European Business Environment

Doing business in the EU

Edited by Frans J.L. Somers

Sonja A. van Hall
Cor van Leeuwen
Egin E. Lengton
René W.H. van der Linden

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Preface

European integration is taught at many universities both inside and outside Europe. Most of the textbooks for these courses are written from an economic or political perspective and put a strong emphasis on common economic policies. This book focuses on the business perspective – specifically, on the effects of European integration on the European business environment and its implications for individual enterprises' international strategies. The European Union's aim of creating a borderless single (or internal) market with one common currency for all participating countries will of course have far-reaching consequences for enterprises doing business in the EU.

The single market

This book therefore puts the spotlight on the *single market*, as the central element of integration from a business point of view, and examines in detail how this market is functioning, especially for businesses. A separate chapter is devoted to each of the 'four freedoms' of the single market: *the free movement of goods, services, capital and people*. To introduce the four key chapters, the economic theory, historical development and judicial basis of integration in Europe are first discussed, with each of these topics being related explicitly to the business environment.

The book is amply illustrated with business case studies and examples. Every chapter starts with an opening case study, which is used to highlight the main issues dealt with in the chapter. Most of the cases are drawn from real life, and they relate to a wide range of countries and industries. Further case studies and short business examples are also introduced in the course of the chapter. The aim of this approach is to give the student a clear idea of the significance of European integration for business and an understanding of how the theory underlying this policy works out in practice for individual businesses. Each chapter ends with brief conclusions and some questions.

An integrative approach

The business environment has many dimensions, and accordingly this book takes an integrative approach. The single market is analysed from the economic, political, legal and marketing points of view, corresponding to the various disciplines of the contributing authors. The final text is, however, the outcome of close collaboration and discussion among the authors and editor, ensuring balanced coverage of the subject.

Relevant courses

This is an essential textbook for students on undergraduate and postgraduate degree programmes in European and international business. In addition, it offers valuable supplementary reading for all courses in European integration, European studies, the economics of the EU and other courses of which business forms an important aspect. The book is also relevant to courses at universities outside the EU, because it explicitly deals with opportunities for non-European companies operating within the EU.

Acknowledgements
First and foremost, I wish to thank all the contributors for their input. Their wide range of expertise has made this comprehensive book possible. They have put an enormous amount of work into writing and revision in order to achieve a consistent approach and satisfy their own high quality standards. Working in a multidisciplinary team is a challenging task, requiring patience, open-mindedness and determination, and the contributors have shown all of these in bringing the project to a successful conclusion.

Special thanks go to Otto Venema, our publisher at Noordhoff Uitgevers in the Netherlands. Otto initiated this project and has remained fully committed, supportive and inspiring throughout the writing process. Without his close involvement, this book could not have been published. I am also extremely grateful to Marijke Quarré, our editor at Noordhoff Uitgevers, who has given invaluable technical support during the production of the book.

Finally, I wish to thank my students at Leiden University and Hanze University Groningen, both in the Netherlands, and the students I have taught at universities abroad, who have inspired me over the years to publish on this fascinating and dynamic subject.

Frans Somers
Glimmen, July 2009

List of contributors

Frans J.L. Somers (volume editor; economics, marketing and law; chapters 1 and 9) studied quantitative economics and law at the University of Groningen and now works as an independent consultant advising universities and businesses, mainly with respect to their international marketing strategies. He has taught European economics and business at the University of Leiden and at Hanze University in the Netherlands and at universities in Prague, Budapest and Moscow. He is the author, co-author or editor of several textbooks, including *European Union Economies, a comparative study* (Addison Wesley Longman; editor).

Sonja A. van Hall (law; chapter 4 and legal sections of chapters 5 and 6) studied law at the Radboud University of Nijmegen and is now a lecturer in international law at the Hogeschool van Arnhem en Nijmegen (HAN University of Applied Sciences). In addition to her university post, Sonja van Hall is the (co-)author of several publications on legal aspects of international trade. In 2008 she wrote the textbook *Contracten in de internationale handel* (Contracts in international trade) for Noordhoff publishers. Sonja van Hall also acts as a legal adviser to businesses participating in international trade and international logistics and offers training courses to such businesses.

Cor van Leeuwen (marketing; manufacturing, export and marketing sections of chapters 5 and 6) studied biophysics at the University of Leiden and is currently senior lecturer at Rotterdam University (a university of applied sciences). He is a member of the curriculum, accreditation and quality control committees. For approximately 25 years he held various commercial and general management positions in the business-to-business and service sectors. In 2003 he changed career to become a university lecturer. His principal areas of interest are the internationalization of SMEs, marketing in life sciences and sustainability.

Egin E. Lengton (law; chapters 3 and 8) studied Dutch law at Maastricht University and business information science at the University of Twente. He is on the staff of the Arnhem Business School, where he teaches international and European law, and works concurrently as an independent legal adviser.

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Contents

Introduction and study guide

This book analyses and discusses the European business environment and its impact on doing business in Europe. This environment is developing rapidly, and European political and economic integration is one of the main drivers for change. Because integration has many aspects, this book takes a multidisciplinary approach, analysing the European business environment from the macroeconomic, political, legal and marketing perspectives.

Two parts
The book is divided into two parts. To introduce the subject, the background to the European integration process is first discussed, from the theoretical, historical and organizational points of view, in part 1, 'The European integration process'.

The core of the book is the analysis of the functioning of the single – or internal or common – market and its impact on business. The 'four freedoms' of this market, being the free movement of goods, services, capital and people, are studied in detail in part 2, 'The single market and international business strategy'. What does the single market mean and how does it work in practice? Have the barriers to trade really been removed and can people move freely? Do we have fully integrated financial markets? And what is the significance of the single market for companies inside and outside the EU? What kind of strategies can be developed in order to benefit from economic integration in Europe?

Part 1
Part 1 starts with a general discussion of the subject. The main themes of the book are explored and linked to each other in chapter 1. In chapter 2 the rationale and principal concepts of the theory of integration are examined. What are the main advantages and disadvantages of economic and monetary integration? What stages of integration can be distinguished? How does economic integration relate to political decision making? What are the effects of integration on business strategy and performance?

In chapter 3 the actual development of economic integration in Europe is reviewed and put in its historical perspective. This development is compared and contrasted with the theory set out in chapter 2, especially the theoretical stages of economic integration, and linked to a number of milestones (the successive European treaties).

Chapter 4 deals with the organization and legal structure of the EU. The difference between the legislative, executive and judicial branches of power is explained. The legislative branch is the source of European law, which is contained in the treaties and in regulations and directives. Executive power is delegated to the Commission, which is responsible for the proper execution of EU law. Judicial power, finally, is held by the European Court of Justice, which ensures that EU law is observed and uniformly applied.

Part 2

In part 2 the single market is analysed in detail. A chapter is devoted to each of the four freedoms, analysing their functioning and significance for international business strategy. The *free movement of goods* is covered in chapter 5, which explains precisely what this means in legal terms. How does it relate to public law and to private law, such as international sales contracts? What are the exceptions? What can be done in the event of infringements of the free movement of goods by Member States? The second part of chapter 5 deals with manufacturing industry in Europe, including its import and export activities, and with the theoretical and practical aspects of the marketing of goods in the EU.

Chapter 6 focuses on the *free movement of services* in the EU. The structure of the chapter is similar to that of chapter 5. First, the nature and the legal basis of the free movement of services (including the exceptions) are explained. A discussion of European protection of the free movement of services follows. Section 6.3 explores the significance of service industries in the EU and their international dimension. The limited nature of international trade in services (apart from traditional sectors as tourism) is discussed, and the success and failure factors, including barriers to cross-border activities in this field, are examined. The chapter ends with a section on the marketing of services in the EU.

The *free movement of capital* refers to the free circulation of money and capital in the EU. This requires the full integration of banking and capital markets and a common currency. Chapter 7 analyses the EU's efforts to reach this goal, which is still far from achieved. The chapter examines in detail the present state of affairs, the effects of financial integration on the European economy and economic policy, and its impact on business. Special attention is given to the introduction of the euro, its impact on the economies of the euro-zone countries and its effects on the European business environment.

Chapter 8 discusses the *free movement of people*, which refers to the right of EU citizens not only to travel freely and live anywhere within the EU, but also to find and take up jobs and to provide services everywhere in the Union. This subject is examined in section 8.1. The free movement of people also includes the right of individuals and companies to establish businesses everywhere in the EU. This topic – and its influence on European company law – is discussed in section 8.2. The chapter ends with a discussion of cross-border labour and social security issues.

Finally, in chapter 9, the challenges of progressive EU integration for businesses operating in the EU are explored. The European business environment is nowadays very diverse, even more so since the accession of the new Member States in Central and Eastern Europe, with their emerging economies. Section 9.1 presents some of the opportunities arising from this situation, illustrating them with graphics and case studies. Section 9.2 reviews the rationale for selecting a target country for international operations within the EU and demonstrates that every Member State has (in principle) its own advantages and disadvantages, depending on a business's strategic aims.

Study guide and teaching approach

All the chapters in this book have a uniform structure. Every chapter opens with a case study, which is used throughout the chapter to illustrate the theory under discussion. The theoretical presentation of macroeconomic, legal and business aspects of the European business environment is also amply supported by graphics and tables.

After each specific facet of this environment has been explained, its impact on business and its relevance for business strategy are analysed. This analysis is illustrated by a number of additional business case studies and examples.

Every chapter ends with a short summary ('conclusions') and some questions. A list of abbreviations, a glossary and a Web guide are provided at the end of the book.

Website

This book is supported by a website: www.europeanbusinessenvironment.noordhoff.nl. The website makes available additional information, including recent articles, additional case studies and questions, and answers to the questions in the book. For lecturers, a secure, password-protected site offers supplementary teaching materials.

The European integration proces

1

1 The changing European business environment

2 The theory of integration

3 The development of the European Union and its impact on business

4 The organization of the European Union

1 The changing European business environment

CASE STUDY

'Selling to another country requires a strategy based on sound research.'

Interview with Frans Alting, Team leader for international trade, North Netherlands Chamber of Commerce

The North Netherlands Chamber of Commerce has a number of tasks. One of them is to support and advise companies planning to start or expand international operations. Originally, the focus was almost exclusively on supporting companies in the region with export activities related to goods. Recently attention has shifted to include other forms of international trade (services and imports). Frans Alting co-ordinates a team of five consultants in this field.

How important are exports these days for companies in the Netherlands, in particular for Small and Medium-sized Enterprises (SMEs)?
The percentage of SMEs involved in this form of international trade is relatively low: about 15% (excluding retail). But there are large variations around this average. For manufacturing industry it is about 40% and for wholesale about 25%. Service companies, on the other hand, are hardly involved in exports at all: only 2% of them.
The Dutch government aims at a percentage for all SMEs of 15% in the near future. This may not be easy to realize, because services are the most rapidly growing industries. That is why the Dutch Trade Board is very committed to promoting the export of services in particular. It is also a natural trend that the continuous growth and development of the service sector will lead to a further internationalization of services as well. Take for instance the IT business. IT companies were originally strongly focused on supporting local companies with the development and implementation of their computer systems. Today, software products are more and more sold internationally; in many cases these products require additional services in the field of implementation, including adaptation and tailoring to the needs of overseas customers.

Can selling to other countries in the EU still be considered as 'exporting'? Or is this just entering another market?
From a customs point of view, only selling goods to non-EU countries is considered as exporting. The euro has made international operations easier and less risky. Nevertheless, from a company's perspective, selling to other EU countries is still definitely exporting. Foreign markets – including foreign EU markets – are very different from the home market. Indeed, other cultures, languages, consumer preferences and distribution channels play a very important role in this. Normally, foreign companies lack sufficient knowledge of this new business environment. But on top of that there are still a lot of barriers related to differences in rules and regulations. In theory, these legal barriers should no longer exist according to the principles of the single market in Europe. The single market entails, among other things, mutual recognition of each other's standards and product norms, and European Standards have been defined for a number of products (CE marking).

In reality, there are many exceptions to the mutual recognition principle, however. And where an agreement has already been accepted for a specific group of products, countries are in many cases still allowed long transition periods before the arrangement comes into effect. A typical example could be the office chairs we are sitting on at the moment. Almost certainly this office furniture would not satisfy German ergonomic standards and hence cannot be sold in that country.

European Standards are only applicable to a limited number of products. Harmonization and standardization of product norms will not be easily achieved, even in Europe. Every country is inclined to use this kind of barrier to protect its own industry. Breaking them down involves tough negotiations. The single market is – despite the '1992 project' which was supposed to achieve it – far from completed. It is an ongoing process. The obstacles in the field of services are far higher still.

A company wanting to install a special sealed floor in a petrol station in Belgium will almost certainly be confronted with all kinds of special rules and regulations, concerning for instance the environment and the employment of staff; rules which may be quite different from the Dutch ones.

Another example: a Dutch business which would like to sell dustbins to the Municipality of Hamburg. The order will be placed as a result of a public tender. The tender will probably have to be made in German and the product must satisfy specific German standards, unknown to the Dutch supplier. If it comes to a contract, it should be specified whether the agreement comes under Dutch or German law. The German client may have a strong preference for German law and even prefer the product to be supplied via a German subsidiary of the Dutch business.

Selling to a customer in another country – even within Europe – means that you have to enter a completely different market, previously unknown to your company. That requires a strategy based on sound research. For SMEs in particular, developing and implementing such a strategy is a long-term investment, costing time and substantial amounts of money. In many cases, large companies already have a marketing department dealing with this kind of research and strategy, meaning that less additional investment is needed and (part of) the knowledge is already available within the company.

What are the main markets for companies starting to export?
Most of the companies going abroad for the first time just go to the neighbouring countries. For the Netherlands, Germany is the most important export market (around twenty-five per cent), followed by Belgium (around fifteen per cent). If they are successful, they might turn to more distant countries.

What are the most important reasons for companies to go abroad?
The most important reason is that companies want to grow. If the Dutch market is saturated, the obvious alternative would be exporting. Businesses considering exporting should have distinctive capabilities, meaning that they should have either a cost advantage or a superior product. In other

words, they should have a competitive advantage which could also be leveraged to foreign markets. A good network, special products or superior logistics (e.g. in the case of import–export businesses) could contribute to such a competitive advantage.

Sometimes there is a clear link with trade. Suppose a company started by importing cheap Chinese products for the Dutch market. If you manage to find other markets in Europe for these products as well (transit trade), you might realize economies of scale. That means that you can negotiate lower purchasing prices, offer a wider range of models and demand exclusivity from your supplier. An example of this is the trade in artificial (plastic) Christmas trees made in China.

For manufacturing industry, scale is a crucial factor. Most producers cannot survive on small volumes, among other reasons because they must cover the costs of their investment in machinery and research & development.

A declining market can also be a good reason for exporting. If the business is going very well, there is no need for foreign adventures; on the other hand, if it is going very badly, there are normally no resources for going abroad. However, in an economic downturn such as we are facing today, businesses' first reaction is to cut costs. The second might be to look for new markets abroad, in order to restore their previous sales level. For that reason, an economic recession could be an incentive for further internationalization.

How do companies start exporting?
In many cases by coincidence. An employee of the company meets someone at a business meeting or other event. It could also be a matter of strategy: most companies are not particularly interested in the mass production of standard products. Generally, they can make more money by making specialist products for a niche market. But a niche market could be very small in the Netherlands. That is why it makes sense to try to find similar markets abroad. In that way you can have both a differentiation strategy and a large market as well. This can be considered a logical and natural development.

Some companies must even internationalize right from the start, particularly if they make very specialized products. Typical examples are companies in advanced sectors, such as hi-tech, biochemistry or medical devices. The Dutch market is simply too small for them. In many cases these are start-ups linked to universities or other knowledge centres.

Can you tell something about the experiences of companies starting to internationalize? What are the pitfalls and what are the success factors?
Failures are mostly related to bad preparation. Some companies just apply a kind of trial-and-error approach. They happen to meet a business contact: an agent, importer or company active in the same business. They do not really check it out and do not start with solid market research or a study of the different options. In the end, it turns out that they committed themselves to the wrong partner. The choice of the wrong distribution channel can also play a role. A key factor for success is the opposite approach: sound research

and good preparation before you make any move. Good entrepreneurship is generally required.

International trade is mostly associated with exporting. What about importing? How important is importing for companies, in particular for SMEs?
Importing is of crucial importance in the Netherlands. In many cases, exporting and importing are linked. This is related to the Dutch trading spirit. Dutch companies import goods in order to resell them abroad (transit trade). This business only makes sense, however, if the Dutch company manages to give the products some added value, whether in terms of logistics, upgrading, marketing concept, packaging or other innovations.

The Netherlands is a trading nation. About sixty-five per cent of our national product is related to international trade. But we are only able to increase our exports if imports are growing too. That is another reason why the Chamber of Commerce has chosen a different approach for its consulting role: the former *export advisers* have become advisers on *international trade*.

Do companies in general look for support when starting international operations?
Many do, although some companies still just go it alone. For smaller companies particularly, this is not really a wise thing to do. Better would be to get some support from experienced organizations which have an overseas network. This can be obtained from (semi-)governmental organizations, such as the chambers of commerce, the Dutch Agency for International Business and Co-operation (EVD), investment and development agencies (such as NOM, the Investment and Development Agency for the Northern Netherlands) and organizations dealing with innovation (such as Syntens) or from private consultancy companies.

The North Netherlands Chamber of Commerce co-operates closely with the other (semi-)governmental organizations mentioned above, because many of their activities are linked. For instance, exporting is also a kind of innovation. On the other hand, if you are making innovative products, you have to go abroad anyway, because the market in the Netherlands is too small for your niche product. And, last but not least, if you are active abroad you may be confronted with new competitors, new ideas and other challenges. This could be an extra incentive to innovate further, in order to stay ahead of the competition. So in fact it is a kind of virtuous circle, where innovation leads to exporting and exporting to innovation.

That is also the main reason why the Chamber of Commerce has chosen an integral and comprehensive approach to its consultancy practice, and also to its organization and co-operation with external partners. You can no longer isolate international trade from a company’s other core activities these days.

In this chapter the background to European integration, the main issues and their relationship to the European business environment are explained and analysed. These issues are explored in more detail in the following chapters.
Section 1.1 focuses on the single market, which is considered to be the central element of European economic integration. Its main principles and its significance for business are explained. In section 1.2 the rationale for economic integration in Europe is discussed, including the assumed benefits and costs, from both economic and business points of view. Section 1.3 examines the background to European co-operation, including the political and economic aspects.

1.1 The single market

The European Union (EU) is of growing importance for the daily life of ordinary European citizens. Today, more than half of new rules and regulations come from 'Brussels'. European citizens are free to travel and settle in other EU countries and to find jobs there. About forty per cent of all products sold in the EU are obliged to satisfy EU norms concerning, for instance, safety, health and the environment. Consumers are also protected in many other ways, e.g. in the field of product liability and adequate product information. The majority of EU citizens – more than 300 million – use the same currency: the euro. The EU is also concerned with environmental protection, equal treatment of men and women, working conditions and social welfare.

European integration is shaping a new business environment as well. Particularly since the latest enlargement rounds, which led to the accession of a number of emerging economies in the eastern part of Europe, a vast number of new business opportunities have arisen. The present-day EU offers great potential for the development of new markets, the expansion of sales or imports, the relocation of production facilities, outsourcing, the recruitment of foreign employees and external financing. As the interview with Frans Alting of the North Netherlands Chamber of Commerce shows, dealing with other countries – even within the European Union – is far more complex than just doing business on the domestic market. It requires a sound strategy.

On top of this, ongoing integration can become a threat to businesses, especially if their markets become internationalized and they do not adjust to the changing circumstances. Competition in home markets can become fiercer due to the appearance of foreign enterprises and the falling production costs of internationalizing domestic competitors. These competitors may, for instance, have access to cheaper inputs from elsewhere in the EU or they may have relocated part of their production to low-cost environments abroad. In short, it will be difficult for most companies to simply ignore ongoing European integration.

The central element in European integration from a business point of view is the single market, with its *'four freedoms'*: the free movement of (1) goods, (2) services, (3) capital and (4) people.

Free movement of goods means that goods can (in theory) be freely exported from one European country to another, without being hindered by all kinds of obstacles. The most obvious barriers to trade are tariffs, quotas and border controls. These barriers have been completely abolished within the EU. Many other hurdles had to be removed as well; for instance, countries might have different product norms. The EU tried to solve this problem by setting common EU standards (known as *Conformité Européenne*, or CE marking) for an increasing number of products. The leading principle, however, is that Member States must (in principle) accept each other's standards for the remaining products. Taxes can also be a hindrance: large differences in sales taxes can give businesses in some countries a competitive advantage. This is why Value Added Tax (VAT) has been more or less harmonized: all countries have set a minimum rate of 15%. Many other obstacles have also been addressed , but a number still remain. See, for instance, the examples of petrol stations and dustbins in the interview with Frans Alting in the opening case study. Some of these barriers – such as administrative measures – can have a hidden character. Countries are inclined to protect their own industries, even if this is not official policy.

Free movement of services implies that restrictions on the provision of services in Member States by companies or individuals resident in the EU are prohibited. Polish construction companies should be able to offer their services in France, German doctors in the United Kingdom, and Finnish companies should be able to offer their training, maintenance and consultancy services in the Netherlands (see case study 9.1, Wärtsilä). In many cases, the free movement of services and the free movement of people (freedom to settle) are related. There are nonetheless quite a number of exceptions to the general rule. Not all services qualify for the free movement principle. Examples are transport and financial services, which are subject to specific regulations and policies. There are also numerous other barriers related to the free movement of services, such as the qualifications of the service providers and other standards, consumer protection, and general concepts such as public interest. Many barriers still remain in this field.

Free movement of capital refers to the free circulation of money and capital across borders, the right to establish financial service companies and to supply cross-border services throughout the Member States, and the existence of common supervisory regulations. Banks and other financial institutions should be able to set up branches or take over competitors in all Member States, and EU citizens and businesses should be able to open bank accounts, transfer money, borrow and invest everywhere in the EU. The aim is to create an open, integrated, competitive and efficient European market for financial services. But the single market for capital is far from complete yet. On the one hand, all restrictions on the free circulation of capital and money have been abolished. In addition, exchange-rate risks no longer exist within the euro zone. EU citizens and businesses are indeed entitled to make financial transactions everywhere in the Union. But on the other hand the financial service industry is still highly fragmented, owing to the complex supervision and regulation of the financial system, which in many cases remains the responsibility of national supervisory bodies. Member States are very much inclined to favour their domestic financial service industry, thereby interfering with an open market and fair competition.

Free movement of people, finally, includes the right of every EU citizen to move and reside freely within the territory of the Member States. Indeed, citizens can travel throughout Europe (almost) without any restrictions, as long as they do not stay longer than three months in any one country. Most countries have completely abolished their border controls for persons (within the framework of the Schengen Agreement).
For longer periods of residence, all kind of conditions and restrictions apply. Most important is the condition that foreigners (and their family members) should be able to support themselves economically. This can be achieved by being (self-)employed or having other financial resources and being properly insured. Workers are allowed to move freely and to stay and work in a Member State under the same conditions as local workers. EU citizens and businesses are also free to establish businesses in other Member States (in principle) without obstacles of any kind. The Finnish company Wärtsilä (see case study 1.1) for instance, is free to set up training facilities in the Netherlands and to employ both Dutch and other EU citizens there. Nevertheless, all movement and residence rights can be denied on grounds of public policy, public security and public health, and there are also temporary limitations for citizens of some new Member States. Other restrictions may also apply.

Case study 1.1 **Wärtsilä expands services offering in the Netherlands**

Wärtsilä is expanding its service capacity in the Netherlands with new, larger premises and a modern training centre. On April 9th Wärtsilä opened a new Wärtsilä Land & Sea Academy training centre at Waalwijk in the Netherlands. With this large-scale training establishment, Wärtsilä is able to offer its customers, its own employees and educational institutions a broad package of technical training programmes. In addition, Wärtsilä opened new and larger service premises in IJmuiden in March.

International training centre in Waalwijk

The Wärtsilä Land & Sea Academy at Waalwijk covers an area of 2,000 square metres and contains nine classrooms, four conference rooms and a large workshop. The new centre is one of 10 Wärtsilä training centres worldwide. 'In 2009, we expect to welcome some 800 to 1,000 students to Waalwijk. We are very pleased to have the Wärtsilä Land & Sea Academy here, where we can provide, among other things, training programmes in propulsion, automation and engine products,' says Job van der Burgt, Vice President Services, Wärtsilä in the Netherlands. The Wärtsilä Land & Sea facility offers product-specific training programmes in the area of diesel engines and propulsion.

New facilities in IJmuiden

Last week, Wärtsilä opened its new modern service premises in IJmuiden, also in the Netherlands, which cover an area of 3,000 square metres. The new premises include office space, an in-house classroom and an impressive workshop. The larger workshop enables the company to deliver a broad range of services. The workshop has state-of-the-art machines and portable tools to carry out repairs and maintenance work. The IJmuiden service location-delivers spare parts, service support and technical expertise primarily to vessels working in dredging, fishing and inland shipping applications. The location makes Wärtsilä well placed to serve its customers in the Netherlands and to provide a rapid response to the demand for services. Because of its favourable location, IJmuiden is a well-established base of operations for shipping leaving Amsterdam for the North Sea, and for vessels returning to port.

Wärtsilä in brief
Wärtsilä enhances the business of its customers by providing them with complete lifecycle power solutions. Wärtsilä focuses on the marine and energy markets with products and solutions as well as services. Through innovative products and services, Wärtsilä sets out to be the most valued business partner of all its customers. This is achieved by the dedication of close to 19,000 professionals manning 160 locations in 70 countries around the world. Wärtsilä is listed on the NASDAQ OMX in Helsinki, Finland.

Wärtsilä (Yantai)

Source: Wärtsilä press release, 9th April 2009

1.2 Aims of European integration

Why is the EU aiming at economic integration and a single market in the first place? From an economic point of view, a single market should in theory contribute to a number of positive effects. Most of these effects are interrelated and a number of them are supposed to mutually reinforce each other. They can be divided into effects on the micro or industry level and effects on a macro level:

Micro and industry level:
1 More competition
2 Improved efficiency
3 Increased specialization

4 Economies of scale and scope
5 Increased productivity

Macro level:
6 Additional intra-EU trade
7 More international investment
8 Better allocation of factors of production (labour and capital)
9 Lower inflation
10 Increased competitiveness
11 Higher economic growth
12 More jobs and less unemployment.

More competition could be considered to be at the core of these assumed positive effects, because it triggers a number of other developments. Opening up markets to foreign competitors means that competition will increase. Domestic suppliers will be forced to increase efficiency or come up with product innovations. This will generally lead to downward pressure on prices, reducing *inflation* (no. 9). Companies might also decide to *specialize* (3) in products or services for which they might have more distinctive capabilities. These capabilities might be influenced by the country in which they are established; for example, the availability of cheap labour or specific know-how, training facilities or a network of related industries.

Free access to a larger market might also result in sales volumes increasing. Production can take place on a larger scale or over a larger product range (scope). Overall, this will lead to lower average costs, because overheads such as research & development (R&D) and administration can be spread across a larger number of products (*economies of scale*, 4) or across a wider product range (*economies of scope*, 4). Greater efficiency, specialization and economies of scale and scope could in turn lead to *increased productivity* (5).

On the macro level, opening markets will normally result in *more trade* within the economic bloc (6: trade creation). There may also be negative effects, however, because of the replacement of cheaper suppliers outside the bloc by more expensive ones inside the bloc – depending on the external tariffs of the trading bloc (trade diversion: see section 2.3). Generally, an open market implies that the barriers to foreign investment have also been removed and that foreign investors are treated in the same way as domestic investors. This will in principle lead to *more (foreign) direct investment* (FDI, 7) in sales offices, production units, etc. Some of these investments take place within the framework of consolidation of production: since the barriers to trade have been removed, it is no longer necessary to have a different production facility in every single country. Is it better to concentrate the production in one or a few locations which have specific cost advantages, and to serve the markets in the trading bloc from there. Generally, concentration may also offer more opportunities to realize economies of scale and scope. Other investments may be triggered by the need for product innovation in order to stay ahead of the competition.

Better allocation of factors of production (8) is a result of specialization and relocation: capital and labour will be employed in places where they give their highest return. For instance, (relatively) labour-intensive production units (e.g. assembly lines for car manufacture) should be established where labour is abundant and cheap (the eastern part of the EU) and R&D facilities in places where scientific knowledge is widely available (major cities in Western Europe).

More efficiency, increased specialization, economies of scale and scope, increased productivity and lower inflation will in turn increase the international *competitiveness* (10) of the businesses in the integrated trading bloc. Businesses will be better equipped to compete on world markets and to export to countries outside the bloc. All these factors together should – on the macro level – result in higher economic growth and more jobs.

Although the single market is thought to have many positive effects, it can have a number of disadvantages as well. The most important is that opening up markets can lead to all kinds of (macroeconomic) *imbalances*. Taking away barriers means that domestic producers can no longer be protected. More competition can lead to the bankruptcy of individual enterprises and even the disappearance of whole sectors of industry. If this is not compensated by new economic activities, it could result in the stagnation of countries or regions and also to high levels of unemployment. These regional disparities can become persistent. The single market is not just an opportunity; for individual companies and citizens it is a threat as well. They can never just sit back and watch. A good business today might be at risk tomorrow if the management does not anticipate changes in the European business environment. The whole idea of the single market is largely based on a *free market philosophy*, with limited opportunities for national governments to intervene and protect domestic industries and employment. In a way, a free market is a kind of jungle: only the strongest will survive.

Opening up markets and stimulating cross-border trade is also facilitated by the use of a single currency. That is one of the main reasons why the euro was introduced in 1999 (for bank transfers; euro notes and coins became legal tender in 2002), within the framework of (European) Economic and Monetary Union (EMU). At the time of writing, the euro has been adopted as the sole legal tender in 16 EU countries: Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain. Eight other countries will follow as soon as they have fulfilled a number of strict entry criteria.

The main advantages of the euro for the realization of the internal market are that it will lead to:

1 Elimination of transaction costs
2 Elimination of currency risks
3 Greater price and market transparency
4 Lower borrowing costs due to more efficient financial markets
5 Lower administration costs.

Elimination of transaction costs (no. 1) and *lower administration costs* (5) will reduce the cost of international trade. *Elimination of currency risks* (2) will reduce the risk of cross-border operations. Lower cost and risk can be expected to stimulate international trade.
Greater price and market transparency (3) will intensify competition. As discussed above, more competition is assumed to have positive effects on efficiency, innovation, specialization, productivity and inflation, and (indirectly) on economic growth and employment. Finally, *lowering borrowing costs* (4) is supposed to reduce production costs and stimulate demand.

Altogether, EMU is assumed to contribute to a more competitive environment in the internal market. Different currencies and exchange rates can be considered a form of hindrance to international trade – even more so if governments and/or central banks (monetary authorities) manipulate exchange rates in order to stay competitive, as has frequently been done in the past by such countries as Italy and Spain (so-called 'competitive devaluations'). A single market cannot be complete without removing this barrier to trade.

From a macroeconomic point of view, a single currency may have disadvantages as well (see section 2.3). Countries are no longer able to set their own monetary policies, and there are no longer any exchange rates, which can have a dampening effect on economic shocks (see sections 2.3 and 7.6).

1.3 The background to European integration

European integration did not begin purely for economic reasons. Political factors may have played an even more important role, not only at the start of the process, but also along the way. The European integration movement has it roots in the aftermath of the Second World War. It was most important to prevent new wars in Europe and also to avoid isolation and poverty in European countries, particularly Germany. Economic and political co-operation could make a strong contribution to a more stable, safer, democratic and prosperous Europe. This is why European integration more or less began with the placing of the French and German coal and steel industry, vital for warfare, under a common High Authority, by means of the Treaty of Paris of 1952. Political and in particular economic co-operation was extended in 1958 with the establishment of the European Economic Community (EEC) by the original six participating countries – France, Germany, Italy, the Netherlands, Belgium and Luxembourg – under the Treaty of Rome. Integration in Europe has since not only deepened, but also widened: the number of Member States has increased from the original six in 1958 to 27 today.

Most enlargement rounds had not only economic but also clear political motives. This was perhaps less true of the first (the entry of the UK, Ireland and Denmark in 1973), but Greece (1981) and Spain and Portugal (1986) were strongly welcomed after they had overthrown their dictatorships. EU membership was supposed to guarantee that these countries would not return to undemocratic systems. Much the same applies to the enlargement rounds of 1995, 2004 and 2007. The 1995 round took place soon after the end of the Cold War in the early 1990s, which opened the way to membership for the former neutral countries Sweden, Finland and Austria. The last rounds to date took place in 2004 and 2007, when many former socialist countries in Central and Eastern Europe (plus Cyprus and Malta) joined the Union. The EU was prepared to accept these countries for reasons of security and stability, even if a number of them were not quite ready at the time (e.g. Bulgaria and Romania). The discussions about the present candidates, Croatia and Turkey, are also significantly influenced by political factors, such as their degree of democracy, human rights, religion and the cultural identity of Europe.

Some developments in the EU, on the other hand, were largely driven by economic factors. Most important were the completion of the single market and the establishment of EMU. Taking the single market first, it was felt during the severe economic recession of the early 1980s that the problems in Europe were intensified by the fragmented European home market, which was still characterized by many internal barriers to trade. Businesses in Europe were losing ground to their main competitors in the USA and Japan. The intended common market, as envisaged by the Treaty of Rome in 1958, had not really materialized. That is why the process of removing obstacles to the four freedoms was speeded up by the adoption of the Single European Act (SEA) of 1985, which was intended to pave the way for the completion of the Single European Market (SEM) in 1992. The main aim of the SEM was to encourage a more competitive and dynamic economic environment. Achievement of this goal involved the establishment of EMU as well, requiring far-reaching co-ordination of monetary and economic policies among the Member States. By means of the Treaty on European Union (TEU), adopted in 1992 and ratified in 1993, it was decided to establish EMU no later than 1999. This was realized according to plan, involving the setting up of a European Central Bank (ECB), a common monetary policy and a common currency (the euro).

Have all the goals of the single market project now been reached? Definitely not. There still remain a large number of obstacles; some are quite obvious and others more or less hidden. They range from non-implementation of Community legislation by Member States and delayed or non-acceptance of each other's standards to administrative, linguistic and cultural barriers of all kinds. Realization of the single market will – in the words of Frans Alting of the Chamber of Commerce – be 'an ongoing process' and probably never fully completed. But is clear that the barriers have been significantly reduced, leading to a huge increase in intra-Community trade.

Conclusions

European integration has been driven by political and economic motives. Economic and political co-operation should contribute to a more stable, safer, democratic and prosperous Europe. From a business point of view, the central element in economic integration is the single market, with its four freedoms. The single market is supposed to stimulate trade and international competition and to have positive effects on business efficiency, economic growth and employment. European EMU, with its single currency, is considered to support the functioning of the single market.

The single market, for all its advantages; could also lead to severe imbalances. Countries and businesses may not be able to cope with the increased international competition, leading to regional industrial decline and unemployment. On top of that, EMU, with its single currency and centralized monetary policy, will lead to a loss of sovereignty, loss of independent monetary policy and fewer opportunities for national governments to adjust to economic problems stemming from abroad.

For business, too, there will be many new opportunities but also threats in the increasingly competitive European business environment. In that sense, 'Europe' is a must: the vast majority of companies cannot sit and wait for foreign competitors to come and take over their markets, deriving their competitive advantage from optimal product locations elsewhere. A more proactive strategy is generally highly advisable. Such a strategy should be based on sound research and thorough knowledge of the changing European business environment.

Questions

1.1 In practice it turned out to be more difficult to realize free movement of services than free movement of goods. What could be the reasons for this?

1.2 Discuss which of the four freedoms of movement might have been relevant for Wärtsilä when it set up the operations in the Netherlands mentioned in case study 1.1.

1.3 Explain why getting involved in international business operations will probably increase the competitiveness of a business in the home market too.

1.4 Explain why multiple currencies can be considered as a barrier to trade and an instrument for protection of the domestic economy.