Networks, Serendipity and SME Entry into Eastern Europe

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Abstract

Going alone on an adventure tour can be hazardous. This holds for individuals as well as for small and medium size firm aiming for major international markets. Business communities therefore follow a joint path of gradual internationalisation that resembles the internationalisation process of firms. However, the co-evolution of the firm and its networks implies that firms only to a limited extend can plan and control their internationalisation path.

Our survey evidence shows the importance of partner-country-specific knowledge in the case of Russia. Our case evidence sheds more light on the dynamics of entry, as events in the network, and expansion of the network, motivate increased commitment. In particular, we find international entry to be driven be a high degree of serendipity.

Introduction

Going alone on an adventure tour can be hazardous. Good friends help, if only through their advice. Before climbing Mt Everest aspiring mountain climbers, gamblers apart, would prepare themselves in many ways: by studying reports on previous expeditions, by obtaining the most suitable equipment possibly custom-made, by extensive training, and by organizing support by a group of local Sherpas to escort them for most of the way. Every successful adventurer benefits from support by many people, some of whom he/she may have met by chance in a local pub.

The same holds for small and medium size enterprises (SME) aiming at international markets. Many smaller firms in the European Unison observe new business opportunities in Eastern Europe, but they are constraint by their lack of resources. To capitalize on these new opportunities, they need to draw upon information, experiences and support services shared with partners in their home environment. This network provides a knowledge-pool that grows with the experiences of the partners while providing stimuli, sometimes apparently at random, to pursue business opportunities. Decisions about internationalisation are influenced directly and indirectly by the home environment and by corporate networks. Business communities therefore follow a joint path of gradual internationalisation that resembles the internationalisation of firms described by Johanson and Vahlne (1990). We therefore integrate network analysis into the internationalisation model.

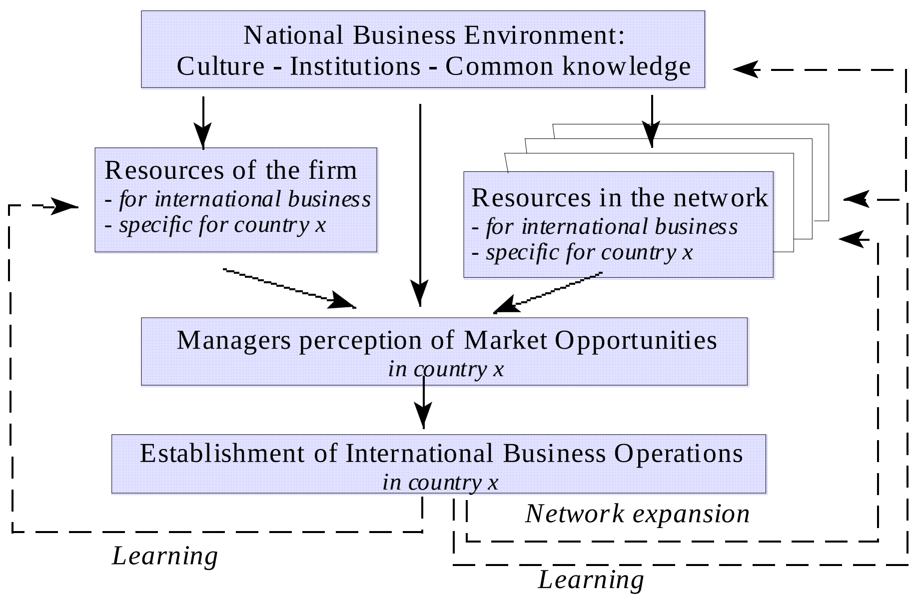
International entry requires not only knowledge of international business as such, but country-specific expertise (Barkema et al. 1996). This is particularly relevant for countries with a very different economic, political and cultural environment, such as East European transition economies - the focus of this paper. Business networks facilitate exchange of such knowledge; and the dynamics of the network in turn influences firms' internationalisation behaviour. As events in the network are generally beyond the control of smaller firms, their strategies are subject to high degrees of serendipity, i.e. i.e. fortunate and unexpected discoveries made by chance. The ability to react to chance events in the network thus can be critical for their survival and growth.

The next section thus introduces a model of internationalisation processes at a national level as the theoretical foundation of the study. We then present empirical findings of two complementary studies on the static and dynamic elements of the model. A survey reports managers' perception of Russia-specific expertise in their firms and their home environment in Denmark and Austria. Cases of small Danish businesses, point to the role of networks, and 'chance' in internationalisation. We conclude with an evaluation of the findings and their implications for management.

Internationalisation Processes

SME are embedded and, more than large multinationals, typified by their domestic business environment. Their technological and managerial capabilities are developed under the influence of national culture, institutions and common knowledge. Furthermore, their '*ownership advantages*' (Dunning 1993) include internal assets and capabilities, as well as resources created in collaboration with firms in their domestic and international business networks, or shared in the wider business environment, and embodied in its institutions, culture or shared knowledge, i.e. 'what is known to most persons in a group or society'. Firms' competitiveness is thus interdependent with that of their national business community, sub-national business clusters (Porter 1990) or industrial districts (Kristensen 1989).

Figure 1: Internationalization Processes



The internationalisation of SME is co-evolving with the internationalisation of their national business environment. Institutions establish international contacts through membership in supra-national organizations (e.g. WTO, ILO) or bilateral co-operation (e.g. chambers of commerce). Shared knowledge on other countries' culture, business and languages grows through media coverage, education, and personal contacts. Even culture evolves in response to international interactions, e.g. increasing awareness and tolerance of cultural diversity. In combination, these factors constitute *national* competitive advantages, which are a foundation of *firms*' competitive advantages, and determine the country's outward international business (Figure 1).

Many of the resources crucial for international business are knowledge-based. They include both knowledge on how to do international business, and expertise specific to the chosen foreign country, such as knowledge on local markets, business practices and institutional conditions (e.g. Barkema et al. 1996). This 'country-specific knowledge' (in this paper this term always refers to knowledge on the foreign partner country) may reside in the firm itself, or in its business networks at home and abroad.

In each country, firm deepen their commitment as they learn about the local environment. Country-specific expertise is arguably of particular importance in transition economies. Entrants need to build specific expertise to overcome administrative and cultural barriers that arise with the specific business culture formed during the region's history, and amended by the socialist experience of the 20th century (Meyer & Møller 1998, Michailova 2000). Moreover, the incomplete institutional framework poses special challenges for inexperienced newcomers, as they have to deal with weakly enforced property rights and high transaction costs.

Availability of such knowledge is crucial for entry into a specific region. It provides a competitive advantage that improves the investment decision and all subsequent strategic and operational decisions. Lack of information is a particular serious obstacle for small firms (e.g. Seringhaus 1987) because information is an indivisible resource, and small firms cannot spread its costs across a large volume of exports in the way that a large firm can. The information sought includes *formal knowledge*, i.e. hard facts, that can be obtained via blueprints or consultancy reports. However, more important for international entry is *experiential knowledge* (e.g. Reid 1984), including expertise in leadership, cross-cultural management and local business cultures.

Formal knowledge is easier to acquire, provided one knows it exists and who has it. Since it is (or can be) written down, it can also be sent over long distances and exchanged via the Internet. On the other hand, experiential knowledge, such as the understanding of a foreign business culture, can be only transferred through active involvement, preferably in the host country itself. Since it is not codifyable, it cannot be exchanged by electronic means, and the Internet revolution has less impact on it evolution.

The experiential knowledge on specific business contexts continues to form part of the capabilities of organizations, and their individual members. It is accumulated in international business and drives the gradual deepening of commitment in foreign markets - the internationalisation process. To some extent, it is shared through personal interaction with business partners. Hence we propose:

Proposition 1: Partner country-specific knowledge that is embedded in firms' networks facilitates their internationalisation into that partner country.

The country-specific knowledge evolves, both within the firm (Johanson and Vahlne 1990) and within its environment. Knowledge is accumulated by interaction with the environment and with business partners in particular. Thus, business networks, that is long-term business relationships between at least two partners, facilitate the internationalisation process (Coviello and McAuley 1999). They facilitate in particular the flow of information between partners and provide access to complementary assets (Dyer and Singh 1998). These aspects are of crucial importance for smaller firms, where networks reinforce the internal learning processes and provide access to new customers and suppliers located abroad.

Business networks are *long-standing relationships between legally independent firms that exploit mutual complementarities and exchange information*. They are neither coordinated through an organizational hierarchy nor through the market, but through interaction among actors in the network, generally based on mutual trust and/or common long-term interests (Johanson and Mattson 1988). Some networks are tightly structured, with high interdependence and strong bonds. However, we also consider loosely structured networks where bonds are weak and considerable 'networking', i.e. exchange of valuable information', occurs informally.

Actors in a network are engaged in combination, development, exchange and creation of new products and services by use of their individual resources (Håkanson 1987). This joint activity includes the exchange of experiential knowledge, which is feasible on the basis of shared knowledge and the principles of coordination of the network itself. Knowledge on business in a foreign country can therefore, partially, be shared within a business networks (e.g. Holmlund and Kock 1998) leading to a co-evolution of the learning process in the firm and its network. This interaction not only enhances individual capabilities of the firms, but leads to capabilities not controlled by one firm, but inherent in their interaction (Kogut 2000).

Consequently, business networks have a crucial role in SME strategies. They not only determine firms' strategic opportunities, but also become an object of strategic activity. Network positions determine the firm's strategic position and the resources it can access. Yet, network positions themselves are generally a result of earlier investments in the network. Actors continuously improve relations to existing network partners that have been useful to the organization, while creating new networks in search of new business opportunities (Håkanson 1987). In this perspective, internationalisation is the process of firms aiming (i) to develop existing positions and increase resource commitments in profitable nets, (ii) to increase the coordination between positions in different national nets, and (iii) to establish positions in new networks (Johanson and Mattson 1988). The internationalisation of a firm is thus an evolutionary process of a developing business network with a changing role of the firm within its network. Relationships are developed as bridges into foreign markets. Decisions over entry, or increased commitment to a market, thus require orientation over the current structure of the network and repositioning of the firm within the network (Axelsson and Johanson 1992).

However, somewhat overlooked by the literature, the interdependence of strategic decisions of the firm and the evolution of its network networks adds an element of serendipity, i.e. fortunate and unexpected discoveries made by chance. Resources held in a firm’s network may be gained or lost as partners enter or leave the network. For instance, new acquaintances offer un-anticipated opportunities by providing complementary resources, knowledge, or contacts. The network evolves outside the control of the firm, as resources in the network cannot be managed to the same extent as internal resources. In particular, knowledge within the firm is concentrated and readily accessible with at least some degree of control over the learning process. Knowledge possessed by the network partners is dispersed, harder to recognize and to combine, and its accumulation is generally beyond the control of the firm.

The internationalisation model suggests a continuous deepening of international commitments. Similarly, networks evolve evolutionary, which implies gradual change, yet with possible radical change in reaction to extraordinary situations. Disturbances in the wider business environment can trigger revolutionary changes in the focal firm’s corporate strategy such as foreign entry. The influence of events in the network on firms' entry decisions thus adds a chaotic element to internationalisation processes, providing a less deterministic perspective on entry behaviour.

Several authors point to the special importance of network relations for business within Eastern Europe (e.g. Stark 1996, Puffer et al. 2000) and for international business relationships with transition economies (Salmi 1999). We thus posit that business networks are crucial for the dynamics of entry processes in the region:

Proposition 2: Firms' internationalisation co-evolves with the internationalisation of their networks, as they can draw upon resources created in the network and react to opportunities arising with business partners.

Figure 1 sums up the theoretical arguments. The national business environment contributes to firms' ownership advantages, which are located in the firms and their networks. Managers' perception of market opportunities and obstacles is influenced by the (internal) resources of the firm and the resources of its network, as well as by its national environment. Resources in both the firm and the network are continuously enhanced by learning processes, yet with qualitative differences. In addition, the network itself expands as a result of the international activity, and through exogenous events.

Study One: Comparative Study on Russia-specific Capabilities

Following a "multimethod design" (Brewer and Hunter 1989), we undertook two empirical studies that employ survey and case data respectively. While each method has its unique strength, using multiple lenses not only enhances external validity, but allows us to explore both the static and dynamic aspects of our model. In this section, we present survey data on Russia-specific capabilities in the national business environments in Denmark and Austria. In section four, we explore the dynamics of the process through case research in 20 small Danish firms.

The Enterprise Survey

We surveyed Danish and Austrian businesses to develop a deeper understanding of Russia specific capabilities in the firms' home environment.[1] Austria and Denmark are not only of similar size in terms of population and of GDP but they also have similar business structures with large numbers of SMEs. Both Danish and Austrian businesses expanded eastwards after the fall of the Iron Curtain. Austria re-established business links with Hungary and other neighbouring countries and was at an early stage in 1990 the largest investor in the region (Meyer 1998). Many SMEs were quick to realize new opportunities while Austrian affiliates of MNEs invested on behalf of their parent firms. Danish businesses have invested less, and focus on countries around the Baltic sea, notably Poland and the Baltic states.

We contacted all firms known to be active in Russia, covering a broader range than other studies as we included not only companies with FDI but all that have any kind of international business activity. The questionnaire was translated into the local language and sent to key informants in the firms.[2] The questionnaire was first designed in English, then translated into German and Danish by independent translators and verified by means of back-translation. Fifty Danish and 144 Austrian firms were contacted in May 1998, returning 62 completed questionnaires (32%). The return rate was 50% for Danish firms and 26% for Austrian firms.[3] The difference reflects international experiences with cross-cultural questionnaire surveys,[4] as return rates differ internationally due to, among other things, cultural differences (Harzing 1998).

The firms in the survey sample are engaged in a variety of business activities. The most common operations are import/export (47%), services (39%), and establishment of sales offices (40%) or representative offices (37%). Eleven firms (19%) have established production in Russia, and only five firms (9%), mostly Austrian, source raw materials in the region.

Country-specific Resources

The first proposition suggests that national business environments differ to the extent that they provide resources for business with specific partner countries, which in turn influence the firm's outward business activity. To establish which resources are most important, we report respondents' own assessment of the importance of various country-specific qualifications when taking decisions to establish operations in Russia. Table 1 shows the results in two ways, the average rank assigned to each aspect, and the frequency with which respondents included an aspect in their ranking. The results indicate that the most important qualification is actual experience. Having 'worked with Russia and Russians for more than three years' has been mentioned by twenty respondents who assigned it on average rank 1.8. Such experience is thus considered more important than formal knowledge, lending support to the emphasis on experiential knowledge in the theoretical argument.

Table 1: Perceived Importance of Management Qualifications

	Average Rank			Number of Mentions		
	Danish	Austrian	Total	Danish	Austrian	Total
They have been working with Russia and Russians for more than 3 years	1.8	1.8	1.8	11	9	20
They speak Russian	2.7	2	2.4	7	7	14
They have lived in Russia for one year or more	2.7	2.4	2.6	7	5	12
They are having private visitors from Russia regularly	2.9	3	2.9	7	4	11
They have close personal friends from Russia	3.3	3.6	3.5	6	5	11
They are Russian expatriates	2	3.9	3.7	1	9	10
They have taken university courses which focus on doing business with Russia	4.2	5.5	4.8	5	4	9
They have relatives from Russia	4.3	5	4.8	3	5	8
They know the Russian partner from their university studies	2.6	3.5	2.9	5	2	7

Note: Respondents were asked to rank the importance that these qualifications had for the companies' decision to invest in Russia. For each qualification, the table reports the average rank (most important = rank 1) and the number of respondents that included it in their ranking.

The second most important qualification, by rank and by number of mentions, is the command of the Russian language. Languages have an important role in multinational companies, but are often underrated by the leadership (Marschan et al. 1998). While the leadership in headquarters and affiliates may adopt a common language, in Nordic companies frequently English, middle management and shop floor employees do often not use this language. In extreme cases this has led to an inability of expatriate managers to communicate directly with local employees in Russia (Michailova 2000). In the case studies reported below, we observed that key people in the Danish firm typically do not speak East European languages, but in addition to English (and Danish), they often command one other language good enough to establish business contacts - typically German or French. In the CEE firm one person often has good language skills, and becomes the key contact. Yet, when this person is not available, then serious communication problems occur.

Further personal and professional experiences are ranked next. They give managers direct contacts with the country, or people from there, and thus permit some experiential learning. ‘Russian expatriates’ are frequently mentioned by Austrian respondents, but only by one Danish respondent. Contacts dating from university are mentioned only by seven respondents, but ranked relatively high by them. Joint education creates common experiences and personal relationships and thus networks. The ‘coincidence’ of an existing personal acquaintance, or friendship, can at some stage become a business asset. The data thus suggest that practical experience is considered the most important form of country-specific expertise.

The actual human resources available in the firms and their environment matches in part the profile of qualifications perceived to be important, yet with some differences between the countries (results available from the authors). Austrian managers receive high marks for their capability to act on Russia markets, while Danish firms can draw upon less Russia-specific expertise, especially with respect to language skills. These differences are grounded in different national business environments, especially the education system and historical relations with Eastern Europe. The differences are largest in the case of language skills as more people in Austria speak Russian, both among managers and among university graduates.

In addition to managerial resources, the national institutions and networks provide key sources of information. In our sample, almost all respondents indicated personal contacts as a source, and three out of four used business connections (Table 2). The personal and professional networks, which in many cases may be overlapping, provide practical knowledge from those actually engaged in business. Institutions such as chambers of commerce and embassies can collect and disseminate such information, if at all, only in stylised, form. The sources of information vary between the two countries, reflecting different roles of supporting organizations in different national business systems.

For many SME, their bank is a key networking partner, and one fifth of the respondents also used their bank to obtain information (Table 3). Beyond this, many SMEs use their main bank for funding business abroad. However, the most important source of finance are internal resources, which reflects the high risk of such business. Two fifths of Austrian firms but only one fifth of the Danes use bank loans. Austrian banks have expanded very rapidly eastwards in the 1990s and may thus be better placed to support businesses with the region. Asked for a recommendation as banking partner, Danish respondents often mentioned an international bank (e.g. from Germany), while Austrians were more inclined to name a bank from their own country. Danish firms are relying more on governmental programs, such as the *Investment Fund for Central and Eastern Europe (IØ-fonden)*.

In conclusion, SME draw upon knowledge held in their business networks when engaging in international business with Russia. This includes country-specific knowledge, some of which is of tacit nature. The second study explores thee dynamics of these networks.

Table 2: Sources of Information on Russia
in % of respondents

	Austria	Denmark	Total
Personal connections	89%	91%	89%
Business connections	80%	73%	77%
Chamber of commerce	46%	5%	30%
Ministry of foreign affairs	14%	36%	23%
Commercial banks	23%	23%	22%
National Bank	11%	none	7%
Other government agency	3%	none	2%
Other	6%	14%	9%

Note: Number of observations: 54 (35 Austrian, 19 Danish) , percentages do not add to 100% as respondents could mark multiple options.

Table 3: Main sources of financing Russian operations
in % of respondents

	Austrian	Danish	Total
Internal resources	88%	95%	91%
Bank loan	36%	20%	30%
Private loan	9%	5%	8%
EBRD	6%	5%	6%
Governmental program	6%	15%	9%
Other source	12%	10%	11%

Note: Number of observations: 51 (31 Austrian, 20 Danish), percentages do not add to 100% as respondents could mark multiple options.

Study Two: The Dynamics of Business Networks

We explored the dynamics of networks in the internationalisation process through a series of 20 cases of small Danish manufacturing and trading firms with up to 25 employees. Denmark is an interesting place to study business networks as they play an important role in the competitiveness of SME in Danish industrial districts (e.g. Karnøe et al. 1999). The cases are based on one-hour-long interviews with the general manager or the export manager resulting in 7 to 12 pages of interview transcripts each. They covered activities in CEE, in addition to Russia, focussing on the entry decision and development. In the following, the 20 cases are referred to as firms *a*, *b*, ... *t*.

Most of the case firms export to CEE (90%), some in combination with a representative office (15%), a sales-JV (10%) or a sales subsidiary (15%). All but one firm established business contacts after 1987, and they had on average five years of experience in the region at the time of the interviews in 1998.[5] The sales volumes are in most cases small, with 60% of firms exporting less than 5% of their turnover to the region. However, firms *s* and *t* are specialized trading firms exporting all their exports to the region. Firms *a* and *d* are procuring from the region, respectively from their JV or a subcontracting partner.

The cases provided us with new insights on the dynamics of networks. Business networks have an essential role in their internationalisation processes as they provide complementary resources especially information, reinforce learning processes and create coincidences that may lead to identification of new business opportunities. Interviewees mentioned among their partners domestic firms with business activity in Eastern Europe as well as firms based in third countries and, especially post-entry, firms in the region itself. Thus, in a small open economy, even small businesses rely not only on national networks. In fact, few distinguished explicitly between national and international business relationships.

We expected networks to have a pivotal role in establishing business. Yet we were surprised how many interviewees indicated some coincidence triggering the interest in establishing business. A prior contact with future partners was the most important determinant when choosing a market within the region, for instance via trade fair contacts:

> Q.: *"How have you established contact with your partners in Eastern Europe?"*
>
> A.: *"It is coincidental. Either I meet some through co-partners from other markets or through meeting people from our trade fairs where we exhibit. There is a big trade fair in Frankfurt. ... when someone approaches us and seems serious enough, we do business, but we do not investigate opportunities in Eastern Europe pro-actively"* (Firm i, manufacturer of household goods in plastic).

> *"Next to our booth was a booth from Lithuania ... They had some products which were totally unsellable, but they were extremely interested in our wares ... One of them was a woman, who had just established a company in Riga and was extremely eager and promised that she wanted to buy a lot from us, and she claimed she had money to do so.*

After the fair, I went to Riga where she had provided an interpreter so we could communicate. Then she began to order goods" (Firm m, trading in leather).

Participation in trade fairs is common methods for SME to facilitate chance encounters that may lead to new business contacts (e.g. Ellis 2000), and firms of the Eastern bloc have used them extensively in the early 1990s. Crucial for the development of the business is how the partners build their relationship after the first encounter 'by chance'.

Table 4: Search versus Chance motivating foreign expansion

		Country				**Entry**		**Industry** [e]	
	# [a]	Poland	Russia	Baltics	Other	1st	2nd /3rd	M	T
"Active Search" [b]	**10**	**5**	**7**	**4**	**2**	**10**	**7**	**5**	**5**
		j, s, k, p, r	c, j, k, p, s, t	o, d, j, s, h	h, k	c, d, j, o, p, r, s, h, k, t	s, h, j, k, p	c, d, h, j, k	o, p, r, s, t
"Reactive entry" [c]	**15**	**5**	**5**	**5**	**7**	**10**	**11**	**10**	**5**
- trade fairs	9	n, k	i, g, o	e, i, m, q	c, e, i, k	e, g, m, n, q	c, e, i, k, m, o	c, e, g, i, k, q	m, n, o
- initiative by future partner	6	---	i, n, r	i	b, f, i, m, q	---	b, f, i, n, q, r	b, f, i, q	n, r
- network [d]	5	a, b, f	i	i, l	i,	a, b, f, i, l	i	a, b, f, i	l
Total # firms [a]	**20**	**9**	**12**	**9**	**8**	**20**	**16**	**12**	**8**

Notes:
[a] : Entries are listed by firm. Row and column total refer to the number of firms in the row/column, excluding double counts that arise from multiple entries (e.g. firms j, k) and multiple motives (especially firm i).
[b] : "Active search" includes travel in the region, local representatives, consultants, specific recruitment, pre-1990 contacts, contacts established via the Danish embassy in the country etc.
[c] : "Reactive entry": cases where contact with the future partner occurred by chance, and led to business with the country.
[d] : Networks generating chance incidences include initiatives or recommendations by unrelated business contacts or intermediaries, and in one case an ex-employees originating in CEE.
[e] : M = manufacturing, T = trading firms.

Table 4 categorizes the firms and their East European entries according to what triggered the entry. Incidences like those reported in the citations are no exceptions: Only half the case firms engaged in systematic search activities before engaging in business in a country of the region. On the other hand, 15 of the 20 firms engaged in business following up an opportunity arising by chance, for instance via a contact established at a trade fair, or being contacted directly by the future business partner. Thus, in addition to initiatives by existing partners, entry of new partners into the network is a typical event triggering international entry. The following to citations illustrate entry triggered by event in the personal and professional network:

> *"it was first about providing materials, starting all the time back in 198,... We had a kind of procurement function, buying products in the whole of Europe for our Polish contact such that he could get access to not accessible raw materials ... Then came our Polish contact and said that he had found a way to manufacture plastic pallets and that he considered to develop this further. He had a fairly primitive prototype at that time. So, he asked if we were interested to come along in this project. ... The result was that we got 20% of equity, a joint-venture."* (firm a, manufacturing plastic pallets in Poland).

> *"The firm in Lithuania has been established in 1993. I made a partnership with four well-educated Lithuanians, of whom one had lived with us for three months while he [took an education in Denmark]. It was an attempt to help the three young ones to start. So, I said we would send some products and finance them so they could sell a little. But it developed better and faster than any one of us had expected. Then we made a joint-venture, ..."* (firm l, manufacturing tools for painters).

Firms included under 'Active' had a pro-active approach to establishing business in CEE. The actual selection of a partner-firm, or even the partner-country was still subject to chance - for instance firm d's manager's Estonian girl-friend appears to have influenced his decision indirectly. On the other hand, firms in the 'active search' category frequently report problems in finding the right partner (more than, they say, in other regions where they do business). Some report failed business contacts as partners were not capable to deliver agreed services, or pay. A typical example of an active search is firm j:

"First, it was Poland. ... We travelled there ourselves after we received some addresses via the Foreign Ministry. The addresses turned out to be useless, but when we first established contact with some people, then they could pass us on to the right persons. The addresses were just door openers. The same approach we used in St. Petersburg and in the Baltics" (firm j, manufacturing electronics).

Active search appears more common in large and - as predicted by the internationalisation model - nearby countries, while 'chance' appears more important in peripheral (other) markets, in this study Hungary, Czech Republic and Yugoslavia (Table 4). Yet, the mode of establishing contact does not appear to influence the future volume of business. Active search has been reported more frequently for first entries than for subsequent entries, while initiative from local businesses motivated subsequent entries of Danish firms already established in a country of the region.

Hence business by small firms with Eastern Europe is often not based on strategic planning, as business literature would suggest, but on reaction to opportunities that arise with specific old or new network partners, and that only later are formed into a coherent strategy.

The businesses interviewed emphasised relations with local business partners. Personal connections are widely used, and are often intertwined with professional ones. The following managers emphasized the importance of personal relationships with Eastern partners:

"The Russians are weary of strangers. Just as we believe they cheat, they also suspect us of cheating. There have been many scams in Russia, so they know they have to be careful. In this connection, the most essential is to create trust. Personal relationships

are important ... We do business with the person not with his company" (Firm j, manufacturing electronics).

"It is of great importance for the East European that you are a friend. You cannot visit a customer without taking time to have a meal with him. You know their wives etc." (Firm r, trading in foods).

"... with East Europeans, you are either friend or not friend. We are friends and cannot even sleep in a hotel. They want to invite us to their homes and see their family" (Firm a, manufacturing plastic pallets in Poland).

These statements suggest that personal relationships are more important in transition economies than in Scandinavia, which is in line with other studies (e.g. Salmi and Bäckman 1999). The importance of trust and the reliance on personal relationships and networks has its origins both in the Russian culture (Holden et al. 1998, Vlachoutsicos 2000) and, related, in the lack of legal institutions that would ensure contract enforcement.

Overall, the experiences of the 20 Danish case firms confirm that networks play a pivotal role in managing and expanding business in CEE. We interpret the empirical evidence as support for proposition 2. However, we observe that events in the network crucially influence the internationalisation process. Entry is triggered by opportunities arising in the existing network and, more frequently than we expected, chance encounters with new partners.

Implications for Management

Our results illustrate the internationalisation of small firms, and the interdependence with their business networks. Firstly, firms accumulate knowledge interactively within their business networks, both domestically and internationally, which forms a basis for a commitment to foreign markets. This leads to a gradual deepening of the international business, as firms take their decisions over entry based on knowledge and contacts that *they, or their partners,* have.

Secondly, country or region-specific knowledge is important for business with transition economies, in addition to general expertise on international business. This knowledge is often experiential and therefore hard to communicate between unrelated partners. The existing knowledge base within a network therefore influences the commitments of its members to the specific foreign market, which in turn promotes further learning. Due to the specific context of the host countries, we have to caution against generalizing this result (but see Drogendijk and Barkema 2000 for similar evidence).

Our third key observation is serendipity, that is elements of chance that may profoundly alter a firm's growth path. For small firms, reaction to specific opportunities may be a crucial competitive advantage, although it deviates from the deterministic view implicit in strategic management textbooks. As networks evolve, firms have to react. Many firms establish their first business contacts by reacting to an initiative, or by establishing contacts on trade fairs (also see Ellis 2000). Acting swiftly, they can realize new opportunities that open with changes in the network, initiatives by existing partners, or new entrants to the network. Social network intertwined with professional ones seem, at least in the East European context, important to identify and react to opportunities.

The degree of serendipity observed has implications for both theory and managers. We had added already a second feedback loop of 'network expansion' to our theoretical model (Figure 1). This feedback loop ought to be integrated into internationalisation process models, and their empirical tests, as it reinforces the feedback loop of knowledge accumulation and commitments elaborated in the original internationalisation process model by Johansson and Vahlne (1990).

For managers, this implies that they may have less control over the evolution of their international business than is often presumed. Especially for SME, sensitivity and flexibility to react to events in the network and to new business contacts are crucial capabilities for successful internationalisation. The capabilities for international business have to be build with a long-term perspective, and include country-specific expertise as well as the establishing and maintenance of networks. An investment in networks can enhance the resource base accessible to the firm. On this basis, we developed a number of propositions for small businesses eyeing international markets (Box 1).

Box 1

Preparing for Internationalisation

- Build and maintain business networks domestically as well as internationally.
- Continuously monitor your own networks for changes and new contacts that may lead to new business opportunities.
- Design a corporate strategy that is flexible to accommodate new business opportunities.
- Build organizational capabilities to react flexibly and without undue delays to new opportunities, in particular flexibility in the mindset of key employees of the firm.

Of Particular Relevance in the East Europe

- Build personal relationships with potential business partners.
- Study the specific economic and cultural context of your business partners, and, if feasible, employ persons competent in local languages.

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<u>Note to the reviewers:</u> We report a medium number of academic references to show the integration of this study in the literature and facilitate reviewing. We would, if the editor so wishes, be prepared to cut the number of references further to, say, 15-20 key contributions in the field, as it fits the style and target audience of this Journal.

Endnotes:

1. Details of this survey are available in a working paper (self-citation, to be added).

2. As the two researchers administrating this survey understand all three languages, we are confident that the translations are precise. The questionnaire was sent along with a cover letter containing a confidentiality statement, and a pre-paid return envelop. Respondents were thanked with a copy of the results if they had included a business card with their response.

3. The Danish firms are those whose details were provided by the Danish embassy in Moscow. The Austrian firms are taken from a list by the Wirtschaftforschungsinstitut Österreich of 686 firms active in Russia, and for whom contact details could be identified in the Austrian company guide published on CD by Austrian Telecom. Contact persons in the Danish companies have been identified in 'Kraks virksomhedsdatabase on CD' as responsible either for the former Soviet Union or for international investment. In some cases, the CEO was contacted.

4. On a systematic cross-cultural study on return rates, Harzing (1998) found the return rate for Danish firms to be 42.1%, the highest of all countries. Austrian firms completed only 19.0% of the questionnaires. Being aware of the different return pattern, we sent the Austrian sample firms a reminder fax, which led to additional returns. Altzinger and Winkelhofer (1998) obtained a return of 16.8% for a similar study in Austria. By these comparisons our return rates are more than satisfactory. In our case, more precise contact information for Danish firms may have helped increasing returns for this subsample.

5. The interviews have been conducted in September and October 1998, at the onset of the economic crisis in Russia. The issues under investigation in our study are not affected by the crisis. Some of the firms suffered considerable losses, yet they all maintained a positive long-term perspective on business prospects in Eastern Europe inclusive Russia.