

**Dainora Grundey (dainora.grundey@vukhf.lt)**  
**Bernardas Toluba (benas777@yahoo.com)**  
**Juste Brukiene (juste\_g@one.lt)**  
**Kaunas Faculty of Humanities**  
**Vilnius University**  
**Muitines 8, LT-44280 Kaunas, Lithuania**

## **COUNTRY IMAGE AS A MARKETING TOOL FOR FOSTERING INNOVATION AND ENTREPRENEURSHIP**

### **Abstract**

Country image can be perceived as the picture, the reputation, the stereotype that businessmen and consumers attach to products of a specific country. How a country is perceived, both domestically and from abroad, from the quality of its goods and services, to the attractiveness of its culture and tourism, investment opportunities and easiness to start-up business, to its entrepreneurship politics, economic policies and foreign policy, can be shaped under a brand. The branding process strengthens democracy and helps both internal development and successful integration into the world community. It is important to countries to use the marketing and advertising tools of modern corporations to achieve their core international economic and political agendas. Progressive improvement of the image of particular country goods and services, economic entities and manufacturers, and country on the whole, can build up and strengthen its competitiveness and attractiveness.

**Keywords:** country image, country branding, marketing mix, competitive advantage, innovation, entrepreneurship, Lithuania. JEL classification: M13, M31, O32, P2.

### **Introduction**

The concept of branding has been traditionally associated with corporations and their products and services, in either the consumer or the business-to-business markets. Today the concept is also being used for the shaping of a country's image. Governments are tasked with the economic and political development of their countries. National development cannot be achieved in isolation of the international community, as markets and foreign policies compete in the international arena. The complex of these elements and a country's political, economic, legal and cultural environment all contribute to a nation's identity and image.

Generally, every country is already a brand: it already exists in the minds of others as an entity with positive and negative attributes. Based on these perceptions, other countries and individuals will interact with it, either contributing to its development or hindering it. This raises a question for any country wishing to raise its profile in the world and increase the key factors in development: trade, investment and tourism. Effective management of the brand and competition at all levels is very important issue for many countries.

It has been almost universally recognized that government promotion of tourism is a good idea that brings excellent results for the money invested and the positive image of the country created. The tourism industry generates jobs as no other, and its development typically leads economy-wide advancement, in everything from infrastructure to education and related construction and service industries. To facilitate this development, governments

set up tourism ministries or agencies and assign budgets for national tourism promotion. However, tourism is only one of several areas that every country needs to develop and only one of the sectors that can benefit from country branding. After all, a country with fine beaches might not also be an easy or safe place to invest in if relevant legislation is not in place and the rule of law firmly established or the trend economic development is not clearly declared.

How a country is perceived, both domestically and from abroad, from the quality of its goods and services, to the attractiveness of its culture and its tourism and investment opportunities, to its politics, economic policies and foreign policy, can be shaped under a brand. The branding process strengthens democracy and helps both internal development and successful integration into the world community, on all levels.

Economically, a qualitative and quantitative benchmark of country's economic abilities and competitiveness creates an image conducive to close business ties. This can facilitate trading concessions and incentives as well as greater flows of investment. These in turn stimulate the national economy, creating jobs and increasing wealth, with consequent increases in taxes. As the world demands greater accountability from corporations, it also does so for governments. Terms such as transparency, accountability and good citizenship increasingly are applied to government institutions as well as private corporations. Many corporations have used sympathetic labels to burnish their images, and governments will have to do the same to protect and develop the good will of others.

A government's image internationally affects its domestic economy and policies, and vice versa. By the same token, country branding should be developed in the broadest possible context, helping shape national identity at home and abroad.

The brand state's use of its history, geography, and ethnic motifs to construct its own distinct image is a benign campaign that lacks the deep-rooted and often antagonistic sense of national identity and uniqueness that can accompany nationalism. Smart states are building their brands around reputations and attitudes in the same way smart companies do. Globalization and the harmonizing effects of European integration put pressure on states to develop, manage, and leverage their brand equity.

**The paper aims** at *multidisciplinary approach* towards a country. *Firstly*, the marketing mix and image theory is applied to produce a possible perspective of country branding as scientific literature is scarce. *Secondly*, country's entrepreneurship modelling is also an under-developed topic, which needs more clarification, in order to achieve a multi-facet result: how country's image can be employed through marketing mix, branding theories and image formation to foster innovation and entrepreneurship in a given country. Multiple examples are given to illustrate this point of view and an adaptive case of Lithuania is also presented.

### **Marketing mix employed in country image formation**

The marketing mix comprises 4 P's which are perfectly applicable to countries as they are to businesses:

- 1) *Product*. "Products" are perceived as a country being tax incentives, infrastructure, natural endowments, human resources, a geographic vantage point, helpful laws and regulations (or absence thereof), etc.
- 2) *Price*. Country must demonstrate a relative or absolute advantage in terms of return on investment.
- 3) *Place*. Country must facilitate the unhindered exchange of goods, services, and capital (tax holidays, free processing zones, no red tape, double taxation treaties and free trade agreements with other countries, etc.)

4) *Promotion*. It involves advertising and dissemination of news and information, lobbying, public relations, media campaigns, etc.

In the context of services marketing, Booms and Bitner (1981) have therefore suggested an extended “7Ps” approach that contains the following additional three “Ps”, which are adopted in this paper for the country image formation purposes:

5) *People*: All people directly or indirectly are involved in the process of country marketing, including business people, consumers, governmental institutions’ clerks, etc.

6) *Process*: Procedures, mechanisms and flow of activities by which country image is formed, including legal-political and socio-economic, cultural-educational, ethical, etc. processes.

7) *Physical Evidence*: The environment in which the marketing process is delivered. It could include governmental institutions and agencies, business entities, research and educational institutions. It also includes communication processes and performance results.

In a marketing mix, the first and foremost element is the product. No amount of savvy promotion and blitz advertising can disguise the shortcomings of an inferior offering. Contrary to entrenched misinformation, the role of marketing precedes the development of the product. The marketer gathers information regarding the expectations of the target market (the customers). In the case of a country, its clients are its citizens, investors (both foreign and domestic), tourists, export destinations, multilateral organizations (the international community), non-governmental organizations (NGOs), and neighbouring nations-states.

The marketer communicates to decision-makers what features and benefits does each of these disparate groups desire and suggests how to reconcile their competing and often contradictory needs, interests, preferences, priorities, and wishes.

The marketer or brand manager then proceeds to participate in the design of the country’s “products”: its branding and public relations campaigns both within and without its borders, its investment laws and regulations, the development and presentation of its tourist attractions, the trumpeting of the competitive or unique qualities of its export products, the tailoring and monitoring of its mutually-beneficial relationships with neighbours, NGOs, and international organizations.

In designing its “products” and, thus, in acquiring a brand name, a country makes use of and leverages several factors (Grundey et al., 2006):

1. *Natural Endowments*. The country’s history, geographical location, tourism sites, climate, national "mentality" (hard working, forward looking, amicable, peaceful, etc.).
2. *Acquired Endowments, Public Goods, and Externalities*. It involves the level of education, knowledge of foreign languages, quality of infrastructure, the court, banking, and public health systems.
3. *Risk Mitigation*. It is perceived as international standing and the resolution of extant conflicts (political risk), the country’s laws, regulations, and favourable international treaties, its credit history, insurance available to investors and exporters.
4. *Economic Prowess*. Growth promoting policies, monetary stability, access to international credit, the emergence of new industries.

Governments can influence many of these factors. There is little they can do about the country’s past history or climate, but pretty much all the rest is up for grabs. Aided by input from its brand managers and marketers, a country can educate its population to meet the requirements of investors and exporters. It can improve infrastructure, reform the court system, pass growth-promoting laws, cut down red tape, support monetary stability, and resolve

Decision makers should hire marketing (and, more specifically, brand name) experts to prepare a thorough and comprehensive place marketing and nation branding plan (Vaknin,

2005a) which consists of: strategic marketing analysis and the application of classical STP model.

### **Branding a Country**

During the 90s, Philip Kotler (Kotler and Armstrong, 2001; Kotler and Gertner, 2002), dealt with the topic of place branding and marketing in four books: *The Marketing of Nations* (actually a book on economic development and government policy rather than on marketing), *Marketing Places Europe* (on how to attract investments, industries, residents and visitors to cities, communities, regions and nations in Europe), *Marketing Asian Places*, and *Marketing for Hospitality and Tourism*.

However, in the era of globalisation when more often different business functions are outsourced, components are produced and assembled all over the world in countries with cheap labour force, the brand is eventually the only one conveying the national origins of the product. Consequently, in the academic literature a move from the country-of-origin concept towards **country-of-brand** notion can be observed. Finally, a concept of **country (national) brand** has been coined. The September 2001 publication in *Foreign Affairs* of the article “The Rise of the Brand State” by Peter Van Ham was a turning point, attracting a great deal of attention both from the academic community and the world of practitioners, and bringing about further research on the multidimensional nature of state branding.

The topic of country-of-origin effect is covered by several books (e.g., *National Image and Competitive Advantage* by Eugene D. Jaffe and Israel D. Nebenzhal, 2001) as well as compilations of research studies, review articles and meta-analyses Peterson and Jolibert, 1995; Verlegh and Steenkamp, 1999).

In this context, one should not forget the work of Wally Olins (2002), whose book *Trading Identities: Why countries and companies are taking on each other's roles* establishes a linkage between **nation branding** and companies going global. His hypothesis is that countries should act like companies, whereas global companies, companies that function in foreign markets, represent a “state within state” entity, so they have to take on different state responsibilities.

Thomas Friedman opened the path in the researched field while dramatising the conflict of *The Lexus and the Olive Tree*, the tension between the globalisation system and ancient forms of culture, geography, tradition and community (Mihalache and Vukman, 2005). In his book, he argues that in today's global world, powerful global companies and powerful countries need to have strong brands that seduce and take hold of consumers and investors. The unique bond they can develop becomes of crucial importance in the author's opinion.

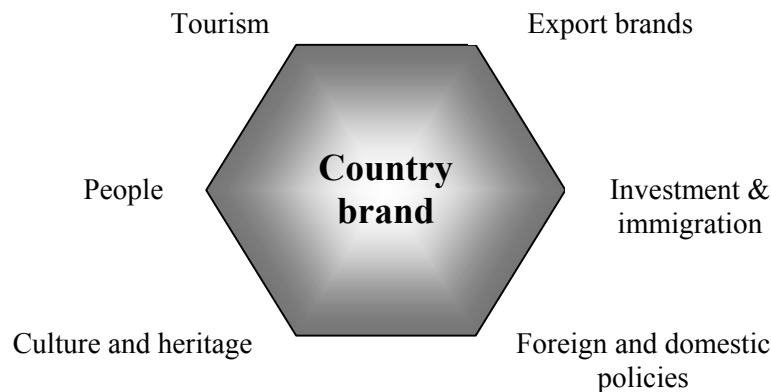
In the consulting world, Simon Anholt (2002), one of the leading international marketing thinkers, has written about state branding in the book *Brand New Justice* (2001), in which he argues that developing countries can increase their competitiveness and therefore reduce economic disparity through effective branding.

In April 2002 *The Journal of Brand Management* devoted a special issue to the topic of “Branding the Nation” bringing together contributions from the leading experts in the field, including scholars (Kotler and Gertner, 2002; Papadopoulos and Heslop, 2002), consultants (Anholt, 2002; Ollins, 2002) and practitioners. It is to this day the most comprehensive and up-to-date set of papers on state branding. All contributors wanted first and foremost to increase awareness with respect to the way such megabrands should be created and managed, as well as to their significance in the current world (Mihalache and Vukman, 2005).

## Country Image: Towards Country Identification

**National image** can be understood as the sum of beliefs and impressions people hold about places (Kotler and Gertner, 2002). Images represent a simplification of a large number of associations and pieces of information connected with a place. They are a product of the mind trying to process and pick out essential information from huge amounts of data about a place.

Figure 1. Country Identification Scheme



Source: Grundey and Brukiene (2006); Anholt and Hildreth (2005).

A country's image results from its geography, history, proclamations, art and music, famous citizens and other features. The entertainment industry and the media play a particularly important role in shaping people's perceptions of places, especially those viewed negatively. Not only are product categories such as perfumes, electronics, precision instruments, wines, cars and software strongly identified with certain places, but also are societal ills such as AIDS epidemics, political riots, civil rights violations, attacks on the environment, racial conflict, economic turmoil, poverty and violent crime.

Country represents its identity and image through a number of actors, which can be classified into six categories (*Figure 1*):

1) *Foreign and domestic policies* (nations are also regarded in accordance with the foreign and domestic policies that their leaders initiate. These activities, likewise all the others mentioned here, need to be performed with sensitivity to the strategic imperatives of the brand. Foreign and domestic policies must be coordinated so that they would invigorate the national brand);

2) *Export brands* (strong, distinctive, broadly-based and exceptional brand is the most valuable gift that can be offered to exporters as identified exported goods is one of the most powerful tools to create and maintain the national image nowadays in the global market);

3) *Tourism* (it is the most visible aspect of a country brand, mainly because it receives large financial support from governments and therefore, turns into the most competent marketing force at the national level. However, it is important not to forget that tourism is only a part of the country brand);

4) *Investment & immigration* (the rate of inward investments is also a topical issue in the global contemporary economy because of the multitude of advantages they bring: positive competition, increased quality standards, an enriched flow of skills, knowledge and information between countries, increased employment, technological advances and

innovations, etc. All countries are now competing for gaining an investment-friendly image. Country brand and everything that it stands for has a lot to say when it comes to attracting foreign direct investments).

5) *Culture and heritage* (country, which evaluates growth only in the economical sense, takes a risk to create a two-dimensional brand image that is interesting only to investors and currency speculators, however culture and heritage provides depth, respect, confidence and dignity to the country abroad and quality of life in the country);

6) *People* (the branding of a country must start from inside because a country's brand is most frequently promoted by its people. Just as corporate branding campaigns can raise the employees' morale, team spirit, and motivation, national branding campaigns must provide the people with a common sense of purpose, of belonging and national pride.

Though it seems that what is true for companies, products, services or individuals, is true also for countries in the context of branding, but ***nations as brands have exceptional features*** (according to O'Shaughnessy and O'Shaughnessy, 2000):

- it is easier to give a unity and uniqueness to a product than to a nation;
- it less easy for a nation to develop a consistent brand personality because a nation is such a constellation of different images;
- country has its identity and image even before the marketing actions, and the product does not have any image in advance of its promotion;
- the concept of national image does not lend itself to the sharp clarity of definition that is possible with the brand image of a product;
- an umbrella country brand is oriented towards many different customers with different needs;
- a nation's image is more likely to be pressed into service as a risk indicator or a conjunctive rule to reduce options than to operate as an emotional pull;
- it is too difficult to put across an overall positive image of a nation that emotionally resonates with the consumer sufficiently to affect behaviour over the whole range of a nation's products;
- products can be removed, modified, repositioned, upgraded, but countries cannot implement many of these actions;
- country image problems are structural that takes years to solve them.

Eventually, ***the consumers' views of the nation as a brand will be a composite of beliefs based on experience (where it occurs) and/or emanate from the imagery of its people and the social, political, and economic conditions prevailing at the time*** (O'Shaughnessy and O'Shaughnessy, 2000). Consequently, country image can have multiple meanings:

- No image (with around 20-30% of the people of Western democracies being functionally illiterate, we assume much too easily that people have strong beliefs and sharp images of other nations in the world).
- Different parts of a nation's identity come into focus at different times (e.g., affected by political events or appearance of a popular movie).
- National images exist at different intellectual and cultural levels, and for different audiences (e.g., Italy has multiple meanings, from Naples and the Mafia to Venice, Tuscany, and Chianti shire).

National image = history + contemporary perception

In essence, national image is **fragmented** (*Table 1*), multilayered, incoherent and complex phenomenon. Country's image is changing all the time; it conveys a range of meanings – folk images, historic images, media history, etc.

Table 1. Country image taxonomy

<i>Categories of country-of-origin</i>		<i>Categories of country image</i>
The country in which the consumer permanently resides. HC has cultural and social impact on the consumer.	Home country (HC)	
The country in which either a part of or entire finished product is designed. Mainly used in the automobile and fashion industries. May influence consumer evaluation of product attributes.	Designed-in Country (DC)	Image of the country-of-design
The country whose name appears on the “made-in” label. It is usually the country where final production takes place.	Made-in Country (MC)	Image of the country-of-manufacturing
The country that is the source of identified key parts or components.	Parts-sourced Country (PC)	Image of the country-of-supply
The country where final assembly took place. Identified by the “assembled-in” label.	Assembled-in Country (AC)	Image of the country-of-assembly
The country which a consumer associates with a certain product or brand as being its source, regardless of where the product is actually produced.	Country of origin (COO)	Image of the country-of-origin

Source: Grundey and Brukiene (2006).

Non-exorcised demons reappear to afflict a nation’s image (O’Shaughnessy and O’Shaughnessy, 2000). Finally, national origin is just one of many factors in a consumer decision, and it can perform different roles in that decision or none at all.

Although a nation is a cacophony of images, in certain cases, it is possible to speak of **a dominant image**, an image powerful enough to crowd out all the other meanings and resonance (O’Shaughnessy and O’Shaughnessy, 2000). Thus, in the case of the United States, although it is a hugely complex and contradictory society, observers may speak of a special connection to the attribute of freedom and the accompanying hedonism. These can transcend all the complexities. National brands may mobilize such a dominant image (if positive), and this possibility makes brand image for the nation real. Where there is a strong, dominant image of a nation, the nation’s products can be viewed as buyer-inferred brand extensions to the national “parent” brand, with the images of all a nation’s products being potentially influenced by where they originated (Jaffe and Nebenzahl, 2001). That means the country-of-origin effect plays.

Similar to the problem of many definitions of brand image, there are many definitions of country image, which can be classified into three **groups** (Hsieh et al., 2004):

(1) *overall country image* (the total of all descriptive, inferential, and informational beliefs that a consumer has about a particular country),

(2) *aggregate product country image* (the entire cognitive “feel” associated with a particular country’s products or with the perceived overall quality of the products from that particular country; e.g. research shows that products originating in developed countries receive favourable attitudes from consumers in developing countries), and

(3) *specific product country image* (the overall perception consumers form of specific product categories from a particular country).

## Entrepreneurship: a Working Model for a Country

### *Entrepreneur's Concept by Schumpeter and Knight*

Joseph Schumpeter presented most of his ideas on entrepreneurship in his book *The Theory of Economic Development* published in 1911 (Schumpeter, 1949). Schumpeter opposed the existing views of the entrepreneur as a risk bearer and a manager of a company. Instead, Schumpeter argued that an entrepreneur is an *innovator* – an individual who carries out one of the following five tasks: 1) the creation of a new good or a new quality; 2) the creation of a new method of production; 3) the opening of a new market; 4) the capture of a new source of supply; or 5) the creation of a new organization or industry (Schumpeter, 1949, p. 66). The entrepreneurial task is thus to *identify* new combinations and react to these by exercising the leadership to profit from them. It should be stressed that it is the task of “carrying out new combinations” which is entrepreneurial and therefore the exercise of leadership to accomplish this is also part of the entrepreneurial activity. However, leadership of a company is not in itself entrepreneurial. Note also that the entrepreneur is not (necessarily) the one who invents new combinations but the one who identifies how these new combinations can be applied in production (Schumpeter, 1949)

Later, Knight (1942) specified three concrete functions of the entrepreneur: 1) leadership in changes and innovations; 2) adaptation to changes; and 3) risk bearing in connection with unforeseen events. These are three different but closely related entrepreneurial functions all involving uncertainty bearing. The innovative entrepreneur disturbs the economic system by initiating changes or innovations. The managing entrepreneur adapts to the new economic situation while the uncertainty-bearing entrepreneur assumes the risk involved in the process.

Table 2. Comparison of Entrepreneur's Concept by Schumpeter and Knight

Schumpeter (1949)		Knight (1942)
<ol style="list-style-type: none"> <li>1) the creation of a new good or a new quality;</li> <li>2) the creation of a new method of production;</li> <li>3) the opening of a new market;</li> <li>4) the capture of a new source of supply;</li> <li>5) the creation of a new organization or industry.</li> </ol>		<ol style="list-style-type: none"> <li>1. leadership in changes and innovations;</li> <li>2. adaptation to changes; and</li> <li>3. <b>risk bearing in connection with unforeseen events.</b></li> </ol>

The main difference between Knight's and Schumpeter's views on entrepreneurial activity is their view on uncertainty (*Table 2*). Knight argues that the key role of the entrepreneur is to assume uncertainty. This is very much in line with the early contributions. Schumpeter, on the other hand, leaves the uncertainty bearing to the banker.

The most important prerequisite of entrepreneurship, though, is a social and cultural environment in which achievement and wealth creation are held in high regard. The Accenture survey, which was conducted in 26 countries, reveals only a handful of nations where society as a whole appears to embrace an entrepreneurial culture.

In contrast, there are other countries where the motives of entrepreneurs are viewed as suspect or the legitimacy of their financial gain called into question. In some countries, an entrepreneurial failure can all but end an individual's career. Yet other countries exhibit a societal preference for the underdog, the gallant runner-up or the individual who is poor but

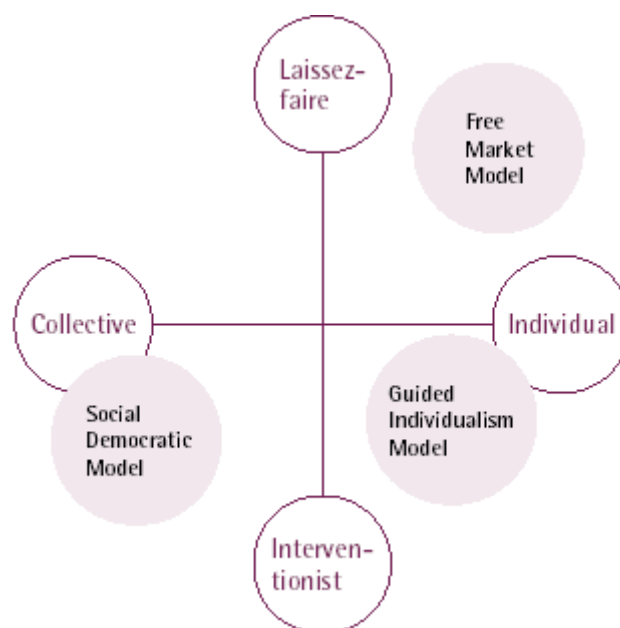


noble.

### *Working models for entrepreneurship worldwide*

How can CEOs characterize the entrepreneurial environment in which their companies operate? Countries and regions around the world differ in the extent of government involvement in the economy and in the way society values individual action versus collective action. Looking at entrepreneurial countries along those dimensions, Accenture developed three illustrative models for conditions under which entrepreneurship can flourish (Figure 2).

Figure 2. Entrepreneurship models for a country



Source: Cullum, Padmore and Purdy, 2002.

1. **The Free Market Model** (examples: The United States and Canada). In this model, the role of government is fairly limited. Public policy can create some of the basic conditions required for an entrepreneurial culture to flourish, such as good telecommunications infrastructure, and can remove many of the obstacles that get in the way, but the rest is up to the private sector. This model thrives in a culture in which entrepreneurial success is celebrated rather than denigrated. The tax structure rewards initiative and financial gain, but the degree of social protection is generally low.
2. **The Guided Individualism Model** (examples: Singapore and Taiwan). This model, too, is based on the encouragement of individual enterprise. Its distinctive feature, though, is the role of public policy in determining the broad sweep of entrepreneurial activity – in effect, signalling the sectors and industries in which entrepreneurial energies can most usefully be directed.
3. **The Social Democrat Model** (examples: Sweden and Germany). This model combines the encouragement of enterprise with an emphasis on social protection. Countries that follow this model create a sort of social partnership, with key aspects of the economic and social framework determined by negotiations between the different social partners, such as employers, employees and government. The collective nature of the social

partnership system means that initiatives to encourage entrepreneurship – such as those promoting *greater labour flexibility* – can be accompanied by other measures (for example, *retraining schemes* and *unemployment benefits*) to offset any adverse impacts on particular sections of society. It thus becomes easier to gain the approval of society at large for the key measures needed to strengthen the productive base of the economy. Characterizing a country's entrepreneurial style

### ***Barriers to entrepreneurship***

It is apparent that entrepreneurial activity is beneficial for developing countries both at a micro level – in terms of creating stable and sustainable employment for individuals – and at a macro level – where it significantly increases a nation's GDP (Bridges, 2002). Yet many developing countries have been unable to create and maintain the favourable environment needed to foster SME development. There are a number of barriers which entrepreneurs in developing countries face which entrepreneurship support initiatives can help address. The factors affecting entrepreneurial activity can generally be divided into *four categories* (Wortman, 1984; Russell, 1996):

- 1) ***Infrastructure***: Quite often the barriers to starting and maintaining a business come down to simple, yet often insurmountable factors, such as lack of roads, facilities, electricity or phones.
- 2) ***Legal and regulatory framework***: Governments need to have a positive perception of entrepreneurial activity, reduce the administrative burden on entrepreneurs, and coordinate among their agencies to ensure that the necessary resources are directed where they are needed.
- 3) ***Financial support***: A major stumbling block for many potential entrepreneurs at the lowest end of the economic spectrum is lack of access to the credit or seed funding necessary to start a business. Entrepreneurs who are starting up larger businesses face difficulty raising investment capital and a lack of sound market-based policies.
- 4) ***Social***: The concept of entrepreneurship is not native to every culture or society. The fear of failure can be a barrier. Creativity and innovation are not always valued traits. Many developing countries have social systems that create dependence and hopelessness. Women and minorities especially need role models to demonstrate the positive outcomes to innovation and risk-taking.

An additional barrier is the overarching mindset that entrepreneurship cannot be taught, that it is a **creative and innovative way of thinking** that comes inherently to some people and not to others. While it is true that some individuals are gifted with creativity to develop new ways of doing things, creativity alone is not sufficient. Ideas must be matched with basic skills and an understanding of business practices – and these are things that can be taught to help burgeoning entrepreneurs create successful businesses.

In *Table 3*, an attempt is made to appoint the best and worst performers within the EU-15 in the six major areas studied (the new Member States are not included in this comparison as there are no comparable figures for these countries in all areas). As regards Sweden, the general picture is that Sweden is performing relatively better than the EU when it comes to education and technological renewal, while some of the problems characterising many of the EU-15 countries (high tax burden and too unfavourable entrepreneurial climate) are even more pronounced in Sweden than in the EU on average. The best performers in creating positive entrepreneurial climate in a country (2005) were Denmark and Ireland, while the old European conservative countries, such as Germany, France and Greece lagged severely behind in macro economic stability, deregulations and opening up markets and **labour market** functioning.

Table 3. Best and Worst Performers in EU-15 Key Areas (2005)

Factor	Best performer	Worst performer
<i>Macro economic stability</i>	Denmark, Finland	France, Germany, Greece
<i>The value of entrepreneurship</i>	Ireland, Spain, UK	Sweden, Finland, Belgium
<i>Deregulations and opening up markets</i>	Denmark, Spain and UK	France, Germany and Greece
<i>Total taxes and taxes on labour</i>	Ireland, UK	Sweden, Belgium
<i>Higher education, R&amp;D and technological renewal</i>	Sweden, Finland	Spain, Italy, Greece
<i>Labour market functioning</i>	Denmark, UK	Spain, France, Greece

Source: Rydeman and Tornell, 2005, p.10.

EU enlargement will change the relative position of quite a number of formally peripheral regions to potential growth centres, which might win or lose in regional competition in accordance with their present and future capacity to retain or attract mobile resources like high potential students, entrepreneurial talent or investment capital. Europe intends to become the world's most innovative and competitive area by 2010 (e.g. Agenda of Lisbon). On the regional levels this calls beyond other things for vivid and dynamic entrepreneurial playgrounds, where new ventures and business initiatives can take off.

At present, many regions support scattered entrepreneurship promotion initiatives with weak links to strategic development objectives, unbalanced short-term goals and long-term visions, partially high costs and limited outreach. The young discipline of entrepreneurship research has limited insight to offer yet and university-based trainers/lecturers are often foreign bodies within their own systems. Thus, there seems to be a high need to find more effective approaches.

In order to *encourage entrepreneurship*, the image, attitudes and promotion of entrepreneurship must be improved. Tools developed on EU level for a better entrepreneurial climate need to be implemented rapidly in the Member States (Dallago, 2005). Today, the entrepreneurs are facing a far too unfavourable balance between risk and reward as well as many administrative obstacles, which taken together are dampening the entrepreneurial spirit. In this way many opportunities for employment and growth are lost.

*Administrative simplification and regulatory reforms* that reduce the overall regulatory burden on companies are crucial in order to achieve a regulatory climate more conducive to innovation and entrepreneurship. There is also strong evidence that small firms are disproportionately hit by current administrative burdens and diverting too much resources away from the true business mission. Special attention should be given to the regulations that have a direct effect on start-up of businesses. Compliance costs must be minimized and the regulations must also be characterised by transparency, consistency and accountability. In this context it is also important to *ex-ante evaluate the cost-efficiency of new rules and laws*. The implementation of administrative simplification must be undertaken both on European and on national levels. Improving the regulatory and administrative environment is also explicitly a policy priority in many countries and quantitative targets have been set aiming at reducing burdens. There is also evidence of improvements and actual reductions of administrative burden in some countries (e.g. the Netherlands).

Getting support for the value of enterprise and improving the conditions for small firms is crucial in order to improve the attitudes towards entrepreneurship. Today the **image of entrepreneurship is too negative in many EU countries**. This problem is also explicitly

addressed in “*the European Action Plan for entrepreneurship*”, where one policy area, “fuelling entrepreneurial mindsets”, is especially dealing with the “**image problem**”. The less positive attitude towards entrepreneurship in many EU-countries reflects the generally too unfavourable economic conditions for entrepreneurs that must be remedied in order to achieve necessary improvements in this area. Thus, the administrative burden must be reduced and so must the overall taxation on enterprise.

The fact that *EU is not “entrepreneur-minded”* enough is reflected in a much more skeptical attitude towards entrepreneurship. There are many factors explaining the attitudes towards entrepreneurship, but the general economic conditions in terms of the balance between risk and reward are of course a crucial factor. The way that entrepreneurs are too often stigmatized if they fail is another obstacle that the EU must get rid of.

Entrepreneurship is a policy traditionally led in Member States. *Entrepreneurship education* aiming at develop the entrepreneurial mindsets among young people and benefits of entrepreneurship education must be recognised. National strategies of entrepreneurship education in primary, secondary and higher education have to better coordinated among national administrations and fully implemented. It addition, it is important that the European Commission continues to enhance the coordination between Member States as well as integrating business experiences in the entrepreneurial education.

One of our basic premises, entering the research, was that there are several problems in the SME policy area, particularly in the areas of definition and evaluation, both of which are imprecise. In part of our work, we examine the differences between SME and E-Policy orientations.

We do not have time to go into a full analysis of this today, but in general, we suggest that governments need to reorient their policies:

1. more towards individuals and individual behaviour and less towards SMEs as firm entities;
2. more towards measures to develop the supply of competent entrepreneurs and less towards ‘picking winners’ among existing firms or sectors;
3. more in favour of measures to support the early phases of the entrepreneurial development process, including the nascent as well as the start-up phase; and
4. more in favour of developing an entrepreneurship culture, while still maintaining a focus on creating a more favorable business environment.

We also suggest that more thought should be given to how to create the right environment and circumstances to *motivate* and stimulate individuals to become entrepreneurs. This includes ‘enabling’ policies both to help them acquire the appropriate *skills* and learning, and to surround them with ‘*opportunity*’ (i.e., access to start-up resources and supports). These three elements, Motivation, Skills and Opportunity, are the basis of the Entrepreneurship Policy Foundations framework (*Figure 5*) and are key to the creation of a more ‘entrepreneurial economy’.

There is a high degree of interdependence between these three elements. Stressing one area and ignoring the others will inevitably lead to sub-optimal results. At present, it appears that governments focus primarily on certain parts of the ‘Opportunities’ area. Only a few in our study have progressed towards an integrated, comprehensive approach.

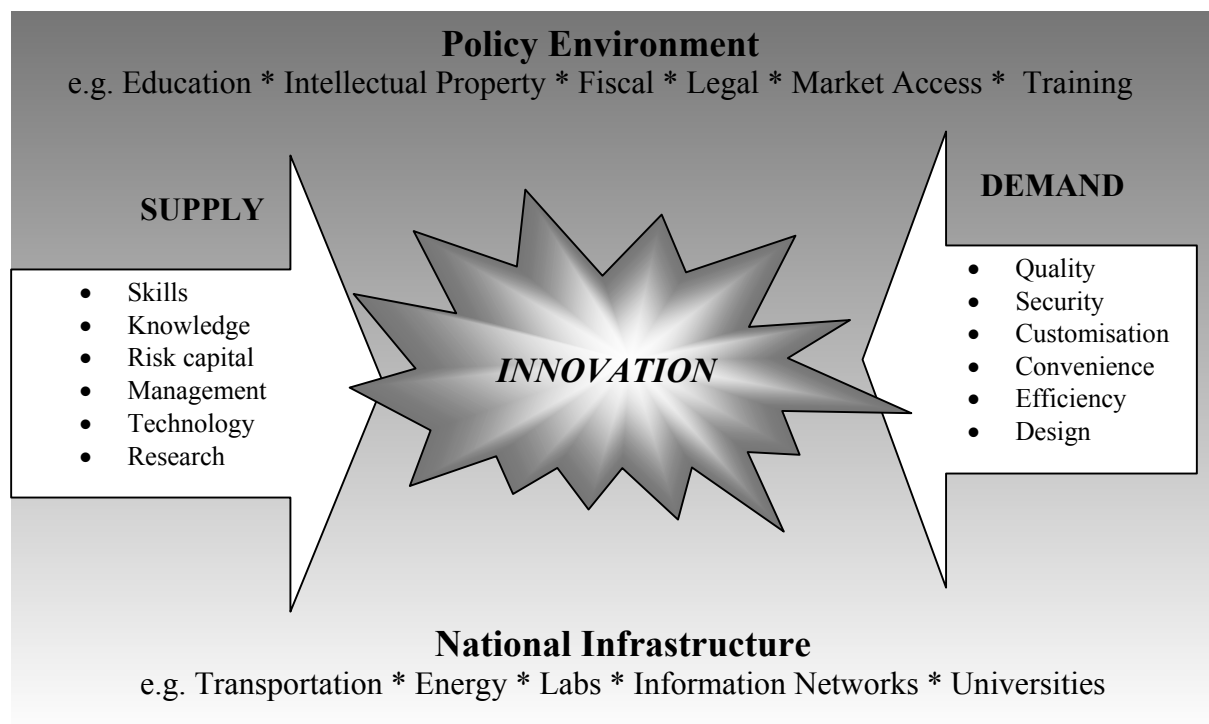
### **Innovation Dilemmas and Opportunities: Creating the National Framework**

What is required to play in this new game? Modern management theory argues for becoming a “sense and respond” enterprise – but even that may not be enough. Within a complex adaptive system, innovation itself is the best (perhaps the only) way to influence and to lead. People today feel themselves buffeted by huge, hard-to-understand forces. Innovation

is about setting the agenda and becoming a force yourself.

The first step toward unleashing innovation is to understand its basic ecosystem dynamics. The NII framework (*Figure 3*) recognizes the influence of innovation supply and demand on the rate of innovation productivity. Supply includes innovation inputs like research, skills, management strategies, knowledge and risk capital. Demand includes innovation outputs valued by societies, such as, quality, security, convenience and efficiency.

Figure 3. National Innovation Infrastructure (NII) Framework



Source: National Innovation Initiative, 2004.

In the past, most of the innovation policymaking and action have focused on the supply side – the 20th century “production model.” We believe that more insight and action to align supply with *market demand* and *customer/citizen value creation* will sharpen the creation of innovative solutions, help manage risk and significantly mobilize the nation’s innovation resources.

The push and pull of innovation supply and demand, however, don't occur in a vacuum. They are strongly influenced by the knowledge environment, public policy and overall innovation infrastructure offered by our society. For example, public policies related to education, training, research and development, fiscal and monetary policy, intellectual property, taxation and market access obviously impact our ability to generate innovation inputs and respond to innovation demands. The same can be said of infrastructure – be it for transportation, energy, healthcare or communication.

Within this innovation framework, what are the major challenges and opportunities? We previously identified five core characteristics of innovation today: *global*, *multidisciplinary*, *multiplying*, *open* and *transformational*. To get a sense of how these frame the issues before us, the seven working groups of the National Innovation Initiative identified some of the innovation-related dilemmas with which institutions and enterprises are now grappling. To identify the right actions, the National Innovation Initiative’s seven working groups (USA) have examined major dimensions and drivers of innovation: *skills*, *finance*,

*infrastructure, the public sector, research frontiers, trade and investment policy, and an understanding of how innovation is evolving.* In this interim report, we preview some of the emerging priorities. Common elements of the priorities can be grouped into three broad categories (Table 4):

Table 4. Charting a National Innovation Agenda (best practice in the USA)

<b>Talent</b>	<b>Investment</b>	<b>Infrastructure</b>
What bold steps should academia, industry and government take – separately and in concert – to <b>develop world-class innovators</b> in services, manufacturing and the public sector?	What can we do to help markets <b>value long-term innovation strategies</b> more highly?	What should our priorities be to create <b>world-class infrastructures</b> for innovation, including transportation, energy, healthcare, and information?
How can we <b>help our workforce adapt to change</b> through a more agile system of training, support, and portable benefits?	How should we adjust our R&D strategies to produce more breakthroughs in areas that require <b>research across multiple disciplines</b> and over longer terms?	How can we <b>make the public sector more innovative</b> through competition and performance standards and early adoption of path-breaking systems and practices?
How can we stimulate a diverse generation of nationals <b>skilled inn science and engineering</b> ?	What are the most powerful incentives to increase <b>early-stage investment in small business innovation</b> ?	How can the <b>regulatory and legal system better support innovation and entrepreneurship</b> while protecting society?
As we protect the homeland, how can the USA assure that they remain an <b>innovation magnet for the best global talent</b> ?	With services accounting for a dominant share of the USA jobs and output, and how should we invest to <b>accelerate innovation in the service economy</b> ?	How do we build a <b>global 21<sup>st</sup> century intellectual property system</b> that protects the rewards of intellectual property and encourages collaboration?

Source: compiled after National Innovation Initiative, 2004.

- *Talent* – the human dimension of innovation, including knowledge creation, education, training and workforce support.
- *Investment* – the financial dimension of innovation, including investment in R&D and risk capital availability, and macroeconomic fiscal and monetary policies.
- *Infrastructure* – the physical and policy structures that support innovators, including network infrastructure, healthcare, transportation networks, energy provision, regulatory systems, intellectual property protection, innovation management and trade policy.

### **Discussion: Innovation and Good Practice in Lithuania**

Despite strong relative rates of economic growth, the Lithuanian innovation system in overall terms performs rather weakly compared to Western Europe. On the other hand,

Lithuania shares many of the challenges as well as the strengths of its Baltic neighbours Estonia and Latvia. The main challenge lies in the group of indicators related to knowledge creation both in terms of inputs (rates of public and business expenditure on R&D) and outputs (US and European patent offices' activity). Although the level of public expenditure on R&D is close to double that of Latvia and close to equal that of Estonia, it remains well below the EU-25 average, while the level of business R&D expenditure is among the lowest in the EU-25 (although problems with accounting of R&D expenditure explain part of the gap) (Trend Chart, 2004, p.69).

However, there is evidence of a positive upward trend, with both public and business R&D expenditure increasing in absolute terms since 2000. Despite a relatively high percent of the population with third level education (although Lithuania has been losing momentum in terms of this indicator since 2000), the figures concerning human resources for innovation also give cause for concern with the potential for upgrading skills of employees through lifelong learning amongst the weakest in the EU-25. Given the weak position of the Lithuanian economy in terms of the **structure of employment** with only 3 percent of the workforce in medium to high-tech manufacturing and only 1.7 percent in high-tech services in 2003, the need for sustained investment in skills development is clear. The only positive note in terms of human resources is the relatively high rate of science and engineering graduates (127 percent of the EU-25 average).

In the context of an innovation system where relatively few SMEs are actively involved in innovation and where innovation management know-how in support structures remains limited, the identified best practice in Lithuania for the period 2003 - 2004 is the project on Support to the Innovation Structure in Lithuania (or SINO). Funded by the Danish Agency for Enterprise and Housing and the Lithuanian Ministry of Economy, the aim of SINO was to strengthen the Lithuanian innovation support network and increase the competitiveness of Lithuanian enterprises in local and international markets. The project ran from May 2003 to June 2004 and was implemented by the Danish Technological Institute in co-operation with the Lithuanian Innovation Centre and six selected partners from three regions: Vilnius, Kaunas and Klaipeda. In total, 35 participants were selected, of which ten were from innovative companies, five from financial institutions, and 20 from innovation support organisations.

Project participants received theoretical and practical training in idea development, creativity, risk management, fund raising, partnering, and other issues. Participants worked in innovative teams preparing an innovation plan. Based on the Innovation Plan, three SINO groups were selected to participate in study tours to Denmark, where they held meetings with potential co-operation partners and business support organisations.

Data on innovation activity and practices in SMEs is limited to the results of the CIS carried out in 2001 and hence it is not possible to identify trends. As with the other Baltic States, at least one of the indicators of innovation activity is well above the EU-25 average, namely the percentage of SMEs involved in co-operation for innovation (12.3 percent or almost 175 percent of the EU-25 average).

The results for the other innovation indicators suggest that more could be done to encourage a larger number of SMEs to innovate more intensively. In terms of technology diffusion, Lithuania shares a common strength with its Baltic neighbours with a very high rate of ICT (Information and Communication Technologies) related expenditure with respect to GDP at 131 percent of the EU-25 average. This investment may help explain the relatively **sustained growth in labour productivity** during the period 2000-2003 and also reflects a national business-led priority to build up a competitive and sizeable IT sector.

As might be expected, the business and market outcome is not particularly positive, indicators on turnover owing to new-to-market and new-to-firm place Lithuania (in 2001) at

about 70 percent of the EU-25 average while value added attributable to high-tech manufacturing stood at only two-third of the EU-25 in 2002. In short, recent economic growth in Lithuania seems to be disconnected from the performance of the innovation system and is essentially due to strong export performance in lower tech and lower value added sectors. As such, a *key overall challenge is to improve the competitive position of Lithuanian enterprises by building a stronger linkage between knowledge production and diffusion in the enterprise sector*. Based on the EIS 2004 results, four challenges for the Lithuanian innovation system can be identified.

**CHALLENGE 1:** *Developing modern skills for innovation* is an important component of a knowledge-based economy particularly with a view to supporting the restructuring of Lithuanian manufacturing and service sectors towards higher value added and higher technology activities. As noted above, the major strengths of Lithuania are relatively high shares of science and engineering (S&E) graduates and population with tertiary education. In this context, the challenge is to continue to improve skills levels, which should be as relevant as possible to industry needs. In September 2004, the Ministry of Education and Science launched a scheme 'Improvement of the quality of human resources for R&D and innovation' in the framework of the Single Programming Document 2004 -2006. The main aim of this measure was to improve the quality of highly skilled human resources in the priority areas of science and technology, for example in biotechnology, agriculture, forestry, mechatronics, laser and optical technologies. Furthermore, a recent State Education Strategy for 2003-2012 aims to help obtain qualifications equal to modern level of technology and to create conditions for lifelong learning.

**CHALLENGE 2:** *Creating effective links between the R&D sector and firms* in order to boost knowledge diffusion requires further support. Investment flows to R&D activities indicate that the scientific sector is integrating itself into international research networks, which is a positive direction in terms of new scientific knowledge creation. One barrier is the low number of R&D personnel working in business and able to absorb new knowledge with the result that the most important source of knowledge remains with customers, suppliers and competitors. Investment in technology parks and innovation centres has only recently been accompanied by two measures strengthening industry-science relations: one is supported by the PHARE 2002 Programme; and the other by the Single Programming Document 2004 - 2006. The overarching aim of these measures is to support joint research projects of companies and R&D institutions.

**CHALLENGE 3:** *Increasing the level of investment in public and private R&D is a third challenge*, which requires a change in policy coordination. As noted above, Lithuania's gross expenditure on R&D is below the EU-25 average and is falling further behind. In 2003, the Ministry of Science and Education approved a long-term R&D strategy. However, increasing funds from the State budget alone, particularly as it already represents 88 percent of all R&D funding, will not solve the underlying problems. There is a need for a radical overhaul of the funding mechanisms and a greater attention to the quality of research financed and its economic relevance. The major part of government financing consists of lump sum funding for public or academic R&D institutions and only a small fraction is allocated through competitive project selection procedures. There is a need for a significant improvement in methods and practices used for the development, monitoring and evaluation of innovation policy.

**CHALLENGE 4:** *Introducing a patenting culture, a prerequisite of a modern economy, is a fourth key challenge* as Lithuania only outperforms Latvia and Poland among the EU25. Given the small size of the economy, the international patenting rate should be significantly higher to ensure the renewal and diffusion of knowledge. Although Lithuania became a signatory of international agreements in the area of intellectual property rights and



the Government has harmonised national legislation with EU rules, the number of patents remains low. A strategy aimed at improving intellectual property rights has been drafted but has not been implemented.

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