THE IMPACT OF THE CHANGEOVER TO THE EURO FOR EASTERN EUROPEAN COMPANIES

NICOLAE MARINESCU
ASSOC. PROF., TRANSILVANIA UNIVERSITY OF BRASOV, ROMANIA
marinescu@unitbv.ro

Abstract
The introduction of the euro as a single currency in Eastern European countries, the new member states of the European Union, has sparked, and still sparks, a great deal of debate concerning the effects that arise from this changeover. Although macroeconomic effects of switching to the euro have been analyzed extensively, microeconomic effects have received far less attention. This paper tries to bring a contribution in this field and fill the existing gap in the literature. It investigates the impact of the introduction of the euro on Eastern European companies. Based on a thorough desktop research, the aim of the paper is twofold. Firstly, it shows the estimated effects companies will experience when their respective country will make the changeover to the euro. Secondly, it analyzes the measures these companies will have to take so as to ensure an efficient transition to the euro, by trying to reap the benefits and mitigate hardships linked to this move. The results of the analysis consist in a kit of operational measures, valuable to owners and managers of Eastern European companies who want to prepare properly for the changeover to the euro.

Keywords: Euro, Eurozone, Eastern Europe, Companies

JEL Classification: O42, O52, L2

1. Introduction and context of the study

On January 1st, 1999, the single European currency (euro) was introduced, with the aim of replacing the national currencies of the 11 participant states in the Economic and Monetary Union. Greece met the criteria and entered 2001. Later on, Cyprus and Malta joined the Eurozone in 2008 following the first enlargement of the European Union (EU) to the Eastern part of the continent.

The new EU Member States will eventually adopt the single currency, according to their duties enshrined in the EU Treaty, although there is no pre-established calendar.

By 2011, only three Eastern European countries have adopted the euro: Slovenia (2007), Slovakia (2009) and Estonia (2011). The two latest entrants are Latvia (2014) and Lithuania (2015), increasing the current number of participating countries in the Eurozone to 19.

The remaining 6 Eastern European countries have a different stance on adopting the euro. In Poland, the Czech Republic and Hungary, authorities and Central Banks oppose joining the euro too soon. Croatia is still working on fulfilling the criteria. Romania is set to join in 2022 if it complies with the criteria, while Bulgaria is pressing for a sooner entry.

In Romania, the increasing budget deficit in the last few years is a worrying issue, as this is a critical indicator needed for a successful changeover to the euro. As statistics show, Romania is among the top 5 EU member states for the largest budget deficit. It records a value under the 3% mark, though. In a recent paper, Popescu Duduiala shows that the increase of the deficit arose as a result of falling tax revenues and increasing social spending, such as benefits for various categories of the population [8].

At present, as Raileanu Szeles and Marinescu (2010) observe, fulfilling the nominal convergence criteria in a sustainable manner is needed for the participation in the Eurozone, while real convergence is imperative for the sustainable development of the EU in the long run. Also, in the context of Eurozone enlargement, real convergence allows the EU monetary policy to be effective for all participating countries [9].

The monetary policy of the EU has been put under a massive strain after the financial crisis of the late 2000s began to show its negative impact on some participating countries in the Eurozone.
At the same time, the appeal of the euro also started to fade for candidate countries. Oprea (2017) makes a grounded review of the literature approaching the effects of the economic crisis on European financial integration and economic growth [7].

Although macroeconomic effects of switching to the euro have been analyzed extensively in the literature (see Marinas, 2013 for a detailed analysis applied on Romania) [5], microeconomic effects have received far less attention. Most contributions were focused on the effect of the euro on trade, like the seminal papers of Rose (1999) and Baldwin and others (2008) [10] [1].

Rose (1999) more generally tried to estimate the effect that common currencies have on the trade of participating countries and found that a currency union has a large positive influence on trade, implying that the countries that share the same currency, as is the case in the Eurozone, will increase trade even threefold compared to the case of different currencies [10].

Baldwin and others (2008) elaborated a study on the impact of the euro on trade showing that in the first years after the introduction, the euro had a positive, but only limited impact on trade thus demonstrating that initial estimations were too optimistic [1].

Another strand of the literature was concerned with price convergence and changeover-related inflation (Mastrobuoni, 2004, Sturm and others, 2009) [6] [11].

Mastrobuoni (2004) investigated the effect of the euro changeover on prices, showing that contrary to the official position that there will be no price increases, consumers perceived it by far differently [6].

In a well-documented study, Sturm and others (2009) analyzed the price developments for different types of households resulting from the euro changeover. As for the cross-border convergence of prices following the changeover, they found the differences in price dispersion across Eurozone member states to be relatively small [11].

Among a few researchers, Crane and Chandler (2005) approached the risks and opportunities for companies from doing business with the euro [2].

Apart from the official documents such as a practical guide for preparing companies to work in euro issued by the European Commission (2008), only a limited number of studies have been conducted at implementation level in companies and obviously even fewer for Eastern European companies [3].

As such, this paper tries to bring a contribution in this field and fill the existing gap in the literature, considering that the topic of the changeover to the euro will have a paramount importance on the way companies in Eastern Europe will conduct their business further.

2. Analysis of the changeover

From the date of the announced changeover, there is the possibility of keeping the accounting records, of having bank accounts, and making electronic payments in euro. Eastern European companies will have only a limited degree of freedom for choosing their own time of transition inside the announced deadline for the complete changeover. When euro coins and banknotes come into circulation, all the accounts are automatically converted into euro. The national currency loses then its validity.

The replacement of the national currencies with a single currency represents an economic and financial milestone that brings with it a lot of opportunities and challenges.

According to this historic moment, the introduction of the euro is a good opportunity for Eastern European companies to conduct a strategic marketing analysis so as to recognize these opportunities and challenges. At the same time, this occasion can be used for a general review and restructuring of the company’s activities (location, product catalogue, price policy, distribution network, services offered to customers, choice of business partners, contracts with suppliers, etc.).

The changeover to the euro brings a multitude of very important strategic effects on Eastern European companies. It facilitates European-wide activities, because it eliminates the risks and costs associated to exchange rate fluctuations, as well as the necessity of keeping accounts in multiple currencies in the case of international companies. Thus imports and exports are
encouraged, and competition in the market increases. Also, the inflation and interest rates converge, which will in turn influence the investment decisions of companies.

Consequently, in order to successfully meet the challenges and risks of the changeover, Eastern European companies need to elaborate a well-grounded strategic plan. This plan should comprise three basic components:

- performing an assessment analysis of the effects of the changeover;
- choosing the changeover strategy;
- developing an action plan to implement the strategy chosen.

These three elements will be detailed in the following paragraphs.

The first element of the strategic plan is represented by the identification of all relevant factors in the context of the changeover and assessing their importance for the dominant activities of the company.

The effects of the changeover will vary depending on a number of elements such as: size of the company, the complexity of its activities, the nature of the products and services it sells, the composition of the customer base and the geographic location.

The final analysis requires the centralization of effects and the comparison of their relative importance with effects in other areas. Synthetically, such an analysis can be undertaken using the structure in table no. 1.

<table>
<thead>
<tr>
<th>Categories of influence</th>
<th>Factors that enhance the impact of the changeover</th>
<th>Factors that decrease the impact of the changeover</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Competitors</td>
<td>- the emergence of new competitors in the market</td>
<td>- price-independent barriers for market entry</td>
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<tr>
<td></td>
<td>- market focused on price competition</td>
<td>- the particular type of market: saturated or mature</td>
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<tr>
<td>2. Suppliers</td>
<td>- the possibility of finding new suppliers</td>
<td>- mainly domestic suppliers</td>
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<tr>
<td></td>
<td>- availability of suppliers</td>
<td>- the late shift of main suppliers to the euro</td>
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<tr>
<td></td>
<td>- the large number of suppliers</td>
<td>- specialized suppliers</td>
</tr>
<tr>
<td>3. Customers</td>
<td>- the emergence of new markets</td>
<td>- customer loyalty</td>
</tr>
<tr>
<td></td>
<td>- the importance of public relations</td>
<td>- delivery to customers outside the Eurozone</td>
</tr>
<tr>
<td></td>
<td>- the large number of customers and transactions</td>
<td>- the late shift of main customers to the euro</td>
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<tr>
<td>4. Marketing</td>
<td>- psychological prices</td>
<td>- products and services tailored to consumers</td>
</tr>
<tr>
<td></td>
<td>- change to a new generation of products</td>
<td>- focus on the domestic market</td>
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<tr>
<td></td>
<td>- labeling and branding</td>
<td>- brand loyalty</td>
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<td>5. Management</td>
<td>- dependence on IT systems</td>
<td>- low volume of transactions</td>
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<td></td>
<td>- financial management</td>
<td>- prior experience with multiple currencies</td>
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<td></td>
<td>- significant seasonality</td>
<td></td>
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<td></td>
<td>- training of employees, changes in human resources</td>
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</tbody>
</table>

Source: Own adaptation from European Commission information material

A first effect of major importance is that expressing the prices in euro will lead to increased transparency of prices, especially in border areas. This will highlight existing price differences which bring both opportunities and threats, depending on the companies’ own pricing policy compared to that of competitors.
Likewise, as more companies will be expanding at European Union level, there is the possibility of losing customers if a certain company does not have the necessary capacities to deliver products EU-wide.

Another important effect is that the introduction of the euro will eliminate exchange rate fluctuations and consequently the risks associated with them. This will probably lead to an even larger increase in trade between Eastern European countries and their Western counterparts inside the Eurozone. Also it will presumably lead to a greater interest from companies in the Eurozone to conclude contracts with Eastern European companies.

Companies serving a multitude of customers, especially those in retail, will have to inform the public about the changeover strategy, for example of payment and labeling the price in euro. It is important for companies to make this changeover as comfortable as possible for customers and to take measures to avoid uncertainties they might have. This involves training all employees who constantly enter in contact with customers and changing all the labels, invoicing software and cash machines used in store.

Companies that have previously used psychological prices and want to keep them in euro will probably also have to change the design, size, packaging, or quality of their products to maintain their existing profit margin. These changes may result in a significant increase or decrease in the overall price level.

The higher the number of customers and suppliers, the lower the likelihood for all of them to engage simultaneously in the changeover. This will lead to the need to keep account (invoicing, payments) both in the national currency and in euro, which entails increased costs during the changeover.

However, companies that sell customer-tailored, traditional, cultural-oriented products or patent-protected products, will be less exposed to the impact of the introduction of the euro. In the same situation are companies that work with domestic or specialized suppliers or the ones that work in sectors that involve large start-up costs. Markets with a high degree of saturation, markets where global competition already prevails, or markets where trade is conducted in another currency than the euro, are also partly sheltered from a large impact of the changeover.

The second element of the strategic plan is represented by the choice of the adequate changeover strategy.

Once all the effects of adopting the euro have been identified by the respective company, the management must consider different changeover strategies, evaluate each of them and decide on the best alternative. There are largely three main ways of making the changeover to the euro: the early-mover strategy, the step-by-step strategy and the late-mover strategy [4]. Each of them has advantages and disadvantages; therefore, it is necessary to perform a rigorous cost-benefit analysis in order to choose the most appropriate one.

The early-mover strategy is adequate when the company is a risk-taker and wants to exploit opportunities arising from the introduction of the euro. This strategy implies a cost reduction, with less bureaucracy and an avoidance of lengthy information systems in both currencies. It also creates a dynamic image for the company. However, it puts a strain on the people to be trained and on the IT-department responsible for changing the system. It also may entail a low return on the initial investment for this move.

The step-by-step strategy requires the parallel use of the national currency and the euro for a period of time. Hereby, the needs of customers and suppliers are matched well, but the operation of both systems may be burdening and slow, especially when the volume of transactions is high.

The late-mover strategy is adequate when the management identifies no particular opportunities or risks for the activity of the company. In this case, there is enough time to adjust and the company may learn from the experience of other firms, but it may lose market share or contracts in favor of faster rivals.

Once the management has decided for a particular strategy (of the above-mentioned three), it must develop a detailed action plan and then apply it.
This is the third and last element of the strategic approach. The detailed action plan should comprise at least the following points:
- designation of the responsible persons;
- setting a deadline for the whole action;
- allocation of the necessary resources (personnel, equipment);
- supervision of meeting the deadline and controlling the activities of the team responsible for the implementation of the action plan.

3. Conclusions

Considering that the share of trade flows with the EU in Eastern Europe’s international trade (exports as well as imports) is above 65%, it becomes obvious that the changeover to the euro bears significant implications.

Increased price transparency caused by the use of the euro will pose significant threats to Eastern European companies that export products with relatively high prices on markets with increased purchasing power but also opportunities for those exporting cheap products to demonstrate their competitive edge.

The changeover to the euro can be the impetus for adopting a unitary European strategy and for penetrating markets still untapped by exporting companies.

The elimination of exchange rate fluctuations is an advantage due to the reduction of administrative costs and the simplification of price hedging instruments. Nevertheless, the evolution of the euro exchange rate against the dollar may have a negative influence, which needs to be anticipated and prevented by Eastern European companies trading with partners outside the Eurozone.

Eurozone companies may require businesses in Eastern Europe to work in euro. To the extent that Eastern European companies will be able to offer EU-wide services, this will enhance their image and give them a competitive edge over rivals.

To sum up, the main effects of the euro changeover can affect Eastern European companies joining the Eurozone both positively and negatively, depending on the particular situation of a company. These developments affecting companies can be shortly summarized as follows:
- higher competition due to increased price transparency;
- the opportunity to enter new markets at EU-level, but also the possibility of losing customers in the absence of the capacities needed for expansion;
- reduced administrative costs and simplified price policies by eliminating exchange rate fluctuations and related risks;
- training of all employees working in public relations;
- informing customers about the payment and labeling of prices in euro;
- transformation of accounting systems and documents as well as change of labels, cash registers and invoicing;
- changes needed for companies using psychological prices, in order to keep the existing profit margin;
- adjusting the cost calculation for exported products.

Taking all these aspects into account, this paper brings an important contribution on the practical side, enabling managers with a kit of operational measures, so as to inform themselves better, to assess the effects of the changeover to the euro thoroughly and to develop a proper strategic plan.

This is especially the case of Eastern European companies actively involved in exporting or importing at EU level, a topic that will be surely approached more often in the literature in the years to come.
4. Bibliography