

**Gabriele Suder
& Johan Lindeque**

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Editorial assistant: Jasleen Kaur
Production editor: Sarah Cooke
Marketing manager: Alison Borg
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5

THE EUROPEANIZATION OF THE BUSINESS ENVIRONMENT

What you will learn in this chapter:

- The European market observed through the lens of business theory.
- European sector dynamics and related EU issues.
- Competition, competitiveness and competitiveness: what does it mean for Europe?
- The main common business-related policies and their impact on business: European business strategy.

5.0 INTRODUCTION

This chapter sheds light on the European business environment as a whole. For the most part, this business environment is made up of a multitude of countries that are, at least partly, constituting an integrated market. They share many of the rules and policies across the EU, EFTA, the EEA and regional clusters. Most of geographical Europe is covered by the EU and its partners. Internally, the creation of a single market allows for wide and deep networks of infrastructures and opportunities for corporate activity. However, this network also challenges firms to consider if the entire Single Market grouping or

an alternative should be considered as their home market. This chapter reviews some of the most important international trade and investment theory related to this issue. It examines, in particular, the elements and contexts that are common to this vast business environment, and focuses on the policies that managers in Europe need to be familiar with if they are to be successful doing business in Europe.

The European business environment has been subject to rapid transformation ever since the mid-1990s, when the Single Market became a reality. The introduction of a common currency in 1999, the extension of the Single European Act rules (SEA, see Chapter 2) to new areas such as e-commerce, and the ongoing trend towards supranational business taxation regulations are developments that have largely contributed to the construction of an increasingly harmonized business environment. This development towards a single market has led to the international diversification of firm structures. More and more multinationals have become European transnational companies that compete worldwide, from a sound and vast home market. SMEs increasingly operate on a European scale. Rugman and Verbeke (2004) would call them mostly home-region oriented multinationals. They are locally, nationally and internationally exposed to large-scale cross-border competition.

European integration increases the pace of economic developments throughout Europe and its neighbouring countries. Similar to globalization, Europeanization compresses time and space. Following developments during the 1990s and the different EU enlargements waves, member states have become closer, both politically and culturally. Logistically, improved infrastructures as well as virtual and real means of transport seem to have reduced distances and the time taken to cover them. Market harmonization rules apply to all actors within the Single Market, resulting in a permanent race for competitiveness, while aiming to respect social values pursued by most European peoples. The diversity and complexity of this Europeanization of the business environment are understood as the changing patterns of economic activity.

5.1 THE MAIN IMPACTS OF EUROPEANIZATION

The opening up of business opportunities is accompanied by rising competition within markets. Some of today's European markets were entirely inaccessible (or difficult to access) in the past. Examples are the deep-seated past animosity that historically opposed Germany and France (see Chapter 2), or inaccessibility due to oppression by another country such as in Eastern Europe (see Chapter 3). In addition to ever-more market access, corporations benefit from the inherently lower costs of doing business in an integrated market. These effects are mainly based on economic and political integration

automatism. The resulting business environment helps save costs, thanks to the realization of Europeanization.

Box 5.1 Actioning Europeanization: the ten top policy tools

1. Integration of major, mainly economic, decision-making at EU level.
2. Widening and strengthening of the Single Market.
3. An evolving form of federalism through monetary unification.
4. Common policies.
5. An intensification of competition.
6. Liberalization and deregulation.
7. Free movement of labour, goods, services and capital.
8. Removal of barriers to entry and to trade, for production and investment.
9. Harmonized norms, standards and legal frameworks.
10. Simplified tax regimes.

Consequently, it is possible to obtain significant cost economies in the Single Market if the mix of factor costs and skills is optimal. The resulting *trade creation* (cf. Chapter 2) generates new economic activity between countries, and provides lower prices for consumers within the EU. Nevertheless, there is also the impact of *trade diversion*, i.e. the shift of economic activity between countries without new value creation, and reinforced competitive advantage for dominant firms to deal with.

5.2 THE IDEOLOGICAL BACKGROUND

The ideology behind the Europeanization of this business environment is based on globalization and free trade and free market concepts that were prevalent in the 1990s. The internationalization of capital markets, technological advances, products and people's way of life at the time accelerated globalization across the world, and marked a key moment in the evolution of (regional) trade groupings. The intellectual foundation for these trends is found in the classic and modern theories of trade and investment. The writings that constitute international trade and investment theory have helped substantially,

not only in understanding the phenomenon, but also in structuring corporate and governmental thinking about the opportunities for and threats from trade across borders. In Europe, this has resulted in mainstream thought that has gradually driven deep and broad market integration.

5.2.1 The main classic international trade and investment theories

Among the leading economic and international trade theories (see Figure 5.1), those of Adam Smith and David Ricardo as well as Heckscher-Ohlin best explain the importance of business operations reaching across borders. The precursor was, however, *mercantilism*, a theory developed at the very beginning of international business and colonial commerce, that argues a country shall best run a balance-of-trade surplus, in a zero-sum game towards other countries. The theory calls for government intervention in the interests of its domestic business interests to ensure their international competitive advantage.

In *The Wealth of Nations* (1904 [1776]), Adam Smith looked deeper into the reasons why trade exists between countries. He put forward the theory that if any given country has an **absolute advantage** in the efficient production of goods, the country should specialize in producing those goods; other goods should be imported. David Ricardo then expanded this theory to that of *comparative advantage*, explaining that within this framework imports may also include goods that could be produced, though less efficiently, in the domestic market. In this manner, free trade without restrictions on the basis of comparative advantage is to turn trade into a positive-sum game that obtains higher-world production levels to the benefit of all participating national economies (countries). Global value chain (GVC) calculations, analysing the trade in intermediates, and fragmentation of goods and services production across borders, are based on this work by Ricardo.

The theories of Smith and Ricardo were reinforced by the Heckscher-Ohlin model that analyses international trade patterns based on *factor endowments*. This model indicates that those goods that are imported or exported are determined by local resource endowments. The factors studied in this theory are labour and capital. In short, a country that is relatively labour-abundant should specialize in the production and export of that product which is relatively labour-intensive; the same would apply for capital. Hence, this demonstrates why certain countries specialize in certain goods and not others, as a reinforcement of the theory of comparative advantage. However, the theory in itself does not explain the phenomenon completely. For example, some countries have minimum

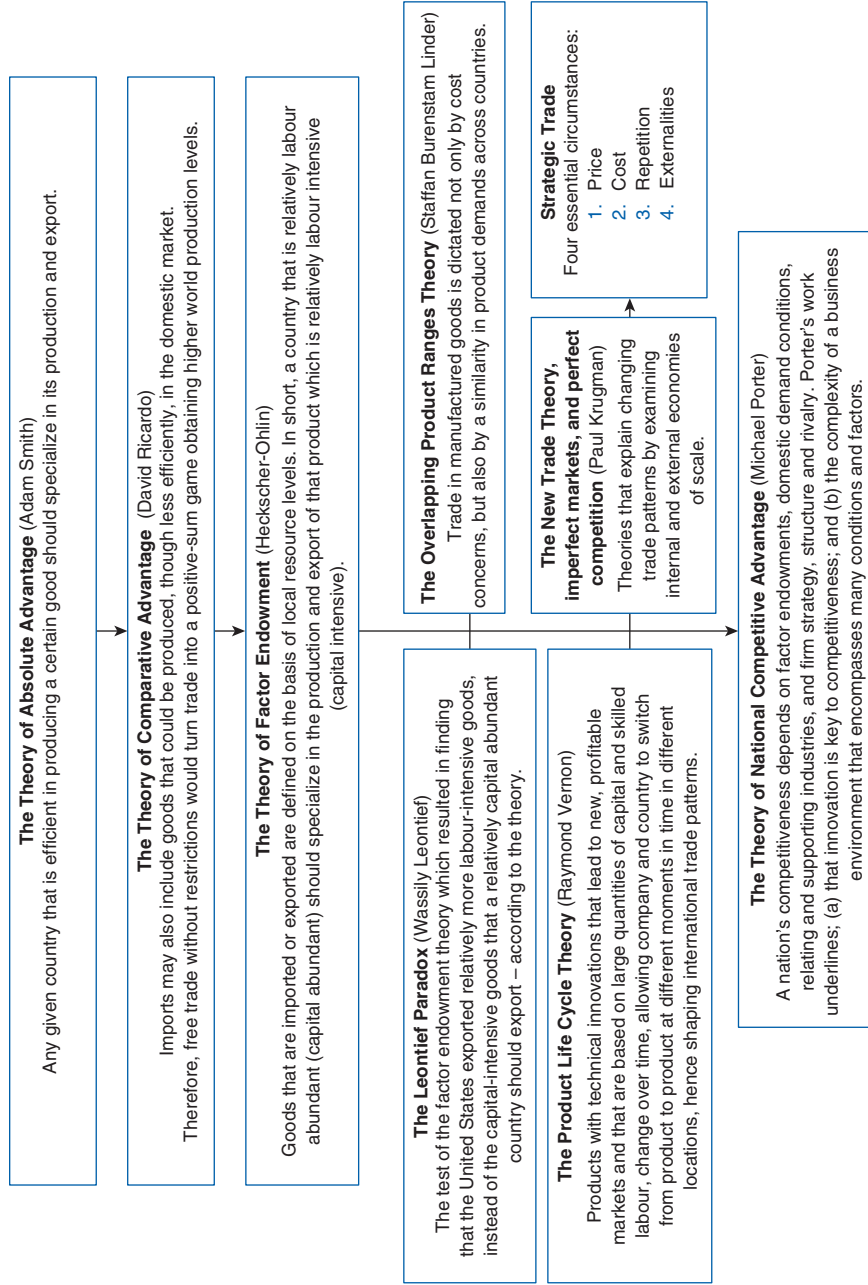


Figure 5.1 The evolution of trade theory

wage laws that result in high prices for relatively abundant labour. The *Leontief paradox* using this framework demonstrated that countries like the USA in the post-war period actually exported relatively more labour-intensive goods and imported capital-intensive goods. A more and more nuanced approach to cross-border trade is therefore necessary. Linder, among others, has engaged in research into these nuances; his resulting *overlapping product ranges* theory holds that trade in manufactured goods is dictated not only by cost concerns, but by a similarity in product demands across countries. This theory therefore centres around preferences of consumer demand or market segments.

Raymond Vernon's **product life cycle** theory was a first valiant attempt to understand how the patterns of trade and investment between countries change over time. The theory suggests that products with technical innovations that lead to new, profitable markets and that are based on large quantities of capital and skilled labour, go through different phases. These begin with introduction, through maturity to standardization, leading to initial exporting of the advanced product, followed by foreign direct investment to realize economies of scale and learning in lower cost locations and finally exporting back to the original **country of origin** for the innovative product. This theory thus explains the shifting patterns of trade and investment in terms of product innovativeness and later maturity and evolving market size domestically and internationally. The complexity of today's operations and productions, and the importance of the service economy, limit the importance of this approach in the current understanding of international trade and business. It is worth noting that the theory mainly still holds for technologically-based mass-produced merchandise.

5.2.2 The main contemporary international trade and investment theories

In the 1970s, the *new trade* theory was developed. This held that when a country produces specialized products, economies of scale and low production costs can be achieved by exporting across borders. This results in relatively cheaper goods as well as more consumer choice. Paul Krugman and Anthony Venables (Krugman and Venables, 1995), among other leading thinkers, contributed to the modern understanding of cross-border trade through an examination of internal and **external economies of scale** that are developed from microeconomics and market structure analysis and that result from *imperfections* of the larger market. He notes, for example, the beneficial role that government can play, and expands the study of the political economy. The theory is based on the understanding that firms' output is differentiated and that market conditions and outputs are heterogeneous (in real or imaginary ways). This stands in opposition to

perfect competition in which these are interpreted as homogeneous, i.e. very similar or equal. The works of Hymer and others explore these imperfections in detail.

The resulting *strategic trade* policy identifies four essential conditions under which strategic trade may be realized: price, cost, repetition and externalities. Nevertheless, this thinking is challenged by the incentives it suggests for governments to turn to protectionism and companies to seek this protection for themselves, even though this may result in retaliation from trade partners. In the EU, the free movement of goods, services, labour and capital and market integration have been established to allow for cost economies by centralizing production in locations with particular factor wealth and specialization of particular resources, whether these be raw materials, supplies, human or capital resources, knowledge or cultural factors. The new trade theory also explores the predominance of first movers and **oligopolies** (industries comprising a limited number of large firms, e.g. European Aerospace or the petroleum industry), and of government intervention by means of subsidies.

Box 5.2 Useful definitions

First movers	<ul style="list-style-type: none"> • First movers attempt to gain a competitive advantage by making a strategic move into a new market before their competitors.
Internal economies of scale	<ul style="list-style-type: none"> • Greater levels of production translate into lower costs of production for each unit; the size of the common market creates opportunities for economies of scale.
External economies of scale	<ul style="list-style-type: none"> • Free movement of the factors of production (capital, labour, etc.) contributes to lower production costs
Absolute economies	<ul style="list-style-type: none"> • The advantage derived from the efficiencies gained when a firm's resources or the endowments of a country enable a business to produce at a lower cost (with greater efficiency) compared to rivals.
Oligopolies	<ul style="list-style-type: none"> • A market characterized by a small number of dominant firms. A monopoly in contrast is a market dominated by one firm and a duopoly is a special case of oligopoly when two firms dominate the market. Highly competitive markets are featured by a large number of firms and customers.
Subsidies	<ul style="list-style-type: none"> • Monetary assistance typically granted by a government to a person, organization or business to support their activities.

Knickerbocker (1973) suggested that the imitative behaviour found in oligopolies can also be observed in the investments of equity funds abroad and in general in FDI. This is often referred to as herd behaviour. In an extension of the theory, it becomes clear that international firms compete in a complex environment like a network of intertwined linkages. They compete at different locations and times and in different industries and markets. In Europe, the increasing competition in Europeanization efforts has led to MNE strategies that favour market share increase through the use of mergers, acquisitions and alliances, or operations through FDI, rather than simple import and export activities. Knickerbocker's theory can hence also help us understand the concentration of, for example, the European mobile telecom industry and other sectors that compete across the Single Market. Let us mention here that, in Europe, joint ventures are rarely used as a means of market entry because of the low level of uncertainty.

Michael Porter's (1990) theory of *national competitive advantage* is very helpful to understand the main attributes of trade of a nation that encompass the so-called 'diamond' of factor endowments: domestic demand conditions, relating and supporting industries and firm strategy, structure and rivalry. Porter's work underlines: (1) that innovation is key to competitiveness; and (2) the complexity of a business environment that encompasses many conditions and factors. Porter adds that competitive clusters form in fields that constitute cutting-edge, highly successful markets. These locate in a concentrated manner to gain the advantages of stimulating network effects in both the corporate and the public environment, and in particular in knowledge transfer. You will find examples of relevant clusters in Europe in the R&D science park of Sophia-Antipolis or the Cancerpole in Toulouse in France, the technology park in Brno in the Czech Republic, the Cambridge Avlar Cluster which focuses on biotech and **venture capital** in the UK, the Austrian bioenergy cluster or InternetBay in Sweden. The European Cluster Alliance and the European Cluster Observatory are part of the EU's support mechanisms for innovation-related business activity. The later generalization of this model into a double diamond (Moon, Rugman and Verbeke, 1998) explains how regional economic integration can allow national diamonds to compensate weaknesses in their endowments. Effectively integration enables endowments that are lacking in the home market, either by removing barriers or enabling the Europeanization of businesses via foreign direct investment.

The theory of *international investment* reinforces the above concepts, in that companies are considered to be making a significant investment and hence contribution to the host economy when they produce in another country. This move is dependent on the mobility of capital at the international level. If the firm invests directly across borders, production, organization, resources management and knowledge management

become increasingly complex. The firm will seek advantages from this diversification of opportunities in resources, factors, knowledge, security and markets. It will strive to profit from access opportunities that may otherwise be difficult (e.g. because of import restrictions), from factor mobility and from management imperfections such as managerial or marketing techniques or financial resources. In addition to this, the theory holds that companies will be able to internalize, i.e. keep in their possession non-transferable sources of advantage such as trade secrets or other specific expertise.

5.2.3 Implications for firms and industries of international trade and investment theories

Successful trade and investment in Europe are dependent on adaptable approaches to weighing options and exploiting opportunities. The European business environment demands careful **market segmentation** and a sound internationalization strategy. It benefits to an important degree from the advantages that trade theories stipulate, and also defines the resulting challenges, depending on sector, production stage and location. Various studies shed light on the effects of market integration using the arguments of trade theory. These studies confirm that business in Europe remains complex despite the elimination of duties and the progressive harmonization of technical and safety standards, administrative barriers and local fragmentations.

Major studies into market integration effects in Europe demonstrate that firm size and market size are interrelated in that industries tend to consolidate and get bigger when markets enlarge and competition grows. It was found that corporations are exposed to an adjustment phase, because integration leads to profit losses through shifting factor advantages, conditions and price decreases. These losses may be short term because, increasingly, less competitive firms fail, while prices rise, mergers and alliances flourish and consolidation takes place. Theory stipulates that the faster an industry adapts and Europeanizes, the less loss it has to bear. The more familiar non-European corporations are with these business realities when targeting Europe, the better they adapt.

What do we learn from these theories? For both European and non-European firms, doing business in Europe engages strategic decisions in primarily location and market entry selection. As we learned in earlier chapters, the fact that most of Europe is part of free trade agreements, a customs union and the EU's Single Market, means that location choices and market entry decisions can focus on a wide range of options and are based primarily on market imperfections. In addition to the explanations based on the above

trade theories, corporate strategies come into play that consider the advantages for first movers, and the influence of governmental policy. As a result of the defragmentation of the European market and the consolidation of competition to realize scale economies and achieve profit sustainability, governmental policy may be seduced by state aid and subsidy solutions to counterbalance the social costs of lay-offs and inefficiency, and non-trade barriers may be used by trade partners that circumvent the intended impact of FTAs. Barriers then act as impediments to corporations' ability to internationalize, for example through **infant industry** protection, **local content requirements**, **voluntary export restraints** or **anti-dumping duties**. This is where common European policies have a role to play in restricting anti-competitive practices and ensuring a 'level playing field' for all firms doing business in Europe.

Box 5.3 More definitions

Infant industry

- An industry, mainly a new and developing sector, that is considered not sufficiently mature to compete on equal terms with international rivals.

Local content requirements

- Some defined fraction of a good that needs to be produced locally.

Voluntary export restraints

- When an exporting country self-imposes export limitations in response to threats of trade barriers from the government of a foreign country.

Anti-dumping duties

- Tariffs imposed by a government in the form of import duties, to counteract the injurious effects of a product sold at a price below the cost of production or below the price it is sold at in its country of origin.

5.2.4 Business realities of intra- and extra-European investment

Corporate Europe (i.e. business entities and industries in Europe) has the opportunity to move to international markets from a home base of the Single Market, which is best used for its cross-border multi-country opportunities.

Economic cohesion creates an inherent and incremental advantage that lies within Europeanization. In this context, international trade theory takes on its full sense. We need to study this theory just one step further to gain the relevant insight into European complexities, through so-called *market imperfection* theories. Internalization theories stipulate that internalization is the decision to take the means of production under managerial control and not organize the exchange in the marketplace. In international business strategy, this would mean that corporations favour FDI above export or licensing strategies because of the likely loss of ownership, control or intellectual property through other modes of internationalization. The Europeanization of business is driven by internalization, as firms seek to retain firm-specific advantages that make them unique, and to protect their core sources of competitive advantage embedded in their intangible knowledge-based assets.

Box 5.4 Foreign direct investment directions

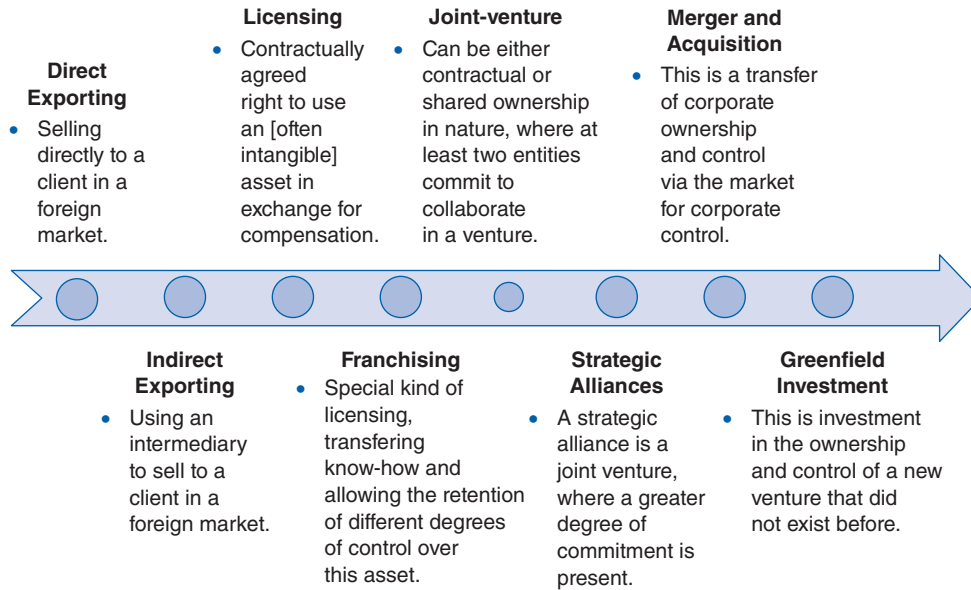
Horizontal FDI

- Investments across borders in the same branch of economic activity. Typically this is motivated by cost and market access considerations.

Vertical FDI

- Investments across borders in different stages of the value chain in different countries. This provides inputs (backward) or outputs (forward) for the domestic production process. This is typically motivated by the absolute economies (cost advantages of specific locations) that can be realized through the fragmentation of the value chain across national locations.

Because of this, **horizontal FDI**, i.e. FDI in the same industry of a given company (Box 5.4), is particularly attractive when market imperfections, transaction costs, location advantages and/or life cycles serve to decrease the efficiency of less risky modes of international business such as exporting or licensing. Attracted by market similarities and relatively low risk factors among member states, companies in Europe use the entire range of internationalization strategies, including horizontal and **vertical FDI** (i.e. providing input or output for a firm's operations), that may take different forms according to the degree of investments to be made and risk involved (Graph 5.1).



Graph 5.1 Strategic international strategy choices for Europeanization

One substantial advantage for subsequent internationalization outside Europe is that a firm's experience curve is at its peak. This is because cross-border trade has become a continuous business reality in Europe for most firms, whether it is as part of the global and regional value chain activity, competitive pressure or through trade or investment. In its cross-border strategy, the Europeanized firm enters into a resource transfer under certain preconditions provided by market integration. However, the Europeanized company might be less experienced than others in the use of specific entry modes in high-uncertainty markets, including joint ventures.

The theoretical and ideological underpinning that we discussed above has accelerated this Europeanization. For example, the UK is one of the member states most open to FDI, but it also intervenes when it comes to national interests and has taken steps to reinforce that by exiting the EU. Most European countries are rather pragmatic when it comes to the costs and benefits of free trade. The import of skills, capital, technology and know-how, as well as employment, is appreciated and can drive the wealth of an economy, e.g. that of Ireland. Some member states actively attract FDI through policies such as tax breaks and grants (see 'Irish tax' case study later). Investment

incentives may also encompass reduced land prices, infrastructure advantages or personnel training support.

Box 5.5 Possible dangers of Europeanization

There are not only benefits but also dangers in Europeanization. Profits from investments may leave the host country and regions. Supplies may come from abroad and basic or traditional knowledge can be lost; operations may turn into assembly only. Factor mobility does not benefit each country in the integrated market equally. Bargaining for greater benefits (rather than costs) leads general European policies to encourage FDI, and for country of origin rules to preserve a certain amount of local identity.

According to the above theories, adequate competition from inside and outside allows markets to function efficiently, in that more competitors will drive prices down, thereby increasing consumer welfare and choice. Again, following theory, competitors will invest more in R&D, personnel training, knowledge and equipment transfer, to win the race for competitiveness, productivity and innovation (recall the discussions in Chapter 3). In this scenario, complementary product and service industries flourish simultaneously.

Nevertheless, this does not tackle all the challenges: increasingly, much thought is given to the issues of offshoring and outsourcing in Europe (see Box 5.6) and the role that the origin of products and services plays. The European general public tends to look at these issues with fear of unemployment and loss of identity. When specific products, close to a population's heart, are produced elsewhere, protests are not uncommon. For example, in 2011, Prada announced their intention to produce a 'Made in' series, collaborating with different artisans to produce their designs utilizing the traditional craftsmanship, materials and manufacturing techniques of specific regions. Products would include items such as kilts from Scotland and alpaca knitwear from Peru. Consumers were troubled that the move would dilute the quality of the brand and voiced their negative opinions online. On the governmental and EU level, rules of origin (RoO) support transparency and decision-making (Box 5.7, cf. also Chapter 5). This is in line with a pan-EU rationale that differences in RoO for intermediaries of goods distort sourcing and trade intentions, and for final goods typically reduce imports from another country (cf. Conconi et al., 2016).

Box 5.6 Offshoring, outsourcing and insourcing

Offshoring: undertaking FDI to serve the domestic market, i.e. relocating a service or production, like a hotline or any other service, that can be carried out remotely from a foreign location. Control of the new company remains with the original company owner, although the activity is carried out in another country. Local employment legislation covering salary or benefits applies. European offshoring focuses mainly on eastern or Far East countries as well as the Maghreb countries. For example, France Telecom's 'hotlines' are located in Morocco.

Outsourcing: external acquisition and purchase of services or products that were previously produced in-house, i.e. subcontracting part of the service or the business to an external company. In some industries, outsourcing is either a company strategy or a necessity because the company does not have the required resource internally. In the pharmaceutical industry, those companies are referred to as contract research organizations (CROs), and they undertake all or part of the R&D process. Outsourcing can be either domestic (same country), nearshore (neighbouring country) or offshore (anywhere in the world), indicating different degrees of distance to the original country of operations.

Insourcing: where operations or activities within a business are channelled to a specific internal entity that specializes in that operation, often in a country other than the headquarters. This is used in production to reduce the cost of taxes, labour, transportation, etc. and in R&D to preserve knowledge. When a new organization is created this becomes known as captive offshoring; here the boundaries to traditional FDI blur and it becomes a matter of preferred naming conventions.

Offshoring and outsourcing can bring several advantages. According to liberal economic theory, when offshore production serves the domestic market, it frees up resources so that a country can focus on sectors of activity that generate comparative advantage. Prices from offshore production are relatively lower than those from domestic production. Companies remain competitive vis-à-vis their international competition which also uses offshoring. Based on this theory, the negative effects on employment would be outweighed by the long-term benefits to both companies and consumers (see also the discussion on subcontracting for SMEs in Chapter 3).

5.3 CHOOSING A LOCATION

In international business strategy, choosing a location implies that a firm opts to seek direct or indirect gains by establishing a physical presence in a location outside its home

Box 5.7 Country of origin rules

Country of origin rules refer to the criteria needed to determine the national source of a product. These rules are of particular importance because they determine duties and restrictions that depend upon the source of imports. Governments vary in terms of criteria. Some governments apply change of tariff classifications, others apply *ad valorem* percentage criteria, and others use manufacturing or processing operation. For example, the EU rules of origin for cotton clothing stipulate that the manufacturing process must ‘manufacture from yarn’, implying that imported cotton fabric cannot be used and that the yarn must be sourced locally. US rules of origin are more restrictive: a change of tariff heading defines the determination of imported cotton fabric, imported yarn and imported cotton thread. The rule requires that the production of cotton thread, spinning this into yarn, weaving the yarn into fabric, and the cutting and making up of fabric into clothing must all be undertaken locally. In 2011, the CEC launched new rules of origin, more favourable than ever for developing countries and a new procedure for demonstrating proof of origin: the responsibility of operators was enhanced. Since 2017, the certification of origin system for third country authorities focuses on statements of origin issued directly by exporters (registered via an electronic system).

country. The theories established by Vernon (1979), Dunning (1989) and many others help to understand what drives a firm to become international or transnational (definitions of the terms ‘international’ and ‘transnational’ in international business were provided in Chapter 1; their marketing application is discussed in Chapter 8). The degree of economic integration between the home and host countries for a firm can have a significant influence on location choices.

5.3.1 Determining European cross-border locations

Locations and modes of internationalization are grounded in corporate strategy, on the basis of the particular advantages that the firm gains from operations that reach beyond the national or regional market. These are outlined in Dunning’s (1989) leading work on internationalization on a global scale, which he called the eclectic paradigm consisting of the so-called OLI advantages. According to Dunning (1989), firms decide to invest abroad when owning strong assets (ownership advantages) and there is an

attractive location abroad for exploiting these assets, and a need to retain managerial control over the use of these assets (internalization) to avoid competitors gaining the use of the (especially intangible) assets. The main benefits of going European in terms of market scale and operations depend on the degree to which a firm remains the owner of its resources and the internalization that it may benefit from. These advantages differ on local, regional, national and global scales, depending on company criteria (nature, organization, sector of activity). Choosing a European, cross-border location is therefore a crucial decision and – in some cases – an important first experience for a company in its internationalization process.

Location decisions are related to either offensive or defensive strategies (Howell, 2001; see also Bouchet, 2005: 445), see Box 5.8.

Box 5.8 Offensive or defensive internationalization strategies

Offensive internationalization: a firm will move faster than its competitors and anticipate market developments on the basis of strong marketing and finances. This is the case, for example, for firms that invest in candidate countries before their definitive accession to the EU.

Defensive internationalization: conducted to preserve market share and competitive advantage in response to other players in the same or in a supplementary market. This strategy is different in terms of its timing because it is conducted at a later stage than offensive internationalization. It may require supplementary efforts to succeed in a complex environment that is already dominated by competitors: differentiation and knowledge of the terrain are essential requirements; one option is to reinforce local product or service adaptation, e.g. in McDonald's decision to sell salads in its French fast-food restaurants. The chain is the market leader in France despite fierce competition from national and international players in that market (Quick, Kentucky Fried Chicken, etc.).

Cross-border development may be a first move for the firm, or it may be part of an established strategy, and add to or change a location of earlier internationalization stages. Decisions are made on the basis of existing alternatives, and are often based on previous experience or an arising opportunity. There is evidence that once firms gain experience with a particular entry mode strategy, this can become embedded as

the preferred approach for establishing a presence in new locations. In particular in European SMEs, first cross-border locations are determined more by ‘knowing people’ or ‘following another firm’s example’ than by rigorous market research, given that uncertainties are reduced thanks to certain market harmonization effects of economic integration.

While gains and losses are intrinsic to any business operation, choosing the right international location is the best solution to obtain competitive advantage. There are significant advantages to be gained from internationalization (See Box 5.9; categories of FDI were developed by Dunning, 1998).

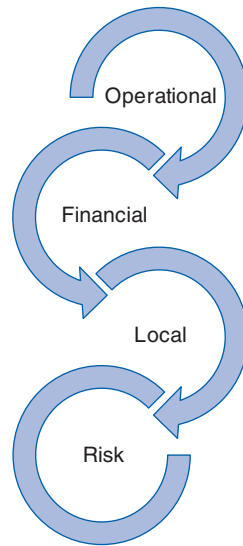
Box 5.9 Main types of FDI and advantages gained from successful internationalization

- Efficiency-seeking FDI: optimization or reduction of costs.
- Market-seeking or resource-seeking FDI: creation of new opportunities for growth.
- Strategic asset-seeking FDI: development of new strategic strengths.

For effective internationalization, the firm screens its environment. In the EU, this environment can offer important advantages along the international value chain, i.e. the path that links primary and support activities for providing goods and services. This value chain covers all stages that lead from procurement up to order fulfilment. No matter whether the location decision is primarily based on market research or opportunism, the value chain is key to the appreciation of a business environment and influences all aspects of management, reaching from human resource management to marketing and sales orientations.

In operational terms, corporate executives generally use four main criteria for location decisions (Graph 5.2).

The *operational* criterion deals with all aspects relating to operational activities, i.e. the quality of transport, logistic and telecommunications infrastructure; the level of local labour skills and education, and their availability; and the proximity of a target market



Graph 5.2 Main internal location decision criteria

(competition). The quality of operational resources is seen as more important than the potential of target markets. The *financial* criterion directly concerns the finances of the company and its management of revenue. In particular, it concerns not only potential gains in productivity, tax burdens and the cost of labour, but also public aid, the proximity of financial markets, the flexibility of labour law, special treatment of foreign investments, the availability of grants and subsidies, access to financial investors and the integration of a particular monetary zone. This criterion mainly ranks second in international location decisions but remains essential, knowing that labour costs and social charges and the level of tax burden are omnipresent. The location, or *local*, criterion concerns the operating environment of the company of a given country or region and the extent to which they offer the necessary means to develop the firm: this includes the availability of sites, the cost of land and regulations, specific skills developed in the region, the availability of specific expertise, local language, values and culture, the proximity of centres of innovation and research, as well as quality of life. The *risk* criterion concerns controllable risk such as legally protectable loss, or uncontrollables, such as political uncertainty and geopolitical instability. In addition to these criteria, the *bandwagon or herd effect* explored by Knickerbocker (1973) is illustrated by Europeanization. Competitors follow firms into emerging markets; this move is accompanied by an investment en bloc into a specific region. Such bandwagon effects are often a response to

uncertainty about the potential future gains of the strategic investment decision. When firms do follow leading investors, they may or may not specifically be assessing the risks of the investment in that specific location. Assessing the risks associated with a specific location can provide firms with a probabilistic understanding of the potential value that may be realized and the likelihood that this may not take place. It is not possible to assess uncertainty in this manner; this is the difference between risk and uncertainty.

The consideration of relocation or location change is often necessary when a firm needs to adapt to local externalities, research and development spill-overs, the costs of knowledge transfer and/or transport (Krugman and Venables, 1995). This scenario applies if the costs of operating in a market are greater than the returns. But a firm may also adapt its cost/return ratio by shifting to a different mode of operation with differently adapted levels of internalization.

5.3.2 FDI: yielding benefits from market-serving, resource-seeking Europeanization

Vernon (1979) and Dunning (1993) argued that firms can leverage resources through FDI, namely with a resources-based perspective. Birkinshaw and Hood (1998) added that the strategy of transnational companies is as much market-serving as it is resource-seeking. TNCs reach scale economies of knowledge using knowledge management (KM) tools on a horizontal transfer of information, talent, skills and innovation across borders. These approaches thus spread across global or regional levels, and Europeanized companies often constitute TNCs to yield benefit from market integration strategy.

The mode of entry that a firm chooses reflects the answer to a multitude of variables that are priorities for the European firm, and are relatively easy to screen in the European marketplace. Firms will pay attention to specific variables that determine their cross-border options, (See Box 5.10).

The complete screening of these variables allows firms to gather information on a European, national and local level. At the European level, CEC databases are particularly useful, and available online. In addition, Eurostat is a very complete research tool; it provides, among other data, information about all the main trade areas in Europe and their trends. At the national level, most useful are DTIs (Departments of Trade and Industry) and similar institutions, as well as trade organizations and business information services such as national and CEC representatives. Company registration offices and local legal offices may also be helpful. The environmental screening process allows the firm to evaluate the potential costs and benefits of locations. Also, operational risk can be limited if

Box 5.10 Cross-border external entry decision variables

- Local advantages: currency, resources, market-related needs, cultures and knowledge management.
- Transaction costs.
- Infrastructures (virtual and physical).
- Decomposition possibilities of activities.
- Company taxation.
- Company law and legal issues.
- Regional policies.
- Sociocultural forces.
- Product life cycles.
- Network effects.
- Government policies.
- Partner and organizational resources.
- Knowledge transfer options.
- Risk-diversification possibilities.
- Cross-border factor mobility.
- Herd or first-mover behaviour!¹

managed within a framework of diversification of sourcing and suppliers and flexibility in entry and exit strategies, on the basis of a firm-specific set of location modes. The European market allows firms to apply these diversification modes.

International trade is dominated by a high degree of cross-investment between economies. Inward FDI into developing countries is rising because firms are aware of the importance of this knowledge for their international presence. Emerging market MNEs (EM-MNEs) started to invest in developed markets, such as in the EU for market access and knowledge sourcing, and in underdeveloped countries, such as in Africa and South America, primarily for resource reasons. European MNEs favour investment in historically close markets or in markets that are governed in special partnership with the EU; we note from the above that this is also the case vice versa: market groupings reduce political risk incrementally as integration deepens, and as its periphery of special relationships expands, stability is gained. The resulting reduction of risk encompasses that of economic risk, financial and transfer risk, exchange risk,

¹ Some parts of this section are based on published material in Suder (2006; 2011).

cultural environment risk, legal and contractual risk, regional contamination risk (spill-over effect), and the systemic risk associated with any global crisis.

5.4 EUROPEANIZATION OF THE FACTORS OF PRODUCTION

Factor mobility does not benefit each country or region in a market grouping equally. The benefit can be measured by examining the distribution of wealth and profit, and it is generally evaluated on the basis of values and the worth of assets. These assets may be stocks and shares, i.e. marketable wealth, or assets like property and land resources that are difficult to assess unless sold. Non-marketable wealth may include rights and wealth support by origin and heritage that include the values of networking, creativity and innovation. For instance, small firms producing innovative machinery and equipment are interlinked.

5.4.1 Labour and income inequality

The distribution of marketable wealth is less even than the distribution of income. Market groupings are often characterized by inequalities in the distribution of income between regions of the same country and the EU is no exception. The GINI coefficient (Figure 5.2) is one of the most commonly used measures of inequality. The coefficient typically varies between 0 (reflecting complete equality) and 1 (reflecting complete inequality), i.e. one person has all the income while all others have none, as in Figure 5.2. Eurostat has converted this to a scale of 100. In 2016 the general pattern was one of the active use of social transfers, including pensions, to achieve more equal societies in terms of income equality. An equitable core comprising Scandinavia, Germany, France and Central Europe can be identified for the data after social transfers. As a broad assessment, there appears to be greater inequality approaching the Anglophone, Mediterranean and Baltic countries. Turkey has the highest GINI core at -43.6. The use of social transfers clearly plays a key role in the Europeanization of income inequality across both old and new member countries. Some of the newer CEE member countries are also some of the most equal in terms of income.

From a Europeanization perspective, one would expect that the pre-transfer inequality across the EU member countries would in time converge, as the free movement of people, finance and firms takes advantage of any divergence in income or cost of doing business. But this does not seem to be the case in the short term and it is unclear if it

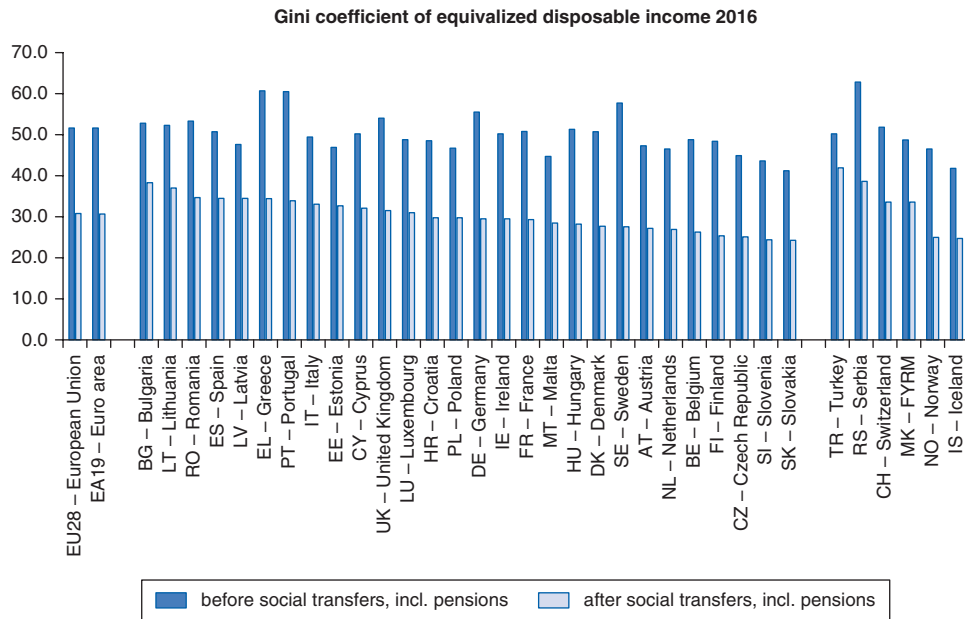


Figure 5.2 GINI index 2016 for European Union members and selected non-EU states

Source: European Union/Eurostat, © European Union, 1995–2018, Table ilc_di12 and ilc_di12b (last updated February 2018)

would be in the long run. Within the EU, parts of Poland, Portugal, Greece, southern Italy and Spain, eastern Germany, eastern Finland and the west of Ireland traditionally show the lowest absolute income figures. In the UK, there is a north–south divide in the distribution of incomes, in Germany this is reflected in an east–west divide, and in France, the highest incomes can be found in the Île-de-France area including Paris and its surroundings, and the lowest incomes in Guadeloupe, Guyana, La Réunion and Martinique. If one relies on market mechanisms, then the rationale indicates that labour flows to high-income regions (workers migrate), while capital flows to low-income regions due to profit rates. In this case, is policy intervention the key to combating regional income inequalities? Any reflection about international geo-economic history indicates that inequalities also occur in planned economies under strong governmental intervention. In practice, labour is in fact relatively immobile because if labour migrates, it takes its purchasing power with it so the home region's income is reduced. Local commerce also obtains less income; shopkeepers, estate agents, solicitors, etc. reduce their spending and all this results in a further reduction of regional income. Moreover, in reality, labour is

not a homogeneous factor, e.g. a skilled carpenter is not a perfect substitute for a pharmacist or an accountant. In addition, there is no substitute for labour if the population is not sufficiently skilled. Following this, an area with relatively unskilled labour is less attractive for business and FDI. The reverse is true for highly skilled labour.

Interestingly, highly educated Scandinavia shows the least variability between income levels in Europe, after social transfers, and has for years been at the head of the World Economic Forum's Competitive Ranking. Table 5.1 below shows the GCI Index for the top 15 countries, including four Scandinavian countries: Sweden, Finland, Norway and Denmark.

Highly skilled labour increases the human resource capital of a country, and normally benefits the balance of payments through investment into the host economy. Low-skilled labour exercises a less important impact on the balance of payments because revenues are often sent back to families in the home country. Nevertheless, labour still contributes significantly to the economic health of the host country. This means filling in demographic gaps, counterbalancing labour shortages in specific areas,

Table 5.1 Global Competitiveness Index 2017–18 rankings and 2010–11 comparisons

Country/Economy	GCI 2017–18		GCI 2010–11
	Rank	Score	Rank
Switzerland	1	5.86	1
United States	2	5.85	4
Singapore	3	5.71	3
Netherlands	4	5.66	8
Germany	5	5.66	5
Hong Kong SAR	6	5.53	11
Sweden	7	5.52	2
United Kingdom	8	5.51	12
Japan	9	5.50	6
Finland	10	5.49	7
Norway	11	5.40	14
Denmark	12	5.39	9
New Zealand	13	5.37	23
Canada	14	5.40	10
Taiwan, China	15	5.33	13

Source: World Economic Forum, www.weforum.org/reports/the-global-competitiveness-report-2017-2018 and www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf

and offering education and training to a diversity of potentials. Labour may move in and out of Europe, or freely within Europe. The Schengen agreement explained in Chapter 3 encourages labour movement through low-administration common rules and procedures for internal and external border controls for citizens of participating countries. The Schengen agreement was also signed by some EFTA countries (Iceland and Norway in 1996, and Switzerland in 2005). The agreement in addition to the movement of people, also facilitates the transit of goods through increased customs cooperation.

In terms of labour and employment policies, the overall European focus on a services oriented economy since the mid-1990s has resulted in services employment accounting for more than double that of industrial employment, and even more than that of agriculture. In a breakdown by gender, more men work in agriculture and industry, while more women are employed in services. Europe encompasses several socioeconomic models (see below in Table 5.2); in each model of capitalism, the labour market is different. The UK with its limited government intervention, decentralized pay bargaining and flexible working arrangements appears to be the most flexible of the EU economies. Ireland and the Netherlands are also examples of comparatively flexible labour markets, yet are respectively categorized into separate employment models.

Member states maintain their exclusive competence in confronting unemployment and encouraging job creation. However, EU governments treat employment policies as a matter of common concern. As a result, joint employment guidelines are published annually and each member state submits a National Action Plan (NAP) for employment. For example, Malta's National Action Plan against Poverty and Social Exclusion is working towards eradicating poverty and achieving an inclusive society. The targeted vulnerable/at-risk-of-poverty groups involve a wide range of categories (children, youths, families; victims of domestic violence, addiction, mental health problems; irregular immigrants, etc.) (see www.epasi.eu/research-units/epasi/country-reports/malta.cfm.html).

The European labour market is not as 'single' and harmonized as might be imagined. Several employment models operate in disharmony within the EU. This creates a great variety of employment conditions, unemployment and retirement benefits and working hours across the EU. The European Commission's monthly labour market monitor is one source of data for labour market conditions. Each wave of regional enlargement: (1) expands the market for firms; (2) adds to the diversity of the labour market in an integrated Europe; and (3) alters expectations for the future of sectors that are increasingly service and financials oriented, despite the effects of the 2008 financial crisis. This adds additional challenges to corporate Europeanization.

Table 5.2 Four employment models operating in disharmony within the EU

Model	Countries operated in	Characteristics	Critiques of model
Mediterranean model	Italy, Spain, Greece	Social spending concentrated on old-age pensions and a focus on employment protection and early retirement schemes.	This model is often criticized for inefficiencies both in creating employment and in combating poverty.
Continental model	France, Germany, Luxembourg	Insurance-based, non-employment benefits and old-age pensions and a high degree of employment protection.	This model has the reputation of being good at combating poverty but bad at creating jobs.
Anglo-Saxon model	Ireland, UK, Portugal	Many low-paid jobs, payments linked to regular employment, activating measures and a low degree of job security.	This model is relatively efficient at creating employment but bad at preventing poverty.
Nordic model	Denmark, Finland, Sweden, Austria, Netherlands	High spending on social security and high taxes, little job protection but high employment security.	This model is successful at both creating jobs and preventing poverty.

5.4.2 Intellectual property in Europe

Intellectual property (IP) refers to creations of the mind: inventions, literary and artistic works, and symbols, names, images and designs used in commerce. Europeanization of IP is very much dependent on international synergies and regulations, and on the will of the people. In Europe, in particular, the preservation of identity and ownership rights is valued as essential. IP is important to preserve, and it is costly when lost for an enterprise. IP laws preserve the values and ethical basis of business management in different societies with regard to creativity, knowledge and innovation, which are the underlying elements for a sound **corporate culture**. The satisfaction of stakeholders and shareholders depends on these values. A harmonization of European and international norms is essential for this type of return on investment: the convergence of principles and behaviours helps people (and business management altogether) to Europeanize and internationalize efficiently, based on European culture, diversity and identity. We will see in this section that IP is well protected in Europe, but less so in its neighbouring countries.

5.4.2.1 Patents

By definition, a *patent* is an exclusive right granted for an *invention*, i.e. a product or process that provides a new way of doing something, or offers a new technical solution to a problem. The process of turning an invention into an innovation is *culturally biased*: an interpretive process is a prerequisite in its diffusion, and ideas have to be put into an abstract form for ‘export’ and protection as a *property*. A patent is granted by a national patent office or by a regional office that does the work for a number of countries, such as the European Patent Office (EPO, www.epo.org). The European and national patent grant procedures exist in parallel, so taking a European or national route for patenting will depend on the countries you wish to cover. The EPO, located in countries across the EU, offers patent protection in 38 European countries, and since 2018 a Unified Patent that can cover up to 26 EU member states with one single submission. Information about IP cooperation and European patents can also be obtained from national IP agencies. For a reach beyond European frontiers, the World Intellectual Property Organization (WIPO) administered Patent Cooperation Treaty (PCT) allows for the filing of a single international patent application with the same effect as national applications that would be filed in the designated countries.

Box 5.11 Europe’s patent costs

In Europe, covering all of the market with a patent used to cost an overall €70,000 using regional and national agencies in 2011, compared with €20,000 in the USA and less in Asia. Yet by 2017, costs when using the EPO on average had been cut to approximately €32,000, comprising fee, attorney, translation, validation and possible renewal. Savings of more than €150 million for companies are thought possible if there is full harmonization through a unitary patent, which came into force in 2018, reducing the cost further.

Patent costs differ when applying in one country at a time or a limited number of countries only. Variation in the cost of national patent applications is due to the application being composed of three categories of costs: (1) the official fees (this varies both by country and in the way in which the application is filed, i.e. paper vs. electronically); (2) the costs made by the patent attorney; and (3) extras/reductions, e.g. some cases will incur additional charges if the application exceeds 30 pages in length or one could receive reductions of 90 per cent if the patent is filed from a third world country. You are advised to check information on www.epo.org/.

Source: Willis (2009); www.epo.org/.

5.4.2.2 Trademarks, industrial designs and other IPs in Europe

A *trademark*, a distinctive sign, serves to identify goods or services as those produced or provided by a certain person or enterprise only. The first objective of trademarks is to make sure that consumers identify and purchase a product or service with a specific image, reputation, nature and/or quality through words, letters and numerals, or other signs. Simultaneously, the owner of the trademark enjoys exclusive use of its rights, or can authorize others to use those rights in return for payment. Therefore, trademarks foster recognition and financial profit. They are related to a specific company culture. The registration of a trademark requires an application to an appropriate national or regional trademark office. The WIPO again allows for the international registration of marks, on the basis of the Madrid Agreement Concerning the International Registration of Marks and the Madrid Protocol, and covers over 60 countries.

Industrial designs help protect a very large array of industrial and handicraft products, including, for instance, electrical appliances and textile designs. The design must be recognizable from an aesthetic point of view, but the protection does not cover its technical features; the first objective here is the marketability of the product. Protection against unauthorized copying or imitation of the design by third parties is meant to encourage creativity, and also to preserve and boost traditional arts and crafts. A new industrial design must be registered in order to be protected under industrial design law, but this is generally inexpensive. The registration certificate issued grants a term of protection of mostly five years, but can often be extended to 15 years. Generally, industrial design protection is limited to the country in which protection is granted. Under The Hague Agreement Concerning the International Deposit of Industrial Designs, another WIPO-administered treaty procedure, international registration is possible.

Geographical source indications are signs used on goods that have a specific geographical origin relating the product or service characteristics to those created in that place of origin. A place name, for example, may be that of perfume from Paris, English tea or Belgian chocolate. The efficiency of such signs in terms of market share or financial profits depends on national law and consumer perception. In the EU, geographical source indications are required by law and protected under European regulation. An appellation of origin is a particular case for products that have a certifiable exclusivity quality, or one that is substantially due to geographically dependent climates, resources or handicrafts. In contrast to a trademark, geographical source indications may be used by all producers who make their products in the very place designated by a geographical indication (cf. Chapter 8), and whose products share typical qualities.

A different case of protection is that of *copyright*, in which rights protect creators' literary and artistic works. For business management, this concerns in particular communication and advertising, or companies in specific related sectors, such as Internet-based firms. Copyright applies to works such as novels, reference works, newspapers, computer programs, databases, films, musical compositions, artistic works such as paintings and photographs, and also architecture, advertisements, maps and technical drawings. These rights protect the original creators of works and their heirs who hold exclusive rights in their use – prohibiting or granting to a third party reproduction, public performance, recording, broadcasting, translation or adaptation within a time limit (under WIPO legislation, this is 50 years after the creator's death). No official filing is necessary for copyright because the work's pure existence is protected at once.

IP protection in Europe, if not filed under the WIPO, does not cover the USA, China or any other third-party markets. In manufacture, in services or in capital markets, successful companies protect innovations that may relate to sales (e.g. outsourcing with or without technology transfer), through the CRO and the contract manufacturing organization (CMO). For any company that works across borders, national protection does not suffice because it most often engages in the transfer of know-how, programmes, license-in or license-out for specific periods, or the transfer of patents if the innovation is to be sold or joint ventured.

5.4.2.3 IP enforcement in Europe

The enforcement of intellectual property rights (IPR) in Europe has been threatened over the last decade due to extremely skilled counterfeiters operating on a global scale, challenging international business activity at home and abroad (see also, Corporate Case 'Alibaba'). The counterfeiters are known to make expert use of technology and trade to produce every imaginable fake item. This includes luxury goods, fashion and film products, cosmetics, hygiene products, medicine, toys and various types of technical and electronic equipment. These sectors are at the heart of European culture, identity and competitiveness for their quality. The EU has therefore implemented a number of legal instruments such as the Enforcement Directive, and seeks to improve the administrative cooperation between authorities at all levels to fight piracy and counterfeiting. One result is the 2008 European Observatory on Counterfeiting and Piracy – a Resolution on a comprehensive EU anti-counterfeiting and anti-piracy plan.

The European Patent Office offers European states an instrument to counteract patent infringement across its 38 EPC contracting states. The unitary patent and the Unified Patent Court (UPC) reinforce legislation and its applicability.

The International Criminal Police Organization (INTERPOL) Database on International Property (DIIP) Crime is an autonomous iBase database that contains information regarding organized IP crimes. The database was created to perform criminal analysis to monitor links between transnational and organized cross-industry sector IP criminal activity, and to facilitate criminal investigations. It is particularly useful because it facilitates law enforcement interventions in transnational organized IP crime, and helps to improve the flow of communication between stakeholders, strengthening the efficacy of international law enforcement.

5.4.3 Capital

Capital is very mobile, not only between regions but also between countries. Therefore, the market mechanism works as capital flows (but it flows globally). The GFC of the mid-2000s had a severe impact on domestic output, reflecting the pre-crisis dependence of many countries on international bank and bond-lending to finance domestic expenditure. The debt crises in some of the high-income European countries (i.e. Greece, Italy, Portugal) and their diminished growth prospects have created uncertainty for developing Europe. The combination of extremely deep falls in 2009 and a modest recovery is characterized by high unemployment. Registered unemployment has risen by 3 million and exceeded 10 per cent of the labour force in several countries, including Latvia, Turkey, Estonia, Lithuania, Slovakia and Hungary. The most vulnerable countries in the overall region include Albania and Azerbaijan, for which Greece, Italy, Portugal and Spain represent more than 20 per cent of their total exports.

Governmental and supranational agencies like the EU intervene mainly through financial assistance programmes and regional funds, research and training initiatives. These aim at making Europe more attractive for internal and external economies of scale on the basis of factor mobility, reinforced flexibility of labour and capital factors, and the highest educational standards recognized EU-wide. The move of the EU towards a knowledge-based economy reinforces these efforts.

The European Monetary Union brought about the creation of the European Central Bank. The Maastricht Treaty detailed the role of the euro system in defining and implementing monetary policy in the eurozone, conducting foreign exchange operations, holding and managing official reserves, promoting the smooth operation of payment systems, and issuing banknotes and coins. A tendency towards monetary integration following the principles of federalism guides the primary objective of the ECB to maintain price stability (Maastricht Treaty). Overall, the EU has successfully centralized its monetary policy and harmonized interest rates (more in Chapter 7).

5.5 THE COMPETITIVENESS OF EUROPEAN MANUFACTURING AND SERVICE INDUSTRIES

The EU 2020 strategy, replacing the so-called Lisbon strategy in 2009, was launched as the CEC's new economic, environmental and social framework strategy. The main focus of the EU 2020 strategy is to combat the effects of economic and financial crisis. The strategy, set up to boost competitiveness, follows a concept that can be defined in several ways: one definition may refer to competitiveness as being industrial, technological or enterprise-related (Box 5.12). In all three cases, the term is used to cover several principal factors: price or non-price (such as high quality, superior design and technical innovation); lower cost; and profitability.

Box 5.12 Distinguishing competition, competitiveness and competitiveness

Competition

- The act of competing, of engaging in rivalry or in contest. In business, for example, competing for markets, customers or access to suppliers and inputs.

Competitiveness

- The ability of a country or region to compete with other countries or regions in the growth of the national or regional economy. This may, for example, include the attraction of foreign firms as investors.

Competitivity

- The ability of a sector or industry to compete; the ability to achieve competitive advantage.

There is a wide range of *indicators of competitiveness*, which may give different results depending on which measures are adopted for assessment. We can distinguish quantitative and qualitative indicators (Buckley and Casson, 1988):

- **Quantitative indicators:** include export market share, market share, export measures, percentage of world manufacturing/GNP and percentage of domestic manufacturers in total output, balance of trade, comparative advantage, cost competitiveness, technology and profitability.

- **Qualitative indicators:** are ownership advantage, marketing aptitude, commitment to international business and globalization, relations with intermediaries, proximity to market, cultural advantages, cross-licensing and acquisition of technology.

Buckley and Casson (1988) conclude that competitive advantage stems primarily from the ability to reach targets at the least possible cost, defined as efficiency, and secondly to choose the right goals, defined as effectiveness. The achievement of these goals is related to the historical situation, existing competitors and the existence of a well-defined counter-factual competitiveness. In terms of international competitiveness, these factors will, together with cost and price developments, either improve or deteriorate the performance of a country or firm. A diverse range of factors can contribute to the long-term competitiveness of a location (see Box 5.13).

Box 5.13 Long-term strategies for sustainable competitiveness

- Long-term contracts or exclusive distribution agreements.
- Increase in product differentiation.
- Technological innovation through R&D.
- Concentration by means of merger or takeover.
- Globalization by means of investment and acquisition policies.
- Establishment or elimination of certain barriers to entry.

The result of market behaviour and a particular market structure is mirrored in the company's market *performance*. It can be measured by a firm's profit margins, sustained growth, the degree of capacity utilization, and product quality. Also, incomes are interpreted as identifications of the degree of competitiveness and the market performance of a company. The aim is to increase incomes as rapidly as the competitors' and to make the necessary investments to remain competitive in the long term. Income is a good indicator of company competitiveness. However, net income in a pure competitive environment is the last thing to increase in a company. In fact, any profit that a company makes and does not reinvest would weaken its current position relative to the competition. Academics argue that the lower the level of nominal

wages, the lower the external value of the currency and the faster an increase in productivity appears; consequently, the greater the international competitiveness of the country's industry.

Following this theory, there are three main options to increase competitiveness (see Table 5.3).

Table 5.3 Main competitiveness raising options in economic policy

Low-wage strategy	Nominal wages are decreased while productivity and exchange rate remain at their normal level; this will result in higher volume sales without a loss in profit margins and will therefore create an effect equivalent to a direct fall in production costs. However, this strategy would have an adverse effect on the international division of labour and is therefore problematic in terms of international competitiveness.
Devaluation strategy	Devaluation of a country's home currency enables its industry to sell products in foreign markets at lower prices than at home. This facilitates the success of domestic sales, because the prices of foreign products in terms of the devalued currency are higher than those of domestic manufacturers.
Innovation strategy	Stimulation of innovation increases productivity in a country where growing incomes stimulate import demand.

These options aim to improve trade conditions and to benefit the economy as a whole. Designing a particular strategy like this must evolve from the growth of demand, the relevant production costs, which depend on location, distribution marketing and transaction costs, and the situation of the industry in general. In Europe, these factors are subject to the forces of the Single Market.

5.6 COMPETITION, COMPETITIVE SECTORS AND BUSINESS-RELATED COMMON POLICIES

Strategy and company policies are not entirely under management control. The dynamic evolution of the European economy means that demand and cost conditions continuously change. It is important for corporations to monitor the 'uncontrollable' variables of competitiveness, such as the strategies of competitors, and to impose even marginal adjustments that may be necessary for sustainable competitiveness. This might mean

that costs can be cut quickly or resources attributed differently. The enterprise can then keep in close touch with demand conditions, thus keeping ahead of competitors.

The preceding discussion could lead to the conclusion that competitiveness could be defined simply as the result of commercializing a product or service at the right time in the right place under the right conditions. It is quantifiable through the sustained performance improvement of industry. However, competitiveness ultimately depends on economic choices, as well as on financial and market, operational and technological, and human resources and organizational issues. On a global scale, European corporations are among the leaders in the chemicals, pharmaceuticals, electrical engineering, information technology (IT), telecoms, food and beverages, metals, motor vehicles, banking, insurance and financial services sectors. Yet, European companies are deeply rooted in their home markets (although transnational companies like Nestlé, Unilever, Philips Electronics, Glaxo-Wellcome and Electrolux are exceptions to that rule). In telecoms and its applications, Europe is highly competitive vis-à-vis its trading partners. The same applies to the fields of nanotechnology and biotechnology. The EU is China's biggest trading partner, and benefits from important FDI opportunities there.

Structural weaknesses hamper EU competitiveness by leaving the European market with high production, capital and labour costs, rigid labour legislation, and heavy social laws that undermine employment flexibility. Yet these factors clearly have a very positive effect on income equality in Europe. Moreover, R&D spending is relatively low in terms of European GDP compared to that in the USA and Japan. Business is therefore calling upon the EU and its members, as a common European institution, to facilitate and stimulate economic activity by:

- eliminating bureaucracy
- increasing the efficiency of procurement processes
- raising the participation of various societal groups in decision-making processes
- encouraging education as a key factor to foster information access and content production
- improving the dissemination of best practice, ultimately leading to better services for citizens and businesses.

Common policies, with supremacy over or to complement national policies, were set up by European treaties to monitor intervention where outcomes may distort Europe-wide benefits. This has been the case in agriculture, transport, social policy and also regional policy since 1987. Foreign and security policy are governed with increasing harmonization. This chapter will now analyse those competition and commercial rules that constitute common policies.

5.6.1 Common policies: competitive market structures and related costs

Competition policy has been part of European integration efforts since the Treaty of Paris and the Treaty of Rome. Its aim is to preserve and stimulate efficiencies and effectiveness in the European market. The CEC is the main institution in charge of antitrust policy, merger policy and state aid controls. The objectives of competition policy are to:

- promote competitive market structures
- discourage anti-competitive behaviour
- guarantee fair competitive trade in the Single Market
- benefit consumers and citizens of the EU.

The Common Competition Policy completes national measures that are (and were) taken by member states under the principle of the supremacy of EU law in case of conflict. It prohibits any agreement as anti-competitive and ‘incompatible with the common market’ that affects intra-EU trade with an objective to prevent, distort or restrict competition. Collusion is therefore generally prohibited, with a few exceptions of cooperation between corporations where this does not harm consumer welfare. It also prohibits the abuse of dominance, whether by an individual firm or jointly. Mergers and acquisitions are subject to prior clearance under the merger control.

Of major importance are state aid rules against distortion of competition across Europe, with few exceptions. In antitrust policy, national competencies share much of the EU application of rules. In mergers, the role of Commission investigations was extended beyond that of market dominance towards a focus on the general effect of mergers. The rather limited numbers of staff at the CEC’s competition directorate means that there is a relatively fragmented control mechanism. The case of the *Commission v. Microsoft* was one of the clearest illustrations of the difficulties in pursuing this policy, starting in 2003 and running over many years.

These commercial policy areas are underpinned by an industrial policy that is not a ‘common’ policy per se. Since the end of the 1980s, Europe has seen a sharp increase in mergers, acquisitions, joint ventures and other cooperative agreements between firms, identified as cluster building or concentration (Cawson et al., 1990). Also, there was a significant rise in FDI within the Single Market as part of the Europeanization of business, underlining the movement towards international economic integration. With this development, European industrial policy shifted the traditional national focus of sponsoring ‘sunset’ champions with sectorial aid, to an economically more sensitive approach of supporting ‘sunrise’ innovation with horizontal aid (El-Agraa, 2004). In conclusion, the

inherent objective of industrial policy is to increase competitiveness in tandem with the requirements of the market.

Altogether, the prime objective of the European competition policy is to eliminate distortions and enhance the proper functioning of market mechanisms. The main challenge is to avoid ‘protectionist’ behaviour that would lead to low levels of knowledge and information flows and hinder innovation. Such behaviour would also increase the difficulty of picking champions, and result in retaliation by trade partners. Counter to this incentive, R&D-supportive initiatives are justified by external factors such as the social returns associated with economic returns. Innovation has become key to European competitiveness. Its promotion typically takes the shape of financial assistance, public contracts, tax incentives, one-off trade barriers in case of unfair competition, and export assistance. Ideally, measures of industrial policy should not intervene actively and directly, with the exception of occasional actions. Rather, measures that stimulate the diffusion of knowledge, innovation and entrepreneurship are to be encouraged.

5.6.2 The Common Commercial Policy

Given that the EU industrial policy is fragmented and sector-specific, the Common Commercial Policy (CCP) is there to help domestic and foreign corporations to benefit from a single market. The CCP is part of the EU external trade policy and is the first single coherent, common European policy. It allows for a common tariff and a common commercial policy towards non-EU countries, with basic common rules in three commercial fields:

- trade with state-trading countries
- import quotas
- anti-dumping measures.

The CCP allows for the common conclusion of tariff and trade agreements, the negotiation of changes in tariffs and the achievement of uniformity in measures of liberalization. European export policy and EU-wide trade protection measures, e.g. anti-dumping and anti-subsidy measures, are occasionally imposed when this is in the Community’s interest (consumer and industry). Box 5.14 summarizes the *trade instruments* that are at the disposal of the EU to make this happen. (Later, in Chapter 10, *trade agreements* will be discussed further.) The 2016 Trade for All strategy is meant to extend the impact of these policies and help deliver real economic results for consumers, workers and small companies. It aims to ensure that trade policy is about values and, hence, increasingly supports fair and responsible cross-border activity.

Box 5.14 Trade policy instruments and types of intervention

- Balance-of-payment measures, including export rebates (restitutions) refunding the difference calculated by the Commission between EU and world market price, applied foremost in agricultural policy, and restrictions on hire purchase.
- Productivity, price and income policies.
- Common customs, taxation and tariff instruments, including import quotas, transit duties, preferential duties and anti-dumping duties.
- Import monitoring associated with Voluntary Export Restraints (VERs), local content requirements and rules of origin.
- Legislation not only to control companies, mergers and restrictive practices within the Single Market, but also to monitor illicit action in third countries where EU firms encounter obstacles to market access, through the 1995 trade barriers regulation, leading to negotiation and/or recourse to the WTO if necessary.
- Control of scientific research and structural aspects of technology.

Overall, European industry excels in the automotive sector and its components, in engineering and electrical skills, in aerospace and in the mobile phone industry. LVMH, Armani, Gucci and Dior are leaders in the luxury fashion industry, while Carrefour, H&M, Zara and Metro are highly efficient retailers worldwide (Doz, Santos and Williamson, 2001). The Europeanization of the business environment has had a largely positive impact on competitiveness and has enhanced the focus of the market towards specific and functional specializations that enhance effectiveness and efficiency. Financial integration in the shape of a common currency in the eurozone stimulates this effect.

5.6.3 Business-related policies: implications

The EU is responsible for a large number of common policies. Among them, you can find the Common Agricultural Policy, the Common Foreign and Security Policy, fisheries, environment and energy, regional, certain social and employment policies, as well as transport, trade and aid policies.

On a *micro and meso level*, common policies are not only advantageous but also challenging. We can observe the potential costs of EU directives with the example of labour. Those common rules harmonized many important areas, making compulsory

employment conditions in and across borders in Europe more transparent, in regard to job contracts, working time (Table 5.4), young workers, pregnancy, parental leave and part-time work.

Table 5.4 Full-time employee average hours worked per week, 2010 and 2017 for selected EU members

	Weekly working hours	
	2010	2017
United Kingdom	42.8	42.7
Germany	41.8	41.2
France	41.1	40.5
Spain	41.7	41.0
Italy	40.6	40.8
Ireland	39.6	40.3
Poland	42.2	42.0
Czech Republic	42.5	41.7
Slovenia	42.0	41.5
Estonia	41.0	40.5

Source: European Labour Force Survey, Eurostat Table lfsq_ewhun2, © European Union, 1995-2017

Employers in Europe bear part of the costs of:

- social security
- high protection standards (such as higher rates per hour)
- individual cases for exemption rights (such as absence for a medical check-up)
- health and safety protection
- additional administrative cost (bookkeeping, scheduling, additional writing requirements).

On a *macro level*, trade policy links the public and private sector to the WTO and deals with global trade issues, sectorial and horizontal issues, and bilateral agreements with one common approach. At the WTO, the member states are represented by the EU. The advantage is that the EU together has more negotiation power; the challenge is that specific issues may well get diluted in the overall objective setting that encompasses all member states' views. These multilateral negotiations have an important impact on

business activity worldwide (see Chapter 10). In global trade, the EU supports developing countries in as much as it helps them integrate into the trading system. The objective is to help these economies mature so as to benefit from liberal trade. The Generalized System of Preference (GSP) runs a *system of non-reciprocal tariff advantages* with the EU for these economies. Similarly, the Commission is engaged in sustainable development initiatives and researches the impact of trade negotiations on developing countries, on social welfare, the environment and civil society. The EU concludes bilateral agreements and devises specific trading policies with non-EU countries and regional groupings. These *bilateral agreements are legally binding* for the partners, as custom unions, free trade associations, cooperation or partnerships. At the same time, European trade policy deals with the horizontal and vertical sectoral issues. *Horizontal issues* may be those of trade and competitiveness, intellectual property, market access policy, trade and competition, trade facilitation, government procurement – as in the example cited above – and export credits are also part of these. As an example, *export credits* that are typically government supported may create unfair competition: they are used when a foreign buyer of exported goods or services defers payment. Export credits are hence subject to OECD agreements and the EU directive on harmonization of export credit insurance for transactions with medium- and long-term cover. They are therefore under supervision from the EU for all member states.

An essential part of European trade policy is dispute settlements, trade barrier regulation, anti-dumping, anti-subsidy and safeguarding policies, and a range of fair trade defence and monitoring tools. These mechanisms complete the sectoral policies that structure a common market for agriculture, fisheries, services and merchandise on a *vertical level*. For example, the EU is the world's largest producer of chemicals and cosmetics (CEC, 2010). Those firms that export need to overcome a number of obstacles such as complex standards and technical regulations, intellectual property laws, registration and certification procedures, while those chemicals companies that enter the EU market need to be familiar with the relevant European regulations.

5.7 RÉSUMÉ AND CONCLUSION

The Europeanization of this business environment is based on the effects of globalization, regionalization and important geo-historical and geo-economic evolutions. International trade theory makes a strong case for the internationalization of firms that can obtain important advantages from going abroad. Also, the theories sustain the

argument that integration is beneficial for the competitiveness of a nation or, in the case of Europe, a market grouping. The European business environment has been subject to major harmonization, liberalization and deregulation efforts, which are illustrated by the common policies that govern important policy areas. Nevertheless, income distribution is not equal, and the EU promises huge efficiency advantages if harmonization efforts continue. Competitiveness is a key issue in the EU.

This chapter has reviewed the main rationale and business-related instruments that drive the common response to the challenges of market mechanisms. In addition, it has reviewed the impact of this market context on international business strategy in Europe, including entry and location modes.

MINI-CASE

The European Sustainability agenda and shared value projects: the Case of the Port of Antwerp

Damiaan Bogaerts, Mattias Bott, Victor Donck, Mirella Lancz, Sofian Ouahchi, Zhilling Luo and Jenny Hillemann, Vrije Universiteit Brussel

Sustainability is one of the most important goals of the Europe 2020 Strategy, in which the European Union and its members jointly outlined their common plan to create a more sustainable Europe and to preserve the earth's natural resources. Its Environment Action Programme, which has been running from 2013 until 2020, is reviewed for extension depending on its track record. Europe 2020 encourages resource-efficient growth and innovation while keeping in mind the natural limits and people's health and well-being (European Commission, 2014).

Some European countries had faced challenges to meet the goals. In 2015, only two years into the strategy, as many as 15 infringements solely referring to high levels of dust particles had been reported, when Belgium received a warning from the European Commission: at that stage, poor air quality in Brussels, the Port of Ghent and around the Port of Roeselare caused more deaths than road accidents each year (European Commission, 2015).

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Fortunately, there were also forerunners already adhering to the goals and sharing their learning. The Port of Antwerp is one organization that undertook timely action. In the past, the port had been known as a major contributor to air pollution. Yet, through targeted investment strategy and action, the Port of Antwerp has become today's sustainability leader on the Hamburg–Le Havre range. This 'range' consists of the ports of Hamburg, Bremerhaven, Rotterdam, Amsterdam, Antwerp, Dunkirk, Zeebrugge and Le Havre, constituting a significant maritime network for Europe and worldwide logistics. The port community consists of approximately 900 companies such as BASF Antwerp, Qpinch, and Gyproc working together to promote sustainability as a shared concern to protect the 3Ps: People, Planet and Prosperity. The Port of Antwerp now extensively deals with mobility, climate, green energy and more sustainable modes of transport (Plasschaert et al., 2011; Port of Antwerp, 2016a).

The Port of Antwerp acted directly in consideration of Europe 2020 by creating the Liefkenshoek rail tunnel and the ECLUSE project, a network for heat distribution, among other projects. The aim of these projects is to reduce CO₂ emission and promote renewable energy (Port of Antwerp, 2016b). The goal of ECLUSE is to substitute large chemical companies' natural gas-based energy supplies by the heat network. This heat network generates heat (in the form of steam) and is operated as a joint venture of the waste processing company INDAVER and SLECO. Infrac, the grid management company is responsible for the distribution network. The expected development is a total CO₂ reduction of 100,000 tons per year. When reaching its full capacity, ECLUSE could be one of Europe's largest industrial heating clusters, producing about 10 per cent of all 'green' heat in Flanders (Port of Antwerp, 2016c).

The fact that large areas of the port fall under the Special Protection Zones of the EU Birds and Habitats Directive (European Commission, 2018b), makes the port's situation very unique. Industry and nature did not always peacefully co-exist here, but after discussions and consultation, all parties agreed that there is a need for a new vision and collaboration instead of legal battles. The Port of Antwerp community (consisting of the 900 companies and the Antwerp Port Authority), in collaboration with the Maatschappij Linkerscheldeoever and Natuurpunt, a non-profit nature association, agreed on creating an ecological infrastructure within the port area and set aside around 650 hectares (around 5 per cent of the port) to ensure the sustainable conservation of 90 protected species (Port of Antwerp, 2015).

Another good example where the Port of Antwerp exhibits its leading position is waste management. The European Maritime Safety Agency (EMSA), which is a EU agency, has named the Port of Antwerp as an exemplary leader and role model for other European ports in waste reception. The port is one of the major players focusing on the circular economy in terms of waste management: Antwerp represents a European hub for the import/export of waste materials being recycled (Port of Antwerp, 2016d).

In 2016, for the second time after 2012, the Port of Antwerp was awarded for the Best Belgian Sustainability Report. The major criterion for this recognition was the jury's focus on how well organizations align their strategies with the Sustainable Development Goals launched by the United Nations. This followed international awards including the prestigious Environmental World Ports Award 2013 (Sustainabilityreports.be, n.d.; Port of Antwerp, 2016d).

The aforementioned course of action was part of the broader Port of Antwerp's Total Plan for a Competitive Port, the 2014–18 Business Plan and is part of its 2030–50 long-term vision. Being the second-largest (214,166,958 tons maritime freight volume in 2016) and leading break-bulk port in Europe, as well as the market leader in fruit and steel handling, the Port of Antwerp is a significant European and international player (Port of Antwerp, 2018). At least since 2010, only the Port of Rotterdam has handled more cargo. Other well-known European ports such as the third-ranked Port of Hamburg and the fourth-ranked Port of Amsterdam have handled about 50 per cent less cargo than the Port of Antwerp, underlining the Port of Antwerp's strong competitive position in Europe (Eurostat, 2017). However, the port's vision is to create maximum sustainable added value so as to even further enhance its competitive advantage by performing sustainable activities. Therefore, the port also reinforces its competitive position as the sustainability leader in the Hamburg–Le Havre range. This achievement is an advantage when being considered by clients and investors, since sustainability and environmental impact are becoming important and key factors in today's business environment. The shift towards renewable energy, the realistic costs and energy savings by means of waste heat recovery are now seen as the main strengths of the port. This adds to the advantages of infrastructure, accessibility, market access, operational costs, logistics competence and business environment that are part of port choice considerations in a market that allows importers and distributors to benefit from a Common Customs area. Being located in what is called the 'Blue Banana' cities, a highly urbanized corridor across Europe, is also considered an advantage.

The port's performance in Europe is widely recognized. The European Commissioner of Environment and Maritime Affairs and Fisheries, K. Vella, visited the Port of Antwerp in 2016 together with two European Parliament members, when the commissioner outlined the consistency of economy and ecology as essential, and emphasized the achievements of the Port of Antwerp in this field. European Parliament member Demesmaeker acknowledged Vella's comment and added that the EU's Birds and Habitats Directive should be maintained. As part of the Fitness Check, the European Commission examined whether the Nature Directives were consistent with the Regulatory Fitness and Performance Programme (REFIT). This

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programme reviews the EU legislation so as to make laws comprehensive and less costly (European Commission, 2016). Instead, ports should focus on implementing these directives completely and correctly to get the full benefit of these guidelines (Natuurpunt, 2016).

Further investments are made in this area, going well beyond these more visible features of sustainability. Part of this is digitalization initiatives. In particular, block-chain technologies, which improve traceability and security in economic transactions online, transform business models, at the same time reducing recalls, unethical sourcing and counterfeits; help secure sustainable projects, transport contracts and supply chain transparency; and better monitor air pollution levels into the future. The EU agenda and its institutional framework are well intertwined with the present and future of decision-making in this industry.

Mini-case questions

1. Why would a major logistics infrastructure such as the Port of Antwerp promote sustainability in Europe? What is the institutional context for this?
2. In your opinion, in what ways does the Port of Antwerp gain competitive advantage from its effort in sustainability? What role may governmental relations and, potentially, lobbying play in this? Which institutions would ports be interested to consult with?

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Chapter review questions

1. **Explain** in which cases offshoring is economically sensible.
2. **Explain** the most suitable contexts in which to use offensive or defensive internationalization strategies in Europe.
3. **Based** on international trade theory, to what extent can a firm be an instrument of effective production and distribution on a European scale?
4. **Where** can you find signs of some possible dangers of Europeanization?
5. **Can** the EPO protect firms from patent infringements occurring across the European market?

Assignments

- **Imagine** that you are the CEO of a European company pondering entry choices in another EU market versus a non-EU market. What factors will most likely make you opt for M&A versus a joint venture, or vice versa? Discuss.
- **Compare** income distribution disparities in your home country with that of any (other) EU member states. Discuss your findings.
- **Case study assignment:** read and prepare the case study 'Ryanair' in Part IV.
- **Internet exercise:** on the Internet, find the main competitiveness charts. Which organizations publish them and what criteria are they based on? Compare the top rankings for the period 2007–2018 and interpret your findings.

Role-play exercise

This exercise is intended to be used by you in class, in tutorials or you could also take this further outside of class in a group training, to engage with the arguments in the chapter in a hands-on manner. This role-play exercise requires sufficient participants to form at least two groups. One group represents one country that aims to promote its clothing industry's internationalization; the other group another country: one will explore the rules of origin applicable in the EU, another group will explore those applicable in a non-EU country of your choice, for example, India. What differences and similarities do you find, especially for products that are part of the global value chain and hence issue from various countries? As representatives of the trade commission of the respective countries, attempt to negotiate convergence of these rules to ensure they will be beneficial to your economy's competitiveness. Debrief with your lecturer on what aspects of business and the economy became most important in the debate, and why.

Further reading

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Internet resources

Trade for All strategy:

http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf

European Patent Office:

www.epo.org/

European IPR Helpdesk:

www.ipr-helpdesk.org/home.html

Internal Market Scoreboard:

http://ec.europa.eu/internal_market/score/index_en.htm#score

United Nations Conference on Trade and Development:

www.unctad.org

World Bank website (information on countries):

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