

# The Role of ASEAN Regional Economic Integration in Finnish Companies' Operations in Southeast Asia

Marketing  
Master's thesis  
Anne Hyttinen  
2011



**Aalto University**  
**School of Economics**

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### **Objectives of the research**

The main purpose of this thesis was to find out how and in what extent the regional economic integration of ASEAN has impacted the operations and decision-making of Finnish companies operating in Southeast Asia. Especially, the impact of ASEAN on the business environment and the institutional constraints the companies are possibly experiencing was studied. To understand the context, the role and the significance of Southeast Asia in the international strategies of the Finnish companies was discovered. This thesis is conducted as a part of the Center of Markets in Transition (CEMAT) research on ASEAN region.

### **Methodology**

In this study qualitative research approach was applied. Data for the thesis was collected through interviews and documentary analysis. The interviewees were the representatives of Finnish companies operating in Southeast Asia who have professional experience of the region. Secondary data was collected from the electronic archives of the Finnish and foreign newspapers, company websites, and archives of the Ministry for Foreign Affairs and ASEAN secretariat.

### **Findings and conclusions**

The findings of this study indicate that the regional economic integration is not clearly visible in Southeast Asia and the business environment where the Finnish companies operate has not significantly changed as a result of regional integration and free trade agreements in the region. The Finnish companies have not experienced considerable institutional constraints and the ASEAN integration has not impacted the institutional framework. The role of Southeast Asia as a region in the international strategies of the Finnish companies is relatively significant, although China's is the most important.

### **Keywords**

Regional economic integration, ASEAN, Southeast Asia, Finland, international operations, Finnish companies, institutional framework, institutional constraint

## ASEAN-INTEGRAATION ROOLI SUOMALAISTEN YRITYSTEN LIIKETOIMINNASSA KAAKKOIS-AASIASSA

### **Tutkielman tavoitteet**

Tutkielman tavoitteena oli selvittää miten Kaakkois-Aasian ASEAN-alueen talousintegraatiokehitys on vaikuttanut suomalaisyritysten toimintaan alueella, erityisesti miten alueellinen yhdentymisen on vaikuttanut yritysten liiketoimintaympäristöön sekä institutionaalisiin rajoitteisiin, joita yritykset mahdollisesti kohtaavat alueella toimiessaan. Tavoitteena oli myös selvittää Kaakkois-Aasian rooli ja merkittävyys yritysten kansainvälisissä strategioissa, ja miten se on viime vuosina muuttunut. Tämä tutkimus on osa Aalto-yliopiston kauppakorkeakoulun Center of Markets in Transition (CEMAT) –tutkimuslaitoksen tutkimusta ASEAN-alueesta suomalaisyritysten liiketoimintaympäristönä.

### **Tutkimusmenetelmät**

Tässä tutkimuksessa sovellettiin kvalitatiivista tutkimuslähestymistapaa. Tutkimusaineisto kerättiin tekemällä haastatteluita ja tutkimalla kirjallista aineistoa. Haastateltavat olivat Kaakkois-Aasian alueella toimivien suomalaisyritysten edustajia ja yritysjohtajia, joilla on kokemusta alueesta. Kirjallisen aineiston lähteenä toimivat mm. ASEAN-sihteeristön arkistot, suomalaisten ja ulkomaalaisten sanomalehtien uutisarkistot, yritysten Internet-sivut sekä Ulkoministeriön arkistot.

### **Keskeiset tutkimustulokset**

Tutkimuksen tulokset osoittavat, että ASEAN-alueen talousintegraatio ei ole selvästi havaittavissa Kaakkois-Aasiassa, eikä liiketoimintaympäristö ole juurikaan muuttunut alueellisen yhdentymisen tai alueen vapaakauppa-kehityksen myötä. Suomalaisyritykset ovat kokeneet suhteellisen vähän institutionaalisia rajoitteita, eikä ASEAN-integraation koettu vaikuttaneen näihin. Kaakkois-Aasian rooli useimpien yritysten kansainvälisissä strategioissa on kuitenkin suhteellisen merkittävä, tosin Kiinan rooli on keskeisin.

### **Avainsanat**

Alueellinen talousintegraatio, ASEAN, Kaakkois-Aasia, Suomi, kansainväliset operaatiot, suomalaisyritykset, institutionaalinen viitekehys, institutionaaliset rajoitteet

## TABLE OF CONTENTS

1.	INTRODUCTION .....	1
1.1.	Background information about Finland-ASEAN trade relations .....	5
1.2.	Previous research and research gap .....	6
1.3.	Research problem .....	12
1.4.	Definitions and limititons .....	14
1.5.	Outline of the thesis .....	16
2.	REVIEW OF LITERATURE.....	18
2.1.	The regional economic integration shaping the business environment....	19
2.1.1.	The concepts of region, economic integration & cooperation .....	19
2.1.2.	Economic integration theory .....	22
2.1.3.	The regional production chains steering Asian regionalisation .....	24
2.1.4.	The significance of the regional economic integration for the companies .....	31
2.1.5.	Regional economic integration as a part of institutional framework ...	36
2.2.	The institutional approach to business strategy and regional economic integration.....	39
2.2.1.	Roots of institution-based view are in the institutional theory.....	41
2.2.2.	Institution-based view of business strategy.....	43
2.2.3.	ASEAN economies as feasible research objects for institution-based view .....	45
3.	THEORETICAL FRAMEWORK .....	48
4.	METHODOLOGY .....	51
4.1.	Methodology for data collection and analysis.....	51
4.1.1.	Interviews as a data collection method.....	52
4.1.2.	Textual data .....	54
4.1.3.	Data analysis.....	55
4.2.	Reliability and validity of the study .....	56
4.3.	Limitations.....	58
5.	EMPIRICAL FINDINGS .....	59
5.1.	Southeast Asia, ASEAN integration & AFTA, and further expansion of the FTA in Asia .....	59
5.2.	The characteristics of the Finnish investments in the ASEAN region ....	63
5.3.	The significance of ASEAN as market for Finnish companies.....	66
5.3.1.	The role of ASEAN in Finnish companies' strategies .....	66
5.3.2.	Significance of ASEAN region compared to China, India and other Asia .....	70
5.3.3.	The degree of integration of ASEAN member states.....	72
5.4.	The impact of ASEAN and AFTA on Finnish companies operations ....	74
5.4.1.	The experiences of Finnish companies about ASEAN integration and AFTA .....	74
5.4.2.	Trade barriers experienced .....	83

5.5.	The impact of ASEAN on regional institutional framework and the business strategies of Finnish companies .....	93
5.5.1.	Is ASEAN enhancing the institutional environment in the region? .....	94
5.5.2.	The effect of ASEAN on companies' strategy and decision making...	97
6.	SUMMARY, CONCLUSIONS AND RECOMMENDATIONS .....	100
6.1.	Summary of the main findings .....	100
6.1.1.	Significance of ASEAN region to Finnish companies .....	100
6.1.2.	The impact of ASEAN on Finnish companies operations .....	101
6.1.3.	The role of ASEAN enhancing the institutional framework in the region .....	104
6.2.	Theoretical conclusions and contributions .....	106
6.3.	Managerial implications .....	107
6.4.	Policy implications .....	109
6.5.	Suggestions for future research .....	110
7.	REFERENCES .....	112
8.	APPENDICES .....	123

## LIST OF TABLES

Table 1: Dimensions of Institutions .....	42
Table 2: Finnish companies' investments and exports to selected ASEAN countries, and China in comparison .....	65

## LIST OF FIGURES

Figure 1: Effects of NAFTA on FDI-based strategies of MNCs .....	32
Figure 2: The possible benefits of regional economic integration for the foreign companies investing in the region .....	35
Figure 3: Business strategies in emerging economies .....	45

## **INTRODUCTION**

The geography of global trade has significantly changed in the recent years. Changes are evident in the trade policies between nations and geographical blocs as well as in the underlying global production chains and companies' operations' far away from the home markets. The focal point in the global economy has shifted more or less from the west to the east and as a trade destination Asia has emerged significantly since the first exports of Finnish companies to the region in the 1980s. According to the observers the growth is there. The context of this study is Southeast Asia and the Finnish companies' operations in the region. The special feature shaping the business environment is the regional economic integration of ASEAN and especially the free trade agreement AFTA. The aim is to create ASEAN Economic Community by 2015, an EU-type of trade bloc promoting ASEAN countries as trade and investment destinations for foreign direct investments and enhancing intra- and extra-ASEAN trade by decreasing the trade barriers. Companies should benefit from locating in a free trade area, as there will be less trade barriers to cross-border trade within the region. The regional economic integration should, as the term suggests, integrate the region, and this should be visible also in the institutional framework the foreign companies face.

Southeast Asia is one of the few regions in the world with real growth in GDP, although during last few years the business interest and attention has been on Asia's growth engines, China and India. However, a vast area and massive amount of people with the rising standards of living and emerging middle class just next these giants should not be forgotten. Some ASEAN economies, especially Thailand and Indonesia, were seriously hit by the Asian

Financial crisis in the end of the 1990s, but after that, double-digit GDP growths have been witnessed in some ASEAN member states however, the road to recovery has not been rapid with all. However, many ASEAN economies have been growing steadily and the whole ASEAN's GDP growth rate in 2005-2009 was 4.8% taking into consideration that the world economy slumped in 2008-2009 and GDP growth in ASEAN was only 1.5% in 2009 (ASEAN Secretariat statistics 2010). In 2010, ASEAN-6 countries reached significant growth of 7.3% in GDP (OECD).

The ASEAN region is a vast and heterogeneous area consisting of ten member states. As a marketplace ASEAN is significant, in 2010 total land area is 4 435 830 km<sup>2</sup>, total population 591 841 000 and GDP per capita 2520 US\$ (ASEAN Secretariat 2010, ASEAN indicators 2009). Most of the ASEAN countries can be described as emerging or developing markets though with some exceptions, such as the ultra modern city state of Singapore which is ranked as the world's easiest place to do business in many years in a row and Malaysia, which is close to the status of "developed" economy. Thus, extreme diversity describes the region in economic development, political structures and physical infrastructure without mentioning the myriad of local languages, cultures and religions.

The Association of Southeast Asian Nations (ASEAN) was established in 1967 with a long-standing aim to create the ASEAN Economic Community (AEC), alongside with ASEAN Political-Security Community and ASEAN Socio-Cultural community (ASEAN secretariat 2010), a single market in Southeast Asia by the year 2015. A step forward was the formation of ASEAN Free Trade Area (AFTA) in 1992, when the first six ASEAN countries: Malaysia, Indonesia, Thailand, Brunei, the Philippines and Singapore, joined it. Newer, but less developed members were Vietnam (1995) and finally Cambodia, Laos and Myanmar joined AFTA in 1999. Basically, the primary goals of AFTA were first, to increase ASEAN's competitive edge as a production base in the world market through the



elimination of intra-ASEAN tariffs and non-tariff trade barriers and second, attract more foreign direct investment (FDI) into ASEAN. ASEAN leaders' summit in 2007 set bold targets of creating "seamless" marketplace and EU-like economic community among 10 member countries by the year 2015, as the region needs economic muscle to counter the competition from the rising giants China and India (Green 2008).

The ASEAN region and regional economic integration of ASEAN was chosen as a research topic due to its interesting role in Finnish companies' internationalization. Finnish companies have been established in ASEAN countries already in the 1980s and the centre of the companies' Asian operations was usually in the Southeast Asia. The Asian financial crisis 1997-1998 and opening up of Chinese markets simultaneously pulled many Finnish firms attention and operations to China and the role of ASEAN region in Finnish companies' international operations slightly decreased. However, as the aim with creating a free trade area to Southeast Asia is to increase the amount of foreign direct investments and enhance the trade, it is interesting to analyze from the perspective of Finnish companies in the region, whether ASEAN integration is a significant factor impacting the companies operations and strategy. Beside the integration process in the region, Southeast Asia has been described as relatively easy operational environment (Finpro 2009-2010: country reports, Kettunen & Kosonen, forthcoming) and there is business potential in many industries where the Finnish companies excel and these factors have kept Southeast Asia as a part of the global strategies of these companies.

As the aim of regional economic integration is to liberalize the regional trade and investments, one may assume that the integration process has direct effects on the MNCs operating in the region: trade is enhanced by removing the trade barriers and forming integrated market within the region. It can be then assumed that the operations of companies should ease across state boundaries. Hence, the role of ASEAN integration is brought into the

discussion and it is interesting to find out whether ASEAN and AFTA has an impact on Finnish companies operations and how these companies have experienced the integration. As this study discusses Finnish companies operations in foreign markets, it is appropriate to study the significance of these markets from Finnish companies' perspective and to discover the role of Southeast Asia as markets for Finnish companies at the moment.

The economies of Southeast Asia can be described from the global trade perspective as emerging markets. Hoskisson et al. (2000) defines those "low income, rapid growth countries using economic liberalization as their primary engine of growth". In these markets the institutional framework is not necessarily as developed as it is in the developed markets. According to Peng (2004) Asian economies are thus "viable research laboratories" for institution-based view of strategy, because in there the importance of institutional forces on business strategy is highlighted.

Hence, in those markets, the strategic choices that companies do, are not only driven by firm-specific resources and capabilities, but those are also a reflection of the formal and informal constraints of a particular institutional framework that decision makers confront in the host markets (Peng 2000). However, the special feature of the markets in Southeast Asia is the regional economic integration shaping the business environment.

Thus, the aim of this research is to study the role and significance of the regional economic integration in Finnish companies operations in the ASEAN region and to define if the integration has an impact on the institutional constraints the companies face and finally, to find out has the integration had an impact on their strategy and decision making.

This study combines the research tradition of political science, where state-led agreements are typically studied, to the international business research, which focuses on the international operations of companies. The ongoing regional

economic integration of ASEAN provides an excellent context for this study as it is a region where Finnish companies have established their operations since the 1980s and it still has a role in the global strategy of many companies.

This thesis is conducted as a part of Aalto University School of Economics' research unit Center of Markets in Transition (CEMAT) research on regional economic integration processes, in this case ASEAN region as a business environment and the effect of ASEAN integration to Finnish companies operations in this region.

### **1.1. Background information about Finland-ASEAN trade relations**

The trade relations between Finland and Asia, and especially with ASEAN countries, are relatively young. The first Asia strategy formed by the Ministry for Foreign Affairs of Finland is made as late as 2001 and this strategy is based on the first Asia strategy of EU which was formed in 1994. The trade between Finland and Asia has been steadily growing since the war period (1945-) in Finland, but the quantities have been small. Although, an interesting growth period regarding Southeast Asian trade was in the mid 1990s, when exports e.g. to Singapore, Malaysia and the Philippines grew quickly. For many Finnish companies Southeast Asia, mainly Singapore, Malaysia and Thailand, were the first locations where they established the first operations in Asia (Kettunen 2002). Since 2003, the focus in the Finnish companies' internationalization to Asia has been on China, as the economy has opened up after joining WTO in 2001. The Finnish exports to China have increased since 2003 and China is also the most important Asian recipient of Finnish FDIs. (Kettunen & Korhonen 2006)

## **1.2. Previous research and research gap**

Southeast Asia or in other words, the ASEAN region, is widely studied in international business research. There exists a share of academic research about ASEAN region as business environment and about certain industries and business operations in different Southeast Asian countries, but only a few of them are conducted from Finnish perspective. Although an article by Kettunen (2002) discusses ASEAN region as a trade destination as a part of Finnish trade policy. The article by Kettunen (2002) is extensive and describes the trade between Finland and Southeast Asia, but it is already almost 10 years old. Also a short study about Nordic investments in Asia's tiger economies is made in 2006, but from ASEAN countries it covers only Singapore (Korhonen & Kettunen, 2006).

There are also few master theses written at Helsinki School of Economics about business in Southeast Asian countries, although the majority is written in the 1990s. The latest, a thesis by Vasamo (2004), discusses the foreign direct investment and location decisions of Finnish companies in Thailand and Malaysia. Even though the thesis discusses the business environment it concentrates on the reasons of FDI and location decision, decision-making process, and market entry mode selection, but not on the institutional environment the region provides for Finnish companies, neither the regional economic integration. Siitonen (1999) studies in his thesis the Finnish FDIs to Malaysia, but there the perspective is cultural, though comprehensive research on the business environments of Malaysia and Singapore is provided. Also a study about Malaysia's business environment and culture is conducted by Peltonen (1992) and also Vaarnas (1996). A study of business environment in Thailand from the perspective of economic geography is conducted by Voutilainen (1991). There are also few theses written about certain industries in the ASEAN region, for example telecom (Ala-Tauriala 2000) and tourism (Jussila 2003, Kattainen 2003, Niskanen 1994). The majority of these studies are fairly old, mainly from the 1990s. That being the reason or not, regional

economic integration in ASEAN is not brought into the discussion. Neither the possible effects of integration initiatives on Finnish companies' operations are discussed.

There exists a wide stream of research about regional economic integration, as almost all countries are part of some type of regional trade agreement (RTA) and institutionalized regional economic cooperation has been the dominating trend of globalizing world since the end of 19<sup>th</sup> century, the most notable cases being NAFTA and EU. The research is conducted usually within political science, commonly from the perspective of international economics, international relations and international political economy. Also in Finland, there is a group of researchers studying ASEAN and their output is well-presented for example in Palmujoki (2003) and Luova & Kokko (2006). However, the perspective of these studies discussing ASEAN is on the state-level agreements and the integration as a part of trade policy and most of these studies are part of political science. Hence, the business perspective is usually lacking.

As the aim of the free trade agreements is to direct and increase the global investments and trade flows (Hill 2009), the connection between the regional economic integration and FDI is studied widely within international economics (e.g. Blomstrom & Kokko 1997, Buckley et al. 2001, Motta & Norman 1996, Aggrawal 2008, Feils & Rahman 2010), also in the context of ASEAN (e.g. Plummer & Cheong 2007). For example Blomstrom & Kokko (1997) find that the integration has positive FDI effects, but the most positive impact on FDI occurs when the regional economic integration coincides with domestic liberalization and macroeconomic stabilization in the member countries. This is a noteworthy finding regarding ASEAN, however, this stream of research rarely incorporates the experiences and insights of the foreign companies in the region about the integration.

Only a few studies focus on the impact of the regional economic integration or free trade area on foreign companies' operations which are investing in the region. Even though, from the perspective of the companies, the state-specific trade policies shape the rules for their foreign trade operations. This affects particularly regional production chains where the company is involved in regional imports and exports. The actual trade flows and trade policies are studied for example in a doctoral dissertation by Kettunen (2004). She provides an extensive research on regionalism and trade policies in EU-ASEAN trade. A comprehensive description of ASEAN integration is Lindberg's (2007) dissertation of the regionalisation process in Southeast Asia and integration of ASEAN's newest members, Cambodia and Laos in it. Kettunen (2002) and Kettunen & Kosonen (forthcoming) are examples of studies where ASEAN region is studied from the perspective of companies investing in the region. Both Kettunen (2002 & 2004) and Lindberg (2007) ground their research to the findings of Alvstam (1993, 1995, 2001a, 2001b) who has been one of the most influential academics studying the linkage between trade flows and FDI affecting the regionalisation. His main message is that the industrial dynamics are changing the geography of the foreign trade in Asia (1995). He uses an example of Japanese companies importing raw materials to be processed in Southeast Asia and then the semi-finished or end products are shipped back to the origin or some other markets. Hence, FDI of MNCs benefit the ASEAN economies and create "real" economic regionalisation in the region (Mirza & Giroud, 2003) because these supply chains enhance the intra-region trade through intra-firm trade flows.

The notions by Alvstam (1993, 1995) and Mirza & Giroud (2003, 2004) are highly beneficial regarding this study. As the aim is to find out how ASEAN integration affects Finnish companies operations in the region, this is best found out by reviewing these companies' regional production networks or extra-region trade. Nevertheless, they see companies' regional production networks "causing" the regionalisation, when in this study, the focus is rather recognizing ASEAN integration as given, formal institution taking place in

the business environment where Finnish companies operate. Nevertheless, Alvstam (1995) and Mirza & Giroud (2003, 2004) are one of the few international business researchers that study FDIs of MNCs and acknowledge the existence of regional economic integration shaping the business environment.

The progress of ASEAN integration and the business opportunities the integration and region provides, are studied by various trade promotion - organizations, such as chambers of commerce (U.S. Chamber of Commerce 2010) or regional trade and development promotion centres, for example EUROPEAID, EU commission's development & cooperation department. These both have published studies regarding the progress of ASEAN integration from the perspective of US-origin Fortune-500 companies (Chamber of Commerce 2010) and also EUROPEAID (2005) has studied the business opportunities for EU companies in the ASEAN area. Even though these studies provide interesting and recent insights about the research subject, these lack the academic ground and do not contribute to the academic research of ASEAN integration. However, these studies provide interesting, comparative empirical research results for this study, showing the progress and impact of ASEAN integration from other than only Finnish companies' experiences.

This study incorporates the institutional theory and institution-based view to study the role of ASEAN integration for Finnish companies, comprehending ASEAN as a formal institution shaping the business environment where the foreign companies operate. Institutional theory has become the most dominant approach to study economies in transition, that are the Post-Soviet states (Karhunen 2008) or emerging economies (Peng et al. 2008) due to the emphasized relationship between the institutions and business strategies in the transition and emerging economies. Hoskisson et al. (2000) argue that the institutional theory appears to be a highly insightful approach when probing into organizational strategies in Asia as there are mainly emerging economies

which are usually characterized by having a greater degree of institutional risk than developed economies. However, the typical institutional studies described for example Peng (2000, 2002, 2004), recognize the strategic choices are influenced by the dynamic interaction between the organization and the institutional constraints of the business environment. In this study, it is assumed that the regional economic integration increases the economic growth of member countries (Vamvakidis 1998, Hartono et al. 2007 (Indonesia), Nguyen 2005 (Vietnam)) and thus, in long term, fosters the institutional framework and decreases the institutional constraints the foreign companies face. Despite of the usefulness of the institutional theory and especially institution-based view, it is not widely used in the research of regional economic integration, and ASEAN integration is not studied as a formal institution of the business environment previously.

Many international business scholars (e.g. Dicken 2007) recognize that it is not possible to separate businesses from the environment they operate in. Institution-based view has the same outlook. The original theory is the seminal work of the Nobelist, Douglass North (1990) “Institutions, institutional change and economic performance”, where North presents the idea of formal and informal institutions as the “rules of the game” that significantly shape the strategy and performance of firms in a given environment. Institution-based view divides the operational environment into two categories; formal and informal institutions (North 1990). Formal institutions are for example legislation, regulations, taxation and so forth. Informal institutions are the shared practices of the companies operating in one region. Informal institutions are for example norms, cultures and ethics. The institutions shape the context where a company operates and sets the institutional framework where a company must be adapted to.

Hence, there exists a clear gap in the research because there have been no previous academic research available that study the business environment where foreign companies operate in, focusing on the role and effect of the



regional economic integration on Finnish companies' business strategies, in the context ASEAN. Therefore this study links the vast research of ASEAN regional economic integration, which usually neglects the company perspective, to the institution-based view of business strategies, where regional economic integration has not been taking into consideration as a formal institution impacting the business environment and institutional framework. When a specific group of business operators, Finnish companies investing in the Southeast Asian region, are the focus group, it is possible to crystallize the existence of research gap.

Also, the general knowledge about ASEAN integration in Finland is quite limited. Southeast Asia is generally understood as a geographical group of countries, and the existence of ASEAN might not be known and the companies are not necessarily taking full advantage of the possibilities, such as the low or zero tariffs within the region, that ASEAN and AFTA provides. Of course, ASEAN has long way to go before it is regarded as similar kind of regional economic community as for example European Union (Green 2008) where the national borders nor regulations do not hinder the trade. Through this thesis Finnish firms might be able to find new ways of conducting business in the ASEAN region. There are many growth markets and a lot of business potential in different countries, and the markets size in total is significant: there are almost 600 million people and growing middle-class. The level of development differs from country to country. For example Indonesia, Laos, Myanmar and Cambodia are still on the way to develop the general infrastructure but for instance, Malaysia has set to its goal to have the status of 'fully developed country' by the year 2020 (Office of the Prime Minister of Malaysia, Vision 2020). Thus, the rising standard of living and emerging middle-class in the ASEAN region definitely creates business opportunities for Finnish companies as well. Previous studies of Finnish companies' investments describe Southeast Asian region much easier operational environment compared to such as India and China (Kettunen et al. 2006). As an example, Singapore has been indicated in many years a row as

the easiest place to do business in the whole world according the World Bank Doing Business indicators (World Bank, Doing Business indicators 2009, 2010). Hence, this study contributes to Finnish managerial knowledge about ASEAN region and ASEAN integration.

### **1.3. Research problem**

Dicken (2007) states that it is not possible to separate business from the environment it operates in. Hence, it has been popular research subject to study various business environments, and for companies it is crucial to understand the possibilities and restrictions a certain foreign business environment imposes. Formal and informal institutions affect this environment (North 1990) and companies need to do strategic choices regarding their operations in the host economy as an outcome of the interaction between various institutions and the organization (Peng 2000). Regional economic integration can be seen as a formal institution with the aim of instead of constraining the trade and business operations of local and foreign companies; actually ease the trade across the national borders within certain region and lower or remove the trade barriers, tariffs or non-tariff ones.

Hence, the purpose of this study is to investigate the role of regional economic integration of ASEAN in the operations and decision-making of foreign multinational companies and find out whether regional economic integration is a significant formal institution that enhances the business operations of these companies that operate in the ASEAN region. As presented in the previous chapter, there is a clear research gap in the business studies of Finnish-ASEAN trade relations and in the research of regional economic integration of ASEAN. Accordingly, a research problem is distinguished:

*What is the role and significance of regional economic integration of ASEAN in Finnish companies' operations and decision-making and is it decreasing the institutional constraints the companies face when operating in the region?*

To be able to answer the research problem and get a full understanding of the issue, it beneficial to divide it into three sub questions:

- 1) What is the significance of ASEAN region for Finnish companies in their international operations?*
- 2) How and in what extent the ASEAN integration affects Finnish companies' operations and decision making?*
- 3) Is regional economic integration enhancing the institutional environment and decreasing the institutional constraints that Finnish companies have experienced?*

The first sub question, “*What is the significance of ASEAN region for Finnish companies?*” enquires into the Finnish-ASEAN trade and investment relations from the perspective of companies. It is important to understand the basis and the historical timeline of Finnish investments in the ASEAN region, because it is the foundation for the operations taking place there now. The Finnish-AEAN trade and investment relations are discussed profoundly in the empirical section, followed by the findings from the company interviews.

The second sub question, “*How and in what extent the ASEAN integration affects Finnish companies' operations and decision making?*” discusses the ASEAN integration and its' impact on Finnish companies operations. Here, the theoretical foundation is in the regional economic integration theory and especially in the theory of regional production networks (Alvstam 1995, presented also in Kettunen, 2004). In the empirical section, is discussed the experiences of Finnish companies operating in ASEAN, how they see the effect of ASEAN on their operations in the region, reflected through their intra and extra-ASEAN trade flows and the experience of trade barriers in

these. In this thesis, the term “operations” or “business operations” is defined as companies’ international activities including export, licensing, franchising, contract manufacturing, subcontracting, project operations, joint-ventures, foreign direct investments and so forth.

The third sub question, “*Is regional economic integration enhancing the institutional environment and decreasing the institutional constraints that Finnish companies have experienced?*” brings the discussion of the regional economic integration to the institutional context. As the aim of regional economic integration as a formal, state-level agreement is to enhance the business environment by eliminating trade barriers and encourage the intra and extra-region trade, it is interesting to find out whether the foreign companies have experienced real changes in the institutional environment or decreases in the institutional constraints, for example decrease in corruption or bureaucracy, or making it easier to move the human capital cross national borders within ASEAN region.

#### **1.4. Definitions and limititons**

*AFTA* means ASEAN Free Trade Area, a trade bloc agreement signed by members of the Association of Southeast Asian Nations in 1992, and further expanded to Vietnam (1995), Laos and Myanmar (1997) and Cambodia (1999)

*ASEAN* refers to the Association of Southeast Asian Nations, the geo-political and economic organization of ten countries located in Southeast Asia, established in 1967.

*ASEAN+3* is the cooperation between ASEAN and the tree East Asian nations: China, Japan and South Korea. It was established in 1999 after Asian financial crisis to create financial stability to the region.

*BTA* refers to bilateral trade agreement, agreed between two sides, countries or trade blocs.

*Company, enterprise and firm* are regarded as synonyms in this study. They are regarded as a unit of economic organization or activity, such as a business organization.

*FDI* refers to foreign direct investment.

*FTA* refers to free trade agreement.

*GDP* is commonly used abbreviation of gross domestic product.

*HQ* refers to headquarters.

*IPR* refers to intellectual property rights.

*Multinational Corporation (MNC)* refers to a firm with foreign subsidiaries and operations extending beyond one country. Synonyms include Multinational enterprises (MNE) or Transnational corporations (TNC).

*NIE* means a Newly Industrialized Economy. Basically, in Asia well-known NIEs are South Korea, Taiwan, Hong Kong and Singapore.

*Non-tariff barriers* are trade barriers that restrict imports but are anything else but tariffs, such as anti-dumping measures, quotas or countervailing duties.

*RTA* means Regional Trade Agreement, such as EU, NAFTA or AFTA.

*Tariff* is defined as taxes levied on imports or exports. There are different kinds of tariffs, for example ‘ad valorem tariff’ is a set percentage of the value of the good that is being imported.

Studying ASEAN as a region sets some limitations. There are 10 member states in ASEAN and an apparent problem is the enormous heterogeneity of the region and large amount of difference between these economies. They differ in size, structural composition, history, the degree of economic development, culture and so forth. Also the institutional framework, that we study here, varies significantly from country to country. It is definitely a limitation to cluster these countries to one and treat those as a region; there are a few reasons for it. First, the Finnish companies’ operations have tended to focus only on a few countries in the region, for example Finnish trade and operations in so called “CLMV countries” (Lindberg 2007) of Cambodia, Laos, Myanmar and Vietnam is nominal. Second, the total amount of Finnish companies operating in the region is limited, for example in Malaysia there are about 40 Finnish companies (Finpor 2009: country report Malaysia) and it would be rather difficult to identify the operations by countries. Third, the companies themselves in most cases do not always specify their operations by countries, rather understanding the whole Southeast Asia as one region and fourth, the scope of the CEMAT research project, of which this study is a part, studies ASEAN region as a whole as well. At the same time, studying only Finnish companies in ASEAN region is a major limitation of this study: it only focuses on the Finnish companies leaving out the experiences of other firms from other nationalities uncovered.

### **1.5. Outline of the thesis**

In the next chapter is discussed the theories regarding a feature of the business environment: regional economic integration, and especially regional production networks –theory to gain understanding of ASEAN integration and its’ effect on the trade in the region. The discussion is then brought to

institutional context where is presented institution-based view of business strategy. In chapter four the theoretical framework on basis of the literature review is conceptualized. In the framework is visualized the connection between regional economic integration, institutional constraints, organization and strategy. The purpose is to help the data collection and guide the analysis of empirical data. The fourth chapter covers the method and design of the empirical research. This study is conducted using qualitative data collection methods. The primary data are the interviews of Finnish companies' representatives, managers and executives who are responsible for their international operations and especially Southeast Asian region. The secondary data are documents, such as annual reports and newspaper and magazine articles and websites. In chapter five empirical findings are presented and discussed. The structure in empirical finding follows the same structure as in research questions and literature review. A summary, conclusion of the study, recommendations for future research, managerial and policy implications are followed then in the chapter six. Chapter seven includes references and appendices.

## **2. REVIEW OF LITERATURE**

To solve the research problem, the existing research and literature of the subject is reviewed. The first part of the literature review discusses the business environment and a special feature forming and developing it: regional economic integration. Since regional economic integration implies the liberalization of regional trade and investments, it can be assumed that the integration process has direct effect on the MNCs operating in the region: the operations of companies should ease across state borders. Hence, it is critical to understand the theoretical basis behind the process of regional economic integration but also the connection between FDI and regional economic integration. Also the significance of the regional economic integration to companies is discussed.

The second part of the literature review combines the research of regional economic integration and business strategies by analyzing the institutional framework the companies need to be adapted when operating in the region. The aim is to provide theoretical foundation to solve the research question: whether regional economic integration is enhancing the institutional environment and decreasing institutional constraints the companies have experienced. Hence, it is crucial to understand the role of institutions affecting the business strategy.

The theoretical basis for this section is the institution-based view of business strategy (e.g. Peng 2000, 2002, 2003 & Peng et al. 2008). He finds the existing strategy theories: resource-based view & industry-based view are lacking the institutional aspect and states that formal and informal institutional constraints affect the companies' strategic choices. Here is also discussed the role of regional economic integration as a part of institutional context and how it changes the institutional environment.



## **2.1. The regional economic integration shaping the business environment**

This study analyzes the effects of ASEAN integration to Finnish companies operating in the region; and the subject is two-fold. First, the formal level of regional integration is reviewed here by discussing the theories explaining the regional economic integration and also the integration's affect on the companies. Particular interest is in international trade & FDI theories, as those are explaining the integration from the firm and industry-level. Second, the informal level of integration is covered in the empirical findings. There, the interest is how trade policies shape the rules for companies' foreign trade operations in the region, especially in the case of regional production chains, and what are the companies' experiences from the implementation of regional trade agreements.

However, it is essential to understand the basic theoretical concepts of economic integration and regionalism. Followed by that is presented two theories explaining economic integration. First is presented the classical economic integration theory by Balassa (1961) and then the trade/FDI - oriented theory. However, there does not exist single 'integration theory' describing the situation of ASEAN integration, as it is rather unique example of economic integration.

### **2.1.1. The concepts of region, economic integration & cooperation**

#### ***Economic integration***

What is actually economic integration? Kettunen (2004) uses Molle's (1990, p. 10) definition of the economic integration, describing it as the integration of markets between countries, that reflects in the economic interchange, such as foreign trade and direct investments. The foreign trade and investments might take place regardless of the possible barriers to exchange although the

barriers to trade and investment are lowered through agreements and by establishing regional organizations to coordinating economic policies (Kettunen 2004). Economic integration usually occurs first in the product markets, where the barriers of trade are lowered, and then proceeds to deeper level, when the markets of production factors such as labor and capital are also integrated. At the third level, economic policies are integrated as well (ibid).

What is then the reason for economic integration? The rationale behind it is obviously economic as the integration brings welfare benefits through increased trade (Kettunen 2004, Lindberg 2007). The most fundamental objective is to enhance trade within the region, by lowering and eliminating the barriers of trade. Although there are also higher aims with integration than trade alone, Molle (1990) writes that the most immediate objective is to raise the prosperity of all cooperating countries but the further-reaching goal is peace policy and in particular to lessen the chance of armed conflicts among participants.

### ***Regional cooperation vs. regional integration***

When discussing the regional economic integration, it is important to make distinction between two central concepts, integration and cooperation. Lindberg (2007) describes *regional cooperation* as a process where actors within a geographical area act together for mutual benefit in certain fields with an aim to solve common tasks despite possible conflicting interests in other fields of activity. This process might be formal and involve a high degree of institutionalism or be based on much looser structure. According to Lindberg (2007) *regional integration* is then a process with more depth, and she uses Deutsch's (1957) classic definition of integration: "by integration we mean the attainment, within a territory, of a 'sense of community' and of institutions and practices strong enough and widespread enough to assure, for a long time, dependable expectations of "peaceful change" among its

population”. Balassa (1961) illustrates the difference between cooperation and integration with an example; international agreements on trade policies belong to the area of international cooperation but the removal of trade barriers is an act of economic integration.

### ***Regionalism vs. Regionalisation & Open regionalism vs. closed regionalism***

When discussing ASEAN or any other regional integration, one cannot avoid terms regionalism and regionalisation. Basically, both refer to the integration in a certain area, but there is a distinction that sometimes causes confusion. According to Hettne (2005, p. 544) regionalism refers to a tendency and a political commitment to organize the world in terms of regions and more narrowly, it refers to a specific regional project. Regionalism is sometimes regarded as a states-led project (Lindberg 2007). Regionalisation is instead the ‘actual’, non-state or societal process of integration, or as Hveem’s (2003, p. 83) states it: “Regionalisation is the actual process of increasing exchange, contact and coordination and so on within a given region”.

It can be argued that there are different waves in regionalism. The literature generally distinguishes old and open regionalism. Old regionalism refers to the protectionist world view, where the purpose of the regionalism process was to promote territorially-based autarkies that mainly caused sharp falls in world trade (Lindberg 2007). This type of regionalism was promoted by the EU and NAFTA (Kettunen 2004). The open regionalism-era started in the 1980s, and it is the opposite of building a region as a fortress as it might be understood from the development of EU and NAFTA. In the basic form, open regionalism refers to a configuration of countries with a regional identity that will strengthen rather than weaken the members’ extra-regional linkages (Ariff 1994). This approach emphasizes that the integration project should be market-driven and outward-looking and should avoid high levels of protection, and should form part of the ongoing globalization and

internationalization process of world economy (Schulz et al. 2001a, p. 12). This is clearly the choice of ASEAN (Ariff 1994, Kettunen 2004).

### **2.1.2. Economic integration theory**

The literature on economic integration has evolved since the 1950s along with the European integration (Kettunen 2004). The basic proposition of integration theories stems from the classical customs union theory (Viner 1950). He suggested that regional trade agreements increase trade between the member countries due to the removal of the trade barriers. Hence RTAs enable the companies operating on a regional basis in line with the scope of the agreement to participate in regional exports and imports with decreased customs procedures and tariffs (ibid).

One of the main contributions to the classical economic integration theory is from Balassa (1961). He divided economic integration into stages that represent the deepening of integration from preferential trade area until political union. The first step is, as mentioned, *preferential trade area* that provides lower barriers on trade within selected groups of items among the participating countries. In the case of ASEAN, this was the ASEAN Preferential Tariffs Arrangements in 1977 (Kettunen 2004). The next stage is a *free trade area (FTA)*, where there are no internal tariffs or quotas, although each country is able to retain its own barriers to trade with non-members. AFTA, which was established in 1992, represents this kind of free trade area in ASEAN. The third stage is a *customs union* that in addition to FTA, harmonises trade policies toward the rest of the world by applying e.g. common external tariffs. In the customs union, the certificates of origin at internal borders no more are needed. ASEAN Customs Union is not realised yet, and for example Plummer (2006) notes that ASEAN Customs Union is needed to ASEAN Economic Community (AEC) to succeed. The fourth stage is a *common market*, in addition to FTA and customs union, there production factors such as service, labor and capital, can flow freely among member

nations. The fifth state is an *economic union* where such as the economic policy, market regulation, macroeconomic and monetary policies are harmonized. Economic Integration also brings one common currency to the member states. In EU, this happened when European Monetary Union was created and common currency, euro, was introduced in 2002. In the ASEAN case, AEC represents this stage of economic integration. AEC was declared as a part of ASEAN Vision 2020 in the Bali Concord II in 2003 “to create a stable, prosperous and highly competitive ASEAN economic region in which there is a free flow of goods, services, investment and a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities in year 2020” (ASEAN secretariat 2003, Declaration of Bali Concord II). The sixth stage in Balassa’s theory is *political union* which means the unification of policies and political institutions in addition to above-mentioned stages.

The traditional economic integration theory by Balassa (1961) is also criticised for being too limited because it is claimed to derive only from one case, European integration, and it raises the question whether the theory is applicable to other regions as well (Lindberg 2007). In the case of ASEAN, even though the integration started with preferential trade agreement and then was followed by free trade area (AFTA in 1992), the next step: customs union is unlike to happen. Mainly because it is a process that involves setting up common external tariffs to non-members, and this is not a very likely scenario in ASEAN, as there are a highly disparate set of trade regimes among ASEAN members (ibid). Even though the goal of AFTA is to encourage the trade within the ASEAN region, the extra-ASEAN trade is not discouraged with trade regimes. Even though AEC is declared as a part of ASEAN Vision 2020, many scholars find this too ambitious (Hew 2003, Plummer 2006, Lindberg 2007). Mainly because ASEAN countries are in different stages of development and there is a gap in the economic development of ASEAN-6 (Malaysia, Singapore, Indonesia, the Philippines, Thailand and Brunei) and newer but less developed countries such as Cambodia, Laos, Myanmar and

Vietnam. Hew (2003) argues that the more realistic choice for ASEAN would be a “FTA-plus” arrangement that covers a free trade area and some elements of a common market, such as the free movement of capital and labor.

### **2.1.3. The regional production chains steering Asian regionalisation**

A set of theories explaining the economic integration stems from the geography of international trade and foreign direct investments (FDI). Theory in international trade is divided by Alvstam (1995) into three categories. First, the macro-level analysis is conducted in economics, and the micro-level research in business studies and the third category is the geography of international trade. The special interest in this study is in the micro-level that focuses on the firm or the industry level of international trade and discovers the dynamics in it. As the objective in this research is to study Finnish companies operations on the ASEAN region and the impact of regional economic integration, it is highly necessary to look at the theories behind international trade patterns in the firm level.

#### ***‘Flying geese’ model and market-led regional economic integration***

A classical model describing international trade and industrialization especially in the Asian context is the ‘flying geese’ model by Akamatsu (1962). It was developed from Japanese perspective describing the regional hierarchy where the production of commoditized goods would continuously move from the more advanced countries to the less developed countries, following the comparative advantage of a location regarding e.g. cheap labor. The first ‘goose’ in the pattern is Japan, followed by NIEs (South Korea, Taiwan, Singapore and Hong Kong) and then ASEAN countries such as Malaysia, Thailand and Indonesia. Last, the production would move to least developed areas, such as China and Vietnam. This model takes into consideration also the business sectors, as the labor-intensive industries move away from the first or second tier countries and give space to capital-intensive

activities, resulting in the distinction of textile industry even from the third tier countries to cheaper locations. The typical sequence of industries moving to lower tier countries is first textiles, then electrical products, electronics and automotive and so on. Abo (2000) argues that the ‘flying geese’ model generated a spontaneous and defensive pattern of economic transformation quite distinct from the other two types – EU and NAFTA (in Lindberg 2007, p. 69). However, it must be noted that the configuration of international trade and investment is changed and at the moment Japan is no more the leading country in the international trade, and for instance the former ‘lower tier’ countries such as China is becoming a world leader also as an investor.

The flying geese model is also referred to as *de facto* regionalisation (Higgot 1997), which indicates that the regionalisation is an outcome of a dynamic tension between globalization and regionalisation, driven by growing intra-regional trade and FDI. *De jure* regionalism refers thus to the regionalism efforts of governments and state-led organizations and is more “agency determined”, an example of this is EU and the focus is e.g. on trade agreements. This type of *de facto* regionalisation could be referred to also as market-led regionalisation, where MNCs have the central role in creating one of type of regionalisation and economic integration, especially in Asia. Foreign MNCs (mainly Western and Japanese) presence has significantly increased in Asia in the 1980s and 1990s it raises the question whether MNCs can be regarded as central ‘agents’ of regional economic integration (Ramstetter 1998 in Lindeberg 2007). This type of informal and network-based integration has been seen as a viable substitute for the formal institutionalization of regional economic affairs (ibid). It has been claimed to be “the embrace of the WTO at the multilateral level and a focus on market-driven, informal integration at the regional level” (Aggarwal & Koo 2005).

Nevertheless, the more recent literature (Nicolas 2008) argues that regional economic integration in Asia has already shifted from market-led integration to institution-based integration. ASEAN has been so far the only institution-

based economic grouping in the region, but the Asian financial crisis on 1997-1998 brought awareness of the risks related to the ASEAN's trade with China, Japan and South-Korea as a result of contagion of the financial crisis without policy cooperation (ibid). This started the discussions for ASEAN+3 grouping including 10 ASEAN member countries + China, Japan and South-Korea. The cooperation was decided to be extended beyond finance and currency matters after establishing Chiang Mai Initiative, supporting the decreases in trade barriers as well (ibid).

### ***Connection between trade and FDI ...***

Alvstam (1993, 1995, 2001a, 2001b) has been one of the most influential academics studying the linkage between trade and FDI in the Asian context. The central statement of Alvstam (1993) was that the industrial dynamics are changing the geography of foreign trade in Asia and he used as an example the networks of production of Japanese companies in Asia. Japanese manufacturing companies had established subsidiaries around East and Southeast Asia and there existed locational specialization between different stages of production chains and the East Asian countries were the production platforms for Japanese companies. Alvstam (1995) sketched a model of a regional production system where intermediate goods or raw materials were imported for processing in a host country, for example Malaysia. Processing would involve one or several stages of production and then intermediate goods would be exported for further processing to some other countries, or back to Japan (Kettunen 2004, Kettunen & Kosonen 2009). Mirza & Giroud (2004) recognize the ASEAN region as a target for this type of FDIs where MNCs selectively locate specific subsidiaries across ASEAN depending on the locational advantages and where the factors are the most appropriate to particular functioning areas of the host economy. ASEAN region has been a major successful recipient of investments by MNCs for three decades, as FDI stock in ASEAN grew tenfold from US\$23.8 billion in 1980 to US\$233.8 billion in 1998.



As an example of the linkage between FDI and trade, Min (2003) studied the connection between FDI and trade in Malaysia between 1988 and 1995 and found that inward FDIs by MNCs facilitated the shift in the pattern of production and exports from the primary goods, such as oil, food products, tin and rubber, to the exportable manufacturing sectors, such as electrical and electronics. Total trade in Malaysia increased significantly since the late 1980s when FDI began to soar, implying that FDIs facilitated the trade and the MNCs contributed to the enhancement of Malaysia's export competitiveness in the world market. Malaysia's share in the world exports increased sharply from 0.6% in 1985 to 1.6% in 1995 along with the significant growth in FDI over the same period (ibid).

A great part of above-mentioned trade between host country and investing country is defined as intra-firm trade where exports and imports flow from the foreign branches of multinational companies to the home country and vice versa, or to third countries for more processing. The intra-firm trade is a very significant factor in international trade, as it is estimated to account for approximately 40% of the US trade (Kettunen 2004). Intra-firm trade takes advantage of transfer pricing and for example host countries' possible tax incentives and free trade zones.

### ***...and regional economic integration***

As mentioned, there is a clear linkage between trade and FDIs, but the literature also provides examples of how these are connected with regionalisation. For instance, Bernard & Ravenhill (1995) argue that the networks of hierarchical production systems and industrial diffusion explain the dynamics of economic regionalisation in East Asia. Barrell & Choy (2003) argue that the integration in East and Southeast Asia is facilitated by the trade and FDI flows that deepened the economic linkages in the region, in particular growing the investments from Japan and NIEs in the mid-1980s

increased the flow of raw materials and intermediate goods and fuelled the rise in intra-regional trade. The economic integration of East Asia and Southeast Asia has been a “spontaneous” process fuelled by the private sector and by the quest for efficiency on the part of MNCs looking for supply chain networks to exploit the economies of scale from division of labor and specialization (ibid). van Grunsven (1998) studied the regionalisation of the production system within Southeast Asia, having an example from multinational audio production, he noticed the connection between Singapore and Malaysia and patterns of extra-regional imports and exports (in Kettunen 2004, p. 53).

An important theoretical contribution to the discussion of FDI and regionalisation –linkages in the ASEAN context, is also the work by Mirza & Giroud (2003 and 2004) where they discuss the impact of FDI on the growth and development of the ASEAN countries (2003) and how FDIs of MNCs have benefited the ASEAN economies and the economic integration of the region (2004). The focus is on the MNCs’ regional and global production networks in ASEAN and how certain less-developed countries, Vietnam in their case, have been integrated into these MNCs’ production networks by attracting FDIs. The validation for their articles is based on a broad empirical research, “Bradford study”, the writers concluded in 2001-2003 when they interviewed 113 MNCs operating in five ASEAN countries: Malaysia, Thailand, Singapore, Cambodia and Vietnam. The majority of the companies (88) in their sample were manufacturing in the region, and most of these companies had been in the region before since the 1980s and 1990s.

Mirza & Giroud (2004) find a clear link between FDI and regional integration; it is caused by the MNCs’ need to stay competitive through global value chains, and MNCs’ regional and the international network of relationships with customers and suppliers. When considering the geographic configuration of MNCs in ASEAN it is essential to understand the locational advantages that a country offers and how it fits a MNC’s strategy and supply

chain. Recently, MNCs have started to integrate their operations worldwide and concentrate the activities to well-selected locations, and the process of integrating these key locations within the overall global value chain is the key to MNCs' competitiveness (ibid). Regarding ASEAN, Mirza & Giroud (2004) use an example of integrated plants, that have replaced assembly or "screwdriver plants" which previously received semi-finished parts from the parent companies for assembly and then these goods were sent back to the home country. Now, the integrated plants either produce parts and components in-house or purchase them from the sister companies or local producers in the region, thus creating a complex network of internal and external relationships. When added also the MNC's regional and global links with the customers and suppliers, there is an intricate pattern of internal and external relationships created that thus drive the integration in the ASEAN forward. In addition to this, Mirza & Giroud (2003, 2004) found out from the Bradford study that there is a connection between the location of headquarters and integration. Regional integration is on its highest in the case of companies with their headquarters in ASEAN and it is the lowest for companies with their headquarters in other East Asian economies or Japan.

### ***FDI inflows and integration***

Mirza & Giroud (2003) argue that one the most obvious form of ASEAN countries to cooperate is promoting inward FDI to ASEAN region. They find that the investment cooperation is a subset of a larger set of regional integration arrangements but according to them it is the one that can help to strengthen the overall integration process in the region, as all ASEAN members are interested to attract FDIs as a booster of growth, development and competitiveness in their countries. In fact, stimulating FDI inflows by reducing business costs associated with multinational activity in the region has always been a primary objective of ASEAN economic cooperation (Plummer & Cheung 2007). An initiative towards investment cooperation and protection in ASEAN is Area (AIA). The AIA has been designed to improve

the process of FDI policy liberalization, promotion and harmonization across ASEAN member states, as well as enhancing the investment facilitation. It covers five sectors: manufacturing, agriculture, fishery, mining and quarrying and also services incidental to these sectors (Plummer 2006).

Mirza & Giroud (2004) argue that simultaneously with the emergence of regional production networks by MNCs, the trends in FDI and trade indicate how closely integrated economies in Southeast Asia have become, and they use Vietnam as an example. Vietnam is a less-developed country in ASEAN compared with for example Malaysia or Thailand, and has mostly labor-intensive manufacturing. However, it is an example of intraregional trade within ASEAN, as one fifth of the investment inflows in Vietnam are intraregional. The majority of these intraregional investment inflows originate from indigenous firms and foreign firms based in Singapore, Malaysia and Thailand. From the overall manufacturing investment inflows to Vietnam, 90 % originate from East Asia (ASEAN countries plus China, Japan, South-Korea, Hong Kong and Taiwan) (ibid). Therefore, Vietnam is an interesting case describing the intraregional investment inflows in East Asia and providing evidence of regional integration. Mirza & Giroud's (2003 and 2004) research on MNCs' regional production networks is an important theoretical notion regarding the empirical research of this study. Mainly because, the aim is to analyze the impact of ASEAN integration on Finnish companies operations on the region, and this is discovered by reviewing the regional production networks or the intra-region or extra-region trade flows of these companies.

Hence, it is argued that East Asia, and then Southeast Asia became the "global factory", rising from poor underdeveloped agricultural backwaters to be the global factory producing first labor-intensive and later more technology-intensive exports, such as chemicals, automobiles and electronics, through systematic learning and innovation taking place in the firm level (Kawai & Wignaraja 2009). As there is a clear connection between FDI and

trade, these are linked to the market-led regionalisation of East Asia and Southeast Asia as well.

Even though it is crucial to understand the trade patterns and industrial dynamics in the micro level of international trade, Kettunen (2004, p. 54) makes an important notion of the international trade patterns not providing any understanding about the role of the states in creating barriers or incentives to trade. That is one of the particular interests in this study, to combine the business-level with the state-level concerning the barriers and incentives of trade and find out how it affects foreign companies' strategies operating in the region.

#### **2.1.4. The significance of the regional economic integration for the companies**

It is highly reasonable to ask, how the companies actually benefit from the free trade agreements and is it significant for them. There are enormous amounts of research about RTAs and economic integration as such, also in the ASEAN context, but there is less research where the focus is in fact on the business level and on the companies' experience of the integration, even though the goal of the regional trade agreements is to remove or decrease the barriers of trade (Kettunen & Kosonen, forthcoming). Basically, from the companies' perspective, the state-specific trade policies shape the rules for their foreign trade operations (ibid). Particularly important the trade policies are in regional production chains, where the company exports and imports regionally and between the different company units (ibid). These regional production chains have been one of the rationales behind of creating the free trade area in Southeast Asia, as Japanese companies used Southeast Asian countries as production platforms, where raw materials or intermediate goods were processed and then shipped back to Japan or other markets (Mirza 2000, Alvstam 1995). Hence, in Southeast Asia the regionalisation process has been described as market-led (e.g. Alvstam 1995, Mirza & Giroud 2004).

The benefit and the goal for the participating countries in free trade agreements and regional economic integration is clear and common: create economic growth and well-being through attracting more inward-FDI in the country level. Peng (2009) also mentions economic benefits such as ‘disputes are handled constructively’ and ‘rules make life easier and discrimination impossible for all participating countries’ but reminds that the economic integration is political in nature, however.

The effects of the regional economic integration on FDI through its impacts on intra- and extra-regional trade are studied by Buckley et al. (2001) in the context of North American FTA, NAFTA. They claim the decrease of trade barriers having four macro-scale consequences in trade and FDI. First, intra-regional trade becomes more attractive and MNCs respond to this by defensive import substitution FDI. Second, locational advantages of members increase related to non-members, MNCs react this by reorganizing FDI. Third, regional economic integration brings cost reductions and efficiency gains, hence, MNCs are able to rationalize their FDI. Fourth effect is market expansion, when MNCs increase offensive import substitution FDI.

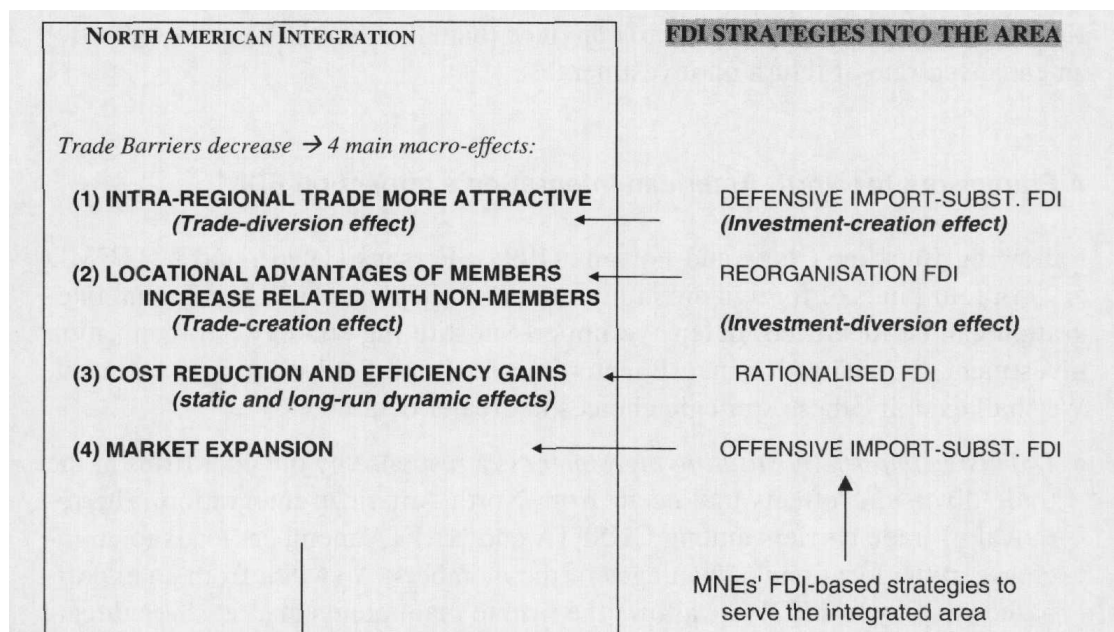


Figure 1: Effects of NAFTA on FDI-based strategies of MNCs, source: Buckley et al (2001)

One approach to review the benefit of economic integration to companies is to study the relationship between regional trade agreements and FDI flows. Aggarwal (2008) has compiled a list of studies that reviewed the connection between major RTAs and FDI flows and found out that a RTA, such as EU or MERCOSUR had positive or strong positive impact on FDI flows. In the case of ASEAN, Jeon & Stone (2000) (in Aggarwal 2008) found an increase on intra-bloc FDI after forming AFTA. Hence, there is strong evidence from many studies that RTAs enhance FDIs (e.g. Aggarwal 2008, Baltagi et al. 2007, Motta & Norman 1996), but economists are not unanimous whether the positive effects on FDI flows are due to intra-regional FDI effects or extra-regional ones (Aggarwal 2008). In addition, the members of RTAs that have simultaneous market liberalization, location advantages, higher education and financial stability attract a larger share of FDI than other RTA members. RTA itself does not guarantee flow of FDIs.

One cannot avoid the fact that there exists myriad of RTAs and BTAs (bilateral trade agreements) in the world. Even RTAs in the Asian context are described as “noodle bowl” for the overlapping agreements and there are claimed to be over 400 RTAs and BTAs in the world (Hill & Menon 2008). Common sense and empirical research say that having multiple RTAs is costly to the participating countries, but it makes the trade actually more complex for the companies who in fact should be benefiting from the trade agreement (ibid). Hence, ASEAN and especially ASEAN+3 are on the right track for consolidating the regional trade agreements.

McKinsey (Schwarz & Willinger 2004), a consultancy, produced an in-depth study on ASEAN integration and its’ effect on the companies and interviewed 100+ investors and executives in the region. Their central finding was that the ASEAN markets are more fragmented than unified, despite of AFTA, and the consequences for the investors are higher costs, uncertainty and subscale markets that fragmentation creates, than it would be with integrated markets.

In the competition China, with significant economic potential and integrated markets, is the winner (ibid). The global investors were concerned for instance on the subscale and individual markets in ASEAN: the fragmentation of the markets forbids them to market and manufacture products on regional scale. Second, there are also unnecessary costs involved because the companies are not able to standardize their products to the whole ASEAN markets due to the various product standards in different ASEAN countries. Third found concern was the unpredictable policy implementations. Even though the official AFTA tariff rate in raw materials is usually 0 to 5%, the customs officials in some countries demand higher tariff rates and also the investors had experiences from customs procedures that took from one day to five weeks with an identical part across the region.

In their study, (Schwarz & Willinger 2004) the focus was especially on two industries: consumer goods and electronics, and how the integration would cut the costs in these industries. They discovered that in the electronics the regional integration could help to cut costs of the companies by 10 to 20 %, mostly for two reasons: bigger market reduces per-unit overhead and direct-labor charges, and second, the lower tariffs on components and possibility to buy the cheapest inputs regardless of the country of origin within the region. In the consumer goods the integration would cut the costs around 20%. Hence, regional economic integration has multiple effects on the companies; it brings increased economies of scale and scope, competition and productivity at the company level as it is possible to combine overlapping procedures and centralize functions. However, it must be remembered that the companies in Schwarz & Willinger's (2004) study are large MNCs and the scale in their Southeast Asian operations differs significantly from the SMEs and smaller firms.

Thus, based on findings of Buckley et al. (2001) about the impact regional economic integration on MNCs' FDI strategies and the study of Schwarz & Willinger (2004) regarding impact of ASEAN on foreign companies in the



region, a list of possible benefits of integration is sketched below. The aim with the empirical research is to define whether these possible benefits or some of them are visible to Finnish companies operating in the ASEAN region.

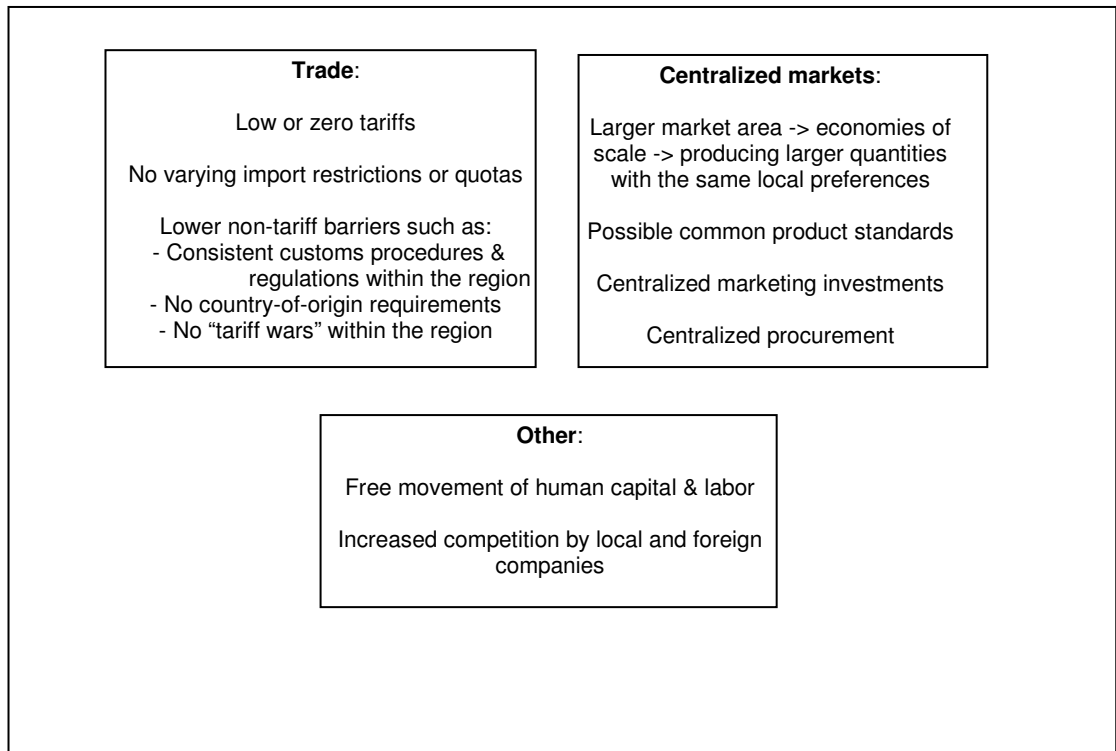


Figure 2: The possible benefits of regional economic integration for the foreign companies investing in the region, source: author

Hence, there is a connection between regional economic integration and increased FDIs, and it appears that the regional economic integration in Southeast Asia, at least when fully established, benefits companies as well. Although, as many researchers have stated, there is a long way ahead before ASEAN is fully-functioning free trade area or even customs union (e.g. Lindberg 2007, Schwarz & Willinger 2004, Hew 2003). Significant changes and initiatives are needed to support the development of ASEAN, however, the benefits in the state-level and business-level will certainly overcome the weaknesses. Thus it is interesting to find out whether the regional integration is a significant issue to the Finnish companies that operate in the ASEAN and

whether it has benefited them. This will be discussed in the empirical findings of this study.

### **2.1.5. Regional economic integration as a part of institutional framework**

The previous chapters of the literature review have discussed the business environment in ASEAN countries from the regional economic integration perspective. The theoretical connection between regional economic integration and institutions is not necessarily very explicit. The literature about regional economic integration provides a great amount of analysis of the integration in the institutional context. Integration can be categorised fairly undisputedly as an institution, but it is mentioned being an *institutional arrangement* (Lindberg 2008, p. 65), *actor*, *instrument* or *arena* (e.g. Kettunen 2004, p. 37). As this research discusses the business perspective of the ASEAN integration, the institutional arrangement or institution may be the most appropriate term.

However, if the regional economic integration is categorised as an institution, and applying the North's (1990) definition of institution as 'the rules of the game structuring human interaction' and his division of institutions to formal and informal ones, where the formal institutions are such as laws and regulations and informal norms, cultures and ethics, the regional economic integration would fall into the category of formal institution. In institutional theory (e.g. North 1990) it is common to use the term 'institutional constraint' but when discussing economic integration, the term 'constraint' does not fully describe the situation. The aim of the integration is to ease and enhance the trade and investments, not to hinder. As Kettunen & Kosonen (2009) notice that from the companies' perspective the trade policies in certain region shape and set the rules for their foreign trade operations, it can be argued that ASEAN probably sets rules or provides some benefits for the companies that operate in the region with the aim of enhancing intra- and extra-ASEAN trade

and FDIs. Peng (2004) makes an important notion that strategies are about choices. Given the influence of institutional frameworks on firm behaviour, any strategic choice that the firm makes is inherently affected by the formal and informal constraints of a given institutional framework (North 1990, Oliver 1997).

It can be argued, in the light of the discussion in the previous chapters, that economic integration in Southeast Asia is a result of market forces and can be defined as market-led regionalisation (e.g. Alvstam 1995, Mirza & Giroud 2004) rather than result of strong institutions or institutional framework. In other words, the integration is a result of global business and manufacturing value chains, not a politically led institutional integration which has a strong political background. Many researchers have found out this and stated that ASEAN is not yet a strong institution in the region (e.g. Hew 2003, Elliot & Ikemoto 2006).

Nevertheless, Lindberg (2007) reminds that the countries in the region have increasingly started signing BTAs and RTAs recently, which actually renders institutional theory and makes it more relevant today than in the past. Asian financial crisis in 1997-1998 was actually one of the most critical moments that created a wake to build bilateral and international mechanisms, in institutional sense, in order to speed up the recovery of the affected countries and prevent further crises erupting. Nicolas (2008) argues that ASEAN has been actually the only institution-based regional integration within East Asia. Even though ASEAN was formally established already 1967, it was relatively inactive in the economic field until 1992 when the AFTA was formed (ibid). He claims that until recently, there have been only few discussions of institution-based integration within whole East Asia. Now this has happened in the form of ASEAN+3. Also Lindberg (2007, p. 26) recognizes that are signs of a growing interest all across East Asia to strengthen the regional links

in an institutional sense as well, and institutional theory should more explicitly be extended to analyze this dichotomy.

As mentioned, ASEAN can be described as an institutional arrangement (Lindberg 2007) but she finds that ASEAN cannot be an *actor* from the institutional point of view, because ASEAN seems to be reluctant to create supranational, institutional structures in the region. It seems that there are some limits of how integrated ASEAN countries want to become, because many of the countries have gained sovereignty in recent years and have been under the influence of other countries or as colonies just recently (Lindberg 2007). In addition, there are also ethnically complicated structures that render supranational compromises difficult, such as the existence of Chinese population in many countries. These are some reasons for the institutional weaknesses within ASEAN and why Asian regionalism appears to be highly intergovernmentalist in nature and in decision-making (Lindberg 2007). However, as the goal of the economic integration is AEC, ASEAN Economic Community, it is clear that there is a need for stronger institutional structures. In the business-level, it could indicate support for foreign MNCs' operations and providing a sufficient institutional framework to overcome obstacles such as corruption or IPR issues to maintain FDI inflows to ASEAN, and also investments and trade within ASEAN by local companies. This is discussed more thoroughly in the empirical section.

### ***Comparing Southeast Asia and the Baltic in the pace of institutional change***

An interesting case regarding regional economic integration in two different institutional contexts is a study by Kettunen & Kosonen (forthcoming) of Estonia and Malaysia involved in regional trade agreements that represent different levels of regional economic integration. They studied the impact of regional economic integration, on the companies' regional operations in two

regions, the impact of EU in Estonia and ASEAN in Malaysia. They found out that these two countries are involved in RTAs that are in the different levels of formal regional economic integration. Malaysia has liberalized its trade policies due to the ASEAN free trade area framework, many trade preferences are also related to attracting inward FDIs. The integration in Malaysia has proceeded gradually and rather slowly as guided by the regional trade agreement. However, the experience from Estonia and EU is quite opposite. Estonia directly integrated into the EU common market which has implied rapid and greater changes in the trade policies and also in the institutions. Policy changes in Estonia happened almost over night and have been much deeper, when Estonia joined EU in 2004, compared with Malaysia where the integration is hardly visible (ibid). Estonia also joined the monetary union EMU in 2011 and changed the national currency to euro (Kauppalehti 8.6.2010).

According to Kettunen & Kosonen (forthcoming) the Estonian EU membership was very visible in many positive ways to the companies operating in Estonia and the business environment in general improved. The changes were for example the increased security in doing business, reduced corruption, possibility to buy land, the increase in quality criteria, improvements in the jurisdiction and legislation of Estonia and also increased transparency in business. It can be concluded that the regional economic integration in Estonia represents much stronger institution than in Malaysia what it comes to ASEAN. If the aim is to become fully integrated 'ASEAN economic community' by 2020, ASEAN needs indeed to strengthen the institutional framework which might require much intensive supranational cooperation.

## **2.2. The institutional approach to business strategy and regional economic integration**

In the previous chapter, the focus was on the business environment and in its feature: regional economic integration. However, here is discussed the strategy perspective – how companies need to be adapted to a certain institutional context and whether regional economic integration decreases the institutional constraints.

The most of the ASEAN member states could be described as developing economies or emerging economies. This indicates that conducting business in the ASEAN region and in developing economies is more challenging than it is in the so called developed or industrial world, as ‘the rules of the game’ might be different. Understanding the formal and informal institutional framework in the host market may be critical to the success in the market, as Wright et al. (2005) states that it is impossible to do well in the emerging economies without understanding how formal and informal institutions affect the firms and consumers. Also Ingram & Silverman’s (2002) point is clear, the remind that the institutions are much more than background conditions, institutions directly determine how a company survives in the struggle of formulating and implementing strategies to create competitive advantage in foreign markets.

As the aim of this study is to discover how ASEAN enhances the institutional framework, it is necessary to clarify what the features of the general institutional environment that ASEAN countries provide for Finnish companies are. Hence, this study concentrates on the contextual factors of ASEAN markets, and proposes that these institutional factors play a crucial role in the success of Finnish companies and their operations in those markets. Since contextual factors are in focus, it is reasonable to apply institutional theory in this study. As the aim of this study is to find out how the companies adapt to the business environment in the region, ‘pure’ institutional theory which is based on sociology does not provide the best answers, rather the institution-based of view of business strategy (e.g. Mike Peng 2000, 2003, 2009) is more applicable in this context.

### **2.2.1. Roots of institution-based view are in the institutional theory**

Since the institution-based view, which studies the institutional aspect of business strategies, is the theoretical base here, it is important to understand the background of this theory. Institutional theory started to develop within social sciences already from the late 19<sup>th</sup> century, as an approach to the study of organization-environment relations (DiMaggio and Powell 1983). The old institutional theory concentrates on developing a sociological view of institutions the way they interact and affect society and it is studied by sociologists (ibid). The economics-perspective of institutions is more relevant in this context and is extensively studied by Nobel-laureates Ronald Coase (1937), Oliver Williamson (1975) and Douglas North (e.g. 1990) and is called “New Institutional Economics”. This stream of research bases on the transaction cost theory, and for example North (1990) states that uncertainty in the firms’ environment increases their transactions costs, and what firms want to do is to reduce their transactions cost to gain better efficiency in the market.

There is no single definition of institutions. However, North (1990) argues that institutions provide ‘the rules of the game’ that structure human interaction in societies. The major role of institutions is to reduce uncertainty by providing stable structures for everyday life. Consequently, when an economic actor, for example a foreign entrant, adapts to the institutional framework in a given environment, it is able to lower its transaction costs and increase efficiency in the market due to the existence of institutions. (North 1990)

### Dimensions of Institutions

<i>Degree of Formality (North, 1990)</i>	<i>Examples</i>	<i>Supportive Pillars (Scott, 1995)</i>
Formal institutions	● Laws	● Regulative (coercive)
	● Regulations	
	● Rules	
Informal institutions	● Norms	● Normative
	● Cultures	● Cognitive
	● Ethics	

Table 1: Dimensions of Institutions, source: Peng et al. (2009)

North (1990) divides institutions formal and informal ones; formal institutions are for example legislation, regulations and taxation. Informal institutions are the shared practices of the companies operating in one region, for example social norms, customs and culture. Other, more sociological perspective of institutions is provided by Scott (1995, p. 33), who defines institutions as “regulative, normative, and cognitive structures and activities that provide stability and meaning to social behavior”. Even though, the disciplinary roots between these views differ, it is certain that institutions do matter to the companies operating in a specific location, but how they matter, under what circumstances, to what extent and in what ways are definitely important issues (Peng et al. 2009).

There exists also critique regarding the distinction between formal rules and informal constraints, Karhunen (2007) states that the distinction is complex, because it is difficult to categorize since they can have both formal and informal features: informal constraints complement formal rules, but formal rules can also complement and increase the effectiveness of informal constraints. Formal rules may also be enacted to modify, revise, or replace informal constraints. One of the North’s (1990) central notions about the differences between the formal and informal institutions is that those act at different speeds, formal rules, such as laws and policies, can change quickly while informal institutions are usually culturally derived and are more resilient to change.



The change aspect is important when ASEAN integration is brought to discussion. ASEAN is a factor of change in the institutional environment in its member countries (Kettunen & Kosonen, forthcoming). As North (1990) states the formal institutions may change quickly and ASEAN integration as a form of AFTA at the moment can be considered as a change in formal institutional environment. AFTA and ASEAN cause changes in the laws and regulations and the member countries, for example import tariffs were gradually reduced to the level of 0-5 % for manufactured goods that have been manufactured in another ASEAN country. The change in the informal institutions is then much slower. Regarding ASEAN integration, a change in for example culture or norms may take decades to become unified, as national cultures are strong in ASEAN member countries and they do not have the history of integration within the region. However, if compared with EU, it seems to be possible to create at least some kind of shared culture or informal institutions as EU has done.

### **2.2.2. Institution-based view of business strategy**

Peng's (e.g. 2002, 2003, 2004) central statement is that the strategy scholars have rarely looked beyond the task environment, which focuses primarily on the economic variables, such as market demand and technological change, to explore the interaction among institutions, organizations, and strategic choices. Institutional environment is taken for granted and the formal and informal institutions are understood as the background conditions (Peng et al 2008). While, this might be the case when operating in the developed economies where institutional environment is rather stable, but when probing into emerging economies the deficiency of institutions might be striking (Narayanan & Fahey 2005). The institution-based view is positioned by Peng (2002) as a third leg of strategy tripod, in addition to the industry-based view (Porter's five forces –model, 1980) and resource-based view (Barney 1991). These two latter ones are often defined as the base for the classic strategy literature, which stem from Western companies that operate and compete in

developed economies. As Peng (2009) states, in developed economies corporate (firm-specific) effects are more critical explaining the variation in foreign subsidiary performance and this is consistent with resource-based view. Also the industry-based view is based on the developed markets where the greatest threat is for example a new entrant, not weak institutional environment.

Hence, the institution-based view then adds the missing part for strategy framework, as the industry- and resource-based views have been acclaimed to ignore the formal and informal institutional underpinnings that provide the context for competition among industries and firms (Peng et al. 2008). Peng's (e.g 2000, 2004) contribution to institutional economics and strategy literature is significant. The institution-based view is relevant theory in this study, as the aim is to find out how the regional economic integration enhances the institutional environment in the host markets and how it decreases the institutional constraints the companies face when operating in the region and whether this affects the strategic decisions. Hence, it is important to understand the institutional framework and the role of institutions in the business strategy before it is possible to analyze whether regional economic integration has enhanced the environment.

The focus in this study is in line with Peng's views: what are the strategic choices that result from the dynamic interaction between the organizations and institutions? Thus, here the aspect of regional economic integration is brought to the discussion. The topic is partly from the area of strategic management, so the institution-based view, which has its roots in North's (1990) view of new institutional economics and formal and informal institutions, developed by Peng highly helpful theoretical framework in here. Peng combines North's (1990) views on new institutional theories on transaction costs and formal and informal institutions with the organizational analysis –perspectives by DiMaggio and Powell (1983) and Scott (1995). The result is framework that combines three important aspects: organizations,

institutions, and strategic choices. The figure 3 visualizes Peng’s theory of how institutions and organizations impact strategic choices. There is conceptualized the dynamic interaction between institutions and organizations and then strategic choices are the outcome of this interaction. Strategic choices are not then driven only by firm-specific resources and industry conditions, but rather those are also a reflection of the formal and informal constraints of a particular institutional framework that decision makers confront in new markets (Peng 2000).

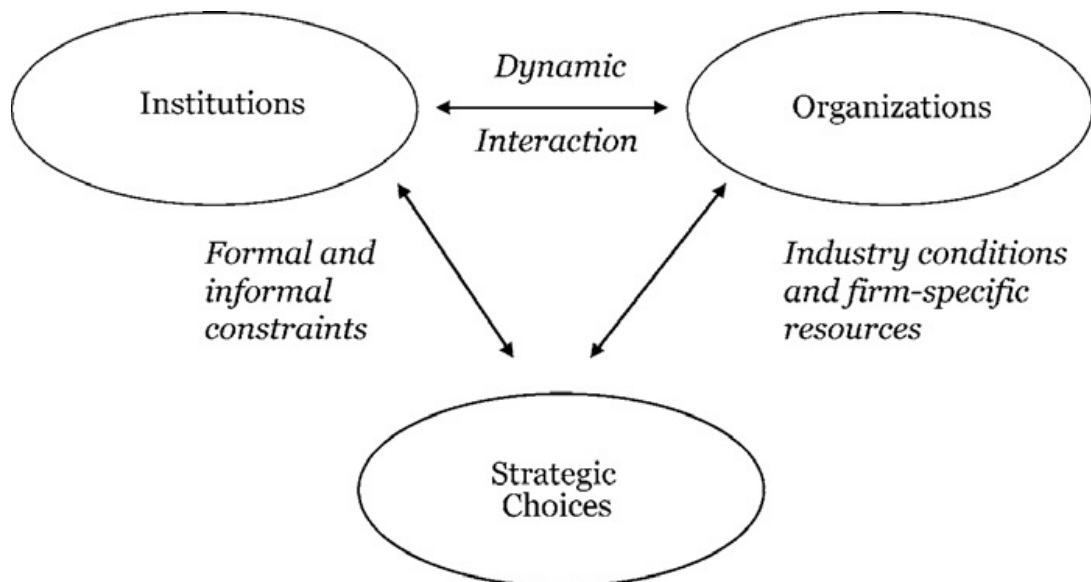


Figure 3: Business strategies in emerging economies, source: Peng (2000 p. 45)

### 2.2.3. ASEAN economies as feasible research objects for institution-based view

Many international business scholars (e.g. Dicken 2007) claim that it is not possible to separate businesses from the environment they operate in, and this is truly the case in emerging economies. Asian economies in general are according to Peng (2004) “viable research laboratories” in the institution-based view studies. Asian economies represent the environments where the importance of institutional forces is highlighted, and studying institutional effect on firm strategy is easier. In the developed Western economies the

'rules of the game' are taken granted and it is difficult to separate the institutional effect on firm strategy and performance. Scott (1995, p.146) notices the same, as most of the previous research in business studies are conducted in the North America or Western Europe, the focus on Asia allows us to vary institutional contexts. Peng (2004) states that emerging economies in Asia are hardly uniform, the formal institutional framework tends to fall short of providing support for low transaction-cost business operations in three critical areas: 1) a credible legal framework, 2) a stable political structure and 3) functioning strategic factor markets. In addition, due to the weakness of formal institutions in Asia, informal constraints rise to play a greater role in regulating economic exchange. (Peng 2004). As Peng & Zhou (2005) also stated it: "We may argue that the only constant in emerging economies in Asia is change", Asia in general seems to be an interesting research field in institution-based view.

The theoretical connection between institution-based view and emerging economies is evident. There are numerous studies in the field of institutional economics that focus on emerging economies for example in Eastern Europe, Russia and Asia, especially a great number studies by Peng (2000, 2002, 2003). One of the seminal studies combining institutional theory to the research of emerging economies is a study by Hoskisson et al. (2000). There, Hoskisson et al. (2000) provide preliminary notions of the enterprise strategies in emerging economies and also lists 64 countries that are defined as emerging economies up to that date. As mentioned also by Peng (2004, p.47), there are many emerging economies in Asia. Although, there are no prevailing scales or given measures to define which economies are "formally" emerging, developed or developing ones. In the listing by Hoskisson et al. (2000, p. 250-251) from Southeast Asian countries Indonesia, Malaysia and Thailand are listed as emerging economies in that date, 2000.

Also, an interesting theoretical notion is by Hoskisson et al. (2000) and confirmed by Wright et al. (2005) as they suggest that when markets emerge,

institutional theory first becomes the most relevant, followed by transaction cost theory and agency theory, and then by the resource-based view. This is due to the process-nature of emerging economies, which the name emerging also suggests. Companies in different markets and countries adopt market-based strategies at different times and rates because institutional factors change at different times and rates (Hoskisson et al. 2000).

### **3. THEORETICAL FRAMEWORK**

The figure representing the theoretical framework of this study visualizes how theories applied in this study and how answers to the research questions are about to be found in the empirical research. The figure below is modified from Peng's (Peng 2000, p. 45 & Peng 2009) framework of business strategies of the companies in transition and emerging economies where the institutions are one considerable dimension on the strategies of the companies. Peng (2002) states that "strategic choices that companies need to do are an outcome of the interaction between institutions and organization", and this describes the framework of this study as well. In this study, the regional economic integration is recognized as a state-level agreement, which is an instance that impacts the whole framework: organizations, institutions and strategies in a certain environment.

First, as of the interests is to find out the role of Southeast Asia as a region in Finnish companies international strategies, it is essential to define the significance of the ASEAN region as it is stated in the first research question. This discussion lacks the theoretical base in a sense, as the answers rather stem from the historical timeline of Finnish companies operations in Asia and the current reviews of the actual operations of the companies. These are described in more detail in the empirical research, simultaneously with the interview results.

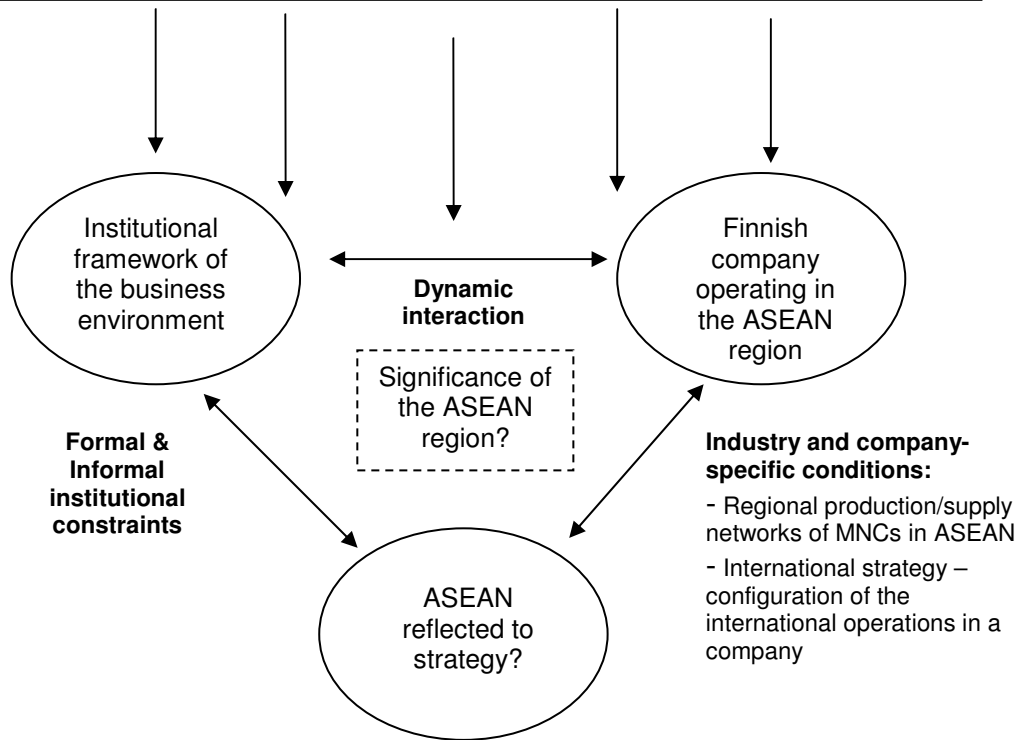
In the framework, the circle 'organization' represents the Finnish companies from various industries operating in the ASEAN region. The strategic choices, which this study concentrates on, are the results from the dynamic interaction between institutions and organizations. The second research question enquires how and in what extent the ASEAN integration affects Finnish companies' operations, and this is then addressed in the figure in the circle 'ASEAN reflected to strategy' as question. According the framework

and strategy research, the company and industry-specific conditions affect the strategy, and in this study ASEAN is brought into this discussion by analyzing regional production and supply networks of the companies to define whether ASEAN has impacted these by decreasing the trade barriers.

The circle, “institutional framework of the business environment” captures the institutional context of the operations and the business strategy. It guides the empirical research regarding the third research question about the role of regional economic integration enhancing the institutional environment. The aim is to find out whether the regional economic integration decreases the institutional constraints the Finnish companies have possibly experienced.

The role of ASEAN integration in the framework is not necessarily unambiguous. First of all, it is certainly an institution. However, as mentioned earlier, the role of ASEAN or the regional economic integration in general is not exactly same as Peng (2000) or North (1990) suggests: it is not an institutional constraint. Rather, the aim is to enhance the operations of the local and MNCs in the region by providing easier access to the near-by markets and easier trade across borders. However, as the regional economic integration is a multidisciplinary subject, institutional theory is only one way to reflect it in the business research. The common ground is theoretically challenging but fruitful.

**State-level agreement: regional economic integration - ASEAN**





## **4. METHODOLOGY**

In this chapter the methodology used for this thesis is presented in order to clarify how this study was conducted. According to Eriksson & Kovalainen (2008, p. 16) methodology represents the methods and the ways that are used in the research when trying to understand a specific issue. Therefore, this chapter focuses on the methods of data collection and data analysis that have been used in this study to solve the research questions. In addition, the choice of the methodological approach of this study will be briefly explained.

This thesis is conducted as a part of The Center of Markets in Transition (CEMAT) research project on ASEAN region as business environment and the effect of ASEAN integration on Finnish companies operations in these regions. The Center of Markets in Transition (CEMAT) is a research unit of Aalto University School of Economics that focuses on research related to Central and Eastern European economies in transition and also rapidly transforming markets and economies in Asia. As the empirical research conducted for this thesis is also used by CEMAT, previous research material collected by the research unit was accessed. These were for example interviews, newspaper articles, and general information about Finnish companies' operations in ASEAN region.

### **4.1. Methodology for data collection and analysis**

Due to the nature of this thesis, the best way to find answers to the research questions is to collect qualitative empirical data. As Hirsjärvi et al. (2004) mention, the basis for qualitative research is to gain holistic understanding about the phenomena. Also, the qualitative research emphasizes the research context, interpretation and understanding of the viewpoints of the participants of the study (ibid, p. 22). In this study, both interviews and textual data were used as data collection methods. Yin (2004) describes it as a case study

method, as multiple sources of evidence are used when drawing results. These include observations, interviews and reports. This kind of research method allows the research to retain holistic characteristics of real-life events (Yin 2004). Also Yin (1994) states that this kind of case study approach is suitable when the research aims at responding to questions “What”, “How” and “Why” as aiming to get more holistic picture of the phenomenon. This is applicable to this study as well, as the research questions are primarily “What” or “How”-questions. It should be remembered that the qualitative research has some limitations as well. Qualitative research might provide results that take long periods of time to attain and the results are also difficult to generalize.

#### **4.1.1. Interviews as a data collection method**

The primary empirical data to this study was collected by using qualitative interviews. According to Hirsjärvi et al. (2004, p. 34) interviewing is a highly flexible data collection method and it allows to gain deep understanding about the phenomenon, and moreover, in other ways than it was expected in the beginning. Qualitative research and especially interviews provide the possibility to clarify and deepen the data when it is collected, for example by asking supplementary questions (Hirsjärvi & Hurme 2008).

The potential companies to be interviewed for this study were identified from various sources. Mainly, this information was gained from newspaper articles, company web pages and directly from the companies. One important source of information about the companies operating in ASEAN region was Finland-ASEAN Trade Association, which members are the companies and private persons who do business with ASEAN member countries. Also an important source of the companies to be interviewed was the previous research conducted in CEMAT, and professional contacts to the organizations. In addition, the persons that who been interviewed for other CEMAT research projects regarding Asia (e.g. Kettunen et al. 2008 (China), Korhonen et al. 2008 (India)) were asked for suitable contacts that would be responsible for

Asia Pacific region. It can be disclosed that a type of convenience sampling was used for the selection of interviewees because the number of Finnish companies operating in the region is limited, for example there are about 40 Finnish companies in Malaysia and the most of the Finnish companies operating in ASEAN were contacted to have an interview. The interviewees are basically the ones who are responsible for the operations in the ASEAN region or whole Asia Pacific and are on the managerial level of the company. They are experts in their fields and have personal experience of business in Asia. Thus, the in-depth interviews were helpful way to access detailed information on the interviewee's experiences and reflections of the topic.

In CEMAT interviews, the anonymity is guaranteed for the interviewees, which allows acquiring more detailed information about the subject because the interviewees can talk more freely and not to worry about revealing any sensitive data. Any names of companies or interviewees are not presented in this study, as it provides the full confidentiality of information gained from the interviews. Either this study is not focusing on any specific industry. The interviewed companies represent various fields of business, and the main selection criterion is their presence in ASEAN markets or experience of this area. The companies preferably have some stream of goods being imported or exported between Finland and ASEAN, within ASEAN or to/from ASEAN to/from some other locations. Though, this criterion does not relate to the companies that are in the service industry. However, as the number of companies operating in Malaysia is quite limited, the possibility of recognition is somewhat high. Sometimes the information about the industry where the company operates cannot be disclosed.

In total 10 interviews were conducted. The interviews were mainly semi-structured, guided interviews and conversational in nature. A list of open-ended questions was prepared and delivered also the interviewees, but those were mostly used to guide the conversation. According Hirsjärvi et al. (2004, p. 35) semi-structured interview is appropriate method in studies where the

subject is less-studied and the data or speech that the interviewee produces is needed to put into broader context. This is also the case with ASEAN, as there is only few studies that discuss ASEAN and Malaysia in the company level and from the perspective of Finnish companies. However, it must be remembered that the interviews included a broader set of questions and themes than this study covers, as this thesis is part of larger CEMAT study.

Eriksson and Kovalainen (2008, p. 79) suggest that there are three types of interview techniques: positivist, emotionalist and constructionist. These interviews included some aspects of all these techniques. First, they were positivist as the research questions were formed so that information and facts about the firms operations in ASEAN and Malaysia could be gained. The emotionalist interview approach was used when interviewees were asked about their own experiences and views about the subject. The constructionist approach was included as well, as the interviews were done in a conversational way. The interviews were done as face-to-face or telephone interviews, due to the fact that the company representatives that are responsible for Asian markets are themselves located in the field, not in the headquarters. The interviews were recorded on tape on the permission of the interviewee and then transcribed word to word.

#### **4.1.2. Textual data**

In this study, textual data represents the secondary data that was used to answer the research questions. Textual data in this study a for example, documents from the Finnish Ministry of Foreign Affairs, various ASEAN-related documents and newsletters from the ASEAN secretariat, company websites and newspaper articles from Finnish publications such as Helsingin Sanomat, Kauppalehti and Taloussanomat. A common definition of textual data is that those are documents or data that exists without the researcher (e.g. Silverman 2000, Ten Have 2004). Ten Have (2004) uses the definition of ‘natural document’ which implies that the documents are preservable records

of text, image or sound, such as official documents or newspaper articles. A significant amount of textual data was conducted as electronic research, as the most of the textual data is on the Internet, this includes company websites or annual reports.

#### **4.1.3. Data analysis**

According to Marshal and Rossman (2006, p. 256) data analysis in qualitative research should be based on the preliminary research, research questions, and the related literature. In this study, the empirical data was analyzed based on the literature review and the theoretical framework presented in chapter 3. Hirsjärvi et al. (2004, p. 136) have found that there are many features that are characteristic to the qualitative data analysis. They find for example that the data analysis starts already in the interview situation where the researcher can already observe any phenomenon that comes up frequently during the interviews or where the participant perceptions differ.

In this study, the interviews were recorded on tape, and then the tapes were transcribed word for word. Then, the transcribed interviews were encoded according to related topics and headings to a software program (NVivo), which is used for qualitative data analysis. After this, the data was encoded manually into smaller subgroups under keywords and themes. The keywords and themes were selected according to the literature review, previous research and research questions. The keywords and themes were: the companies operations on the region, the significance of regional economic integration to the companies, the companies' experiences of the regional economic integration which means how the interviewees while operating in the region have experienced ASEAN in their daily work and how they perceive it, the connection between the regional economic integration and decision making, the institutional framework and institutional constraints the companies have faced in Southeast Asia and last, how the companies have experienced ASEAN integration impacting the institutional constraints in the region.

The keywords follow the structure of this thesis; hence the result of data analysis was then a collection of citations and quotes. Consequently, the empirical section was constructed according to these keywords and themes. Eskola & Suoranta (2005) state that this type of grouping of the data under themes and specific topics, requires the theory and empirical part are combined, as it was done in this study as well. According to Eskola & Suoranta (2005) the rich use of citations and quotes from the interviews, gives a reader a good understanding about the data and leaves space for the reader to assess if researcher's conclusions are relevant.

#### **4.2. Reliability and validity of the study**

Qualitative research differs significantly from quantitative research when comparing the measurement of reliability and validity of the research. In qualitative research there are no single, defined instruments to do this (Hirsijärvi & Hurme, 2001, 184-190). However, Eriksson and Kovalainen (2008) state that reliability, validity and generalizability are the common criteria for good quality research. These criteria can be used to evaluate studies that represent the critical realist philosophy of research. This stream of research focuses on studying the structures of the social world, this thesis can be classified as this kind of study as well, as the aim is to study ASEAN and its' impact on Finnish companies.

According to Hirsijärvi & Hurme (2001, p. 186) reliability in qualitative research means that if the research is replicated, the result will be the same, or if some other researcher end up in the same results when studying one subject. Yin (2003, p. 37-38) has the same conclusion: "the same procedures, conclusions and findings should be achieved by anyone attempting to complete the same case study". Hence, reliability is related to the consistency of the research results. According to Yin (2003) the reliability is increased by documenting and presenting the procedures of the study, such as including the

questions asked from the interviewees in the study. In this study, the questions asked in the interview can be found in the appendix 3 and extensive reference list in the end.

According to Hirsjärvi & Hurme (2001, p. 187) the validity of a study is defined as whether the study is basically “valid” and the terms and concepts are relevant to the subject and those reflect the real nature of the phenomenon. According to Yin (2003) the validity of a qualitative study can be defined with three tests of construct, internal and external validity. First, construct validity is built already during the data collection phase, and the best way to enhance construct validity is to use multiple sources of information. In this study having the access to the right and most informative and experienced respondents from the organizations significantly improved the construct validity of the research process. In addition to this, secondary and alternative information about the interviewed companies was looked for well before the actual interviews, which then enriched the conversation. Internal validity measures the relationship between the cause and effect and how well the experimentation functions as an indicator of the phenomenon (Yin 2003, p. 36). However, in this study there is no need to pay attention to this criterion because the research questions do not seek to find or explain causalities, whether event x lead to event y.

External validity refers to the extent to which the empirical research results are generalizable and transferable beyond this particular study (Yin 2003, p. 37) to contexts of other people, places or times. Yin (1994) emphasizes the importance of analytical generalization especially in the qualitative research, compared with quantitative survey research which relies on statistical generalization. In analytical generalization, the researcher is striving to generalize a particular set of results to a broader theory. In this study, external validity is maybe on the average level, because the amount of interviews is limited due to resources and some conclusions or results might be biased by the opinions or experiences of some interviewees. However, the external

validity is improved by using also other sources of data, such as textual data and documents, which improves the generalizability as this data is available for everyone and it can be reviewed repeatedly.

Generalizability is a common and constant “problem” in qualitative research as Alasuutari (2007) claims. He states that qualitative research produces deep but poorly generalizable information. According to Alasuutari (2007) qualitative research is always close to case studies, as each qualitative study is an individual case and the results can be rarely generalized to a larger context, as can be done in the quantitative research. However, even the researchers have different opinions about this.

### **4.3. Limitations**

The data collected in the broader ASEAN research project by CEMAT discusses all ASEAN countries as a group and not emphasizing any specific countries. However, this is the major limitation of this study as well; it is not possible to give a detailed picture of the Finnish business operations in specific countries in the ASEAN region. The reason not to limit the scope for specific countries and instead studying the region as a whole stems mainly from the research subjects: the operations of the Finnish companies are scattered around Southeast Asia and focusing only one or two countries would not have given enough answers. Furthermore, the companies themselves tend to cluster regions similarly and understand Southeast Asia as one region. One limitation regarding the interviews was the companies that refused to be interviewed for this study. There were many interesting companies which would probably have provided good insights regarding the subject.



## **5. EMPIRICAL FINDINGS**

This section presents the empirical findings of the study in light of the theoretical notions studied in the previous chapters. Following the structure of the theoretical section and the research questions, this section is divided into four chapters. First is introduced the region by describing the features and development of ASEAN and AFTA followed by a historical overview of Finnish companies operations in Southeast Asia. Next is presented the findings from the empirical research, the interviews with Finnish business leaders responsible for the firms' Asian strategies and their perceptions of ASEAN region as a business environment and the significance of ASEAN region. Third chapter discusses the impact of ASEAN integration on Finnish companies' operations and decision making in the region. Last, the impact of ASEAN integration enhancing the institutional framework is discussed.

### **5.1. Southeast Asia, ASEAN integration & AFTA, and further expansion of the FTA in Asia**

The research context of this study is Southeast Asia. All of the countries in Southeast Asian are ASEAN members: Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. In 2010 total land area was 4 435 830 km<sup>2</sup>, total population 591 841 000 and GDP per capita 2520 US\$ (ASEAN Secretariat 2010).

ASEAN has been established already in 1967 with the focus on political security among the member states, and it was not until the 1970s when the first initiatives to promote intra-regional trade and economic cooperation were raised. However, the critical point was in the end of the 1980s when the global trend was towards economic integration with examples such as European Union or NAFTA. It became increasingly important for smaller and newly industrialized economies to regionally cooperate (Elliot & Ikemoto

2004). Also the emergence of China was seen as a threat to the foreign direct investors' interest in ASEAN countries.

The result was that ASEAN member states agreed to form ASEAN free trade area and AFTA agreement was signed in ASEAN summit in Singapore on January 1992. At that time, ASEAN had only six members: Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand, and Vietnam joined ASEAN in 1995, Myanmar and Laos in 1997 and Cambodia in 1999. These less-developed latecomers, sometimes quoted as CLMV countries (e.g. Lindberg 2007) did not fully meet the economic requirements of AFTA but they were given longer time to meet AFTA's tariff reduction obligations for instance. The aim is to fully realize AFTA by 2010 for Malaysia and other ASEAN-6 countries and by 2015 for the less-developed member countries, however, many researchers find these deadlines too optimistic and state that ASEAN has a long way to go before becoming "a real free trade area" (Green 2008) or ASEAN economic community (AEC) compared the one in Europe.

The AFTA agreement included several measures to enhance regional trade, such as the elimination of non-tariff trade barriers, but the main instrument was the Common Effective Preferential Tariff (CEPT) scheme. According to CEPT, the tariffs on locally produced manufacturing goods in intra-ASEAN trade were gradually reduced to 0-5% within 15 year period (1993-2008) (Lindberg 2007). The countries were able to determine the annual rate of tariff reductions on the national basis, which has led to sometimes criticized "Inclusion Lists" and "Exclusion Lists": some product groups and sectors were and are still protected by excluding them from the low tariff trade. The most well-known examples are such as non-processed agricultural products, for example rice, livestock and natural rubber, which are highly protected sectors in many of the ASEAN countries (Kettunen & Kosonen 2009). Also products such as electrical products, transport equipment, paper products, iron and steel and petroleum are excluded, which then means that the trade in these sectors is not liberalized (ibid). However, the most of the products and

sectors are in the 'inclusion lists', for example the tariffs on all manufactured products, such as textiles and electronics, and processed agricultural products have been identified for faster tariff reductions already in the beginning of AFTA. The bulk of the trade within ASEAN takes place in these sectors.

However, ASEAN members have agreed to eliminate virtually all tariffs from all imports by 2010 for the six original ASEAN members and by 2015 for the CMLV countries. According to the ASEAN secretariat, the situation at the moment is quite good, 99.11% of the tariff lines (54,457 tariff lines) have zero-tariffs. The latest 7,881 lines added to the zero-tariff scheme include products such as air conditioners; chili, fish and soya sauces; as well as intermediate materials such as motorcycle components and car cylinders. Also products such as iron and steel, plastics, machinery and mechanical appliances, chemicals, prepared foodstuff, paper, cement, ceramic and glass (ibid).

However, the zero-tariff scheme applies so far only to intra-ASEAN trade. The ASEAN members are still able to impose tariffs against external trading partners based on national benefits and schedules, therefore ASEAN is almost on the second stage of economic integration development described by Balassa (1961). The third step of economic integration is customs union where member states have harmonized trade policy towards third countries, which happens in EU. The customs union would be beneficial to foreign investors as the companies will face zero-tariffs in intra-regional trade and the same tariffs in their external imports regardless of the country they are located in (Kettunen & Kosonen 2009)

The non-tariff trade barriers such as varying customs procedures have been one of the major headaches for the foreign investors and companies in the ASEAN region (e.g. McKinsey report) and ASEAN secretariat (2010) claims that there is an active process ongoing of 'formulating streamlined and simplified customs procedures for the clearance of goods and eliminating

non-tariff measures' through 'Single Window' initiative. The aim with the project is to allow importers to submit all information related to the transaction electronically at once, and this information could be shared with all ASEAN national customs authorities (ibid). ASEAN secretariat (2010) is also working for Intellectual Property Rights (IPR) regime and removing the obstacles hindering the movement of professional and skilled workers. Hence, this is the aim of this study: to find out whether the work towards these goals is visible to the companies operating in the ASEAN countries.

### *Towards ASEAN+3 free trade area*

One of the current and prominent issues regarding regionalism in Asia is the wider cooperation between ASEAN and Northeast Asia, mainly countries such as China, Japan and South Korea. There are various models developed for regional trade agreement between these actors, for instance ASEAN+3 would be the free trade agreement between above mentioned countries and it was suggested informally already in Kuala Lumpur in 1997 (Lindberg 2007). ASEAN has though developed bilateral trade agreement for instance with China already, ASEAN+1 free trade agreement was signed already in 2002 and will be fulfilled gradually by 2015, but starting already with the first six ASEAN members already in 2010 (Kettunen & Kosonen, forthcoming). This agreement will benefit the companies trading between these countries.

However, it must be remembered that ASEAN, even though having 10 different countries in it, is a fairly minor player in the ASEAN+3 -framework. Lindberg (2007, p. 170) has compiled an interesting figure to describe the relative strength between these countries, and for example, regarding foreign trade and nominal GDP, China and Japan are the most powerful and the most significant actors in the framework. For instance, regarding the population China has 64% (ASEAN 28%) of the all population within the ASEAN+3 area and in nominal GDP Japan holds 49%, China 29% and ASEAN only 12%. In the foreign trade, these countries are quite equal; of all foreign trade

within the ASEAN+3 region, ASEAN has 31%, China 33% and Japan 23% (ibid).

Nevertheless, ASEAN has basically two choices, join the neighbouring economic giants or to stand alone. Not joining any further Asian free trade agreements would not be the wisest decision as ASEAN is often described as marginal player in Asian arena (ibid, Holst & Weiss, 2004) and China's economic power seems to be overwhelming, at least according to the companies and foreign investors (e.g. McKinsey 2004). The percentage of intra-ASEAN trade of all trade to/from ASEAN was only 24.5% in 2009, thus 75.5% of all trade is extra-ASEAN and conducted with countries such as China (11.6% of all trade), 25 EU-countries (11.2%), Japan (10.5%) and USA (9.7%) (ASEAN secretariat 2009). Many researchers have raised the question about avoiding the "noodle bowl" effect of various FTAs, and suggested consolidation of multiple and overlapping FTAs into a single East Asian FTA, such ASEAN+3, that would help to mitigate the ambiguity of different tariffs, rules of origin and standards (e.g. Kawai & Wignaraja 2008).

## **5.2. The characteristics of the Finnish investments in the ASEAN region**

Trade relations between Finland and Asia as whole, and especially with ASEAN countries, are relatively young. The first Asia strategy formed by the Ministry for Foreign Affairs of Finland was made as late as 2001 and this strategy is based on the first Asia strategy of EU which was formed in 1994. The trade between Finland and Asia has been steadily growing since the war period (1945- ) in Finland, but the quantities have been small. However, an interesting growth period regarding Southeast Asian trade was from the beginning of 1990s, when exports e.g. to Singapore, Malaysia and the Philippines grew quickly. For example, regarding Finnish exports, on 1992 the most important destination was Thailand, followed by the Philippines, Indonesia and Singapore. For example the Finnish exports to the Philippines grew significantly due to few important actors and cooperation in the power

producing industry in 1994, and exports in those sectors increased to FIM 1 billion. Also imports from ASEAN countries grew, for example Malaysia was to the biggest Southeast Asian country exporting to Finland, mainly electronical equipment. When looking at the trade figures for example from 1997, it is obvious that the trade took place mainly between Finland and Thailand, Singapore, Malaysia and Indonesia, to other Southeast Asian countries trade was basically non-existent (National Board of Customs 2000). For many Finnish companies Southeast Asia, mainly Singapore, Malaysia and Thailand, were the also the locations where they established their first operational units or regional offices in Asia (Kettunen 2002).

One of the most significant events in the Southeast Asian markets was the Asian financial crisis on 1997-1998 which had remarkable effects on the economies of the ASEAN countries. The growth rates of the economies of Southeast Asia were high and there flew significant amounts of FDIs and foreign currency to the region. Finally, the crisis started in Thailand when Thai baht collapsed after the government decided to float the baht. The crisis hit hard mainly Thailand, Indonesia and South-Korea, but also for example Malaysia and the Philippines were affected as well. The crisis had long term effects on the economies of Southeast Asia, and the growth rates after the crisis were slower (Green 2008) and it has been claimed that China benefited most from the crisis, as it lent 4 billion USD via IMF to ASEAN countries and helped to rebuild their financial systems. At the same time it improved legislation, financial institutions and partly dispensed with state-owned enterprises to attract foreign direct investors from ASEAN countries to China (Goldstein 1998). The impact of Asian financial crisis on Finnish imports from ASEAN countries was not considerable, but Finnish exports to ASEAN region were affected due to financial difficulties of these countries to pay for the imports (Kettunen 2002). For instance, Finnish exports to Thailand decreased from 2 billion FIM (in 1997) to 568 million FIM in 1998 (National Board of Customs 2000).

Since 2003 the focus in Finnish companies internationalization to Asia has been in China, as the economy has opened up by joining WTO in 2001. Finnish exports to China have increased since 2003 and China is also the most important Asian recipient of Finnish FDIs (Kettunen & Korhonen 2006). The latest figures from the National Board of Customs in Finland (2009) show that China is the strongest Asian trade partner with Finland, for instance the exports from Finland in 2009 were worth of 1,86 billion euros, compared to 700 million euros worth of exports to all ASEAN countries combined. The emergence of Chinese markets since the beginning of 2000 has accelerated ASEAN's development and integration initiatives as a response to China's rise to major recipient of FDIs in Asia.

Even though China is possibly the focal point of Finnish companies' investments and operations in Asia, still the significance of ASEAN region has not radically decreased. There are still many Finnish companies from for example manufacturing, electronics and telecommunication industries operating in the ASEAN countries and do not see a need to relocate to Chinese markets and find ASEAN countries attractive (Kettunen & Kosonen, forthcoming) and look forward the growth in these markets. The following table sums up basic figures of Finnish companies operations in ASEAN countries.

<b>Country</b>	<b>Finnish companies, (n)</b>	<b>Finnish FDIs, million EUR (2009)</b>	<b>Finnish exports, million EUR (2009)</b>
Thailand	40	27	104,3
Malaysia	40	46	109,3
Indonesia	23	20	91,7
Singapore	70	1019	242,6
Philippines	n/a	5	81,8
China	260	2459	1.857,5

Table 2: Finnish companies' investments and exports to selected ASEAN countries, and China in comparison, source: National Board of Customs (2009), Finpro 2009 2010, Bank of Finland 2009

### **5.3. The significance of ASEAN as market for Finnish companies**

This section discusses the experiences of Finnish companies that operate in the ASEAN region about their understanding and opinions about the significance of ASEAN markets for their company. The aim of studying the significance of ASEAN region is to understand, how the companies perceive the ASEAN region as a market and how it is competitive compared to other Asian regions, for example China. It is interesting to find out whether ASEAN is a significant market in the companies' strategies and how they see their companies' future in this region. This section also tackles the question whether ASEAN region can be understood as one regional market or are the ASEAN countries rather individual markets within Southeast Asian region.

#### **5.3.1. The role of ASEAN in Finnish companies' strategies**

Company representatives have told various reasons why they find Southeast Asia as an attractive market to enter, and some why it is not. It is possible to notice that these reasons have changed over time. An interesting comment from a CEO of a Finnish company when we told about this research and its topic, was *"Oh, is the Southeast Asian region in fashion again?"*. This indicates that there might be some trends regarding the internationalization of the Finnish firms to different regions.

According to Kettunen (2002), the trade between Finland and ASEAN countries has been growing steadily from the year 1980. Before the Asian financial crisis (1997-1998) Southeast Asia was the focal point in Finnish companies operations in Asia. However, the Asian financial crisis halted the growth and many companies withdrew their investments. The crisis did not have significant effect on imports from ASEAN to Finland, but Finnish exports to ASEAN suffered as the ASEAN countries were not able to finance their imports (Kettunen 2002). One interviewee states: *"Altogether, I think Southeast Asia has been kind of disappointment lately, when the good growth curvebrake during the Asian crisis, there were not much left."* Finnish exports



to Thailand and Indonesia dropped significantly, for example pre-crisis amount of exports to Indonesia was 1500-2000 FIM (millions) but after crisis, only 350 FIM (millions) in 1999 (National Board of Customs, 2000). In 1998, Finnish exports to individual ASEAN countries amounted only about 0,2-0,5 % of total exports of Finland (Kettunen 2002).

Kettunen (2002) states that there are three factors which support the trading potential of Southeast Asia with Finnish companies. First, the Southeast Asian countries are historically trading nations; the excellent location at the crossroads of main sea routes between major continents has ensured the centre-position for exchange and trading. Second, the ASEAN region encompasses a large potential for trade. This is due to emerging economies which are resource-rich with young populations. Export propensities are high due to the restricted size of national markets. Third, in many ASEAN countries is generally accepted export oriented industrialization policy (EOI) that substituted Import Substitution Industrialization (ISI) policy. EOI strategies support the export-oriented growth and trade. Economic policies were successfully implemented in the ASEAN region to attract FDI and build up the industrial base. The ASEAN countries have been industrializing rapidly, especially in the labor oriented industries. However, Kettunen (2002) finds that the major obstacle to the trade is physical and cultural distance, and in addition to these regional variations in cultural diversity, political differences, and various levels of economic development and infrastructure pose some challenges to Finnish companies operations in Southeast Asia.

The countries where the Finnish companies operate cover basically the largest economies in the ASEAN region. According to Finnish National Board of Customs (2009) Finnish companies traded mostly with Singapore, Malaysia and Thailand (in accordance of amount of exports and imports, see Appendix 2). These same countries can be recognized from the interviewed companies' operations as well. Of course there is a great deal of heterogeneity regarding the countries where each company operates, but in general it is possible to say, based on the interviews the countries the most companies mentioned

were Malaysia, Thailand, Indonesia, Singapore and the Philippines. The market size is the most important factor for companies; especially *“Each market in Southeast Asia is relatively significant; for example, the population of Indonesia is 240 million! In The Philippines it is 96 million, Vietnam 80 million, and Malaysia, about 25 million and so on”*.

Lindberg (2007) provides an in-depth analysis of integrating the less developed countries, such Laos, Cambodia and Myanmar to ASEAN. She states that there is a gap in the development of ASEAN-6 countries (Malaysia, Thailand, Singapore, Indonesia, The Philippines and Brunei) compared to CLMV countries (Cambodia, Laos, Myanmar and Vietnam). Regarding both Cambodia and Laos, the countries have significant shortcomings as being interesting FDI recipients, they have supply-side limitations, such as weak production bases and low education levels, but also concrete and generally known problems regarding the boarder procedures, e.g. lack of information and slow handling and generally very high level of bureaucracy and strong presence of illegal trade (Lindberg 2007). This reveals the need for ASEAN countries to harmonize their customs procedures and align regulations and standards (ibid), before ASEAN Economic Community (AEC) can take place.

According the interviews, Laos, Cambodia and Myanmar are understood as underdeveloped and too small markets and especially in Myanmar, the political situation hinders all investments there. Basically, only the infrastructure projects and consultancy in these interests Finnish companies. Both Laos and Cambodia recall for FDIs on infrastructure, especially in the energy sector, and in fact, Finnish and Swedish cooperation with Laos has emerged in building water-power plants in Laos recently.

Among Finnish companies interviewed in this study, there is enormous interest towards the markets of Vietnam, almost all interviewees mentioned that they look forward to the opening of the Vietnamese markets or at least following the development of Vietnam. Vietnam joined the WTO in 2007 and

this has provided Vietnam a way to attach to the global markets and to enhance the domestic economic reform process (CIA Factbook 2010, Vietnam). Vietnam joining WTO was a significant step in the process of recovering from the war, and extricating the country from the rigidities of a centrally-planned economy. There is significant interest towards Vietnam as interviewee states: *“Of course we have various operations in the region, some bigger, some smaller, but however, we are already there and we are ready to react when something happens. There is a lot of potential especially in Vietnam and from there we are expecting growth”*.

However, it seems that these expectations have not been realizing yet with Finnish investors; there does not seem to be any real growth in the trade between Finland and Vietnam according to Finnish National board of Customs trade figures 2009 or 2010 (January-July) (Appendix 3). Although in the global scale, Vietnam was the third largest recipient of FDI's after China and India during 2007-2009 (Finpro 2010: Vietnam country report). Most Finnish companies stated that the cheap labor and availability of raw materials interests them, especially Finnish forest and paper industry companies find Vietnam attractive (ibid).

The possible risks of the investment are the major concern for the companies investing in ASEAN region. The risks might be political, cultural, societal, to do with natural circumstances, unstable institutional environment, local competitors or customers and so forth. Basically anything that makes the business in the region hazardous and might affect the profitability and cause costs. Asian financial crisis in 1997-1998 was a considerable factor that affected Finnish companies' investments and scared some companies away from Southeast Asia (Kettunen 2002). Regardless the crisis occurred more than 10 years, still some interviewed companies found that restrictive factor when considering investments in Southeast Asia.

However, the political risks were mentioned and discussed in the interviews most often. Some of the mentioned were the reformations during Suharto's

ascendancy in Indonesia, the situation in Thailand regarding the former Prime Minister Thaksin, “yellow and redshirts”, political takeovers, floods and so forth. Myanmar is generally a region off the limits, mostly due to the military junta which is in the control of the region.

However, many interviewees find Southeast Asia in general as quite easy operational environment, when comparing with other regions in Asia, mainly China and South Asia, especially India, as an interviewee finds out: *“Operating in Southeast Asia is much easier in comparison with South Asia, by it I mean India, Bangladesh and Pakistan. I think Malaysia, Thailand, Vietnam and the Philippines are very easy markets to operate in, and politically much more stable than South Asia.”*

The competitive edge of Finnish companies in Southeast Asia is above all: quality. Many of the interviewees agree that local and Chinese companies’ strategy is to compete with price, but it is impossible for Finnish companies already due to costs of transportation and production. *Even though we are exporting all of our products all the way from Finland, there are many companies who need high quality products that we are offering.”*

### **5.3.2. Significance of ASEAN region compared to China, India and other Asia**

When looking at the Finnish National board of Custom’s figures of foreign trade between Finland and Asian countries, one cannot avoid the fact that China dominates these figures. In 2009, Finnish exports to China were worth of about 1 860 000 000 euros (4,1% of total exports), imports were worth of 3 480 000 000 euros (8,0% of total imports) (National Board of Customs 2009, appendix 2). For example exports to Malaysia, Thailand or Indonesia were each only 0,2% of total exports in 2009. This can be recognized from the interviews as well.

What defines companies' interest towards certain market is according to the interviews, mostly the market size. There, China and India are strong, even though the operational environment might be more challenging in these markets, as it is noticeable from CEMAT studies regarding these markets as operational environments for Finnish companies (Kettunen et al. 2008 & Korhonen et al. 2008). The following was quite usual respond in the interviews: *"I think the real growth markets are China and India, where are huge populations, and in these markets is our focus as well. The other countries in Asia, (Southeast Asia) come along, if at all"*. Many of the companies experienced ASEAN not highly significant market, as the economies are rather small compared to China and India, where the market potential is drastically larger. An interviewee concludes: *"When there was kind of Southeast Asia "hype" in the 1990s, China and India were the backwaters where were very few Western companies. I personally think that if a Finnish company wants to go to Asia, it rather goes to China"*.

A popular term in the media and literature during last few years has been a kind of "China hype". Of course, it is understandable as Chinese markets have been opening since the 1980s and especially after China joined WTO in 1999. India was mentioned in the interviews by many companies and it is a significant host market, there are 85 Finnish companies operating in India and the Finnish investments to the region grow steadily (Finpro 2010: India country report). Also ASEAN secretariat has recognized this and pointed out that it is even more important to improve the integration of Southeast Asian countries and through that the attractiveness this area for the FDI's.

*"Personally I think ASEAN is a highly significant market; there are more than 600 million people nonetheless. There's generally good infrastructure, not everywhere but mostly, the growth of GDP is still 6-7% and English is widely spoken. I think that Finnish and generally Western companies have lot possibilities in Southeast Asia, but the region has been in the shade of China and kind of China-hype lately. Now many companies focus on China, but later, when China's growth is normalizing and double-digit growth figures are over, I personally think that Southeast Asia has a lot of possibilities. However, many Finnish companies have transferred their local headquarters to China."*

It can be concluded that the significance of ASEAN countries to Finnish companies has changed over time. During the 1990s Southeast Asia was the most important and first destination where Finnish companies internationalized in Asia. Even though the Asian financial crisis did not significantly hit Finnish operations, it affected companies' investment decisions and at the same time the markets of China started to open up. Clearly the majority of the interviewed companies are more focused on China at the moment, and the role of Southeast Asian countries is less significant than before. Although, there are some companies who are not interested in China or India, and rather continue their operations in Southeast Asia. Easy operational environment was stated as a benefit of the developed ASEAN countries, and some companies have their local HQs in Singapore or Malaysia. Large populations and business potential attracts companies' interest in Vietnam and Indonesia. However, it must be remembered that even though the GDP growth rates at the moment in China are double-digit, there are significant markets in Southeast Asia and possibilities for Finnish companies as well. In the media, for example The Economist on 21.7.2011 suggests that Indonesia could be one of the fast-growing and promising BRIC countries, adding one more "I" to the acronym.

### **5.3.3. The degree of integration of ASEAN member states**

When studying ASEAN as a region, it must be remembered that ASEAN consists of group of member states that are widely heterogeneous. Regional variations are considerable as to the geographical size, natural and human resources, and economies of the ASEAN countries. In the ASEAN region, there is also a high amount of cultural pluralism, comprising of various ethnic groups, with a variety of religions and languages. Many of the ASEAN countries are truly multicultural, containing ethnic Malays, Chinese, Indian, and various indigenous populations (Kettunen 2002). Some interviewees find that ASEAN is too diverse area to be integrated and the countries are highly

heterogeneous that might hinder the integration in the region. This is also the finding in the Schwarz & Willenger's (2004) study, ASEAN markets are more fragmented than unified, despite of AFTA. A Finnish interviewee states that integration will take many years: "*I would say that the countries here are so different and SO far away from each other and the integration would take many, many years.*"

The degree of integration in ASEAN is not at the same level as in EU, and this is a common critique related to ASEAN. Company representative states: "*The countries in Southeast Asia are not similar with each other any more than the countries in Europe are similar. When you look at Europa as a region, every country has its own things. And it is the same in here (Southeast Asia)*". The degree of integration in ASEAN is not at the same level as in EU, and this is a common critique related to ASEAN. When reviewing AFTA in the light of the Balassa's (1961) theory of the development of integration, it is clear that AFTA is not yet even a full free trade area or customs union, even though the goal is to establish a common market, an ASEAN community by the year 2020. The member countries have retained their sovereignty and do not have a common trade policy. The decision making and implementation of trade measures occur within the national administration of the member states (Kettunen 2004). This is one major source of heterogeneity regarding economic policies. The role of ASEAN is to be a forum or an arena for cooperation and consultation in different issues: economic, political, cultural etc. but there is no supranational objective (ibid). As the fundamental principles of ASEAN mention (Aseansec.org), ASEAN countries want to remain "mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations", one can find out that the becoming a closely integrated region has not ever been the intention of the founding fathers of ASEAN. The rationale behind ASEAN has however changed since the 1960s, moving from a political union towards an economic one (Lindeberg 2007).

The perceptions of Finnish companies about the integration of the region are clear, there is a high amount of geographical dispersion and significant differences in cultures, languages and religions cross the national borders. One interviewee notes that we far away in the Northern Europe might think that the countries are similar to each other, but after staying in the region longer periods one can notice the myriad of the cultures and histories of the ASEAN countries. Also an interviewee states that: *“There exists also quite much competition between the countries”*, which is a noteworthy issue when discussing regional integration.

#### **5.4. The impact of ASEAN and AFTA on Finnish companies operations**

In this section the second research question, which enquires into the effect of ASEAN integration on Finnish companies operating in Malaysia, is examined. The aim of this chapter is to form a general understanding of how and in what extent ASEAN integration affects these companies operations, and also, whether it has an impact also on Finnish companies' decision making regarding their operations in the ASEAN region. First is studied the effect of ASEAN integration to overall trade to/from ASEAN countries. Second subchapter discusses the trade barriers in intra-ASEAN and then in extra-ASEAN trade with the aim of finding out whether the integration has decreased the barriers of trade.

##### **5.4.1. The experiences of Finnish companies about ASEAN integration and AFTA**

ASEAN was established already in 1967 with the focus on political security, and it was not until 1970s when the first initiatives to promote intra-regional trade and economic cooperation were raised. This was a result from United Nations studies which suggested regional import substitution. However, the critical point was in the end of 1980s when the global trend was towards economic integration with examples such as European Union or NAFTA. It



became increasingly important for smaller and newly industrialized economies to regionally cooperate (Elliot & Ikemoto 2004). According to Menon (1996) the formation of NAFTA and the EU raised the questions about the access of ASEAN exports to the markets of North America and Europe. One significant reason for regional integration was also the increased competition to attract FDIs to region and the emergence of China as a global economic power and a location for Western FDI (Elliot & Ikemoto 2004). Also ASEAN countries perceived competition for FDIs with the Eastern European countries and Mexico (Kettunen 2002). In addition, the failure of the General Agreement of Tariffs and Trade (GATT) Uruguay Round to get conclusion caused concern among ASEAN countries that the multilateral world trade system was becoming more restrictive (ibid).

The result was that ASEAN member states agreed to form ASEAN free trade area and AFTA agreement was signed in ASEAN summit in Singapore on January 1992. The goal was a free trade area by 2008, but the target has been postponed continuously. The agreement included several measures to enhance regional trade, such as elimination of non-tariff trade barriers, but main instrument was the CEPT (the Common Effective Preferential Tariff) scheme. According to CEPT, tariffs on locally produced manufacturing goods in intra-ASEAN trade were gradually reduced to 0-5% within fifteen-year-period (1993-2008) (Lindberg 2007). Fifteen product groups were accepted for accelerated tariff reductions, including such as electronics, textiles, pharmaceuticals and plastics. There was also a requirement for local content: at least 40% of product's content must originate from an ASEAN member state to get the tariff reduction (Kettunen 2002).

However, often criticized issue was then and still is: the inclusion and exclusion lists. Lindberg (2007, p. 127) lists such as Inclusion lists (ILs), General Exclusion Lists (GELs), Sensitive Lists (SLs) and Highly Sensitive Lists (HSLs) which left the substantial areas untouched, e.g. excluded agricultural products from the CEPT scheme. One could argue that only

recently AFTA takes place, as for example on August 2007, 98.6% of the total products in ASEAN had been brought into the inclusion list which indicates that those are under CEPT. Also the removal of trade barriers was not easy task to fulfil, because every country had their possibility to set up their own plan for tariff reductions which resulted in fear among the ASEAN members that country might lose its competitive edge if it reduced its barriers and others did not (Lindberg 2007, p. 127).

Intra-ASEAN trade was around 15-20% of all trade when the AFTA agreement was signed in 1992, but started to grow during the mid-1990s (Kettunen 2002). However, a significant drawback was caused by Asian economic crisis that had a direct negative effect on intra- but also extra-ASEAN trade. Elliot & Ikemoto (2004) have conducted extensive research about ASEAN trade flows and studied how signing of AFTA and Asian financial crisis have affected on those. They used a modified gravity model approach and mathematical modelling of the trade flows, and found out that the trade flows were not significantly affected in the years immediately following the signing of AFTA agreement. However, they also note that the institutional structure of ASEAN was quite weak back then. Elliot & Ikemoto (2004) discovered that even though the Asian economic crisis had serious impact on the economies of Southeast Asian countries, e.g. GDP growth rate of Thailand dropped from 5.5% in 1996 to -10.2% in 1998 (World Bank data in Elliot & Ikemoto 2004, p. 3), exports from ASEAN were not radically affected. Also they claim that Asian financial crisis may have worked as a trigger for further acceleration of the *de facto* integration process, as Asian crisis generated a strong desire to source imports from within the region, because many ASEAN countries were not able to pay for the expensive imports (Kettunen 2002). Even though ASEAN countries slowly recovered from the crisis, it still has a fade of fear among ASEAN members. Few interviewees of this study stated that the robust growth in Southeast Asia halted in the crisis and the growth has not recovered to the same level. Some of the interviewed companies' representatives divide the time of their

presence in Asia as “before the crisis” and “post crisis”. Some stated that the market saturation in their field coincided with the crisis and that with the opening of Chinese markets supported the decision to transfer the Asian headquarters to China.

China emerged quickly to be the main competitor with ASEAN region as a FDI target county. ASEAN was almost forced to accelerate its development towards more integrated market area and seriously defend the competitive edge of ASEAN region when the Chinese markets started to open up for foreign investments (e.g. Elliot & Ikemoto 2004). It seems so from the interviews as well, China is still growing and is the most attractive international market for Finnish companies and it dominates Finnish trade figures. However, ASEAN secretary understood this threat and ASEAN secretary general Rodolfo Sererino commented already in the beginning of 2000 that Southeast Asia should ‘integrate the regional economy to a closer degree to the integration of the Chinese market’. The first high-level talks about establishing FTA between ASEAN and China started already in 2002, and when implemented it would be the world’s largest FTA and generate trade worth of \$ 1.2 trillion (Elliot & Ikemoto 2004). At the moment these discussions are dominated with the concept of FTA: ASEAN+3.

Nevertheless, the last thirty years were a period of robust economic performance and growth for ASEAN countries. One significant reason for this success was the engine of growth that resulted from extra-ASEAN trade, and FDIs which were the result of member state’s own, independent outward-looking policies, rather than intra-ASEAN trade. This has questioned the need for regional integration attempts. (Elliot & Ikemoto 204). However, Kettunen (1998, 2002) reminds that the rationales behind the AFTA agreement were not purely the attempts to promote intra-ASEAN trade; rather the ultimate object of AFTA was “to increase ASEAN’s competitive edge as a production base geared for the world market”. And also, to attract more inward FDIs with

an image of a 'trade bloc' and free trade area, which would enhance or ease investors businesses in the region (Kettunen 1998).

The aim of this study is to answer the research question how all the integration affects Finnish companies operations in the region. The interviewees in general indicate that the impact of ASEAN or AFTA on Finnish companies operations in the region is less significant. The following sections provide four categories of perceptions and experiences about ASEAN integration grouped under themes.

### ***The lack of intra-ASEAN trade***

The main instrument of creating free trade area within ASEAN is the CEPT scheme, which reduced the tariffs of locally produced manufacturing goods to 0-5%, however, this applies only to intra-ASEAN trade. There were recognized only few companies having intra-ASEAN operations, hence the benefits of the integration and AFTA such as zero-tariffs do not affect the companies. The trade flows take place between an ASEAN member country and some other country, e.g. China or Finland typically.

*"When we are looking for a new location where we establish our subsidiary, we are naturally interested in customs duties and whether the goods move without tariffs. If the company has local production and they ship the products within the region, of course they want to be inside the customs area. But when the manufacturing outside of ASEAN, then of course we do not care about customs duties that much, we have to pay them anyway."*

Many interviewees agree that AFTA does not necessarily touch them and is not very important to them because they do not have intra-ASEAN trade. However, when a FTA takes place between ASEAN and China and ASEAN and India, then they see that they can benefit from AFTA in greater extent, because most companies have operations in various locations around Asia.

***Change in the operational environment through AFTA or ASEAN integration?***

There are few experiences of AFTA and even some benefits of it among Finnish companies, but some of the respondents have not seen any change in the operational environment. Two companies have seen progress with tariff-free treatment of products in the customs during the time they have been in the region. Although there are still exclusion lists of sensitive products, such as non-processed agricultural goods, not having zero-tariffs, but nearly all products (99.11% of product categories) have no tariffs in intra-ASEAN trade. One interviewee has recognized the negative progress: *"I think the tariffs have not decreased yet enough that it would matter to companies. There are still, regardless of AFTA, a lot of sectors and product groups for example in Indonesia and Thailand which are protected by the local government, and there cannot be foreign companies operations at all. The countries have not opened up enough even inside the ASEAN"*.

There is a point in the statement, ASEAN member countries are still able to apply product categories to the 'General exclusion lists' according their national interest, for example Malaysia has excluded from the AFTA products that are vital in the Malaysian economy such as electrical products, transport equipment, natural rubber and rice (Kettunen & Kosonen, forthcoming). Hence, the trade in these sectors is not liberalized accordance to the FTA, and this makes it rather difficult for companies to foresee the benefits of regional economic integration and its' progress non-transparent.

The customs and customs procedures are few of the first instances where AFTA could be visible to the foreign companies but it seems that at least Finnish companies have not experienced progress in here as a result of AFTA. *"The customs procedures have not become easier at all. It is a fortress hard to break down. We have had a lot of problems with Thai customs, they require us paying the taxes as deposit even though it should be tax-free and pay them back after more than a year, if at all."*

Although one interviewee has recognized progress with the customs procedures: *"The customs procedures have become more effective and simplified during the last years, and I trust the system they have, however, the slowness is still sometimes a problem"*.

### ***ASEAN markets do not seem to be integrated***

Many of the interviewees find that ASEAN markets are not integrated markets or those could be understood as a single market area. Many compared the integration development of ASEAN to EU, and found that these regions are far away from each other: *"ASEAN is kind of superficial integration, not even close to EU. I think nothing has changed or will change. I understood that they are not even interested to integrate any more than this."*

The companies and even the managers operating in the region themselves have very few experiences of the actual integration. Few suspected the integration to take place only in the agreements and official declarations: *"There are a lot of declarations, statements and policy recommendations about AFTA, but has it realized at all? Not that much"*.

The integration was criticized for significantly slow progress *"even though AFTA was signed 20 years ago the cooperation is not concrete yet"*. An interviewee speculated whether it is more visible in the politics or somewhere else than business: *"Laws are not harmonized or anything. They do not hinder the trade, but it is not any kind of internal market"*. Most of the interviewees stated that the markets are understood as separate.

And one view is that the integration occurs on two levels, state and business level, and there are not connected to each other: *"I think the integration happens only in the business level, companies do business cross national borders and many companies have the APAC as one business area. I do not know is it integration or globalization or what. However, it is totally different thing what contracts and agreements they do in the state level"*. This view is

supported by the literature as the research of ASEAN region can be divided into two categories: political research studying economic integration as a tool of trade policy through state-level agreements (Lindberg 2007) but also the research of regional production networks which were established first by Japanese MNCs (see for example Alvstam 1995, Rana 2006, Kawai 2005 etc.) that have enhanced the regional trade and economic interchange. Similar business-led regionalisation, though in small-scale, can be recognized from the interviewed Finnish companies operations: operations are scattered around Asia and free trade agreement within larger area, such as ASEAN+3 would benefit the companies.

***FTAs are distant, uninteresting, and hard to understand***

ASEAN integration and free trade agreements are perceived as hard to understand and distant for companies, according to the interviewees. It can be concluded that the most of the Finnish companies interviewed are focused on the operations rather than the operational environment or the trade policies, this applies especially on smaller companies and SMEs: *they do not have time to think about the big picture, how the free trade agreement affects their operations when they have to be in few hours at the customer's changing a sparepart. These things are taken as given*". Some were more interested in trade policy and the benefits of AFTA, but some find those complex and time-consuming and almost impossible for a company to be aware of all changes in trade policies or in the development of free trade agreements.

It seems that there is also a gap between the personnel who work with the trade related issues, such as logistics or supply chain management, who see the daily business and challenges in it, but the decision making takes place on the executive level. This might be a lack in this study, as only the executives were interviewed in this study. Many interviewees stated that there are not any problems or they have not heard about those, as one interviewee states:

*“It is hard to tell whether ASEAN would affect our business because I do not understand about these much, but we have not had any significant problems when operating there, so I do not know how it would be any easier. The costs could always be lower, regarding taxes and tariffs in some countries.”*

The multiplicity of trade agreements was experienced complicating the trade. It was stated by an interview being impossible for a single company to find out where to establish production if there are “hundreds” free trade agreements in the region. Also a software or database was suggested as an answer for the complexity of trade agreements and to assist companies’ decision making: *“It is impossible for a single company to go through the huge amount of documents and find out which free trade agreement is valid where and what categories of products does it cover. They should have some software or database for this, and a company could just enter the country and the item and it would show what free trade agreements there are valid.”*

In fact such a database is online provided by the trade and investment division of United Nations ESCAP (United Nations Economic and Social Commission for Asia and the Pacific website 16.9.2011), where is possible to search for trade agreements by country, product group, scope and so forth. However, the usability of the search is not the best one, and it is promoted mostly to the researchers and policymakers themselves.

However, it should not be a surprise that ASEAN or AFTA matters so little to the Finnish companies that operate in the region. The results from the studies that have researched the connection between AFTA and the possibly increased trade, indicate the same, the impact of AFTA on trade is exiguous. This has been noted for example by Plummer & Cheong (2007). If AFTA does not encourage even the local companies to trade with other ASEAN member countries, as the intra-ASEAN is still low (24,5% of all trade in 2009), how it could then be attractive to the foreign companies to benefit from ASEAN integration or AFTA? It seems that Finnish companies operating in ASEAN region, and why not elsewhere, are focused more on the



operations itself. The location matters only through the attractiveness of the market, good infrastructure, good connections and so forth. The questions related to the possible free trade area and trade policies seem to be distant and difficult to understand. The benefits occur rather by accident, but do not guide the decision making. However, there is an understandable reason for that, why to bother if it does not provide any distinctive benefit or advance?

#### **5.4.2. Trade barriers experienced**

The fundamental aim of a RTA is to increase the trade within the member countries by removing the trade barriers (Viner 1950). Studying the trade barriers the foreign companies have faced when in their operations on the region shows in detail the actual challenges the companies have experienced when trading over national borders within ASEAN or importing or exporting between ASEAN and other countries. Hence, it is a feasible way to analyze the progress of regional economic integration and how regional economic integration enhances the removal of the trade barriers.

Trade barriers are the general term for any government policy or regulation that restricts international trade. The basic idea for most of the trade barriers is the same: the imposition of additional cost on trade that raises the price of the traded products. Trade barriers are often divided into tariffs and non-tariff barriers.

Tariffs are the main instruments of trade policy. It is common in the developing countries that tariff have an important function in fiscal policy, as those are one type of tax income for the nation (Kettunen 2004). Non-tariff barriers (NTBs) are generally trade barriers that restrict imports but are not in the form of tariff. There is a large amount of various NTBs, and WTO mentions the following ones as examples: import licensing, quotas, rules for the valuation of goods at customs, preshipment inspections, the rules of origin, investment measures, and antidumping practices (WTO website 2010,

understanding WTO). According to Asean secretariat (2010), ASEAN conducted an extensive study in 1995 identifying major non-tariff barriers in ASEAN region, and they discovered that that NTBs affecting intra-regional trade were customs/import surcharges, technical measures and product characteristics requirements, and monopolistic measures.

The Finnish companies face various trade barriers in ASEAN region. Most of the interviewees mentioned the heavy customs procedures, the high level of import tariffs, national standards, anti-dumping accusations, and “tariff wars” between countries as the trade barriers they faced.

### ***Trade barriers in intra-ASEAN trade***

Promoting intra-ASEAN trade has been one of the crucial questions during the existence of AFTA. As Elliot & Ikemoto (2004) and other researchers have found out, the signing of the AFTA agreement in 1993 has not significantly affected the intra-ASEAN trade flows. Partly, due to historical reasons the main trading partners of ASEAN countries are outside of the region. Strong links have been maintained with the US, Japan and EU (Kettunen 2004). The amount of intra-ASEAN trade is relatively low. In 2009, the percentage of all trade, imports and exports combined, was only 24.5 %, valued at US\$376.2 billion. The rest of this trade, 75.5 % was extra-ASEAN, as it is visible from the appendix 1 describing ASEAN trade flows. It can be noticed that only the less-developed and poorer countries, Laos and Myanmar, traded mostly with other ASEAN members.

In a newspaper interview in the Nation on October 2010, ASEAN Secretary-general Surin Pitsuwan stated that ASEAN’s intra-trade should account at least 40 % of all trade to ASEAN be stronger and able to rely on its own markets. This would add the attractiveness for FDIs as well. One significant act that Surin recalled was the elimination of non-tariff trade barriers and thus, reducing the competition between the ASEAN member states. The 17<sup>th</sup>

ASEAN Leader's summit will take place in Hanoi on October 28-30 and there, the master plan to enhance ASEAN connectivity is presented to the 10 ASEAN leaders. According to Surin, it will outline the key policy changes for better physical infrastructure, institutional environment (harmonization of regulations, rules & standards and so forth to facilitate the trade) and people-to-people exchange. (The Nation 4.10.2010).

However, before analyzing the interview results regarding the intra-ASEAN trade, it must be remembered that there exists relatively small amount of intra-ASEAN trade that is facilitated by Finnish companies. In the interviews, three cases were found out; one of the interviewed companies exports from Malaysia to several countries in the region. Another company has regional trade indirectly, through distributors. Also, one company imports raw material from Malaysia to Singapore and then distributes the end product to Finnish and other European markets. In general Finnish companies' supply chains are more global than local, raw materials, manufacturing and end-markets are not necessarily in the same region. Most of the interviewed Finnish firms are importing mainly from Europe and/or from China and India for their Southeast Asian operations.

Generally there seems to be only few barriers in the intra-ASEAN trade, or those are not significantly affecting the decision making in the firms. Hence, it seems that not significant tariffs exist, and AFTA is taking place at least in the sectors where the interviewed companies operate as a company representative states: *"No, we have not had any barriers in intra-ASEAN trade. Goods move easily and money moves easily as well. The only problems we have had with the Indian and Chinese customs"*.

*"I think there are not big differences in import regulations in ASEAN countries, although, there were some import tariffs and quotas a while ago in some product categories even though it is not accordant to the common benefit. Singapore is the only exception."*

An interesting discovery from the interviews is that the trade barriers seem to increase when there are signs of recession: *“It feels that some countries try to protect their own industries a bit, always when it is possible. Especially when it is recession”*. Some interviewees pointed clearly out that there is clear connection with the signs of recession and increases in the trade barriers. The increase in trade barriers as a result recession is not specific only intra-ASEAN or extra-ASEAN trade, it affects both: *“I think this is really interesting subject to study, how fast these Asian countries start to create trade barriers and protect their own production when there are signs of recession. This has happened right now in India, and earlier also in Malaysia and Indonesia. I see these as a part of larger trade war.”* However, studying the relationship between recession and the increase in trade barriers would be highly interesting, but it is unfortunately out of the scope of this study.

Although, one interesting intra-ASEAN trade barrier was mentioned being the currency risk and the different currencies in the ASEAN countries. This is usually very tangible risk for companies and it can be perceived as a trade barrier because the considerable changes in currencies decrease the motivation towards FDIs: *“I think the currency risk between ASEAN countries is one significant barrier of trade, especially the currency exchange controls affect our business and the long term business plans. It is impossible to know how the local currency is behaving in two years, and protection against it is really expensive.”*

The companies' solution in many cases is to bind the prices or the offering to US dollar which is reasonable when for example the prices of necessary raw materials are also in US dollars. As an interviewee states, when the offering is bind to US dollar, the risk is transferred to the customer. Companies though see the currency risks as common risks related to foreign trade: *“Sometimes we have won and sometimes lost, but yes, currency risk is obvious”*.

A variety of exchange rate regimes exist in Southeast Asia, but no concrete steps have been taken yet to initiate exchange rate policy coordination. As the

degree of economic interdependence is increasing in the region through trade, it is ever more important to maintain stability in intra-regional exchange rates (Kawai 2005). Also there is the risk that one country's exchange rate or currency adjustments have serious competitive implications for neighbouring economies. One and obvious outcome for ASEAN is to move to single currency area and this is considered in the economic integration theory (e.g. Balassa 1961) as the fifth step of economic integration: "economic union". Euro-area is at the moment singly currency area although coming there has taken 40 years (Kawai 2005). According to various researches ASEAN or forthcoming AEC is still very far away from this because even customs union is not in place yet. Hew (2003) and Lindberg (2007) state that the different states of development among ASEAN countries, mainly ASEAN-6 versus CLMV-countries is the main reason why economic integration progresses slowly.

#### ***Trade barriers in extra-ASEAN trade***

The extra-ASEAN trade accounted 75.5% of all trade in 2009 (see the table on the previous page). Top trading partners with ASEAN countries in 2009 were China (11.6 % of all trade), EU (11.2%), Japan (10.5%) and USA (9.7%). Hence, the regional economic integration initiatives of ASEAN must be considered in the context of the global economy, and the high number of external economic links forbids forming "fortress ASEAN" – type of closed and inward-looking economic community (Plummer 2006). That is the reason why ASEAN promotes the concept of "open regionalism".

One significant issue in the ASEAN's development towards customs union or AEC is the agreement on joint external tariffs (Lindberg 2007, p. 161). At the moment, the member states are free to decide their own external tariffs. The situation with the external tariffs seems to be complex and there is considerable unpredictability in the structure of tariffs across ASEAN member states and across commodities and product groups within countries.

Singapore seems to be only true free-trade economy, and the tariff structures in the other member countries vary considerably by sector. Generally, tariffs are low on machinery and electronic equipment in every countries, but e.g. tariffs on transport machinery and food products are quite high in all countries, except Singapore (Plummer 2006, p. 926). An interviewee experiences the situation seuraavasti: *"When we import from our factory in China to Southeast Asia, the tariff rates are quite low. In Singapore there is no import duty, but in Malaysia, Vietnam and Indonesia the import duty for our products is about 5-10%. However, our competitors also import their products here and their have the same costs. And this is not that much it would give some competitive edge to the local competitors"*. One company has experienced high import duties when importing old machinery to be used as second-hand manufacturing equipment from Europe to Southeast Asia, and he speculates the reason: *"Maybe they do not want to be the last resort for old machinery, but I think these duties can basically prevent the investment in the first place..."*. The prevailing situation is criticized for example Hew (2003) stating that if the AEC is truly the aim, a customs union must be created and the questions of harmonized external tariffs must be brought shortly to the agenda.

Hence, it seems that the import tariffs are not significant barriers of trade, at least in the case of Finnish companies' operations in the region, but the harmonization of external tariffs would have benefits, as many researchers find it. An interviewee finds that ASEAN countries use the tariffs and quotas directing the trade: *"They (ASEAN countries) use quite actively and independently the tariffs and quotas directing the trade and especially the imports. When the price of crude oil was high, they set export duties and wanted to prevent the exports. But then their stocks were full and they removed these tariffs and wanted to promote the trade."*

Hence, it seems that the countries operate quite independently regarding the external tariffs and look for their own advantage. However, if the total benefit

of ASEAN region is recalled, common external tariffs (CET) would be needed. Plummer (2006) makes important contribution to the subject and finds out that even though the ASEAN customs union (ACU), where is agreed about CET, may seem distant at the moment, but the benefits it would gain, neutralize the possible costs and challenges. He finds that zero-CET would be the optimal, most outward-oriented and “world trade friendly” solution, however, embracing pure open regionalism and internal and external tariff-free zone is politically difficult endeavour. According to Plummer (2006, p. 937) ACU would bring various benefits, such as the direct effect on additional trade and investment creation, improvement of the global competitive position of ASEAN, unifying effect on ASEAN policies vis-à-vis third countries, increasing the negotiating power of the region, reducing the “noodle bowl” problems associated with third country FTAs, the enhancement of socio-cultural cooperation as a result of market integration and last, as EU experience shows the customs union is necessary for the full market integration. However, the main challenge is the situation of the CLMV countries, which are highly dependent on import-related taxes. Cambodia, for example, received until only recently about 70% of its government income from import-related taxes (Lindberg 2007).

The most discussed and prominent feature of Asian regionalism during the last few years is the widened cooperation in the region between ASEAN and external countries, most notably the economic links to other parts of Asia, countries such as China, Japan and South Korea (Lindbeg 2007). For example Kawai & Wignaraja (2008) state that for the past 25 years the rapid expansion in trade, both to developed markets and within the East Asia and Southeast Asia has accelerated the process towards economic integration. They find that the current plethora of various and even overlapping FTA agreements of in Asia is carrying the risk of becoming unwieldy and makes doing business more cumbersome, as one company representative notices: *“All these different FTAs are really complex, many of those are overlapping and it is really hard for us to find out the specific benefits for one company”*. There is

the risk of “the noodle bowl” effect, due to different and competing tariffs, regulations and standards, such as ‘rules of origin’ questions, resulting from various bilateral trade agreements between individual ASEAN countries and East Asian countries, but also “plurilaterally” between ASEAN and Northeast Asian countries, China, South Korea and Japan. This “plurilateral” agreement between above-mentioned countries is often called as ASEAN+3. (Lindberg 2007).

It is visible from the interviews as well that the most often mentioned and most important extra-ASEAN trade flow according to the interviewees is between ASEAN countries and China. As mentioned in the chapter 1.1.2, many Finnish companies operating in Asia have transferred their regional offices to China, and many companies mentioned that they have a significant amount of the production facilities in China. Japan and Korea were also mentioned few times as the locations of the Finnish companies’ offices in Asia.

However, according to the interviews, there are some trade barriers in the extra-ASEAN trade. Those usually relate to the tariffs and the difficulties with the customs, especially in China and India. Many company representatives commented that there are high tariffs when exporting from ASEAN region to China: *“The high tariffs are only a problem when we are exporting from Southeast Asia to China, that is why we do not do that, we rather operate there locally as the high tariffs raise the price we are selling to the customers and then it is difficult to compete with the local companies.”*

From the experiences of Finnish companies, various non-tariff barriers of trade such as lack of common standards and other technical requirements, quantitative restrictions, prohibitions, state trading, anti-dumping measures, export promotion and guarantees, safeguarding and subsidies were recognized. These vary from country to country and sector to sector, but most mentions of non-tariff barriers related to Vietnam, Indonesia and Thailand. One interviewee sees the lack of common standards in Southeast Asia



countries as the main barrier of trade: *“In many countries, also in Vietnam, there is this JIS-standard, Japanese Industrial standard which is the most important and if your products are not like that, then it is more difficult. But all of our products are accordant with European industrial standards.”*

A Finnish company in the paper industry has had to defend their company against dumping charges for example in Malaysia and Indonesia, at it seems to be a common in the paper industry. The interviewee states: *“We were charged for selling to these markets for less than our costs. Sometimes we have won and sometimes we have been able to negotiate. However, these penalty tariffs are 10-50% of the price of the product and already 10% is enough to kill the business.”*

Having the goods in the right tariff list is crucially important according to an interviewee: *“It is the most important thing that our products are in the right tariff lists or categories with right names. I have heard that when this Finnish company X’s products were on wrong tariff category, even though there did not exist exactly right one, they had to pay a lot more tariffs, even though it was not their problem.”*

Also here, as in the intra-ASEAN trade, currency risks are the most significant risks related to the trade: *“When we are exporting from Finland to ASEAN countries, the greatest risks are the currency risks and the rapid changes in customs issues. These might change very rapidly, even during the shipping.”*

One noteworthy issue is the lack of interest of knowledge regarding the trade barriers. One interviewee finds out that the personnel who are working directly with these issues are not always aware “what is normal” in tariffs: *“They think that 50% tax on imports is normal and it is not perceived as a barrier. Those are taken as granted. Most of the business managers mentioned that they follow closely the tariff levels and changes in those. However, it is mostly the management located in corporate HQ who are*

interested in the tariff levels and other barriers of trade, not the personnel executing the tasks related to cross-boarder operations as an interviewee states: *"Often when I try to inquire after the barriers of trade from the local personnel, they do not exactly understand what is a barrier or a difficulty in trade, the perception is often "it has been always like this and we have to live with this...". They do not necessarily see it could be done more easily"*.

It is visible that there are some barriers of trade in intra-ASEAN and extra-ASEAN trade, and two managers mentioned some potential solutions that they have discovered in order to tackle the trade barriers in the region. One solution mentioned is to use the local public sector officials as intermediates and delegate the issue to local trade officers, sometimes using personal relationships. If the problem is related to Finnish industries in general, the company turns to Finnish Embassy who helps finding solution with the host country officials. Another alternative can be "hinting" about the trade barrier to Finnish ministers when they are visiting the region and trying to get the issue addressed in the minister's speech.

How ASEAN integration has increased or decreased these barriers is rather challenging to analyze. First, the amount of intra-ASEAN trade flows of Finnish companies is quite limited and we are talking about only a few companies which trade actively between two or more ASEAN member countries. Extra-ASEAN trade is more active, which takes place for example between ASEAN countries and India and China, and of course Finland.

However, the interviewed Finnish companies operating in the region that have intra-ASEAN trade flows have not discovered any change in the trade barriers in the last few years, because the trade barriers the interviewed companies have faced have not been highly significant or those have not been perceived as problems or significant challenges preventing the business or hindering the trade. In extra-ASEAN trade, the main barriers seem to be Indian or Chinese customs. Also the currency risk is perceived as a relevant risk in both, intra-

and extra-ASEAN trade. An interesting phenomenon that an interviewee mentioned is the increase in trade barriers after the signs of the global recession emerged. It seems that the countries want to protect their own production and set various protective tariffs when the economy is in the downswing.

However, to the extent as it is possible to analyze, it seems that there is not a clear connection between increasing or decreasing of the barriers of trade with ASEAN integration process, or at least it is not visible through Finnish companies' operations or their trade flows in the region.

Even though the goal of ASEAN integration is to decrease the trade barriers and to become ASEAN Economic community by 2015, it must be remembered that the overall amount of intra-ASEAN trade is still quite low (24.5% of all trade in 2009), and the role of ASEAN as an institution seems to a quite invisible to the companies and there is not a clearly recognized connection between free trade agreements and the actual trade that companies carry out.

### **5.5. The impact of ASEAN on regional institutional framework and the business strategies of Finnish companies**

The aim in this subchapter is to broaden the discussion from the regional economic integration to institution-based view of business strategy and find out, whether the model of by Peng (2000, p. 45) is applicable to this context. According the model there is dynamic interaction between the institutions and organizations in certain context and this affects the business strategies of the companies operating in this environment.

### **5.5.1. Is ASEAN enhancing the institutional environment in the region?**

The aim of free trade agreements in general, is to ease the operations of the companies doing business within the free trade area (Viner 1950). As suggested in the theoretical framework, the purpose of this study is to find out whether regional economic integration has had an impact on the institutional constraints the foreign companies face in a different business environment. The most common institutional constraints the Finnish companies have faced, such as bureaucracy, taxation, corruption, different legislation, IPR issues, business culture, labor and human capital issues such as work permits some to mention.

As presented in the literature review, the fundamental statement of Peng (2000) is that the strategic choices companies do are not driven only by firm-specific resources and industry conditions, but rather those are also a reflection of the formal and informal constraints of a particular institutional framework the decision makers confront in new markets. Hence, it is reasonable to study whether the regional economic integration first, has decreased the institutional constraints the companies face in the host markets and second, if it has an impact on the strategy.

During the analysis of the interviews, it became evident that the ASEAN integration does not have very strong impact on the operations of the companies. When analyzing the impact of regional economic integration decreasing institutional constraints from the experiences of Finnish companies, it became clear that the only part of the institutional framework ASEAN seemed impact is the transfer of human capital and the work permit issues.

According to integration theory (Balassa 1961) *common market* is the fourth stage of regional economic integration where in addition to a FTA and customs union, the production factors such as service, labor and capital can

flow freely among member nations. In ASEAN, an ASEAN Framework Agreement on Trade in Services (AFAS) was adopted in 1995 with the aim of liberalizing the trade of services and also human capital. One interviewee has experienced change in the transfers of human capital along with the integration: *“Also it is possible for them (the local workers) to move from country to country without visa, before e.g. Vietnamese had to have a visa to go to Singapore, but not anymore. You can see the impact of regional integration. It has increased the trade as well.*

However, the real impact of AFAS on the movement of natural persons within ASEAN has been criticized being minimal and it is not in line with trade liberalization in the region (Tullao & Cortez 2006). There are still a large variation in the migration regulations among ASEAN member states (ibid). The national policies and government regulations limit the movement of professionals with visa arrangements, work permits, language tests, citizenship requirements, and economic needs and labor market test. The most of the interviewees had the same outlook: *“In the work permit issues ASEAN is not visible and the countries are not integrated, every country has its own requirements and regulations”.*

The companies often have short-term needs to transfer employees from a country to country, for example on project-basis, but dealing with work permits was mentioned being time-consuming and difficult as an interviewee states, *“If we have a project in another ASEAN country and we need to move people, the work permit and tax issues are quite difficult, AFTA does not help in here”.* The companies regarded EU as an ideal for ASEAN in the movement of labor, where the companies do not need to use resources to tackle with work permits for the access to the optimal employees.

Manning & Sidorenko (2006) who studied the regulation of professional migration in ASEAN in IT and healthcare sectors, found out that more advanced countries in ASEAN, such as Singapore, Malaysia and Thailand

have more liberal regimes in the regional movements of skilled manpower compared to others. Although, an interviewee stated that ASEAN countries have highly varying requirements when hiring also foreign expats: *“In some countries, if you want to hire one expat, you have to hire one local. But then, for example in Thailand, when you hire one expat, you need to hire seven locals. And all countries have different regulations in this.* Understandably ASEAN countries support the employment of their citizens; however, usually the companies see this type of regulations as restricting the business.

An interesting observation was made by an interviewee regarding work permits and recession: *”When we are talking about the transfers of goods and human capital, it must noticed that when it is more or less recession, all the work permit issues etc. have become much more tighter”*. This was noticed by Fix et al. (2009) as well they studied the connection between 2008-2009 global financial crisis and migration flows. They found out that countries who hosted large number of migrant-worker populations have closed or partially shut their migration doors, although they also discovered that the recession slowed down migration, although the immigrants stayed in their new country despite of the lack of jobs.

As the end-goal of the ASEAN integration is AEC, a single market by 2015, the liberalization of the regulations of human capital flows cross national borders definitely needs attention. Also Manning & Sidorenko (2006) called for more consistent and standardized regulations for visas and work permits across the region, also to support the strong economic growth in the region and foreign investors need for work force.

Otherwise, the interviews showed that the institutional constraints are not overwhelming in the ASEAN countries. The only ones the companies had experienced were such as rather heavy bureaucracy in some ASEAN countries, such as Indonesia and Thailand, corruption, IPR and general lack of

transparency issues in all other countries than Singapore, and political risk, mostly in CLMV countries but also Indonesia and lately in Thailand.

Hence, it can be stated as Elliot & Ikemoto (2004) and Hew (2003) find out, ASEAN is rather weak institutional arrangement and according to the experiences of Finnish companies, it does not decrease the above-mentioned institutional constraints. The only impact on institutional framework the companies had experienced was the transfers of human capital. When revisiting the theoretical framework and premises of the institutional-based view of business strategy (Peng 2009), it can be concluded that ASEAN is still in the early stage of regional economic integration, thus it is not yet a considerable factor enhancing the institutional framework.

#### **5.5.2. The effect of ASEAN on companies' strategy and decision making**

One of the research interests of this study was to discover whether the ongoing regional economic integration affects the MNCs' strategy and decision making. In general, many interviewees find ASEAN as generally a positive thing; but yet, it rarely has a real impact on companies' decision making and strategy. Some companies find free trade agreement within the region as one manager puts it: "*nice to have*", but it seems that for the most it has not a tangible effect on the decision making. ASEAN is neither considered as a "*top priority*" regarding the investment decisions, the most interviewed companies stated that the main concern is to minimize the risks related to the investment. Most saw European Union as a model for ASEAN and stated that similar free trade area where national borders do not matter in business and institutional environment is stable and predictable, would be ideal, though many found it as a distant "*dream*" considering the slow progress of ASEAN integration. "*No, the free trade area does not affect our decision making, e.g. where we establish next subsidiaries and what we produce in each place, the effect they hope it to have.*"

If the benefits of free trade area occur, it is rather a lucky accident as an interviewee stated it: *“Sometimes the benefits of the free trade area might take place accidentally, but we do not look at those when we decide something about our locations”*. The same approach seems to apply to the forthcoming China-ASEAN free trade agreement. Companies explain this by the fact that it is hard to build strategies on FTA that is only making. One company representative states that a company cannot build competitive edge based on the expectations of a FTA that are uncertain and the possible advantage of (FTA) is realized only afterwards.

In the investment and location decisions possible free trade area or regional trade agreements do not matter much. The decision making regarding the FDIs and the locations of those is based for instance on the market size and attractiveness of the market, good connections & good infrastructure, the location of subcontractors and generally the supply chain structure, and investment support received from the host government, and above all, the global strategy of the company.

As stated by an interviewee, also the location, needs and requirements of customers dictate the location where a company establishes their operations rather than free trade agreement: *“The requirements and the needs of the customers and our credibility as trustworthy supplier are much more important than trade agreements. Reduction of 2 -3 % in tariffs does not make the case”*.

As a comparison, a survey conducted by the US Chamber of Commerce (2010) about Fortune-500 companies operating in ASEAN region shows similar results: regional economic integration in ASEAN is not regarded as a critical factor in the decision making, uncertainty about timeframes and unpredictability of a state-led agreement decrease the significance of ASEAN free trade agreement in the decision making of US corporations. According to the survey (ibid) 6% of the firms indicated that they have based their business



strategy on a fully integrated ASEAN. These firms considered positioning themselves to take full advantage of the regional market with the “first mover advantage”.

## **6. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

In this section the findings of the research are examined. First, the findings for the three research questions are discussed. Second, the theoretical contributions of this study are concluded and the theoretical framework is re-evaluated in the light of the empirical research. Last, the managerial and policy implications are provided with suggestions for future research.

### **6.1. Summary of the main findings**

The goal of this thesis was to study the role of regional economic integration on foreign companies operations and the context of this study were the Finnish companies' operation in Southeast Asia and the ongoing regional integration, ASEAN. The research problem was divided into three parts and research questions: first was analyzed the significance of the ASEAN region for the Finnish companies, then the impact of the integration on these companies operations, and last was analyzed whether the integration enhances the institutional framework and has impact on these companies' strategies. Next, the findings of each research question are discussed in more detail.

#### **6.1.1. Significance of ASEAN region to Finnish companies**

The first research question enquires into the Finnish-ASEAN trade and investment relations. The aim is to define the role of ASEAN countries in the global strategies of Finnish companies. Asia in general, including the Southeast Asia perceived as one of the few regions in the world with the real growth in the economy as a result of large populations, rising living standards and middle class. Most of the interviewed Finnish companies consider Southeast Asia an important market in their operations, although many emphasized the importance of China in their international operations.

Southeast Asia had a central role in Finnish companies' internationalization in the 1980s and 1990s when Singapore, Thailand and Malaysia were among the first locations in Asia where the companies exported and invested in. Asian financial crisis in 1997-1998 was mentioned "cutting the good growth" in Southeast Asia and simultaneous opening up of Chinese markets in the beginning of 2000 left Southeast Asia as "the second best" region in Asia.

However, many of the companies have units in several ASEAN countries, and especially Singapore, Malaysia and Thailand were mentioned as relatively easy environments to operate in, in comparison with China and India. Singapore and Malaysia due to easy business environment, high technological development and good connections were described as ideal locations for regional HQs. From the ASEAN member states, Vietnam attracts most of these companies with the liberalization of the markets after the communist era, recent WTO membership, inexpensive labor and growing home markets.

The integration within the ASEAN region is perceived as low. The most of the interviews were sceptical with the integration process ongoing in the region as there is a high degree of diversity between the countries and the markets are more fragmented than unified. However, there is emerging interest in the larger trade agreements, such as ASEAN+3 which attaches China, India and South-Korea to ASEAN. Some mentioned this fitting best their Asian strategies and easing the trade between units scattered around Asia.

### **6.1.2. The impact of ASEAN on Finnish companies operations**

The second research question into the impact of ASEAN regional economic integration on Finnish companies operations. This was studied by analyzing the experiences and perceptions of the companies from the integration and also analyzing the trade barriers the companies have faced in their intra- and

extra-ASEAN trade to observe the progress of trade liberalization within FTA.

The results of the interviews indicate that the ongoing regional economic integration is not highly significant for the companies and it does not have a real effect on their operations. First of all, the lack of intra-ASEAN trade of the interviewed companies hinders the analysis on the impact of AFTA, as the 99% tariff-free trade implies only to intra-ASEAN trade flows. However, it was stated that when making decisions about the locations, ease of doing business and the tariff levels matter. Second, the companies did not see significant change in the operational environment through AFTA and ASEAN. Particularly problematic are the exclusion and sensitive lists, where ASEAN member states are still able to add product categories which are sensitive to their economy. Furthermore it was stated that the national governments have yet strong role in trade policies and regimes. Although, some interviewees experienced that the customs procedures have become more efficient and simplified recently, thanks to integration. Third, the companies have not experienced tangible examples of the integration and they see the progress of the integration as slow. For them, ASEAN is mostly official declarations and policy recommendations but not real change in the business level. Fourth, FTAs are perceived by the business executives as distant, uninteresting and hard to understand. When operating in host markets, the interviewed companies focus on the operations and the operational environment rather than trade regimes. The large amount of RTAs and FTAs (AFTA, ASEAN+3, ASEAN-China, ASEAN-India and so forth) confuses the companies, and it was mentioned being impossible for a single company to find out the benefit of a FTA and to define whether it applies also the products the company is producing. An easy-access database was suggested to be provided by the policy makers to increase the awareness of FTAs and the benefits for foreign companies.

An interesting notion from the interviews was the different perception of the regional economic integration depending on the size of the company. The small and medium sized (SMEs) do not consider ASEAN as a significant factor of a business environment and are not necessarily aware of the possibilities such as zero tariffs. However, the directors of larger companies are generally more interested in FTAs and at least interested to find out what the benefits for them might be. In general, ASEAN seems to affect the companies only in the cases when the firm has production in the ASEAN region and they need to ship goods to other locations within ASEAN or for example China.

The interviewed companies have faced various kinds of trade barriers when operating in Southeast Asia. These are such as high tariffs in extra-ASEAN trade, heavy and inconsistent customs procedures across the region, high import tariffs varying from country to country, national technical standards, anti-dumping accusations, currency risks, and tariff “wars”, which means two or more countries pressuring each other by raising taxes or tariffs.

It was mentioned that the most of the ASEAN countries seek only their own interest and want to protect their own industries, regardless of the free trade agreement. They use rather independently quotas and tariffs directing the trade and especially the imports. Companies had varying experiences from the trade barriers in different countries, but Vietnam, Indonesia and Thailand were brought up most often. It was also stated that when the first signs of the global recession emerged, the trade barriers increased and the ASEAN countries started to protect their own industries.

The trade barriers especially tariffs were not experienced as troublesome or hindering the trade, since the foreign competitors face the same and the Finnish companies do not usually compete in price with the local competitors, rather with quality. The possible solutions for the trade barriers were such as using local public sector officials as intermediates and delegate the issue to

local trade officers, sometimes utilizing personal relationships. Other solution is to turn to Finnish Embassy who helps finding solution with the host country officials. Also, hinting about the problem for the Finnish ministers visiting the region might help.

### **6.1.3. The role of ASEAN enhancing the institutional framework in the region**

The third research question discusses the regional economic integration in the institutional context and the role of ASEAN as decreasing the institutional constraints the Finnish companies face when operating in the region. The underlying doctrine of the institution-based view of business strategy is that the formal and informal institutional constraints of a business environment impact the strategic decision the managers need to do when operating in the markets where the institutional environment is not as strong as in the home markets. Peng (2004) states that the Asian economies are feasible “research laboratories” for institutional-based view as the institutional framework is not similar as in the developed markets.

However, it was suggested in the theoretical framework that the regional economic integration instead of acting as an institutional constraint, would rather enhance the institutional framework. Nevertheless, the interviews showed that ASEAN integration has not decreased the institutional constraints. The only instance where few companies had experienced ASEAN enhancing the institutional framework was the transfers of human capital and work permit issues. One interviewee stated that it is now easier to the workforce to move within the region, however the most stated that ASEAN and AFTA are surprisingly invisible in the work permit issues even though one could assume the regional economic integration improving the internal mobility within the region.

Otherwise, the interviews showed that the institutional constraints are not overwhelming in the ASEAN countries. The only ones the companies had experienced were such as rather heavy bureaucracy in some ASEAN countries, such as Indonesia and Thailand, corruption, IPR and general lack of transparency issues in all other countries than Singapore, and political risk, mostly in CLMV countries but also Indonesia and lately in Thailand. However, the institutional framework varies significantly from country to country and in here, the lack of specific scope for a specific country restricts the deeper and further analysis. As mentioned, the companies have not experienced ASEAN decreasing the above-mentioned institutional constraints when operating in the Southeast Asia because ASEAN as an institution itself is rather invisible for the businesses.

For the most companies ASEAN is a rather insignificant factor in the decision making. This is explained for instance by the fact that it impossible to build strategies on an agreement that is only in the making. Furthermore, the few percents cuts on tariffs were considered by many companies as too small that it would affect decision-making. However, the most companies stated that the integration is interesting and it would increase the attractiveness of the area. The SMEs and large corporations perceive ASEAN differently, the small companies are not necessarily aware of the integration initiatives of FTA in the region, but for large companies, regional economic integration is something they follow actively or inactively and try to find out if it benefits them.

The decisions about the locations where the companies operate and invest are based for instance on their global strategy, the location of subcontractors, suppliers and customers and generally the supply chain structure, the markets size and the attractiveness and liberalization of the market, the investment support received from the host government and the good connections and infrastructure.

## **6.2. Theoretical conclusions and contributions**

Studying regional economic integration means collecting and attaching several theoretical notifications from various theoretical discussion and research streams. As Lindberg (2007) found out as well, there is no single theory explaining regional economic integration thoroughly. It is definitely a multidimensional phenomenon which concerns the economists, political scientists and international trade theorists. As a research subject, ASEAN is particularly interesting as does not necessarily follow the same integration path as the tradition integration theories which stem from the European integration.

However, studying it as a feature of the business environment where a foreign MNC operates, anchors it in this context to the international business research. In this study, the institutional theory was applied to answer the research questions that concerned also the institutional environment the regional economic integration possibly shapes. It is also a suggestion of Lindberg's (2007) to use institutional theory bridging the research streams studying regional economic integration together.

The regional economic integration implies the liberalization of regional trade and investments; it can be assumed the integration processes have direct effects on the MNCs operating in the region: the operations of companies should ease across state boundaries. The basic proposition of integration theories comes from classical customs union theory (Viner 1950).

To understand the effect of regional economic integration on businesses and the institutional framework the companies need to adapt, the institution-based view of business strategy was introduced. For this thesis, the framework guiding the empirical research was formed on the basis of Peng's (2000, p.45) view of the business strategies in emerging economies where the dynamic interaction between institutions and organizations affect the strategic choices



the companies. However, the model by (Peng 2000) does not incorporate the impact of state-level agreements shaping the business environment, the framework in this study is reviewed in the light of the regional economic integration. Also in the institutional theories, formal and informal institutions are seen as *constraining* the business, but as the aim of regional economic integration is enhance the trade and investments, it can be assumed that the effect would be opposite, rather enhancing the trade. Hence, this is a unique perspective to institution-based view and it is rarely used previously. However, being possibly the reason that the regional economic integration of ASEAN is still in its initial stage, there were no significant changes in the institutional environment and decreases in institutional constraints discovered in the empirical research.

Nevertheless, the common ground of the institutional theory, international trade theory and the theories explaining regional economic integration is significantly fruitful. The company perspective seems to be lacking in the regional economic integration studies even though the aim is to lower the trade barriers and enable the trade and investments of local and foreign companies.

### **6.3. Managerial implications**

It is highly useful for Finnish companies to know about the possibilities the regional economic integration provides for MNCs operating in the ASEAN region in the form of decreasing trade barriers, such as tariff-free treatment of goods or eased customs procedures in the export and import operations cross the national borders. It became evident while conducting this study that the companies are not necessarily aware at all of the business opportunities the free trade agreements provide, for example the tariff-free treatment of exports and imports in intra-ASEAN trade. FTAs were perceived as overlapping, hard to understand, time consuming and sometimes irrelevant to the business. However, there perceptions of FTAs varied significantly according the size of

the respondent's company, large companies were interested about the progress of FTAs in the region and decreasing barriers of trade, though smaller companies rather take FTAs as given. In general, the managers' interest in FTAs is on multilateral agreements, such as ASEAN+3 or ASEAN+China agreement, which support best the companies' Asian strategies with multiple locations around Asia and the trade between these locations.

As found out in the empirical section, the relative attractiveness of the ASEAN markets decreased after the Asian financial crisis (1997-1998) and the opening up of Chinese markets simultaneously. However, due to characteristics such as large population of 600 million people, close proximity to growth markets of China and India, relatively high GDP growth rates (4.8% in 2005-2009 on all ASEAN members and 7.3% in 2010 on ASEAN-6), ASEAN countries are attractive investment and trade destinations for Finnish companies. There are business opportunities in various sectors such as forestry and wood, electronics, chemicals, oils, telecom and services.

ASEAN region was described by the interviewed managers as relatively easy operational environment, no significant challenges or very strong institutional constraints were mentioned. Although, bureaucracy, corruption and the use of personal contacts in business relations were mentioned as examples of the constraints the companies had experienced in all other ASEAN countries than Singapore. However, it must be noted that there are extreme diversity in the levels of development within ASEAN region. The Finnish operations focus on ASEAN-6 countries such as Singapore, Malaysia and Thailand where the infrastructure is developed, high technology and good connections are the norm. The CLMV countries were criticized for the lack of basic infrastructure, weak institutional environment and heavy bureaucracy hindering the trade and investments. There are though business opportunities for Finnish companies in infrastructure projects and consulting in these.

#### **6.4. Policy implications**

As Elliot & Ikemoto (2004) and Hew (2003) already found out, ASEAN is described as institutionally weak arrangement. ASEAN secretariat is not enough visible or a strong institutional organ in the region, same conclusion had the McKinsey report already on 2004 and according the interviews the situation has not changed significantly. Increasing the awareness among international investors of the business opportunities the FTAs provide would be highly beneficial. Investor friendly websites about investing in ASEAN where would be gathered information about all ASEAN countries, the investment possibilities these countries provided, tariffs, customs procedures and so forth, would help ASEAN to attract FDIs. Each ASEAN member states have such in the national scale, such as MIDA (Malaysian Industrial Development Authority), BOI in Thailand (Board of Investment) or Singapore's EDB (The Singapore Economic Development Board), but nothing on a larger scale and a collaborative way. A beginning could be a database from where an investing company could easily search for valid RTAs and BTAs in a specific region and in selected product categories.

In general, the possible national-level and sector-specific exceptions to RTAs affect the companies possibilities for regional trade. One form is the use of exclusion and sensitive items lists directing the product groups that have the tariff-free treatment in cross-boarder trade. However, it is reasonable towards the trade of the poorer ASEAN members to be supported by the inclusion and exclusion lists, though EU should possibly be used as an example: there the national or sector-specific exclusions are not allowed at all.

The cooperation in external tariffs, which would be a move towards customs union, would be highly beneficial for the investing companies. As the interviews highlighted the varying levels of tariffs towards third parties, standardizing these would ease the trade for foreign companies. Here again, the situation of the poorer ASEAN members must be considered.

It can be expected that the ASEAN integration process continues to evolve only gradually, and the plans to ease cross-border investment, intra- and extra regional trade and to create a legal entity for the association will take time. However, as Lindberg (2007) concluded in her very extensive research about the progress of ASEAN, the result is same in this study, the lack of awareness about ASEAN among international investors and MNCs should be the top concern for the decision and policy makers of ASEAN. Is it an entity and a region to be taken seriously?

### **6.5. Suggestions for future research**

As mentioned earlier, studying regional economic integration means collecting and attaching bits and pieces of theoretical notions from various theoretical discussion and research streams. Either, the regional economic integration is not widely studied subject in the business research tradition. Here, the focus has been Finnish companies operating in the entire ASEAN region which of course leaves several issues without attention. Defining the scope of the study would be interesting, to cover for example Nordic companies or to study ASEAN integration from the local companies' perspective.

As it was mentioned in the interviews, few interviewees had recognized the barriers of trade increasing in the ASEAN region during the signs of recession and economic downturn in 2008-2009. It would be interesting to define how ASEAN economies direct their foreign trade independently and in what extent the protectionism increases while world economy is the downswing.

It was stated by an interviewee that the regionalisation processes taking place in Asia are divided to state-level agreements and the regional operations by the companies, and these two are far away from each other. This statement has in fact theoretical background as well. One of the theories explaining

regionalisation is Alvstam's (1993, 1995) suggestion for foreign, especially Japanese, MNCs' local production chains changing the industrial dynamics and therefore increasing *de facto* regionalisation, market-led integration fuelled by the private sector (Barrel & Choy 2003). Also Kettunen (2004, p. 54) states that the international trade patterns do not provide any understanding about the role of states in creating incentives or barriers to trade. Hence, it would be interesting to combine the two aspects of regionalisation process in Asia, business-level and state-level to compare for example Finnish companies Asian strategies and operations to the intergovernmental and multilateral free trade agreements, such as ASEAN+3. The goal would be to define what the real trade and investment flows are and what are supported by state-led agreements.

The role of regional economic integration impacting the institutional framework of host economics needs definitely further theoretical research within international business and ASEAN provides a fruitful premise being one of the central FTAs occurring in Asia, where is still growth in the global economy. If ASEAN continues to develop towards institution-led regional integration it will be interesting to find out in few years whether the institutional framework strengthens further and ASEAN integration becomes more visible for the companies as well.

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## 8. APPENDICES

Appendix 1: Intra- and extra-ASEAN trade (2009). Source: ASEAN Secretariat

Country	value in US\$ million; share in percent/share in percent											
	Intra-ASEAN exports			Extra-ASEAN exports			Intra-ASEAN imports			Extra-ASEAN imports		
	Value	Share to total exports	Total exports	Value	Share to total exports	Total exports	Value	Share to total imports	Total imports	Value	Share to total trade	Total trade
Brunei Darussalam	1,229.3	17.1	7,168.6	1,242.8	51.8	2,399.6	1,156.8	48.2	2,399.6	2,472.1	25.8	9,568.2
Cambodia	644.6	12.9	4,965.8	1,453.3	37.3	3,900.9	2,447.6	62.7	3,900.9	2,097.9	23.6	8,886.7
Indonesia	24,623.9	21.1	116,510.0	27,742.4	28.7	96,829.2	69,086.8	71.3	96,829.2	52,366.3	24.5	213,339.2
Lao PDR	997.4	80.6	1,237.2	1,480.8	85.8	1,725.0	244.2	14.2	1,725.0	2,478.2	83.7	2,962.1
Malaysia	40,365.1	25.7	156,890.9	31,700.2	25.7	123,330.5	91,630.2	74.3	123,330.5	72,065.3	25.7	280,221.4
Myanmar	3,196.7	50.4	3,144.8	2,065.7	53.7	3,849.9	1,784.1	46.3	3,849.9	5,262.4	51.6	10,191.3
The Philippines	5,838.4	15.2	32,496.2	11,561.1	25.4	45,633.9	33,972.9	74.6	45,633.9	17,399.5	20.7	83,868.6
Singapore	81,646.5	30.3	269,832.5	59,047.6	24.0	245,784.7	186,737.1	76.0	245,784.7	140,694.1	27.3	515,617.1
Thailand	32,490.6	21.3	120,006.6	78.7	152,497.2	26,759.5	107,010.1	80.0	133,769.6	59,250.1	20.7	286,266.8
Viet Nam	8,554.8	15.1	48,136.2	13,566.7	19.6	69,230.9	55,664.2	80.4	69,230.9	22,121.5	17.6	125,921.9
<b>ASEAN</b>	<b>199,587.3</b>	<b>24.6</b>	<b>810,489.2</b>	<b>176,820.1</b>	<b>24.3</b>	<b>726,354.1</b>	<b>549,734.0</b>	<b>75.7</b>	<b>726,354.1</b>	<b>376,207.3</b>	<b>24.5</b>	<b>1,536,843.3</b>

Source: ASEAN Merchandise Trade Statistics Database (compiled/computed from data submission, publications and/or websites of ASEAN Member States' national statistics offices, national statistics offices, customs departments/agencies, or central banks)

#### Notes

- not available as of publication time  
 n.a. not applicable/not available/not compiled  
 Data in *italics* are the latest updated/revised figures from previous posting.

All figures are preliminary.

Details may not add up to totals due to rounding off errors.

Symbols used

Appendix 2: The outline of the interview questions [in Finnish]

Aalto-yliopiston kauppakorkeakoulu / Center for Markets in Transition  
Haastattelukysymykset

**Suomalaisyriyten kansainvälistyminen yhdentyvillä markkinoilla:  
Liiketoimintamahdollisuudet Kaakkois-Aasiassa ja Itämeren  
talousalueella**

**1. Emo- ja tytäryrityksen taustatiedot**

- Toimiala
- Yrityksen koko (liikevaihto, henkilöstön määrä)
- Päätuotteet ja -markkinat
- Kohdealueen merkitys yritykselle
- Investoinnin arvo (€, \$)
- Sijainti (kussakin maassa esim. pääkaupunki, erikoistalousalue)
- Omistusosuus (enemmistö, vähemmistö, 50 - 50, 100 %)
- Perustamistapa (uusperustanta, yritysosto)
- Yrityksen alueellinen arvoketju Kaakkois-Aasiassa / ASEAN-alueella (toimintamuoto, kuten valmistus, T&K, myynti, vienti/tuonti maasta toiseen)
- Yrityksen toiminnot Kaakkois-Aasiassa / ASEAN-alueen rajojen yli (raaka-aineiden tuonti, valmiiden/puolivalmiiden tuotteiden vienti)

**2. Yrityksen suhde julkiseen sektoriin**

- Oikeuslaitos ja lainsäädäntö (lakien toteutus ja sovellus käytännössä)
- Henkilökohtaiset suhteet viranomaisiin (kehen, missä kysymyksissä/ongelmissa)
- Lobbauksen tarve/merkitys
- PR-toiminta, goodwill
- Korruption tarve/merkitys
- Byrokratia
- Merkittävimmät julkiseen sektoriin liittyvät haasteet/ongelmat
- Merkittävimmät ratkaisumallit julkiseen sektoriin liittyvissä haasteissa/ongelmissa

**3. Alueellisen yhdentymisen vaikutukset yritykseen**

- Miten alueellinen yhdistyminen (yhteistyösopimukset, vapaakauppasopimukset) ovat vaikuttaneet liiketoimintaympäristöön?
- Miten suhtautuminen ulkomaisiin investointeihin on muuttunut? (investment climate)
- Miten alueellinen yhdistyminen (yhteistyösopimukset, vapaakauppasopimukset) ovat vaikuttaneet yrityksen toimialaan ja sen käytäntöihin?
- Miten alueellinen yhdistyminen (yhteistyösopimukset, vapaakauppasopimukset) ovat vaikuttaneet yrityksen toimintaan?

- Miten tariffit ovat muuttuneet ja mikä on ollut muutoksen vaikutus yrityksen toimintaan?
- Miten tullikäytännöt ovat muuttuneet ja mikä on niiden merkitys yrityksen toiminnalle?
- Miten viranomaiskäytännöt ovat muuttuneet ja mikä on niiden merkitys yrityksen toiminnalle?
- Yhdentymisen vaikutukset IPR-lainsäädäntöön ja –käytäntöihin
- Valuuttaerojen vaikutukset
- Mikä tekee Kaakkois-Aasiasta / ASEAN-alueesta houkuttelevan investointikohteen?
- Millaisia investointiesteitä alueella on?

#### **4. Yrityksen suhde Kaakkois-Aasian /ASEAN-alueen yrityksiin**

- Mille paikallisten yritysten kilpailukyky rakentuu?
- Minkälaista yhteistyötä tai kontakteja yrityksellä on paikallisten yritysten kanssa (esim. asiakkaat, alihankkijat)
- Eroavatko paikalliset toimintatavat suomalaisista seuraavien asioiden suhteen: sopimusten merkitys, henkilökohtaisen suhdeverkoston merkitys, ystävyys-suhteet liiketoiminnassa, ongelmienratkaisu
- Miten alueellinen yhdentyminen on vaikuttanut yrityksen suhteisiin muihin yrityksiin?
- Merkittävimmät haasteet/ongelmat suhteessa paikallisiin yrityksiin?
- Tärkeimmät ratkaisumallit paikallisiin yrityksiin liittyvissä haasteissa/ongelmissa?

#### **5. Yrityksen suhde työntekijöihin**

- Suhtautuminen ulkomaiseen työnantajaan?
- Työntekijöiden liikkuvuus?
- Mikä paikallista työvoimaa motivoi?
- Ammattiyhdistysliikkeen merkitys? Järjestäytymisasteen kehitys tulevaisuudessa?
- Henkilöstöjohtamiseen liittyvät haasteet?
- Tärkeimmät ratkaisumallit paikalliseen työvoimaan liittyvissä haasteissa?

#### **6. Tulevaisuuden näkymät kohdemaan, paikallisten yritysten ja suomalaisen liiketoiminnan näkökulmasta**

- Miten kohdemaan liiketoimintojen odotetaan jatkuvan/kehittyvän?
- Mitkä ovat merkittävimmät paikalliseen toimintaympäristöön liittyvät riskit tulevaisuudessa?
- Aiheuttaako alueellinen yhdentyminen tulevaisuudessa vaikutuksia yrityksen toimintaan? Jos, niin mitä?
- Onko joitain yleisiä ongelmia/virheitä, joita suomalaisyritykset tekevät kohdealueella?
- Miten nämä ongelmat voitaisiin ratkaista?