wealth creation in the future. Therefore, the relationship between entrepreneurship and de-internationalization is not unidirectional. This aspect needs further attention in the future studies in this field of research.

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