



Differences between Croatia and EU Candidate Countries: the CAGE Distance Framework

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Abstract

Background: Nowadays, international cooperation is unevenly divided among countries. The decisive criteria imply cultural, administrative, geographical, and economical closeness among countries. Therefore, understanding such factors can significantly facilitate the performance of the company on foreign market. **Objectives:** The goal of this paper is to identify the fundamental differences between Croatia and the EU candidate countries through a comprehensive and systematic analysis of the determinants within the CAGE Distance Framework. This systematic analysis can significantly intensify Croatia's international exchange and improve Croatia's performance at important foreign markets. **Methods/Approach:** Research comprises original datasets on distance factors within CAGE distance framework. With cultural, administrative, geographic and economic data of Croatia and EU candidate countries, empirical support about the impact of distinctions on international exchange has been given. **Results:** Cultural and geographical similarities are particularly noticeable among Croatia and EU candidate countries, although there are also no significant differences in the administrative and the economic dimension. However, Turkey is the only country that somewhat differs in each segment. **Conclusions:** Similarities have significant influence on cross-border trade. With all present similarities and differences, cooperation among Croatia and the EU candidate countries has a perspective for development, especially at a time when all candidate countries join the EU.

Keywords: the CAGE Distance Framework; Croatia; EU candidate countries

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Introduction

Croatia has, due to the membership in the European Union (EU), managed to overcome the economic crisis after seven years of difficult struggle. EU accession process required many international reforms that demand great haste in passing

legislation in Croatia (Koprić et al., 2012). Access to EU has significantly influenced the improvement of disordered internal economic system that reigned in Croatia. Specifically, EU has provided facilitated international cooperation with many developed countries. On the other hand, EU candidate countries (Albania, Bosnia and Herzegovina, Montenegro, Macedonia, Kosovo, Serbia and Turkey) also represent an important foreign trade partner of Croatia. In fact, 21% of Croatia's goods and services are intended for EU candidate countries market (Croatian Bureau of Statistics, 2014). Intensive cooperation stems from the fact that all states were members of Central European Free Trade Agreement (CEFTA). However, Croatia's accession to the EU has resulted in an automatic exclusion from CEFTA, therefore hampering international exchange between them. Hence, by identifying the features that are reflected as crucial differences between countries, established trade can be well preserved and even improved. The cultural, administrative, geographic and economic determinants can help in identification and evaluation of the impact of present distance on collaboration. Market risk increases with the diversity between countries. On the other hand, similarities provide business potential.

Therefore, the aim of this paper is to identify the fundamental differences between Croatia and the EU candidate countries through a comprehensive and systematic analysis of the determinants within the CAGE Distance Framework. This systematic analysis can significantly intensify Croatia's international exchange and improve Croatia's performance on this profitable and important foreign market.

The organization of the paper is as follows. Section 2 presents the components of the CAGE Distance Framework. Section 3 presents the used methodology and data while Section 4 shows the results. Section 5 summarizes the paper with the concluding remark.

The CAGE Distance Framework

The CAGE Distance Framework represents an appropriate model that identifies cultural, administrative, geographic and economic differences between countries (Ghemawat, 2001). It helps in the assessment of the effects of distances that act as barriers to the export, facilitates acquiring a competitive advantage and provides the possibility of equal competition. Additionally, it enables implementation of quantitative analysis by offering expanded and comprehensive view on distances that arise among countries and provides another perspective on each dimension. Eventually, it ensures better understanding of trade, capital, information and human behaviour patterns (Sakarya et al., 2007).

Cultural distance represents the starting point of the CAGE Distance Framework as culture is considered to be the "software of mind" (Geert, 2001, p. 89). Namely, even though culture is invisible; it determinates the way individuals observe values and behaviours. Consequently, it reflects as the difference in societal norms, racial differences, language and religious credential between two countries (Griffith et al., 2014). Human development is under the influence of accustomed culture. Human beings adjust the environment according to their own needs instead of depending exclusively on personal selection to realize business success. Cultural differences must be observed on national level. The reason for that is the fact that culture leaves the formative impression on international collaboration (Malhotra et al., 2009).

Administrative distance reflects the historical and present political and legal associations between trading partners (Moser et al., 2008). Administrative factors imply bureaucracy, political structure and operating system in one country. Institutional environment highlights the impact of social values and norms that cause

restrictions on organizational behaviour. More precisely, culture represents an important part of the environments informal institutions that supports formal institutions (Peng et al., 2008). Government regulation is composed of political and legislative regime. Political risk is often of crucial importance; it affects the collaboration because it brings into question the stability of the foreign market (Quer et al., 2012). Administrative distance is reflected in the different government policies and government effectiveness as well (Ghemawat, 2001). Slow and inefficient government with complex legislation will aggravate business activity. In such an environment managers are forced to invest more money and waste more time to overcome present regulations (Poynter, 2012). In that manner, many countries are seeking to establish the policy of free trade throughout trade agreements. The EU is a leading example of a conscious endeavour to remove administrative and political differences and thus facilitate cooperation among the member countries (Balassa, 2013). The EU, as well as the negotiation and political alliance, represents a community in which decisions are taken together and the currency and legal structures are shared.

Geographic distance, except the actual distance between countries, implies topographic features, the size of the country, the average distance of some cities to national borders, the condition of roads and access to waterways. It also consider the access of transportation and overall communication infrastructure. Thereby, it affects the cost of transportation and induces communication and information barriers (Ojala et al., 2007). In the selection of foreign market, geographical segment is of great importance. Specifically, costs are significantly reduced between companies that are geographically close to each other (Sousa et al., 2006). Thus, for companies that are starting to internationalize their business, geographic distance may represent a crucial factor. However, it is neglected with the companies experience and long-standing presence on the global market.

The economic dimension concerns the economic circumstances prevailing in the country. The stated implies the underlying diversities in income, wealth distribution and the relative purchasing power (Cassey et al., 2011). Significant economic diversities between countries hamper company's international activity. Specifically, similar gross domestic product (GDP) per capita and consumption patterns are positively correlated (Ghemawat, 2001). Additionally, it is much easier to transfer implemented business model on the market that has close or similar economic features (Mitra et al., 2002). This manner facilitates achieving economies of scale (Waugh, 2010).

For most companies it is easier to standardize and centralize its business in a way that the same product or service is offered on the market, regardless of the present diversity. However, it has been proven that ignorance of distinguishing criteria leads to a reduced profitability and falling revenues (Hofstede, 1991). Additionally, the implementation of the adjustment is often very complex and requires certain financial expenses. However, for long-term sustainable business success internationalization is essential. In the analysis and reduction of time and cost consequences can vastly aid application of the CAGE Distance Framework. The CAGE Distance Framework can be used for better understanding of trade, capital, information and human behaviour patterns. By applying the CAGE Distance Framework, and guided by their own priorities, companies can more easily study the parameters of the distance within a single model, identify and recognize attractive markets and more clearly see the possibilities and risks of international business.

Methodology

The CAGE Distance Framework is multidimensional tool that has been used to assess bilateral trade sample with the objective to identify and accentuate the importance of international flows and differences important for the development of Croatia's international exchange with EU candidate countries. In the observed distance comparison, Croatia is situated in the centre of research as the main and starting point. EU candidate countries are the ones that have been recommended by the European Commission to be granted an EU candidate status. Montenegro and Turkey are negotiating; Albania, Macedonia and Serbia are still waiting to start their negotiation, while Bosnia and Herzegovina and Kosovo are identified as potential candidates for EU membership - they were promised the prospect of joining when they are ready (European Commission, 2015).

The fundament of this research has been based on CAGE Comparator which represents an official online tool to extenuate comparisons between two countries based on the CAGE distance framework. It encompasses 16 different kind of Cultural, Administrative, Geographic, and Economic (CAGE) attributes. It contains data about 163 countries and 65 industry groups (Ghemawat, 2015). Cultural (religion and language), Administrative (trade agreements) and Geographic (distance, land area, population, time zone and climate zone) data have been obtained from the CAGE comparator. Due to the obsolescence of economic data in CAGE Comparator, other statistical sources were used.

Cultural distance has been measured with three additional indicators - Indicators of governance and development: The Human Development Index, Voice and accountability and Rule of law. The Human Development Index (HDI index) measures the average achievements in a country in three basic dimensions: a long and healthy life, access to knowledge and a decent standard of living. Second measure is Voice and accountability which captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media. Finally, Rule of law is dimension that captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. Points of both dimensions estimates range from about -2.5 to 2.5 and higher values correspond to better governance outcomes (Transparency International, 2015). Data were acquired from United Nations Development Programme and Transparency International.

Administrative differences were also observed throughout level of corruption which is measured with The Corruption Perceptions Index. This indicator ranks countries based on how corrupt a country's public sector is perceived to be. It is a composite index, drawing on corruption-related data from expert and business surveys carried out by a variety of independent and reputable institutions. Scores range from 0 - highly corrupt to 100 - very clean (Transparency International, 2015).

Economic distance is related to income, wealth distribution and the relative purchasing power. Income of the consumer is presented as one of the major economic characteristic that can create difference among countries. Moreover, it has a significant impact on the possibility of achieving business cooperation and the level of trade. In accordance with that, the latest World Bank's official data have been used. Statistical data about foreign trade in goods of Croatia in 2014 were acquired from the Croatian Bureau of statistics (2015).

Table 1
Methodology framework

| Cultural distance | Administrative distance | Geographic distance | Economic distance |
|----------------------------------------------------------------------|--------------------------------------------------------------------------|-----------------------------------------------|-----------------------------------------------------------|
| CAGE indicators Source: CAGE Comparator | CAGE indicators Source: CAGE Comparator | CAGE indicators Source: CAGE Comparator | GDP (2014), mil. \$ Source: The World Bank |
| Human Development Index Source: Transparency International | Corruption Perceptions Index Source: Transparency International | | GDP per capita (2014), \$ Source: The World Bank |
| Voice and accountability Source: Transparency International | | | |
| Rule of law Source: Transparency International | | | |
| Source: Authors' work | | | |

Results

Cultural Distance between Croatia and EU candidate countries

Culture has significant influence on cross-border trade which is supported by the representation of the EU candidate countries in the export of Croatia. Bosnia and Herzegovina represents Croatia's second largest export trade partner (Croatian Bureau of Statistics, 2014). Vitality is triggered by cultural semblance, especially linguistic, ethnical and historical background. A similarity of language facilitates communication which usually represents one of the biggest obstacles to the realization of international business (Hutzschenreuter et al., 2011). Croatia also shares relative similar culture with Montenegro, Macedonia and Serbia. There is great linguistic similarity among other EU candidate countries and Croatia, except Turkey. In that matter additional costs in obtaining information do not appear as well as the possibility of disrupting communication processes. Observing belief, Christianity and Islam are dominant religions. In a review of migration processes it is visible that Croatia represents a productive market for achieving economic prosperity, especially for Bosnians and Serbs (CAGE Comparator, 2015). Table 2 shows cultural indicators measured using CAGE Comparator.

However, some cultural distances are difficult to identify at first. It is impossible to measure and evaluate social behaviour patterns as well as adopted system of values. Indeed, there are indicators of governance and development that provide additional measurement of cultural distance between countries, facilitate understanding of the complex cultural factors and help spotting present diversity.

Table 2
Cultural distance measured using CAGE indicators

| Country | Language | Religion (% population) | Migratory movements between Croatia and EU candidate countries (1995 – 2004) |
|-------------------------------|----------------------------|-----------------------------------------------------------|------------------------------------------------------------------------------|
| Albania | Albanian | Islam (70%); Christians (30%) | 185 |
| Bosnia and Herzegovina | Bosnian, Croatian, Serbian | Christians (46%); Islam (40%); Others (14%) | 490.217 |
| Croatia | Croatian | Christians (93%); Atheists (5%); Others (2%) | - |
| Kosovo | Albanian, Serbian | Islam (96%); Christians (4%) | Unknown data |
| Macedonia (FYR) | Macedonian | Christians (65%); Islam (33%); Others (2%) | 10.456 |
| Montenegro | Montenegrin | Christians (78%); Islam (18%); Others (3%); Atheists (1%) | Unknown data |
| Serbia | Serbian | Christians (92%); Islam (3%); Others (3%); Atheists (3%) | 94.688 |
| Turkey | Turkish | Islam (98%); Christians (2%) | Unknown data |

Source: CAGE comparator

Table 3 shows Indicators of governance and development: The Human Development Index, Voice and accountability and Rule of law.

Croatia is the only country that is classified in the highest category according to the HDI index (very high) while all EU candidate countries are situated in a group of countries that have high human development index (United Nations Development Programme, 2015). Croatia dominates in the freedom of expression and independent decision-making process although it has low Voice and accountability index value (Transparency International, 2015). EU candidate countries are experiencing even less autonomy of the population while Bosnia and Herzegovina, Turkey and Kosovo have the lowest degree of freedom; their coefficients of voice and accountability are negative. According to the criteria of the rule of law Macedonia, Croatia and Turkey have the best established political systems. In other EU candidate countries has been present high probability of the occurrence of violence and crime, especially in Albania and Kosovo, what leads to the aversion of doing business on these markets.

Table 3
Selected cultural distance indicators

| Country | Human Development (2011) | Voice & accountability (2010) | Rule of Law (2010) |
|-------------------------------|--------------------------|-------------------------------|--------------------|
| Albania | high | 0,1 | -0,44 |
| Bosnia and Herzegovina | high | -0,12 | -0,36 |
| Croatia | very high | 0,44 | 0,19 |
| Kosovo | 0 | -0,17 | -0,64 |
| Macedonia (FYR) | high | 0,09 | 0,29 |
| Montenegro | high | 0,21 | -0,02 |
| Serbia | high | 0,29 | -0,39 |
| Turkey | high | -0,16 | 0,1 |

Source: United Nations Development Programme and Transparency international

Administrative Distance between Croatia and EU candidate countries

On the observed market operate two organizations – The Central European Free Trade Agreement (Albania, Bosnia and Herzegovina, Montenegro, Kosovo, Macedonia, Serbia) and The Black Sea Economic Cooperation (Albania, Serbia, Turkey). Croatia has significantly improved its activity on the regional trade agreement scene after the acquired independence. Up to joining the EU, Croatia was part of CEFTA. Stated association contributed to the establishment of a strong trade relation with other member countries (Table 4).

Table 4
Administrative distance measured using CAGE indicators

| Country | Trade bloc | Currency |
|------------------------|-------------|----------|
| Albania | CEFTA; BSEC | ALL |
| Bosnia and Herzegovina | CEFTA | BAM |
| Croatia | EU | HRK |
| Montenegro | CEFTA | EUR |
| Kosovo | CEFTA | EUR |
| Macedonia (FYR) | CEFTA | MKD |
| Serbia | CEFTA; BSEC | RSD |
| Turkey | BSEC | TRY |

Source: CAGE comparator

Corruption makes an important obstruction in internationalization (Weitzel et al., 2006) which increases administrative distance between countries. Countries that are faced with corrupted institutional systems and poor corruption control will likely prefer to establish cooperation with similar countries (Ghemawat, 2014). Accordingly, EU candidate countries generate an intensive international exchange. Croatia could also be included in the same category, although she successfully struggles against corruption in recent years which leads to targeting other more developed and secure markets. Table 5 shows the corruption situation in Croatia and EU candidate countries (Transparency International, 2015). Croatia is best positioned but despite the effort in curbing corruption, The Corruption Perceptions Index is still very low (48). In EU candidate countries, corruption is at high level. Administration and law are non-transparent because of the absence of the economic development and significant disparities in income. The worst situation is on Kosovo and in Albania. In addition to being highly corrupted, public authorities generally act for their own benefit.

Table 5
Corruption Perception Index (2014) and Percentage of Corruption Control in Croatia and EU Candidate Countries (2010)

| Country | Corruption perceptions index (2014) | Control of corruption (2010), % |
|------------------------|-------------------------------------|---------------------------------|
| Albania | 33 | 41 |
| Bosnia and Herzegovina | 39 | 48 |
| Croatia | 48 | 59 |
| Kosovo | 33 | 32 |
| Macedonia (FYR) | 45 | 56 |
| Montenegro | 42 | 47 |
| Serbia | 41 | 52 |
| Turkey | 45 | 58 |

Source: Author's illustration

Geographic Distance between Croatia and EU candidate countries

Table 6 presents geographical features of Croatia and EU Candidate Countries. Croatia borders with Bosnia and Herzegovina, Serbia and Montenegro what intensifies international trade between them. Likewise, there is a proximity to other EU candidate countries. This results in reduced time and lower transportation costs. There are also no distinguishing features in terms of climatic conditions, as well as time constraints that would prevent the development of mutual trade relations between Croatia and EU candidate countries. Observing the land area and population, Turkey deviates from other countries significantly. Namely, all countries together make up less than 35% of the total area and population of Turkey. Thus, Turkish market offers numerous possibilities for international business.

Table 6
Geographical Features of Croatia and EU Candidate Countries

| Country | Geographic factors | | | | |
|------------------------|--------------------|----------------------------|--------------------|-----------|--------------|
| | Distance, km | Land area, km ² | Population (2010.) | Time zone | Climate zone |
| Croatia | - | 56.594 | 4,4 | 1 | Temperate |
| Albania | 586 | 28.748 | 3,2 | 1 | Temperate |
| Bosnia and Herzegovina | 290 | 51.197 | 3,8 | 1 | Temperate |
| Montenegro | 637 | 13.812 | 0,6 | 1 | Temperate |
| Kosovo | 896 | 10.887 | 1,7 | 1 | Temperate |
| Macedonia (FYR) | 611 | 25.713 | 2,1 | 1 | Temperate |
| Serbia | 371 | 77.474 | 7,3 | 1 | Temperate |
| Turkey | 2.070 | 780.580 | 72,8 | 2 | Temperate |

Source: CAGE Comparator (2015)

Economic Distance between Croatia and EU candidate countries

Looking at the gross domestic product, Turkey has by far the highest GDP. However, observing the GDP per capita, Croatia takes the first place. Inclusive, there are no major distinctions and significant deviations in GDP per capita of other EU candidate countries (Table 7).

Table 7
Economic characteristics of Croatia and EU candidate countries

| Country | GDP (2014), mil. \$ | GDP per capita (2014), \$ |
|------------------------|---------------------|---------------------------|
| CROATIA | 57 223 | 13, 507 |
| Albania | 13 370 | 4 619 |
| Bosnia and Herzegovina | 18 344 | 4 796 |
| Montenegro | 4 583 | 7 371 |
| Kosovo | 7 274 | 2 801 |
| Macedonia (FYR) | 11 324 | 5 371 |
| Serbia | 43 866 | 6 153 |
| Turkey | 799 535 | 10 542 |

Source: The World Bank (2015)

Conclusion

In the modern economy there is a decisive importance of trade agreements. EU represents the ideal instance of a conscious attempt to originate large unique market without administrative and political barriers. However, Croatia is achieving a notable international exchange with the EU candidate countries as she was a member of CEFTA by the time of accession to the EU. In accordance with that, cooperation was to some extent hampered.

The CAGE Distance Framework presents one of the most extensive multidimensional framework for inquiring the importance of different factors on international business (Ghemawat, 2014). It encompasses quantitative and qualitative methods in measuring differences in market potential emphasizing not only visible features, but pointing out the covert ones. Taking them all into consideration, companies can make a systematic analysis that will result in the achievement of a successful business in foreign markets.

The goal of this paper was to compare Croatia and EU candidate countries according to the CAGE Distance Framework using the CAGE Comparator. Croatia has the biggest interaction with Bosnia and Herzegovina, but a strong performance and exchange with other EU candidate countries is present as well.

Culture and geographical similarities have significant influence on cross-border trade which is supported by the representation of the EU candidate countries in the export of Croatia. However, EU candidate countries are faced with the institutional structures which have remained embedded within ethnic and political divisions. There is also a lack of transparency and accountability. Furthermore, all of them, including Croatia, tackle corruption, although numerous measures have been taken to eradicate the corruption. Troubleshooting complicates the complexity of the process which requires years of effort, perseverance and resume control.

Turkey is the only country that in each segment differs somewhat (language, religion, size, population, GDP). But these differences, especially the size of Turkish market should encourage the development of international trade. Croatia has to focus own interest to this market that is full of possibilities.

Limitations of the research should be taken into consideration. The main limitation represents the fact that some economic data are deprecated. In accordance with that other sources have been used in this research. But, on the other hand, dimensions measured by CAGE framework do not change very fast. For example, it takes a long time to change cultural, administrative and geographical distances.

To conclude, with all present similarities and differences, cooperation between Croatian and EU candidate countries has a perspective for development especially at a time when all candidate countries join the EU. In fact, they are all small (except Turkey) and resource-poor countries that have a significant need to integrate into the world economy. Thus, similarities with them should be utilized; diversities accounted and benefit from them wisely.

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