Foreign Direct Investment in Central Europe (the Czech Republic, Hungary, Poland, Romania, and Slovakia): A Study of Major Western Investors

Volume I

A Doctoral Thesis Presented by

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Submitted to

City University

in fulfillment of the requirements for the degree of

Doctor of Philosophy

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June 1997

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Foreword

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June 1997

In the latter half of 1989 a series of events began to unfold in the countries known as *Eastern Europe* which were to dramatically reshape the region as well as the balance of power in the World. What began in Poland as a simple labor dispute in the shipyards of Gdansk under the banner of *Solidarnosc* eventually blossomed into a full scale challenge against the authority of the Polish Communist Party to govern the country. By the latter half of 1989 the unthinkable had happened, the Polish people installed their first freely elected and non-communist government since the end of the Second World War. These historic events took on a momentum all their own as a wave of revolutionary change swept across the countries of the region fuelled by the economic failings of the Communist system. From Warsaw to Prague and Bratislava, from Budapest to East Berlin, from Belgrade to Sofia, and from Bucharest finally onto Tirana a wave of massive popular discontent topple each of the ruling Communist regimes in these respective countries thus putting an end to the Party's official hold on power in the region. Yet, this wave of revolutionary change was not solely restricted to the confines of the countries of Eastern Europe. The shock waves from these events moved further eastwards across the frontiers of the Soviet Union and into the various republics where popular discontent was also high. By 1991 the mighty red empire had officially ceased to exist.

The one event that came to signify the demise of the Communist regimes happened on a chilly November night in 1989 when a group of East German citizens scaled the infamous Berlin Wall at the Brandenburg Gate. The wall itself had come to represent both the symbolic and physical *Iron Curtain* that had divided the East and West for over 40 years during what had been termed the *Cold War*. Atop the wall, the daring East Germans began the unprecedented process of tearing it down. Cheering them on, as well as aiding in the destruction of the wall, were West Germans citizens. That historic night ushered in a new era of East-West cooperation as well as the beginning of the process of economic, social, and political transformation in the countries now known as the *Central European Countries (CEC)* and the *New Independent States (NIS) of the former Soviet Union (FSU).*

In light of these fundamental changes, there has been a dramatic increase over the last seven years in both the interests and activities of Western firms in the business environment of the CEC and the FSU. In a great many cases the changes that have occurred in the East have been seen as opportunities for expansion by Western firms, many of whom constitute some of the world's largest *Transnational Corporations (TNCs)*. In seeking to realize these new opportunities many of these firms have decided to enter these virtually new markets in the East via the act of *foreign direct investment (FDI).*

The focus of this research study is on the nature of these investments. More precisely, a series of exploratory propositions are addressed to the senior executives of local firms with foreign capital participation, which include ***Why do firms invest?; How do they invest and how do the chosen modes of investment change over time?; What means do these firms employ to evaluate the performance of their investments and subsequently what levels of performance have been achieved by these same firms?***; and ***What strategies are used by these firms in their operation?***

However, given the vast complexities involved in administering a study encompassing so many cases of FDI in the CEC and the FSU it was decided by the researcher to partition the study into a series of independent stages, each of which is defined by a set of parameters. Hence, this thesis represents the first stage of the study in which a detailed examination of FDI by major Western firms that have occurred between 1989 and the end of the first quarter of 1996 within the context of the environment identified as *Central Europe (CE)(the Czech Republic, Hungary, Poland, Romania, and Slovakia)* is presented.

In this first stage of the study, an examination of the activities of Western firms in the environment of CE was conducted through a sample of 1,222 individual local firms with foreign participation. In doing so, the researcher utilized an amalgamation of desk research, research questionnaires, and selected case studies. The report that follows is the result of literally several thousand hours of dedicated research, interviews, and analysis involving numerous trips to the research site in pursuit of answers to the aforementioned research propositions.

This thesis contains a total of seven chapters, each of which covers a different aspect of the overall research study. ***Chapter One*** begins by providing an historical backdrop to the study by highlighting the significant events related to the rise and fall of communist based regimes in the CEC and the FSU. In doing so, prime consideration is given to the countries of the CE group. The latter half of the chapter focuses on the ongoing transformation process in the region with special attention given to economic concerns and the role of FDI in the transition process. The chapter culminates in pointing out the requisite for research in this area and then postulates the propositions forming the basis for this first stage of the research study.

In ***Chapter Two***, a review of the relevant literature related to the subject is presented. This analysis is done on two levels. To begin with, the researcher provides an overview of the relevant theoretical literature with regards to general FDI theory as well as the basic motivations for FDI. The remainder of the chapter concentrates on providing a detailed examination of the appropriate literature on FDI in the context of the CEC and the FSU and with regards to both the pre-1990 and post-1989 environments. Once again, special emphasis is given to those studies that have previously examined FDI within the countries of CE.

Chapter Three details the research methodology which was utilized in the study as it pertains to the research strategy, parameters, site, profile of the population, and the research methods employed. Special attention is also given to detailing the various means and methods used in the study, namely the utilization of desk research activities, postal research questionnaires, and descriptive case studies.

In the previous three chapters the foundation of this study was carefully laid by defining the research propositions, providing a critical review of the respective literature, and specifying the methodology employed. ***Chapter Four*** presents the fruits of these efforts by providing a detailed description of the results from a survey of 1,222 major Western investors that have engaged in FDI within the CE group of countries under the defined parameters. This survey was implemented utilizing a postal questionnaire instrument that was designed and constructed on the basis of the stated research propositions.

In ***Chapter Five*** and ***Six***, two case studies are presented in the *descriptive single-case study* format which have been drawn from the population of actual survey respondents. Together, these two case studies provide a more in-depth examination of the activities of individual local firms operating within the CE environment in light of the stated research propositions. In ***Chapter Five***, the first case study presented examines *ABB Asea Brown Boveri*, the Swiss/Swedish engineering firm, with its multiple investments operating throughout CE in the areas of manufacturing and service. In ***Chapter Six***, the second case study details the experiences of the *Generali Group*, the Italian based insurance and financial services organization, via its two Hungarian operations *Generali Budapest Biztosító* and *Providencia Osztrák-Magyar Biztosító.*

In ***Chapter Seven***, the final chapter of the thesis, a number of important areas are covered and loose end tied up. In the first part of the chapter the researcher reviews the essential ingredients in a doctoral thesis, reiterates the research questions, and provides a detailed discussion of both the survey and case study evidence. In the remainder of the chapter the issue of contribution is addressed, as are the limitations of the study, and areas for future research. The researcher also provides a personal retrospective view of the research process before offering a final word in closing this first stage of the research study.

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Acknowledgments

It gives me great pleasure to acknowledge the assistance and contributions given to me by individuals over the long duration of my doctoral research project. I would like to acknowledge and extend my sincerest thanks to the following individuals, groups, and organizations that made this research study a reality.

Professor Alec Chrystal, as my doctoral supervisor over the last two years, you gave me a tremendous amount of support in terms of both my research and as my white knight in securing my position within the Business School. Through our many conversations in your office you made me better understand the nature of the process of achieving a doctorate as well as what it meant to do meaningful and practical research.

Dr. Stefano Cavaglia, as my interim doctoral supervisor, you intervened at a time when my research was floundering in a sea of political bureaucracy and it was in serious jeopardy of being swamped and sunk. Your support, encouragement, insight, and advice allowed me to get through this rough period and put my research back on a clear and concise course.

To both Elliot Kushell, Professor of Management, and Bill Filbert, Honorary Professor of International Business at California State University, Fullerton. You have each been inspirations and constant supporters of mine since I first began the pursuit of my doctor philosophy degree some years ago. It is very much appreciated and will not be forgotten.

To all the individuals and their respective organizations and institutions that participated in the pre-testing stage of the design of my research questionnaire. Your feedback, comments, and suggestions greatly assisted me in making the questionnaire a much more effective and efficient instrument. From within this group, I would like to extend a very special thanks to several key individuals, namely Paul Marer, Professor of International Business Studies at the University of Indiana, Wladyslaw Jermakowicz, Professor of Business Studies at the University of Southern Indiana, and Matija Rojec, Senior Research Fellow with the Centre for International Cooperation and Development in Slovenia. In effect, each of you has functioned as an *"unofficial supervisor"* in providing me with invaluable insight into my area of research that was a key component in making the questionnaire phase of my study such a success. Overall, your assistance was clearly above and beyond what was expected or hoped for.

To each and everyone of the senior executives of the 334 firms who actively participated in my postal survey by completing and returning a questionnaire to me. The aims of this study could not have been realized if it was not for the invaluable assistance of individuals like yourself in volunteering the time necessary to assist me in this endeavor.

To all of the individuals and their respective firms which kindly cooperated in the development of the case study phase of the research my most sincerest thanks. At *ABB Asea Brown Boveri* my thanks go out to Mr. Hans Wikse, Vice President of Business Development for the Czech Republic, and Mr. Michael Robertson, Assistant Vice President of Corporate Communications based in Switzerland. I would also like to acknowledge and thank the executives of various ABB companies based in Hungary and Poland for their input into this research study. In Hungary: Mr. Rikard Jonsson, Chief Financial Officer, *Asea Brown Boveri Kft.*; Dr. Zoltan Kóvesdi, General Manager, *ABB Energir Kft.*; Mr. Zsolt Csikai, Sales Engineer, *ABB Szerviz Kft.*; Mr. Gyórgy Pálos, Managing Director, *ABB Pacont Processcontrol Kft.*. In Poland: Mr. Dariusz Karwacki, President, *ABB Dolmel Sp. z o.o.*; Mr. Jerzy Pawliczak, President, *ABB Elta Sp. z o.o.*; Mr. Jaroslaw Nowicki, Public Relations Manager, *ABB Zwus Signal Sp. z o.o.*; and Mr. Ryszard Jaskólski, Quality & Processes Manager, *ABB Zamech Sp. z o.o.*.

At *The Generali Group* my sincerest thanks for all of the invaluable assistance that I received to Dr. Zsolt Vágó, General Director and Chief Executive Officer, and Mr. János Kisvari, Marketing Manager, both at *Generali Budapest Biztosító* and to Dr. Károly Gergely, Deputy General Manager and Chief Financial Officer, and Mr. Támas Hák-Kovács, Assistant to Deputy General Manager, both at *Providencia Osztrák-Magyar Biztosító*.

Furthermore, although they were not included as case studies within the actual thesis, my esteem thanks go out to Mr. Albert Lidauer, Managing Director, and Mr. Zoltán Kaszás, Public Relations Manager at *Opel Hungary (Opel [General Motors (GM)])* and to Mr. Urs Kamber, Chief Financial Officer, Mr. Alexander Karlen, Project Manager, and Mr. Bessel Kok, Vice Director General at *SPT Telecom* (partially owned by *PTT Telecom [Koninklijke PTT Nederland (KPN)]* and *Swiss Telecom [PTT Suisses]*) for all of their assistance with my research.

I would also like to thank each of the examiners in my VIVA, namely Mark Schaffer, Professor of Economics, Centre for Economic Reform & Transformation (CERT), at Heriot-Watt University, and Andy Mullineux, Professor of Economics at the University of Birmingham. Your suggestion to add to my concluding chapter made it all the better.

Last but not least, I would like to thank my family, friends, and colleagues for all of their encouragement and support over the last three and half years. I would especially like to thank Sofia Despotidou not only for her constant diligence, patience, and fortitude during the period of my studies but also for all of the emotional support she has given me, which in the end helped make all of this so very possible. Finally, I would like to thank both Frank and Pamela Pye, my beloved father and mother, each of whom never had the opportunity to pursue any form of higher education of their own because of lack of opportunity due to poor economic circumstances at the time.

This thesis is dedicated to my beloved parents,
Frank and Pamela Pye

Abstract

In the wake of the fundamental changes that have occurred in the *Central European countries (CEC)* and the *New Independent States (NIS) of the former Soviet Union (FSU)* since the events of late 1989 there has been a considerable increase in the activities of major Western firms in the region via acts of *foreign direct investment (FDI)*. In seeking to better understand the nature of such activities this thesis provides a detailed examination of FDI by major Western firms that has occurred between 1989 and the end of the first quarter of 1996 within the context of the environment identified as *Central Europe (CE)(the Czech Republic, Hungary, Poland, Romania, and Slovakia)*.

The focal point of this investigation is on a series of exploratory type questions that needed to be asked and answered, namely *Why do major Western firms engage in FDI within a specific CE host country (motivational and locational factors of FDI)?; How have major Western firms invested within a specific CE host country (entry modes) and how have these modes evolved over time (evolution of ownership modes)?; What means are utilized by major Western firms to evaluate the performance of their FDIs (performance criteria) and consequently how have these direct investments performed within the chosen CE host country environment (relative performance) over time?*; and *What strategies have been employed by major Western firms in the CE environment (geographical and functional strategies)?*

The study was facilitated by an examination of the activities of Western firms operating within the CE environment through a sample of 1,222 individual local firms with foreign capital participation. In doing so, the researcher utilized an amalgamation of desk research, research questionnaires, and selected case studies.

In reference to the pertinent literature, this study reinforces some previous findings, contradicts others, provides some clarification in certain areas, and also adds something new to the base of knowledge of the subject.

Abbreviations

Terminology:

AA	Asset Acquisition
CE	Central Europe: the Czech Republic, Hungary, Poland, Romania, and Slovakia
CEC	Central European Countries: Albania, Bulgaria, Czech Republic (formerly part of Czechoslovakia), Hungary, Poland, German Democratic Republic (GDR)(former East Germany), Slovakia (formerly part of Czechoslovakia), Romania, and the former Yugoslavia Republic (FYR)(which comprises: Bosnia/Herzegovina, Croatia, the Federal Republic of Yugoslavia [a union of the former republics of Serbia and Montenegro], FYROM [the former Yugoslav Republic of Macedonia], and Slovenia).
CMEA/COMECON	The Council for Mutual Economic Assistance
EBRD	European Bank for Reconstruction and Development
EFTA	European Free Trade Agreement
EI	Equity Increase
EU	European Union
EWIC	East-West Industrial Cooperation
FDI	Foreign Direct Investment
FSU	former Soviet Union
FTO	Foreign Trade Organization
GDR	German Democratic Republic (former East Germany)
G-7	Group of Seven most industrialized countries. Currently comprises Canada, France, Germany, Italy, Japan, the United Kindgom, and the United States of America
HQ	Headquarters (in the context of this study this abbreviation is used to refer to TNC HQ)
IJV	International Joint Venture
IMF	International Monetary Fund
ISIC	International Standard Industrial Classification
ITD	Hungarian Investment and Trade Development Agency/ Magyar Befektetési és Kereskedelfejlesztési Részvénytársaság
JV	Joint Venture
JVA	Joint Venture Acquisition
MNC	Multinational Corporation
MNE	Multinational Enterprise
NATO	North Atlantic Treaty Organization

Terminology (cont.):

NIS	Newly Independent States (used to refer to the NIS of the FSU): Russia (including Kaliningrad), Ukraine, Belarus, Republic of Moldova, Latvia, Lithuania, Estonia, Georgia, Armenia, Azerbaijan, Kazakhstan, Turkmenistan, Uzbekistan, Tajikistan, and Kyrgyzstan.
OECD	Organisation for Economic Co-operation and Development
PAIZ	Polish Foreign Investment Agency/ Panstwowa Agencja Inwestyeji Zagranicznych
RDA	Romanian Development Agency/ Agentia Romana de Dezvoltare (ARD)
SA	Share Acquisition
SIC	Standard Industrial Classification
SNAFID	Slovak National Agency for Foreign Investment and Development/ Slovenská národná agentúra pre zahranicné investície a rozvoj (SNAZIR)
SOE	State Owned Enterprise
TNC	Transnational Corporation
UN	United Nations
UNCTC	United Nations Centre for Transnational Corporations
UN/ECE	United Nations, Economic Council for Europe
UNTCMD	United Nations, Transnational Corporations and Management Division
UNDESD	United Nations Department of Economic and Social Development
USSR	Union of Soviet Socialist Republics: Abkhasian ASSR, Adzhar ASSR, Baskir ASSR, Chechen-Ingush ASSR, Chuvash ASSR, Daghestan ASSR, Kabarbin-Balkar ASSR, Kalmyk ASSR, Karelian ASSR, Kara-Kalpak ASSR, Mari ASSR, Mordovian ASSR, North Ossetian ASSR, Tatar ASSR, Tuva ASSR, Udmurt ASSR, Armenian SSR, Azerbaijan SSR, Byelorussian SSR, Estonian SSR, Georgian SSR, Kazakh SSR, Kirghiz SSR, Latvian SSR, Lithuanian SSR, Moldavian SSR, Tajik SSR, Turkmen SSR, Ukranian SSR, and Uzbek SSR.
WOS	Wholly-Owned Subsidiary

Currency Abbreviations:

CZKcs	Czech korunas
HUF	Hungarian forints
PLZl	Polish zloties
ROLeu	Romania Leu/Lei
SKKcs	Slovak korunas
USD	United States dollars

Country Abbreviations:

AU	Australia
BD	Germany
BG	Belgium
CN	Canada
CZ	Czech Republic
DK	Denmark
ES	Spain
FN	Finland
FR	France
GR	Greece
HU	Hungary
IR	Ireland
IT	Italy
JP	Japan
LI	Liechtenstein
LX	Luxembourg
NL	The Netherlands
NW	Norway
OE	Austria
PT	Portugal
RO	Romania
SK	Slovakia
SD	Sweden
SW	Switzerland
TR	Turkey
UK	United Kingdom
US	United States of America

Chapter 1

The Rise and Fall of the Iron Curtain: Capitalism Goes East!

1.1 An Overview

"Progress, far from consisting in change, depends on retentiveness. Those who cannot remember the past are condemned to repeat it."

George Santayana, an American philosopher and poet[1]

In keeping with the moral of this phrase the first half of this introductory chapter is devoted to providing an historical background to the events surrounding the rise and fall of communist based regimes in the countries referred to by the West as *Eastern Europe*[2], with the inclusion of the *German Democratic Republic (GDR)*[3]. In doing so this chapter will proceed in both a rational and chronological order. Firstly, a brief overview is provided covering the meteoric rise of communism in Eastern Europe and occupied East Germany after the close of the Second World War and the leading and fundamental role that he *Soviet Union (USSR)*[4] played in this process. Secondly, there will be a review of the key economic, political, and social problems that eventually led to a chain of events causing both the downfall of the communist regimes across the region and the eventual break up of the Soviet Union. It should be noted that this approach of providing an historical perspective in the first half of the chapter has not been done to either indulge the writer nor to tire the reader but in an effort to illustrate clearly the historical significance of these events that have shaped this century.

[1]Taken from Santyana, G. (1905-06), *The Life of Reason, Chapter 12, Reason in Common Sense.* See Daintith, J. (1994), *Bloomsbury Treasury of Quotations*, quotation no.# 24, pp. 309.

[2]The concept of *Eastern Europe* started to be used in the West after the close of the Second World War and has often been used interchangeably with the term *East-Central Europe,* to refer to the *"people's democracies."* Under such a definition Eastern Europe included the countries of Albania, Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and Yugoslavia (please note that this term did not include or refer to the German Democratic Republic [East Germany] which was not historically linked to this group of countries in this manner).

[3]The *German Democratic Republic (GDR)* refers to that part of Germany (eastern) that was under Soviet occupation following the end of the Second World War. In October 1949, the Soviets created the German Democratic Republic in response to the West's creation of the Federal Republic of Germany, or West Germany as it was better known, five months earlier in May of that same year.

[4]Also known as *The Union of Soviet Socialist Republics (USSR)*. This terms refers to both the former Soviet Socialist Republics (SSR) and the former Autonomous Soviet Socialist Republics (ASSR) that comprised the former Soviet Union or Russian Soviet Federative Socialist Republic (RSFSR) which are as follows: Abkhasian ASSR, Adzhar ASSR, Baskir ASSR, Chechen-Ingush ASSR, Chuvash ASSR, Daghestan ASSR, Kabarbin-Balkar ASSR, Kalmyk ASSR, Karelian ASSR, Kara-Kalpak ASSR, Mari ASSR, Mordovian ASSR, North Ossetian ASSR, Tatar ASSR, Tuva ASSR, Udmurt ASSR, Armenian SSR, Azerbaijan SSR, Byelorussian SSR, Estonian SSR, Georgian SSR, Kazakh SSR, Kirghiz SSR, Latvian SSR, Lithuanian SSR, Moldavian SSR, Tajik SSR, Turkmen SSR, Ukranian SSR, and Uzbek SSR.

In the second half of the chapter, the focus shifts from the historical perspective to that of the practical realities of the situation facing the countries now referred to as the *Central European countries (CEC)*[5] and the *New Independent States (NIS) of the former Soviet Union (FSU)*[6]. The latter term simply referred to by the abbreviation of *FSU*. Subsequently, several key issues will be addressed with regard to the ongoing process of economic, political, and social transformation in these countries. Firstly, this chapter focuses on the responsibility and role of the West in assisting the countries of the region in this transformation process. Within this context special attention will be given to defining the unique and important role that foreign enterprises, especially *Transnational Corporations (TNCs)*[7], have to play in the process of economic transformation in the CEC and the FSU via *foreign direct investment (FDI)*[8]. Secondly, the researcher will address the requisite for beneficial research to be conducted into this fascinating and very neglected area of international business. Thirdly, a series of *exploratory* research questions will be postulated which will serve as the basis for an examination of FDI by Western firms operating within a selected group of the CEC. Finally, the chapter concludes by highlighting the significance of events that have occurred in the East and reiterates the need for meaningful research to be conducted in this important area of international business studies.

1.2 The Curtain Rises and a Wall is Built

In late 1945 the Second World War officially came to an end. It had been a long and disastrous conflict that had cost the lives of over 55 million combatants and non-combatants with as many as two or three times that number left homeless and/or dispossessed, and resulted in the wholesale destruction of the vast majority of European, Asian, and Pacific nations. However, as this chapter in the world's history came to a close the next chapter to unfold would prove to be just as equally divisive amongst the nations of the world, especially among those on the European continent.

[5]The term *Central European countries (CEC)* refers to the following countries: Albania, Bulgaria, Czech Republic (formerly part of Czechoslovakia), Hungary, Poland, German Democratic Republic (GDR)(East Germany), Slovakia (formerly part of Czechoslovakia), Romania, and the former Yugoslavia Republic (FYR)(which is comprised of: Bosnia/Herzegovina, Croatia, the Federal Republic of Yugoslavia [a union of the former republics of Serbia and Montenegro], FYROM [the former Yugoslav Republic of Macedonia], and Slovenia).

[6]The *New Independent States (NIS) of the former Soviet Union (FSU)* refers to the following newly created and/or liberated countries that use to comprise the Soviet Union: Russia (including Kaliningrad), Ukraine, Belarus, Republic of Moldova, Latvia, Lithuania, Estonia, Georgia, Armenia, Azerbaijan, Kazakhstan, Turkmenistan, Uzbekistan, Tajikistan, and Kyrgyzstan. For purposes of this research the shorter term of *FSU* is used throughout this thesis to refer to the NIS of the FSU.

[7]A *Transnational Corporation (TNC)* is an enterprise, irrespective of its country of origin and/or its ownership, including private, public, or mixed, comprising entities in two or more countries, regardless of the legal form and fields of activity of these entities, which operates under a system of decision-making, permitting coherent policies and a common strategy through one or more decision-making centers, in which the entities are so linked, by ownership or otherwise, that one or more of them may be able to exercise significant influence over the activities of others and, in particular, to share knowledge, resources and responsibilities with the others. The term TNC is often used interchangeably with *Multinational Enterprise (MNE)* and *Multinational Corporation (MNC)*.

[8]*Foreign Direct Investment (FDI)* is defined by Dunning as *"The investment is made outside the home country of the investing company, but inside the investing company. Control over the use of resources transferred remains with the investor. It consists of a 'package' of assets and intermediate products, such as capital, technology, management skills, access to markets and entrepreneurship."* See Dunning, J. H. (1993a), *Multinational Enterprises and the Global Economy*, pp. 5.

By as early as 1946 it had become blatantly clear to most observers that the victorious western Allies, led by the United States of America and Great Britain, had distinctly parted company, primarily on ideological grounds, with their eastern counterpart the Soviet Union. A new conflict was emerging that now pitted the communist countries of the East against the democratic capitalist countries of the West. Once again the nations of the world would have to take up sides in what was to become known as the *Cold War*.

1.2.1 *"The Sinews of Peace"*

Winston Churchill, the then former Prime Minister of Great Britain, aptly described this situation in what was to become one of his most famous speeches. The date was the 5th of May, 1946, the place was Westminster College in Fulton, Missouri, USA, and the speech appropriately entitled *"The Sinews of Peace,"*

> *"A shadow has fallen upon the scenes so lately lighted by the Allied victory. Nobody knows what Soviet Russia and the Communist international organization intends to do in the immediate future, or what are the limits, if any, to their expansive and proselytizing tendencies.*
>
> *From Stettin in the Baltic to Triest in the Adriatic, an iron curtain has descended across the Continent. Behind that line lie all the capitals of the ancient states of central and eastern Europe. Warsaw, Berlin, Prague, Vienna, Budapest, Belgrade, Bucharest and Sofia, all of these famous cities and the populations around them lie in the Soviet sphere and all are subject in one form or another, not only to Soviet influence but to a very high and increasing measure of control from Moscow....The Communist parties, which were very small in all of these eastern states of Europe, have been raised to pre-eminence and power far beyond their numbers and are seeking everywhere to obtain totalitarian control....Whatever conclusions may be drawn from these facts - and facts they are - this is certainly not the liberated Europe we fought to build up. Nor is it one which contains the essentials of permanent peace."*[9]

In his speech Churchill had thrown down the gauntlet to both the Soviets and Western powers while at the same time offering the world the hope of a peaceful solution. Yet, part of the responsibility for the rise of Soviet influence and Communism in the nations referred to by the West as *Eastern Europe* and a post-war Germany must be assumed by the United States of America and Great Britain and their respective leaders at the time. This responsibility stems from February 1945 with the historic meeting of the *Big Three* leaders, namely Winston Churchill of Great Britain, Franklin Roosevelt of the United States of America, and Josef Stalin of the Soviet Union, which was held in the Livadia Palace at Yalta, in the Crimea. This meeting not only decided the terms of unconditional surrender for the aggressors of the war but also adopted *"The Declaration of Liberated Europe"* which was supposed to allow for *free and unfettered* elections in the countries liberated from the Nazis. However, this declaration was never fully implemented by Stalin and was the primary reason for the breakdown of cooperation that occurred between the Allied powers after the Second World War and subsequently started the Cold War. Therefore, in the eyes of most East Europeans the Yalta

[9]See Churchill, W. (1946), *The Sinews of Peace*, extracts from *Vital Speeches of the Day*.

agreement determined not only the fate of a defeated Germany and her allies during the war but also the future of the nations and their people in the countries known as Eastern Europe.[10]

From the Eastern perspective, several authors and commentators have offered their own assessment of the decisions made at the Yalta summit. These views and opinions are quite illuminating and in hindsight offers a brutally honest evaluation of how the West betrayed the East and subsequently allowed Europe to be divided. In the opinion of Jacques Rupnik, a Czech born political commentator and writer,

> *"For the nations of the Other Europe* [in reference to the countries of Eastern Europe and Germany] *Yalta is the 'original sin', the founding myth of a divided Europe. It has become synonymous with Sovietization and the disappearance of the very notion of Central Europe. The fate of the lands in between Germany and Russia was decided by the Soviet Union and the United States. Europe divided by non-European superpowers: that is the potent myth of Yalta."*[11]

An even more critical retrospective view of the Yalta summit was expressed by Leszek Kolakowski, a Polish philosopher. According to Kolakowski, *"...the fate of millions was decided by three old men: a bloodthirsty tyrant, a terminally ill statesman who knew little about the issues, and a Realpolitiker of a declining Empire."*[12]

Still, with complete disregard for such opinions by the close of 1948 local Communists, with strong support from Stalin and his henchmen in Moscow, had gained complete control of the power structures in Albania, Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and Yugoslavia. A year later in October of 1949, in response to the West's creation of the Federal Republic of Germany (West Germany), Stalin created a puppet regime called the *German Democratic Republic (GDR)* out of what had been Soviet occupied East Germany. There was to be no *free and unfettered* elections in these countries as was promised by Stalin at Yalta. Instead, a process aptly labelled *Stalinization* was implemented in each of these respective countries which was an effort to recreate the main institutions of the Soviet Union. This program of Stalinization included the adoption of Marxism-Leninism as the sole ideology, the establishment of a large conscript army, a command style economy based on central planning, an economic shift to heavy industry, strict censorship of all forms of media, and most importantly a monopoly of all power by the State under the Communist Party.[13] In the wake of such fundamental changes it became clear that a physical, ideological, and psychological *Iron Curtain* had taken form across Europe thus dividing the continent between the communist East

[10]It should be pointed out that Bulgaria, Hungary, and Romania fought with Nazi Germany during the Second World War, with the result of Hungary being defeated and both Bulgaria and Romania switching sides late in the war. However, in the Soviets' opinion, each of these three countries were deemed to be enemies of the Motherland and were to be treated as such after they were occupied by the Soviet military forces.

[11]Rubnik, J. (1989), *The Other Europe: The Rise and Fall of Communism in East-Central Europe*, pp. 63.

[12]*Ibid.*, pp. 63.

[13]See Zonis, M. and Semler, D. (1992), *The East European Opportunity: The Complete Business Guide and Sourcebook*, pp. 14.

and the democratic West. The Cold War was on.

Though, no sooner had the Cold War began than some cracks started to appear in that infamous Iron Curtain as the Soviets suffered from some severe setbacks. The first of these came as early as 1948 when Stalin and Marshal Josip Broz Tito of Yugoslavia split over political and ideological differences that were based upon different visions of what communism should and would be in Yugoslavia as well as over the tone of Tito's foreign policy towards the West. Ironically, Stalin had felt that Tito's aggressive policy towards the Western powers was too harsh and not prudent given the situation at the time. As a result of this split Yugoslavia was expelled from the *Cominform*[14] and isolated economically from both the Soviet Union and its Eastern European satellites. Stalin also made a call for *healthy forces* in Yugoslavia to overthrow Tito but these pleas met with no success.[15] The end result of all this intrigue was that Tito shifted Yugoslavia from a strict communist orthodoxy to an authoritarian style system while at the same time adopting a much more positive attitude towards the West in exchange for their economic support. The myth of the monolithic Communist system had been badly damaged. Yet, while Yugoslavia's departure from the Soviet sphere of influence was considered bad news the economic situation in the Eastern Bloc was received as good news, at least by the Communist Governments of the region and the authorities in the Soviet Union.

The primary goal of the *Stalinist Model*, as Stalinization became known in economic terms, was to attain an accelerated rate of economic growth that would not only enable the countries of the East to rebuild from the devastation effects of Second World War but also allow them to reach production levels comparable to the developed market economies of the West within a decade or so. One of the model's main tenets was the fundamental economic shift from agriculture to industry, with a concentration on both heavy industry and the arms industry. Given that most Eastern Bloc countries had traditionally been agriculture based economies this was viewed as a serious change of direction by them. The only real exception to this being Czechoslovakia, primarily the Czech lands, which had been fairly heavily industrialized before and during the war. Moreover, the Eastern Bloc countries themselves did not possess an abundance of natural energy resources, with the exceptions of Romania's oil deposits and Poland's coal reserves. As time progressed the region as a whole was to become extremely dependent upon the Soviet Union for both energy supplies as well as basic raw materials to maintain the production machine. For repayment, the Soviet Union had the Eastern Bloc countries supply them with finished goods for use in supplementing the needs of their own domestic economy.[16]

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[14]*Cominform*, or the Communist Information Bureau, was the successor to *Communist International (Comintern)*, which was founded in early 1919 in the Soviet Union as an organization to preserve the ideological commitment of Communism and advance the national interests of the Soviet state. In 1947 the Soviets replaced Comintern with Cominform in an effort to counter both the new Truman Doctrine and the forthcoming Marshall Plan. See McClellan, W. (1986), *Russia: A History of the Soviet Period*, pp. 102 and pp. 205-207 respectively.

[15]Zonis and Semler, *op. cit.*, pp. 367.

[16]See Ehrlich, É. (1992), *Economic Growth in Eastern Central Europe after World War II*, pp. 9-12.

At first, the implementation of the Stalinist Model appeared to be working as the Eastern Bloc countries obtained high rates of economic growth even by international standards. This rate of growth was most pronounced in the southern countries of the region such as Bulgaria, Hungary, Romania, and nominally independent Yugoslavia. The growth rate in the northern countries of Czechoslovakia, Poland, and the GDR was somewhat less pronounced yet still impressive.[17] Despite the end of the Second World War the Soviets and their Eastern European allies maintained their respective economies on a virtual war time footing which sought to continually maximize production output. However, by concentrating so heavily on promoting the growth of heavy industry, central planners seriously neglected the agricultural and consumer sectors, which in turn lead the countries of the Eastern Bloc down the same road of unbalanced economic growth that the Soviet Union was already on.[18]

By the early 1950s the economic growth rate began to falter as the failures of the system of central planning began to emerge mainly in two key areas. Firstly, failure was very pronounced in the agricultural sector where the central planners use of *compulsory delivery* and taxation based on *productive capacity* lead to the peasantry losing their incentive to produce.[19] The end result was a severe shortage of foodstuffs that lead to queuing throughout the Eastern Bloc that had not been experienced by the population since the war years. Secondly, because central planners were concern primarily with quantitative measures of production growth in industry, the issues of product quality and modernity were seriously neglected. Hence, firms turned out quantities of goods of questionable quality and use that both increased the volume of unsold goods as well as under utilized precious resources.

While serious economic problems were beginning to manifest themselves throughout the region another severe political blow to the illustration of the communist system heralded by the Soviets as being *ideal* came in Hungary during the early fifties. By the beginning of the 1950s the Hungarian economy was suffering, like others in the region, and the country was gripped by growing discontent amongst the population. In 1953, Imre Nagy, a reformer from within the Party, was appointed to the position of Premier of the Hungarian Workers' Party (HWP) replacing Matyas Rakosi who had fallen out of favor with Stalin. Nagy began his tenure as Party leader by directing Hungary towards a new course, both politically and economically. Nagy's reforms from 1953 to 1956 were both popular with most Hungarian citizens and heralded as a major model of internal reorganization of the Communist system in Hungary.

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[17]Ehlich makes these points on the basis of both official statistical data available from respective host countries and calculations using the Physical Indicator Method (PIM) devised by the UN/ECE. *Ibid*, pp. 10 and 34.

[18]See Zonis and Semler, *op. cit.*, pp. 98-99.

[19]*Compulsory delivery* meant that the supplier was given production quotas by the Central Planners that had to be deliver or the supplier would face intervention by the State authorities (often by the Security Services). *Productive Capacity* was a system of taxation that in agricultural terms based taxes owed by the farmer to the State on both the quantity and quality of lands held. See Ehrlich, *op. cit.*, pp. 11.

However, during the closing months of 1956 events in Hungary spun out of control as a wave of revolutionary fervor swept the country. On the 1st of November, 1956, Nagy issued a statement calling for both the withdrawal of Hungary from the *Warsaw Pact*[20] military alliance and requesting that the United Nations provide the country with protection against possible (Soviet) aggression. The *Hungarian Uprising of 1956* was now officially in progress. The Soviet response to what they termed as *insurrection* by the Hungarians was both quick and overwhelming with Soviet tanks and troops rolling into Budapest on the morning of the 4th of November. Within days the so-called insurrection was quelled with considerable loss of Hungarian life, including Nagy himself who was apprehended and summarily executed by the Soviets. The United Nations protested at the invasion but took no direct action to assist the Hungarians despite their previous pleas for assistance. In the aftermath of the Hungarian Uprising a policy of *"normalization"* was enacted in Hungary by the local Party leaders newly appointed by Moscow. As defined by Rupnik, *"Normalization, in Communist language means the restoration of Soviet control over the country, and of the Party's self-confidence and controls over society. It rests not just on repression, but above all on society's acceptance of defeat."*[21] Once again the opponents of the communist regimes within the countries of region felt that they had been betrayed by the West.

1.2.2 *"Ich bin ein Berliner"*

Seventeen years after Churchill's *"The Sinews of Peace"* speech, on the 26th of June, 1963, John F. Kennedy, the President of the United States of America flew into West Berlin, West Germany where he delivered a speech entitled, *"Ich bin ein Berliner* (I am a Berliner)." At the time of this speech tensions were running very high between East and West and the probability of the Cold War escalating into a full-scale war was also high. Given this situation, President Kennedy addressed a crowd outside West Berlin's city hall in Rudolph Wilde Platz,

> *"Two thousand years ago the proudest boast was Civis Romanus sum. Today, in the world of freedom, the proudest boast is Ich bin ein Berliner....There are many people in the world who really don't understand or say they don't, what is the great issue between the free world and the Communist world. Let them come to Berlin. There are some who say that communism is the wave of the future. Let them come to Berlin. And there are some who say in Europe and elsewhere we can work with the Communists. Let them come to Berlin. And there are even a few who say that it is true that communism is an evil system, but it permits us to make economic progress. Lass' sie nach Berlin kommen. Let them come to Berlin.*
>
> *Freedom has many difficulties and democracy is not perfect, but we have never had to put a wall up to keep our people in, to prevent them from leaving us. I want to say, on behalf of my countrymen, who live many miles away on the other side of the Atlantic, who are far distant from you, that they take the greatest pride that they have been able to share with you, even from a distance, the story of the last eighteen years. I know of no town, no city, that has*

[20]In 1951, Stalin was deeply concerned that the United States of America would make a first strike against the Soviet Union and/or its allies. In response to this concern the Warsaw Treaty of Friendship, Co-operation and Mutual Assistance, better known as the *Warsaw Pact*, was created as the communist's world defense pact, with Poland as a founding member. Other member countries in this alliance included Albania (whom withdrew from the organization in 1968 in protest over the invasion of Czechoslovakia), Bulgaria, Czechoslovakia, GDR, Hungary, and Romania.

[21]Rubnik, *op. cit.*, pp. 253.

been besieged for eighteen years that still lives with the vitality and the force, and the hope and determination of the city of West Berlin. While the wall is the most obvious and vivid demonstration of the failures of the Communist system, for all the world to see, we take no satisfaction in it, for it is, as your mayor has said, an offense not only against history but an offense against humanity, separating families, dividing husbands and wives and brothers and sisters, and dividing a people who wish to be joined together.

Freedom is indivisible, and when one man is enslaved, all are not free. When all are free, then we can look forward to that day when this city will be joined as one and this country and this great continent of Europe in a peaceful and hopeful globe. When that day finally comes, as it will, the people of West Berlin can take sober satisfaction in the fact they were in the front lines for almost two decades.

All free men, wherever they may live, are citizens of Berlin, and therefore, as a free man, I take pride in the words Ich bin ein Berliner."[22]

Five years after Kennedy's speech the economic and political situation in Czechoslovakia was reaching a crisis point, as it was in most of the *Eastern Bloc*[23] countries. However, the Czechoslovakians were well aware of the Hungarian experience of 1956 and certainly did not wish to repeat it. In fact reform elements inside the Czechoslovak Communist Party (CCP) did not seek a collapse of the Party but its rejuvenation from within. In 1968, fearing another *insurrection*, the Soviets endorsed a change of leadership at the top of the Czechoslovak Communist Party which led to the appointment of an ethnic Slovak named Alexander Dubecek as First Secretary of the Party. In April of 1968 Dubecek embarked upon what he termed an *Action Program*, which called for the restoration of civil liberties to create a form of democratic socialism, accompanied by significant and widespread economic reforms, and a constitutional amendment allowing the Slovak Republic more autonomy. This period was to become known as the *Prague Spring* and was to be a very short season of change.

In reflection, Dubecek's reforms were similar to the ones that would later be developed in the Soviet Union as *Perestroika* and *Glasnost*.[24] However, in 1968 the Soviet leadership was far from conceiving, let alone implementing, such visionary reform programs. Therefore, on the 28th of August, 1968 Soviet armed forces, along with token military units from their Warsaw Pact Allies (with the exception of both Romania and Albania[25]), invaded Czechoslovakia crushing the rebellion and snatching Dubecek and other reform leaders. The Prague Spring had ended in Czechoslovakia and once again a program of *normalization* was implemented by the local Party in this defeated country. The Czechoslovakians now sarcastically claimed that they had been

[22]Kennedy, J. F. (1963), *Ich Bin Ein Berliner.*

[23]The term *Eastern Bloc* is used to refer to the countries comprising Eastern Europe with the inclusion of the German Democratic Republic (GDR)(East Germany).

[24]*Perestroika* and *Glasnost* were two of Soviet Premier Gorbachev's instruments of reform in the late 1980s aimed at changing the communist system from within. Perestroika was a program of economic based reform and restructuring and Glasnost was a program of openness.

[25]Both Romania and Albania refused to participate in the invasion of Czechoslovakia. Romania refused to particiapte and *"Ceausescu's vehement denunciation of the invasion shocked the world."* See Zonis and Semler, *op. cit.*, pp. 228-229. Albania, whose relations with the Soviet Union were already greatly strained by other differences, also publically protested at the invasion and subsequently withdrew from the Warsaw Pact military alliance.

liberated from oppression three times within the same century, first through Nazi Germany's annexation of their country in 1939, secondly by Soviet tanks in 1945, and once again by Soviet tanks in 1968. Despite the irony of this boast, the fact remained that Czechoslovakia, like most of its eastern neighbors within the Soviet sphere of influence, remained firmly under the control of the USSR and its ruling Party officials in Moscow.

1.2.3 *"In an ironic sense Karl Marx was right"*

On the 8th of June, 1982, thirty-six years after Churchill's famous *"Sinews of Peace"* speech and nineteen years after Kennedy's passionate *"Ich bin ein Berliner"* address, another American President spoke of on the topic of Communism. The speaker was President Ronald Reagan, the venue was the Palace of Westminster in London, the United Kingdom, and the audience was both Houses of the British Parliament. It should be noted that President Reagan himself was a staunch opponent of both the Soviet Union and its communist doctrine. Therefore, at the time most commentators and critics did not place too much credence in his words on that day. However, in the late eighties Soviet Premier Mikhail Gorbachev would exonerate Reagan's message as he revealed the extent of the Soviet Union and its Eastern Bloc Allies obvious decline. In the words of President Reagan on that day in June,

> *"From the Stettin on the Baltic to Varna on the Black Sea, the regimes planted by totalitarianism have had more than thirty years to establish their legitimacy. But none - not one regime - has yet been able to risk free elections. Regimes planted by bayonets do not take root.*
>
> *The strength of the Solidarity movement in Poland demonstrates the truth told in an underground joke in the Soviet Union. It is that the Soviet Union would remain a one-party nation even if an opposition party were permitted because everyone would join the opposition party....*
>
> *In an ironic sense Karl Marx was right. We are witnessing today a great revolutionary crisis, a crisis where the demands of the economic order are conflicting directly with those of the political order. But the crisis is happening not in the free, non-Marxist West but in the home of Marxism-Leninism, the Soviet Union. It is the Soviet Union that runs against the tide of history by denying human freedom and human dignity to its citizens. It also is in deep economic difficulty. The rate of growth in the national product has been steadily declining since the fifties and is less than half of what it was then.*
>
> *The decay of the Soviet experiment should come as no surprise to us. Wherever the comparisons have been made between free and closed societies - West Germany and East Germany, Austria and Czechoslovakia, Malaysia and Vietnam - it is the democratic countries that are prosperous and responsive to the needs of their people. And one of the simple but overwhelming facts of our time is this: of all the millions of refugees we've seen in the modern world, their flight is always away from, not toward the Communist world."*[26]

The Hungarian Uprising of 1956 under Nagy and the Prague Spring of 1968 led by Dubecek were important signals of strong discontent and the pending demise of communism in the

[26]See Reagan, R. (1982), *President Ronald Reagan Foresees the Crisis of Communism*, extracts from *Political Speeches.*

Eastern Bloc countries, but they had both failed to sustain the fires of revolution. The match that would finally ignite a sustainable fire that would bring about the political collapse of the communist regimes of Eastern Europe and the GDR actually began in Poland with an independent trade union movement called *Solidarnosc*, or *Solidarity* as it became better known in the West.

The Solidarity movement began its accession to power in the late summer of 1980 during a time of growing labor unrest in Poland. The leader of Solidarity was a charismatic unemployed electrician named Lech Walesa. However, it should be noted that Solidarity was not founded as an organization to change the Polish government and/or remove the Communist Party from power but as a simple labor movement seeking pay increases and better working conditions for its members.

In 1982, pressure from Solidarity and other growing labor movements resulted in General Wojciech Jaruzelski, First Secretary of the Polish United Workers' Party (PUWP), imposing martial law throughout the country and outlawing the Solidarity movement as well as other *subversive* organizations. Another threat of revolution against the communist system had apparently been crushed by the Communist leadership. However, despite the Polish Communist Party's efforts to extinguish the social unrest, the Solidarity movement survived and simply went underground hoping to live to fight another day.

Yet, it should be noted that circumstances in Poland at this time were quite different to those found in Hungary and Czechoslovakia previously. Before, in the aftermath of events in Hungary in 1956 and Czechoslovakia in 1968, the local communist party leaders were able to restore a sense of order by providing economic incentives to the populace in each respective country. However, this time around Poland, like most of its communist neighbors, was beginning to suffer from severe economic shortages of almost everything and the country's political leaders simply could not supply the treats necessary to lure and bribe their subjects into submission. Hence, the usual program of *normalization* could not be enacted effectively and therefore Solidarity and other similar movements continued to exist.

1.3 The Curtain Falls and the Wall is Pulled Down

In 1989, that other day finally came when Solidarity resurfaced in Poland this time with less support from the people but with far greater political ambitions and desires. The time was right for change in Poland, as it was in many other countries in the region. Eastern Europe and the GDR as a whole were facing a combination of tremendous economic difficulties including a lack of available state funds, unserviceable hard-currency foreign debts, a severe shortage of modern technology for production, and the growing threat of labor unrest that could bring the entire economy to a standstill. The situation has been aptly described by Marvin Zonis and Dwight Semler, *"All the typical defects associated with a state socialist economy became manifest: chronic shortages, shoddy consumer goods, poor worker morale and discipline, arbitrary and capricious management by the 'nomenklatura'*[27]*, unpredictable supplies of production inputs, and false reporting to fulfill the quotas and 'The Plan'."*[28]

Most of the problems that were facing the communist regimes of the region at the time had been a result of the failed economic programs of the 1970s. During the 1970s many of these countries tapped into foreign credit lines (loans) in an attempt to push for economic growth based on a massive investment drive. The idea of many ruling *Communist Technocrats* in the region at the time was to buy technology and know-how from the West, which could be utilized to reinvigorate the activities of the *State-Owned Enterprise (SOE)* system, thus boosting overall production output of more desirable goods of world class trading standards, that could in turn be sold to the West to both increase the level of exports and gain hard currency with the overall aim of repaying all the foreign loans and greatly improving the domestic economy in the process. Yet, unfortunately for the governments and people of the Eastern Bloc countries this ambitious program failed to achieve any of the desired results and goals for which they were designed. Instead of prosperity, it was soon apparent that the only significant outcome of this endeavor was that it severely burdened the Eastern Bloc economies with an enormously high level of foreign debt that in many cases respective countries of the region were unable to service let alone be able to repay the principle amount of the loan.[29]

Given these conditions, Lech Walesa, at the head of the still outlawed Solidarity movement, was able to mount a strong political, economic, and social campaign against the local Polish Communist Party that simply outmaneuvered them at every turn. On the 4th of June, 1989 Solidarity scored an overwhelming victory in the first multi-party parliamentary elections. On the 19th of August, 1989 the Polish people installed their first freely elected and non-communist government since the end of the Second World War.

The new Solidarity led government went to work right away on putting together a tough economic stabilization program which at the time was the most radical and far-reaching reform

[27]*Nomenklatura* is a term associated with the communist elite in the totalitarian system. In communist countries there were two parallel and complementary power apparatuses: the State and the Party, each similarly subdivided functionally (for example, central committee departments and government ministries) and geographically. All senior and middle-ranking posts in industry and the administration could only be filled by persons approved by the equivalent level echelon of the party structure (for example, the central committee organization department). It was the people on these lists of names with party clearance who formed the Nomenklatura. In large industrial establishments all senior managerial appointments were restricted to the Nomenklatura while in smaller enterprises it might only be the managing director. See Dobosiewicz, Z. (1992), *Foreign Investment in Eastern Europe*, pp. 5.

[28]Zonis and Semler, *op. cit.*, pp. 15.

[29]An exception to this could be found in Romania when in 1982 Ceausescu, the country's leader, declared that the foreign debt would be repaid by the end of the decade whilst still maintaining the pace of the economy's growth. Given such a scenario, Romania was able to pay off almost all of its foreign debt but only at the expense of the local population whom suffered greatly as a result, many dying annually due to a combination of malnutrition, cold, and lack of proper food supplies. See Zonis and Semler, *op. cit.*, pp. 231.

effort that had been made in any Eastern Bloc country. The aims of this stabilization and reform program called for the elimination of the rising budget deficit, currency convertibility of the Polish Zloty, liberalization of all major prices to world market levels, the abolishment of restrictions on the private sector that were impeding their activities, and the development of a program for the privatization of the massive SOE sector which dominated the local economy. This process of economic transformation in Poland would be carried out under what was termed the *Balcerowicz Plan*, named after its primary creator, Leszek Balcerowicz, the country's new finance minister. This plan would later be referred to as *shock therapy* and the *big bang.* However, the real *shock* and *bang* would come as the dramatic events in Poland carried on over to their Eastern Bloc colleagues.

Solidarity, in conjunction with a host of other new political parties, had officially ended over 40 years of communist rule in Poland through democratic means supported by an overwhelming majority of popular support. The downfall of Poland's communist regime in 1989 marked the turning point in the history of the region and the beginning of a wave of revolutionary political, economic, and social change that was to sweep the across region and eventually even permeated into the Soviet Union.

The events in Poland started a wave of revolutionary change that was to lead to a time of irrevocable transformation across the entire region affecting every communist regime. From Warsaw to Prague, from Budapest to East Berlin, from Belgrade to Sofia, from Bucharest and finally onto Tirana a tidal wave of popular discontent took shape. In one Eastern Bloc country after another the local population abandoned the totalitarian communist regime that had dominated their lives for over forty years and the dominoes began to fall across the region. In Czechoslovakia, Vaclav Havel and his *Charter 77* group negotiated the Czechoslovak Communists out of power in what came to become known as the *Velvet Revolution.* In Hungary a *Quiet Revolution* was unleashed in a country where economic and political reforms had been taking place from within the Party, under *Goulash Communism,* since the late 1960s. In Romania a bloody peoples' revolution instigated a premature internal coup before Christmas of 1989 that toppled the extremely oppressive Maoist-style regime of Nicolae and Elena Ceausescu, both of whom were caught fleeing the capital Bucharest, secretly tried for crimes against the people, and summarily executed on Christmas Day. In another internal coup d'état, Todor Zhivkov, Bulgaria's longtime leader and the longest-reigning Communist Party boss in the Eastern Bloc, was removed from power by his closest aides with the blessings of Gorbachev in Moscow. The revolution in Yugoslavia was pre-empted by the death of Marshal Tito, the country's leader since the 1940s and probably the only true *Yugoslavian* national in the entire country, back in 1980 lit the fuse on the end of a federation of six republics that eventually exploded into a brutal armed conflict in 1991 over ethnic and nationalistic differences and which has only recently subsided through the combatants exhaustion and external intervention. In the GDR

(East Germany) the local hardline communist leader Erich Honecker, the architect of the Berlin Wall, was forced to flee for his life by a flood of popular discontent which eventually culminated in the reunification of East and West Germany. Finally, in 1991 Albania caught the wake of the revolutionary wave that had swept the region and reacted by ousting its own communist leader Ramiz Alia, the chosen successor of Albania's long reigning xenophobic leader Enver Hoxha, through the democratic process of free elections.

It should be pointed out that all of these revolutions were carried out by popular uprisings in each respective country. Furthermore, almost all of these revolutions were relatively peaceful with little bloodletting or settling of old scores, with the only real exceptions being the cases of Romania and Yugoslavia. A central element in the revolutions in most of these countries was the total reversal of economic policy from central planning to market orientation. The first historic step had been taken towards bridging the enormous gap which had separated much of the world since the close of hostilities following the end of the Second World War. The Cold War that had begun in the mid-forties was now apparently finally coming to an end. The Iron Curtain had finally begun to fall.

Another affect of these changes in the region was that the terms *Eastern Europe* and the *GDR* failed to have any realistic meaning as events made such terminology both outdated and redundant. The former becoming better associated with the term *Central and Eastern Europe* or as referred to in this research project as the *Central European Countries (CEC)*(See **Figure 1.1**). The latter term of the GDR simply ceased to exist and became delegated to the history books along with the name of West Germany, as these divided sides of one country were once again merged into a unified Germany.

Furthermore, all these events came about with the acquiescence, and even assistance at times, of the ruling Soviet leadership in Moscow, under Premier Gorbachev, who were supposed to be the strongest bastions of the communist system. Still, it is evident that Gorbachev had never intended his programs of Perestroika and Glasnost, seeking to reinvigorate and redesign the communist system from within, to contribute to its eventual collapse. The goal of Gorbachev's reform efforts was to produce not the end of the Communist Party, the Nomenklatura authority, and the communist system in general, but its revitalization through the creation of an improved economic system along with the creation of a new breed of leadership that would be more savvy, tolerant, and thus more capable of steering the Party into the future. This new breed of leadership would replace the corrupt and inept party leaders that had flourished since the onset of *Stalinism* and enable both the Eastern Bloc countries and even more importantly the Soviet Union to compete in a rapidly changing global environment.

Yet, unfortunately for Gorbachev and other internal reformers circumstances were against such radical internal based reforms as the massive machinery of the Communist Party with its many parts simply proved to be incapable of meaningful change from within. These limited economic reform efforts proved simply to be a case of too little too late. The end result of this failure of the Mother Party in Soviet Union was the creation of a new group of popular leaders who acceded to power in the CEC which were not those that Gorbachev had contemplated, desired, or had any influence or control over.

The pinnacle of this revolutionary period came with the destruction of the Berlin Wall which had come to symbolize the physical Iron Curtain that had divided the world as well as Europe between the democratic capitalist West and the communist planned economies of the East. The dismantling of the wall brick by brick and stone by stone came to symbolize the struggle of the people of the CEC and the reunification of both East and West.

The repercussions of these events in the region were eventually to carry on over to the Soviet Union bringing the downfall of their own communist system. By the end of 1991 the Soviet Union had officially ceased to exist and the former Soviet republics became known as the *New Independent States (NIS) of the former Soviet Union (FSU)*(See **Figure 1.2**). Even Mikhail Gorbachev, who had tried to reform the system from within during the 1980s both throughout the USSR and Eastern Bloc satellites, did not survive this tidal wave of change that swept away communist regimes across the region. Furthermore, the demise of the old guard communist in the Soviet Union was also made clearer by the failed coup d'état of August 1991 and again in the October Moscow rebellion of 1993.

1.3.1 The Morning After

However, it was not that the capitalistic and democratic West had been seen as some kind of *Holy Grail* by the peoples of the East. Quite the contrary, as the peoples of the CEC were well aware that time and time again the West had let them down as was clearly illustrated at Munich in 1938, at the Yalta summit in 1945, in Hungary in 1956, and in Czechoslovakia in 1968. Whatever the excuses of the Western powers might have been at the time, or are today, the fact remains that the CEC have often felt abandoned and sacrificed by the West in an attempt to assure global peace. Yet despite these obvious shortcomings, the East has continued to view the West through a pair of rose-colored glasses, seeing the West's seeming abundance of free choice, capitalistic opportunities, Coca-Cola, and Levi's jeans as something to aspire to.

It should also be pointed out that it was not necessarily the case that *Communism* as a system was ideologically incorrect or wrong in the eyes of the people of the CEC. In fact if one takes a good look at the writings of Marks and Engels in their *"Communist Manifesto"* of 1848 they can see some merits to such a communal system where everyone works according to his or her own

Figure 1.1, Map of the Central European countries (CEC) and the Baltic States

Source: Department of Trade & Industry (DTI), Her Majesty's Government, United Kingdom

Figure 1.2, Map of the New Independent States (NIS) of the former Soviet Union (FSU)

Note: The Baltic States are not included in this map although they are part of this grouping of countries.

needs and abilities. However, the communism described by Marks and Engels was not the same one administered and twisted by comrade Stalin during the years of terror that purged the East of so-called enemies of the state and/or the method of *Stalinization* employed in the Eastern Bloc countries. Therefore, the downfall of Communist regimes across the region was not so much a result of failed ideology but because the monolith that was the communist system had simply made sustainable economic growth impossible throughout the region. The upheavals that led to the demise of communist governments in the CEC removed the barriers and constraints that had restricted earlier attempts at reform. However, once the system was in chaos the opportunity to implement new radical economic changes was finally possible.

In the aftermath of the events of late 1989 through to 1991, each of the CEC and the FSU has decided the course of actions needed to meet the conditions and considerations given their country's particular situation so as to implement the transition process in their respective country with the most efficiency and effectiveness. Vaclav Klaus, a former dissident and the Czech Republic's residing Prime Minister aptly described the situation facing each of the CEC in the process of transition in an interview with the *Wall Street Journal Europe* in early 1994,

> *"Central and Eastern Europe should be viewed as a hospital where each patient knows he needs treatment of some sort. Some remain in the waiting room, hoping aspirin will be enough when only major surgery can work. Other countries enter into surgery, only to lose courage halfway through and the patient remains cut open in the operating room. Still others pass through surgery and make their way to the recovery room. And the most courageous (Mr. Klaus seemed to count only his country in this group) pass to the fitness center for some body building so that they can take on world competition."*[30]

In hindsight, Mr. Klaus's analogy of the situation should come as no surprise given the combination of the very different starting places that each of the CEC and the FSU began with and the variety of policies that each has pursued in their efforts to transform their own economies. Furthermore, it should also come as no surprise that each of the CEC and the FSU has achieved different levels of progress in the process of transformation.

In regards to this last point, several noted Western institutions and organizations have attempted to measure the extent of economic transformation in the CEC and the FSU (See **Table 1.1**). These institutions and organizations include the *European Bank for Reconstruction and Development (EBRD)*[31], the *Economist Intelligence Unit (EIU)*, and the *World Bank*. The EBRD (1994 & 1995) has judged the level of progress achieved in each country of the region on a four point scale based upon nine individual transition elements: large-scale privatization, small-scale privatization, enterprise restructuring, price liberalization, trade and foreign exchange system,

[30]See Kempe, F. (1994), *Eastern Europe's Do-It-Yourself Recovery*, in *The Wall Street Journal Europe (WSJE)*.

[31]The first article of the EBRD's mandate states that, *"In contributing to economic progress and reconstruction, the purpose of the Bank shall be to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economies."* See EBRD (1992), *Political Aspects of the Mandate of the European Bank for Reconstruction and Development*, pp. 1.

Table 1.1, Progress in Institutional Reform in the CEC and the NIS of the FSU

Host Country	Aggregate EBRD Index**	EIU Index of Institutional Development***	EIU Index of Political Development***	World Bank Classification****	Private Sector Share in GDP (%), 1995	Change in Private Sector Share of GDP (%), 1989-95
Albania	2.3	2.1	2.0	3	60%	55%
Armenia	2.1	1.9	1.9	0	45%	37%
Azerbaijan	1.6	1.6	1.5	0	25%	20%
Belarus	2.1	1.4	1.3	1	15%	10%
Bosnia-Herzegovina	n/a	1.4	1.4	0	n/a	n/a
Bulgaria	2.6	2.2	2.2	3	45%	30%
Croatia	2.8	2.3	1.9	0	45%	30%
Czech Republic	3.4	3.3	3.5	4	70%	59%
Estonia	3.4	3.0	2.9	3	65%	55%
FYR of Macedonia (FYROM)	2.4	2.1	2.2	0	40%	30%
Federal Republic of Yugoslavia	n/a	1.8	1.4	0	35%	22%
Georgia	2.0	1.8	1.8	0	30%	12%
Hungary	3.4	3.3	3.5	4	60%	45%
Kazakhstan	2.1	1.9	1.6	2	25%	10%
Krygyzstan	2.8	1.8	1.7	2	40%	35%
Latvia	2.7	2.6	2.5	3	60%	50%
Lithuania	2.8	2.5	2.5	3	55%	45%
Moldova, Republic of	2.6	2.1	2.1	2	30%	25%
Poland	3.3	3.3	3.3	4	60%	31%
Romania	2.4	2.2	2.0	3	40%	27%
Russian Federation	2.6	2.3	2.1	2	55%	50%
Slovakia	3.2	2.7	2.5	4	60%	50%
Slovenia	3.1	3.4	3.5	4	45%	37%
Tajikistan	1.6	1.2	1.2	0	15%	10%
Turkmenistan	1.1	1.4	1.3	1	15%	10%
Ukraine	2.0	1.8	1.9	1	35%	30%
Uzbekistan	2.3	1.5	1.3	1	30%	25%
Total: CEC & FSU*	**2.3**	**2.2**	**2.1**	**1.9**	**42%**	**32%**
Total: CEC*	**2.9**	**2.5**	**2.5**	**2.4**	**51%**	**38%**
Total: FSU*	**2.0**	**1.9**	**1.8**	**1.4**	**36%**	**28%**

Sources: EBRD (1994, 1995), EIU (1996), World Bank (1996), and the researcher's own calculations.

Notes: *Regional averages are unweighted averages. **The EBRD scores for 1994 and 1995 have been summed together and averaged to make them more comparable with the EIU scores. ***The EIU classifications are based on the extent to which the CEC and the NIS of the FSU currently measure up to average standards found in the countries of the European Union (EU), 1= no progress towards this standard, 2=modest progress, 3=considerable progress but with significant remaining tasks, and 4=the approximate attainment of average EU standards. ****World Bank classification: 4=leading reformer, 3=advanced reformer, 2=intermediate reformer, 1=slow reformer, and 0=countries affected by regional tensions, such as war.

competition policy, banking reform and interest rate liberalization, securities markets and non-bank financial institutions, and the extensiveness and effectiveness of legal rules of investment.[32] The EIU also utilized a four point scale based on an internal poll of thirty analysts on the CEC and the FSU whom assessed the countries of the region on the basis of institutional and political development in comparison to average standards found in the European Union. Lastly, the World Bank employed a five point scale classifying each country on its respective level of reform achieved.[33]

In comparing the assessments by these three institutions and organizations on the status of economic transformation in the region the countries can be grouped into three different categories. The first and top category represents those countries that have made the most advances in the transition process and are subsequently closer to reaching the standards found in the developed nations of the world. This first group of countries includes the Czech Republic, Estonia, Hungary, Poland, Slovakia, and Slovenia. The second tier of countries are those that have made some headway in the transformation process but still have a long way to go and are currently caught somewhere in the middle ground. This second group of countries includes Bulgaria, Croatia, the former Yugoslav Republic of Macedonia (FYROM), Latvia, Lithuania, Romania, and the Russian Federation. The third and bottom grouping of countries represents those that have only made very nominal progress on the road to transition and which subsequently need to make substantial advances if they are to attempt to catch up with their former associates or risk being left behind altogether. This third set of countries comprises Albania, Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Kazakhstan, the Republic of Moldova, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

To summarize, it has now been over seven full years since the dramatic events of 1989 first occurred which led to a wave of revolutionary and fundamental changes that swept across the CEC and which also eventually leading to the break-up of the Soviet Union and the creation of the NIS of the FSU two years later. In retrospect, those revolutions proved to be only the first step in what surely will be a long road to transition. It is now obvious that the more profound revolutions of political, economic, and social reform still lie ahead for many of the peoples and the governments of the region. Yet, the gravity of the situation and conditions in the CEC and the FSU means that these countries will need a great deal of assistance in the transition process and most look to the West to provide a significant part of this assistance.

[32]In 1994 the EBRD evaluated the progress in transition for the CEC and the FSU on the basis of only six factors: large-scale privatization, small-scale privatization, enterprise restructuring, price liberalization and competition, trade and foreign exchange system, and banking reform. See EBRD (1994), *Transition Report: Economic Transition in Eastern Europe and the former Soviet Union*, pp. 10-11. For 1996, the EBRD expanded the number of transition elements used to measure the level of progress in the region to nine, as listed. See EBRD (1995), *Transition Report 1995: Investment and Enterprise Development*, pp. 11-14.

[33]See Kekic, L. (1996), *Assessing and Measuring Progress in the Transition*, excerpts in the World Bank (1996), *Transiton: The Newsletter about Reforming Economies*, Policy Research Department, July/August, pp. 9-10.

1.4 The Role of the West in the Process of Transformation in the Central European countries and the New Independent States of the former Soviet Union

Overall the West, especially the *G-7* nations[34], have a strongly vested interest in ensuring the successful and smoothest possible transition of the new liberal democracies of the CEC and the NIS of the FSU on the basis of several key factors. These factors mirror the process of transition itself and concern economic, national security, political, and social issues. Although it is not within the scope of this work to provide a detailed analysis of these factors, some general points are worth mentioning so as to provide a better understanding of the important role that the West has to play in the transition process of the CEC and the FSU as well as some of the underlying motivations for undertaking this research project.

Firstly, with regard to economic issues, the opportunity exists for expanding international trade links through the process of *internationalization*[35] that will in turn assist these countries in developing their own markets. This opportunity is a driving factor for firms investing or seeking to invest in these transitional economies. While the Cold War, that lasted over forty years, may have finally come to an end the downfall of communism has left a vast gap to be filled and a restructuring process that could only remind us of the days of the *Marshall Plan*[36] in a post-war Europe and Japan. However, today faced with the sheer cost of implementing a modern version of a Marshall type plan in the CEC and FSU brings to light not only the reluctance of the Western governments to pay for such an undertaking but also their inability to finance such enormous costs when they are faced by numerous problems themselves. Therefore, much of the Western assistance that has been directed at the CEC and the FSU has been in the form of promoting the transition process via the functions of private enterprise, especially with respect to *foreign direct investment (FDI).* Within this framework, the *Transnational Corporation (TNC)* as a foreign investor is ideally placed to play a crucial role in these transitional economies as the transplanter of Western management practices, technology, processes, skills, and access to world markets. As such, the TNC can act as an engine for growth in these economies in their shift from a command economy to that of a market oriented economic system.

[34]The *Group of Seven (G-7)* was formed in 1975 as a forum for discussion of global economic issues and in recent years it has become increasingly involved in global politics as well. Each of the seven member countries is represented by their respective head of state, or their representatives, at formal summit meetings of the group. The G-7 member countries include: Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States of America. Since the downfall of the Soviet Union, the political leadership of Russia has pushed for entrance into this select group. In response to this the G-7 has recently included Russia as an active participant in at least the political part of the summit meetings.

[35]Dunning provides a thorough explanation of this process. See Dunning (1993a), *op. cit.*, pp. 189-193.

[36]The *Marshall Plan* began in 1947 under the United States of America as a program of economic aid, loans, and grants for Europe to finance its economic recovery after the Second World War. Stalin did not permit any of the Eastern Bloc countries under his control to participate in this program due to ideological and policy differences with the United States of America. For further details see McClellan, *op. cit.*, pp. 205.

Secondly, the successful transition of the region is a vital political issue on the grounds of national security and foreign policy for many nations. It should not be forgotten that the Soviet Union and its Eastern Bloc allies were considered a serious threat to world peace by the Western powers for over 40 years and vice versa. The fact that the gap that had separated the world's two great superpowers and their respective allies has now been somewhat bridged does not necessitate the creation of an overall state of peace in the world. Along this same line of thought, another factor of concern is the re-emergence of nationalism and ethnic tension that had been suppressed under the former system but have now resurfaced. For example, the separation of Czechoslovakia into the Czech Republic and Slovakia in January, 1993 may have been termed the *Velvet Divorce* for its peacefulness and smoothness but it clearly showed the differences that existed between ethnic Czechs and Slovaks since the countries founding; in the former Republic of Yugoslavia we have seen a situation where a combination of ethnic and nationalistic fervor has ignited a bloody and brutal civil war that has seen horrific atrocities committed by all combatants; and in the Russian region of Chechyna a rise in Muslim fundamentalism, the region's use as a base for organized crime, and a calls by local for its independence finally led to intervention by Russian military forces in an attempt to suppress such activities. Overall, it must be remembered that even as we approach the end of the millennium and prepare to enter the 21st Century the world is still a very volatile place despite the progress that has been made towards world peace. In fact, today tensions and armed conflicts still flourish around the globe and while the threat of global nuclear war may have decreased somewhat as a result of the events in 1989 to 1991, all the causes of war as well as all the tools necessary to wage it still exist.

Thirdly, the continuation of the region's reform policies greatly depends on the actions of Western countries which provide them with the skills and resources necessary to allow for the transition from a command economy to a free market structure, new markets to help these countries survive and grow during the transition period, and also disincentives to extremism and the possibilities of a reversal of the economic, political, and social transition. Once again however, it must be pointed out that over forty years of communism and its command economy structures can not be changed over night, it will take time and in many countries in the region it will take a great deal of time and possibly even more revolutions. It should also be pointed out that never before in the world's modern history has such an undertaking involving such a large percentage of the world's global means of production ever been attempted. While economists might theorize on how to achieve successfully this transformation, reality often dictates a different set of results than found in the laboratory. Therefore, patience and fortitude must be the so-called *buzz words* of the day and in days to come for the peoples of the region.

Finally, on both moral and ethical grounds the West owes a duty to the CEC and the FSU to assist them in the process of economic, political, and social transformation. It should not be forgotten that during those long *Cold War* years the West consistently held out a carrot and told the East to take a bite of it. Well, in a sense now the West's old adversaries have finally taken a bite of that carrot. Whether it is what they thought it would be remains to be seen with only time to provide the answer. However, in this researcher's own opinion making sure that the carrot is good for them is the responsibility and duty of the West.

1.5 Capitalism Goes East: The Role of Foreign Enterprises in the Transition Process

Now, after over 40 years, the lands of the East are truly opening up to the West and vice versa. The opportunities are enormous but so are the challenges and risks. Overall, the CEC and the FSU represent a region that possesses a relatively vast untapped market of over 416 million potential customers and consumers whose demand for Western goods and/or quality domestic consumer goods has been pent-up over 40 years; some countries that are endowed with an abundance of new and underdeveloped natural resources; in the case of the CEC there is the advantage of proximity to the markets of the *European Union (EU)* and countries associated with the *European Free Trade Agreement (EFTA)* to the West and the former *Council for Mutual Economic Assistance (CMEA)*[37] markets to the East, that is both a strategic and locational advantage to firms considering the region as part of their regional core network strategies; considerable human resource endowments that are available at a relatively low cost; and overall, a wide spectrum of new opportunities for investment.

Given this environment, foreign enterprises, especially Western based TNCs[38], have been carefully analyzing the immense array of opportunities as well as the challenges that these dynamic emerging markets have to offer. These same firms are also keeping a close eye on the actions and movements of their competitors and/or client companies who may either already be active in the region or are currently in the process of considering market entry into one or more of the CEC and/or the FSU. However, while some firms have waited to become active investors others have decided that the benefits outweigh the risks and have taken advantage of investment opportunities that exist in selected countries via direct investment utilizing greenfield and/or acquisition modes of investment. Furthermore, those firms that have invested

[37]*The Council for Mutual Economic Assistance (CMEA)*, or COMECON as it was better referred to in the West, was first established in 1949 by Josef Stalin of the USSR as a regional trading bloc that was dominated by the Soviet Union. The CMEA encouraged national economic systems to specialize in the manufacture of specific goods and attempted to match individual member countries' long-term production goals to meet the whole bloc's basic needs. The CMEA system was oriented toward the coordination of individual government's economic plans and the unification of central planning methods. Besides the Soviet Union, the CMEA comprised the following countries as members: Albania (which left the CMEA in 1961 over growing political tensions with the Soviet Union), Bulgaria, Czechoslovakia, German Democratic Republic, Hungary, Poland, Romania, Mongolia, Vietnam, and Cuba. On the 1st of January, 1991 the CMEA was effectively abolished and the organization ended its existence six months later with its central power ceasing to exist by the end of the same year.

[38]For the purposes of this research study, the phrase *Western Transnational Corporation (TNC)* will apply to TNCs which are based (main company headquarters) in a home country within one of the following regions: Europe (excluding any CE, CEC, and/or FSU countries) or North America (excluding Mexico).

thus far seem to have either focused on a specific country as a market or on a regional strategy encompassing a multitude of countries and their respective markets within the region. Still, despite the general level of enthusiasm generated by the opening up of these markets to the West, other firms have decided that the timing and the environment is not yet right and have adopted a *wait-and-see* strategy before choosing to enter what has been termed by some investors as the *Wild East*.

However, in light of the challenges and difficulties of trying to do business in the Wild East, many Western firms have continued to commit themselves to investment in the area. The simple logic behind such an investment decision is that the investing firm is motivated by the opportunities of both the vast economic and market potential that these new and emerging markets have to offer which in their opinion outweigh the associated risks involved. According to a survey on FDI in the CEC and the FSU by Rene Gatling (1993)[39], which is often quoted in the research literature but which is only based upon a limited sample of foreign investors[40], the primary motivations given by firms for engaging in FDI in the region are (presented in their order of importance) to *"establish market share,"* to *"tap the regional market"* as a whole, to take advantage of *"low-cost sourcing"* in the CEC and the FSU, and the utilization of the region as a base to tap into the markets of Western Europe. Other motivations described by the survey for firms to invest in the region included *"following the client," "going where the resources are...," "...where the infrastructure isn't,"* on the basis of directives to invest in the region that came down from the top level of a company's own management (usually directives from the Chief Executive Officer [CEO] and/or Board of Directors), and direct investments based on a combination of the above stated reasons.[41] Several other studies have also eluded to similar motivational factors for FDI in the CEC and the FSU, although not necessarily with the same rankings of importance.[42]

On the other side of the equation, an extensive assortment of independent local enterprises (privatized SOEs, SOEs that have been bought out from within [MBOs EMBOs, etc.], and newly created local firms) and firms still owned and operated by the State (SOEs) are seeking Western firms as strategic partners or buyers to assist them in their quest to become internationally competitive by the foreign partner firm providing them with a variety of inputs such as capital investment, modern technology, management skills and development, world class manufacturing standards, etc.. Accordingly, the new democratically elected governments

[39]This survey and subsequent report was made in association with *Creditanstalt Bankverein* (of Austria) and the *Economist Intelligence Unit (EIU)*(from their Austrian office).

[40]Gatling's survey results are based on only '87' responses from foreign investors whose investments spanned the entire CEC and FSU region. Therefore such a small and limited sample may not represent an accurate picture of the motivations of foreign investors to invest in these particular countries. See Gatling, R. (1993), *Foreign Investment in Eastern Europe: Corporate Strategies and Experience*, pp. 10.

[41]*Ibid.*, pp. 9-18.

[42]These studies will be thoroughly covered in detail in *Chapter 2, A Review of the Relevant Literature*.

of the region have each taken their own approach to privatizing the enormous number of SOEs under their control. Some of these privatization efforts have been directed at finding suitable Western firms, such as TNCs, either to cooperate with the SOE or arrange for its transfer to the private sector via a direct or indirect sale. Acknowledging the overwhelming level of state ownership in these former communist countries each host country government is now trying to develop its own strategy for privatizing these means of production. Of course, the one thing in common with almost all these countries is their belief that FDI from the West, and in particular from TNCs, will be able to provide their economies with an engine of growth that will assist them in making the successful economic transition they seek.

While it is still too early for many investing firms to ascertain, it appears that the performance of foreign investments throughout the region have met with varied levels of success. Some firms seem to be excelling in this challenging new environment, while other firms find themselves somewhere in the middle ground traversing a path either up or down, and a few firms have been either forced, or chosen, to liquidate their investments due to the complexities of doing business in this rapidly changing environment and/or a lack of adequate preparedness on their part for the conditions and nature of these developing transitional markets.

Furthermore, it should be pointed out that most major investing firms that are currently active in the region view their investments as part of a long-term proposition given the vast complexities and difficulties of doing business in this changing business environment. Therefore, the long-term view of FDI in the countries of the region does not necessarily equate to positive short-term measures of performance, especially such short-term financial indicators like *return-on-investment (ROI)*. Nevertheless, the realities of the business world dictates that a firm must be able at least to maintain a certain degree of satisfactory performance in its operations in these transitional markets if it is to endure. Moreover, if that same firm is to grow and prosper over time then an increasing level of performance needs to be achieved. Of course this statement holds true in this or any other business environment. Therefore, in conclusion of this point it would seem a logical reply that those investing firms that appear to be doing well with their respective investments in the region are those which exercised due diligence prior to investing and are responsive to the ever changing nature of this environment.

1.5.1 The Potential Impact of Foreign Enterprises in the Process of Economic Transformation

The prospective role that FDI, especially by TNCs, can play in the former communist countries' economic transformation is far beyond the direct impact of the inflow of invested foreign capital. This was the point made in a joint research paper by Wladyslaw W. Jermakowicz and

Carl. J. Bellas (1994)[43], two academics working in the field of foreign investment and privatization in the transitional economies, who have described FDI as the driving force towards achieving four primary goals in the CEC and the FSU[44]. These four goals include the ability of FDI to provide a basis for capital investment into the economy that can not readily be achieved by domestic means due to a serious lack of savings, high inflation levels, etc. as well as providing the host country with an inflow of foreign exchange to finance imports; to accelerate the privatization process in the region by providing a good base of investors who possess the necessary capital resources to turn ailing SOEs around; to inject new production methods and techniques that can dramatically improve both the quality and quantity of goods produced which in turn can counterbalance the previous *continuous shortage economy* and also provide a sturdy platform for the development of export markets in the West; and to provide both modern technology as well as the transfer of Western management techniques (marketing, accounting, management, etc.) to enable local firms to function in the new market economy system.[45] In general, the active role of Western firms engaging in FDI has the potential for assisting in speeding up the entire transformation process across the region. This opportunity to assist host countries in the transformation process is particularly evident from cases of FDI in some of the more economically advanced countries of the region, notably countries like Hungary, Czech Republic, Poland, and Slovenia.

In general, FDI by TNCs has the capacity to assist in the region's domestic economic recovery and in the overall process of transformation from a command economy system to a more market oriented structure. This was the point made in a report on global investment by the Division on Transnational Corporations and Investment of the United Nations Conference on Trade and Development (UNCTAD-DTCI [1994]).[46] The authors of the report alleged that FDI by TNCs in the CEC and the FSU has a duality of roles to play, both *tangible* and *intangible*, each of which will now be profiled in greater detail.

On the *tangible* side, the impact of FDI by TNCs may be greater than the actual size that these investments currently suggest. These tangible elements cover three main areas. Firstly, FDI by TNCs in key industries in the region seems to have had a positive affect in contributing to economic recovery, especially with regard to the individual industry associated with the investment. In this respect, a type of *follow-the-leader* scenario has been developing as TNCs engaged in FDI within a specific industry have pushed themselves to the forefront of that

[43]This paper is actually part of a larger joint effort by the *Center for Social & Economic Research (CASE)* in Poland to study FDI and privatization in the CEC and the FSU. See Bellas, C. J., Bochniarz, Z., Jermakowicz, W. W., Meller, M., and Toft, D. (1994), *Foreign Privatization in Poland.*

[44]The authors use the term of *Central and East European countries*, which they define as including: Albania, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, Russia, Slovakia, Slovenia, and Ukraine. *Ibid.*, pp. 4.

[45]*Ibid.*, pp. 4.

[46]These areas are discussed more fully in UNCTAD-DTCI (1994), *World Investment Report 1994: Transnational Corporations, Employment and the Workplace*, pp. 98-116.

particular industry, often taking other firms with them. There has also been associated cases of spill-over and trickle-down affects as related economic segments gain from such innovations and improvements within related sectors of the economy. This factor has the capacity to be even more constructive and observable over time.

Secondly, TNCs have facilitated progress in the area of increased trade activity (imports/exports) with both Western Europe (the EU and EFTA countries) as well as within the former CMEA markets (the CEC and FSU). The Western markets are especially fundamental in terms of re-establishing the region within the context of the world's global economy after its extremely long hiatus period. Equally important is the restoration of historical and traditional trade links between the markets of the East and West, which is critical in assisting the improvement of region as a whole through the process of economic recovery.

Thirdly, TNCs, as a result of their dynamic nature, have contributed to the East via the transfer of vitally needed capital investment, modern technology, know-how, management practices, human resource development, etc.. Once again, these contributions have had various network affects in re-shaping local firms, whether it be through *greenfield* or *acquisition* based investments.

On the issue of the *intangible* affects of FDI by TNCs in these transitional economies, the previously cited UNCTAD-DTCI report states that, "*Beyond these direct impacts, FDI and TNCs also play an indirect - though difficult-to-measure - role in the establishment of a market economy, be it in Central and Eastern Europe or elsewhere....*"[47] This statement generally refers to three intangible aspects related to creating a more enabling environment in which the overall role of FDI and its affects on the local economy can be more constructive.

One of these intangible elements relates to the fundamental process of institution building within the CEC and the FSU. Given the fact that TNCs are used to and prefer to operate in a legal environment that is conducive to FDI, certain issues like company laws, bankruptcy, taxation, accounting, profit repatriation, and the general overhaul of the entire financial system need to be addressed. Therefore, given the desire of host countries to attract FDI, the process of institution building in the region as a means of dealing with these types of issues should be expedited. This process should also be facilitated by the additional pressure placed on respective host countries and their governments from TNCs to deal with these issues as a condition of FDI activities. However, it should be remembered that under communism almost all vestiges of private enterprise were efficiently and effectively eradicated via the policy of wholesale nationalization of all means of economic production. This policy was implemented because the very concept of private enterprise was against the fundamental doctrine and principles of the official communist ideology that permeated the entire region. After the events

[47]*Ibid.*, pp. 104.

of 1989, the legal and regulatory frameworks on the activities of private enterprises that emerged in some countries of the region were either a restatement and/or enhancement of existing commercial laws, or in some cases a resurrection of the commercial codes, that existed prior to the beginning of the Second World War.

A second of these intangible features of FDI by TNCs relates to the immense undertaking of privatization currently going on in the region, which in a rare case like the Czech Republic is now reported to be almost completed. However, as it has previously been noted within this chapter, during the former days under the communist system the process of Stalinization resulted in the elimination of the concept of private ownership via the wholesale nationalization of almost all the means of economic production, with the only limited exception coming in the agriculture sector. Under this program private firms were confiscated and subsequently transformed into SOEs all under the direction and control of the State, which in turn was a manifestation of the local Communist Party. Market factors were quickly replaced by a command economy structure with the State exerting complete control over economic decision making. Yet, one of the key elements that greatly contributed to the downfall of the communist system was the ineffectiveness and inefficiency of this system (the combination of a command economy and SOE system) not only to pursue a program of economic growth but to simply maintain stability within the economy in general. As a remedy to these shortcomings, the new governments of the region are seeking to undertake the monumental task of privatizing the SOE sector that saturates the domestic means of production. The impetus behind this privatization effort is the belief that the SOE, placed in the hands of private ownership in a market style economy, will instill in the privatized firm, and its new owners, the basic economic reality of the new situation. The situation being that the privatized firm, cut off from government support, its administration, and its directives, will be on its own and will have to not only survive in the new economic environment but also to seek to prosper and grow within it as well. In this sense, the privatized firm would be energized to be both responsive and proactive to market forces. The result of private ownership in this scenario would be the creation of a firm that is a more effective and efficient and thus more likely to benefit the economy as a whole.

Consequently, within the overall scope of ongoing privatization efforts of the CEC and the FSU, TNCs can play both a direct and indirect role in developing the private ownership structure. In the direct role, TNCs have the ability to provide the necessary resources for the purchase of SOEs, which themselves are usually suffering from a severe shortage of capital. In this respect, TNCs can provide the necessary injection of capital into these SOEs that has been unavailable from local sources due to the shortage of domestic savings, an erosion of savings due to high inflation, and the general state of the financial system of the CEC and the FSU. Indirectly, TNCs can act as a role model and thus assist in the development of private entrepreneurship, which has already taken off in some economic sectors. They can also foster this entrepreneurial spirit via spill-over and trickle-down effects as a result of their own activities in these countries.

Thirdly, another key intangible elements that FDI by TNCs can indirectly bring to these transitional economies involves the role of competition within the market environment. Once again, the UNCTAD-DTCI report previously quoted claims that, "*An important role that TNCs can play in the establishment of a market economy is through the introduction of competition into local markets. Exposing domestic monopolies to a more competitive environment is a means to improve allocative efficiency and to facilitate the free determination of prices.*"[48] Given the monolithic structure of many SOEs and their respective industries, the insertion of competition could lead to restructuring of these enterprises from within and for the industry overall. However, the fragility of some of these SOEs under such competitive pressures will probably require that some attention be given to their restructuring and possible downsizing prior to the complete opening up of their respective markets to external forces.

The potential role of FDI by TNCs in such SOEs has been argued from both sides. In one aspect, it could be the case that the TNC will simply take advantage of the monopolistic position of the SOE and seek to further enhance that position given special considerations from the host country. On the other hand, the TNC even with all the resources at its disposal is not a miracle worker and will need time to undo the affects of the former totalitarian regimes and their associated command style economies and structures.

Finally, according to a more recent UNCTAD-DTCI (1995) report on TNCs and competitiveness in the global economy, "*The role of FDI in the transition process and the recovery from the transformational depression may have been greater than what would be expected from the limited capital invested in the region....*"[49] That said, the question of how much foreign capital has been invested by foreign enterprises in the CEC and the FSU since the dramatic changes in the region that began in late 1989 needs to be addressed.

1.5.2 A Review of the Statistical Data on Foreign Direct Investment in the Central European countries and the former Soviet Union: Expectations and Reality

As events unfolded in 1989 through to the beginning of 1991, expectations were running high in both the East and the West that extremely large inflows of FDI would soon be heading into the Eastern Bloc countries and the FSU to aid these countries in their process of economic, political, and social transformation. The common thought at the time amongst numerous Western businessmen, academics, governments, and institutions was that given the circumstances

[48] *Ibid.*, pp. 106.

[49] See UNCTAD-DTCI (1995), *World Investment Report 1995: Transnational Corporations and Competitiveness*, pp. 108.

Western private enterprises would see this as a great opportunity to tap into relatively new markets. It was hoped that the flood of new FDI via private enterprises would at least partially circumvent the need for the implementation of another *Marshall Plan* in the nations of the East that would cost the West a great deal of their own valuable resources.[50]

However, so far the flood of FDI in biblical proportions that was originally forecast by some over enthusiastic self-proclaimed pundits in the financial community has failed to arrive. What we have seen in the way of FDI could be better described as a small steady flowing river which is gradually growing and gaining momentum over time. In fact, depending on whose statistics you consider[51], between around $34.0 to $36.0 billion dollars worth of cumulative FDI has been invested in the CEC and the NIS of the FSU during the 1989-1995 period (See **Table 1.2**). Still, while this is truly a substantial amount of investment, it is clear that in relation to other destinations of worldwide FDI inflows that the amount of foreign capital that has been invested within these economies in transition is still small by international standards. For example, during the same 1989-1995 period of time $148.9 billion dollars worth of FDI was invested in the United Kingdom, a developed country, and a total of $20.8 billion in Argentina, a developing country.[52] In comparison, during the 1989 to 1995 period total cumulative inflows of FDI in the CEC and the FSU accounted for less than 2% of the total worldwide inflows.[53] Yet, as of 1995 this figure had grown significantly to represent 4% of the shares of global FDI inflows (See **Figure 1.3**). Even on the basis of the forecast by the Economist Intelligence Unit (EIU) for FDI between 1996-2000 it is clear that the vast majority of countries in the region will still not have obtained international levels of FDI by the year 2000 and thus they will continue to lag behind the rest of the world. According to EIU projections, FDI into the Russian Federation will only reach $21.969 billion dollars over the next five years, a comparable figure to the amount of investment in Argentina noted above. Still, as was mentioned at the beginning of this sub-section, forecasts are more often than not prone to a great deal of error due to the obvious complexities involved in trying to foresee the future so the EIU data presented should be treated with a certain degree of skepticism.

While these statistics may paint a somewhat depressing picture of the significance of FDI in the

[50]See UN/ECE (1994a), *Economic Survey of Europe in 1993-1994*, pp. 5-6.

[51]It should be noted that the statisical data for FDI in the CEC and the FSU varies greatly depending upon the source of the data and the organization reporting it. The host countries themselves generally tend to over inflate their own figures for FDI. External organizations like the EBRD, IMF, OECD, and the United Nations (UNCTAD-DTCI and UN/ECE) also report various figures for FDI within specific host countries as a result of different means of data collection and analysis. For example, the statistics on total cumulative FDI for the CEC and the FSU as a whole available for 1989-1994 show a variety of figures: the EBRD data shows $17,709 mn worth of FDI in the region as a whole; the UNCTAD-DTCI indicates a total of $21,509 mn has been invested over this same six year period; and the UN/ECE states that $24,877 mn has been invested during this same period of time. These problems of statistical reliability are eluded to in greater detail in Meyer, K. E. (1994), *Direct Foreign Investment in Central and Eastern Europe: Understanding the Statisical Evidence* and in Brewer, T. L. (1995), *Indicators of foreign direct investment in the countries of Central and Eastern Europe: a comparision of data sources.*

[52]This data comes from the UNCTAD-DTCI, which primarily based their calculations upon IMF balance-of-payment tapes. See both the UNCTAD-DTCI (1995), *op. cit.*. and UNCTAD-DTCI (1996), *World Investment Report 1996: Investment, Trade, and International Policy Arrangements.*

[53]UNCTAD-DTCI (1996), *op. cit.*.

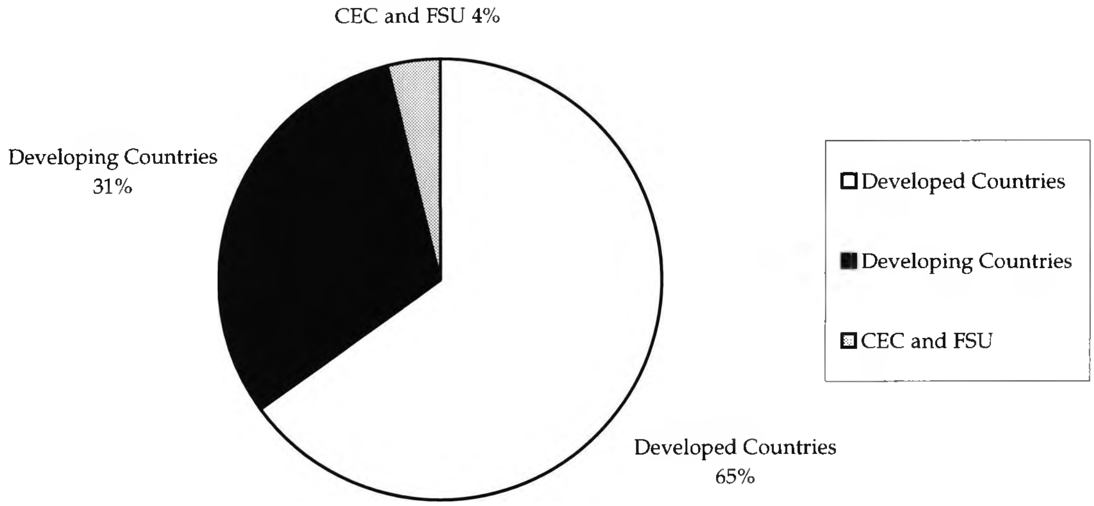
Table 1.2, FDI Inflows into the CEC and the NIS of the FSU, 1989-1995 (in millions of US$ dollars)

Host Country	FDI Inflows by Year 1989	1990	1991	1992	1993	1994	1995	Cumulative FDI 1989-1995	FDI Distribution 1989-1995 (%)	EIU FDI Forecast 1996-2000
Albania				20	58	53	70	201	0.59%	583
Armenia						8	10	18	0.05%	
Azerbaijan							110	110	0.32%	
Belarus				7	10	15	20	52	0.15%	
Bosnia-Herzegovina*									0.00%	
Bulgaria		4	56	42	55	106	135	398	1.16%	1,428
Croatia				13	72	98		183	0.53%	
Czech Republic**		120	510	983	654	878	2,500	5,645	16.43%	15,466
Estonia				82	162	214	188	646	1.88%	
FYR of Macedonia (FYROM)						5		5	0.01%	
Federal Republic of Yugoslavia*									0.00%	
Georgia*									0.00%	
Hungary	187	311	1,462	1,479	2,349	1,144	3,500	10,432	30.36%	12,968
Kazakhstan				100	150	185	284	719	2.09%	
Krygyzstan						10	15	25	0.07%	
Latvia				29	45	214	250	538	1.57%	
Lithuania				10	12	31	50	103	0.30%	
Moldova, Republic of				17	14	23	32	86	0.25%	
Poland	11	89	291	678	1,715	1,875	2,510	7,169	20.87%	21,969
Romania			40	77	94	340	373	924	2.69%	4,017
Russian Federation				700	700	1,000	2,000	4,400	12.81%	26,960
Slovakia**		69	113	82	193	203	250	910	2.65%	2,150
Slovenia	3	4	65	111	111	84	130	508	1.48%	3,052
Tajikistan				10	15	10	25	60	0.17%	
Turkmenistan***				11	104	100		215	0.63%	
Ukraine				200	200	159	200	759	2.21%	1,400
Uzbekistan				40	45	50	115	250	0.73%	
Total: CEC & FSU	**201**	**597**	**2,537**	**4,691**	**6,758**	**6,805**	**12,767**	**34,356**	**100.00%**	**99,178**
Total: CEC	**201**	**597**	**2,537**	**3,485**	**5,301**	**4,786**	**9,468**	**26,375**	**76.77%**	**63,843**
Total: FSU	**0**	**0**	**0**	**1,206**	**1,457**	**2,019**	**3,299**	**7,981**	**23.23%**	**35,335**

Sources: UNCTAD-DTCI (1996) estimates (data supplied via direct communication from the Research and Policy Analysis Branch [RPAB]), which are based on IMF balance-of-payments tape. Other sources of data included EBRD (1995), IMF (1995, 1996), UN/ECE (1995a, 1995b), Wiener Institut fur Internationale Wirtschaftsvergleiche (WIIW)(1995 & 1996 [the latter by direct communication]), and the researcher's own calculations. Forecast data for 1996-2000 are based upon projections made by the Economist Intelligence Unit (EIU)(1996), some of which have not been included. The data that has been omitted includes $2,210.0 million for all of the former Yugoslavia (except Slovenia), $1,890.0 million for all three of the Baltic States, and $5,085.0 million for the countries of the FSU (excluding the Russian Federation and the Ukraine).

Notes: *FDI data is currently not available for Bosnia-Herzegovina, Federal Republic of Yugoslavia (Serbia & Montenegro), and Georgia. **Data for both the Czech Republic and Slovakia between 1990-1992 are based upon balance-of-payment data from the WIIW and statistics for 1993-1995 are from UNCTAD-DTCI data. ***The EBRD advises that FDI data for Turkmenistan is subject to a higher than usual degree of uncertainty.

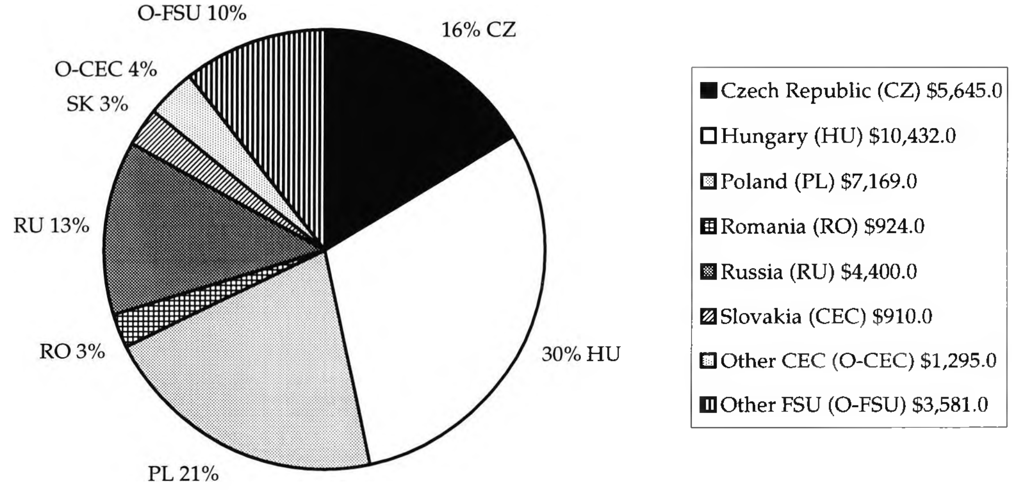
Figure 1.3, Shares of Global FDI Inflows, 1995



Sources: UNCTAD-DTCI (1996) estimates (data supplied via direct communication from the Research and Policy Analysis Branch [RPAB]), which are based on IMF balance-of-payments tape. Other sources of data included EBRD (1995), IMF (1995, 1996), UN/ECE (1995a, 1995b), Wiener Institut fur Internationale Wirtschaftsvergleiche (WIIW)(1995, 1996 [the latter by direct communication]), and the researcher's own calculations.

Note: For 1995, annual FDI totals for each of the regions stated were as follows: Developed Countries received USD $203,168.0 million, Developing Countries had USD $98,886.0 million, and the CEC and the FSU with USD $12,767.0 million

Figure 1.4, Cumulative FDI Inflows into the CEC and the FSU, 1989-1995 (in millions of US$ dollars)



Sources: UNCTAD-DTCI (1995, 1996) estimates (data for 1996 supplied via direct communication from the Research and Policy Analysis Branch [RPAB]), which are based on IMF balance-of-payments tape. Other sources of data included EBRD (1995), IMF (1995, 1996), UN/ECE (1995a, 1995b), Wiener Institut fur Internationale Wirtschaftsvergleiche (WIIW)(1995, 1996 [the latter by direct communication]), and the researcher's own calculations.

economies in transition the reality of the situation tells quite another story. However, prior to addressing the fundamental role of foreign enterprises, especially TNCs, and FDI in the region's transformation, several other pertinent points should be addressed regarding the statistical data on FDI in the CEC and the FSU.

When one examines the statistics currently available on FDI in this area since 1989 two key points become very apparent. The first point is that the distribution pattern of investment inflows clearly shows disproportionate amounts of FDI concentrated within a very select group of host countries (See **Figure 1.4**). For example, when one examines the cumulative FDI statistics from 1989-1995 noted previously (See **Table 1.2**) it becomes apparent that the heaviest concentrations of FDI are mainly found within four host countries, namely Hungary with $10,432.0 million (30%), Poland at $7,169.0 million (21%), the Czech Republic with $5,645.0 million (16%), and investment in the Russian Federation amounting to $4,400.0 million (13%). Consequently, these four host countries accounted for almost 80% of total amount of FDI entering the region as a whole. Moreover, between 1989-1995 the CEC as a single group attracted almost $26.3 billion dollars worth of FDI, or 77% of the total amount invested.

Still, while this phenomenon is not desirable from the standpoint of assisting the economic recovery of the region as a whole it is to be expected. This is because each of the CEC and the NIS of the FSU has charted its own path down the road to economic transformation from very different starting positions. For example, Hungary, which based on the data available has obviously attracted the lion's share of FDI, has been trying to liberalize its own economic system since the late 1960s through to the 1980s under their *New Economic Mechanism (NEM)*, although with mixed results. Therefore, in comparison to its neighbors Hungary's economy was deemed to be very advanced. Subsequently, when the Berlin Wall came crashing down in late 1989 Hungary found itself perched in an advantageous position to attract FDI in comparison to its Eastern Bloc neighbors.

Yet, it is also evident from the statistics that this heavy concentration of FDI within a select group of host countries in the region is gradually diminishing.[54] Still, the regional preference of Western firms in directing their attention to the somewhat more economically advanced CEC will probably mean that this group of countries will continue to attract the bulk of FDI over the next decade or so.

The second major point which is apparent from the statistics on FDI, and which was referred to earlier in this section, is that so far the actual level of FDI going into the CEC and the FSU has failed to live up to the earlier optimistic expectations by both the East and the West. While one

[54]The EBRD contends that this concentration of FDI within a few host countries is gradually eroding over time and in the words of the actual report, *"It is likely that these developments are explained primarily by the continuing progress in reform in a wide range of countries."* EBRD (1995), *Ibid*, pp. 86.

could easily partially explain this situation by stating that initial expectations and forecasts were simply overly optimistic, which is of course very much true given hindsight, it does not negate the fact that FDI inflows to date still remain very small by international standards. These lower than expected levels of FDI have generally been the result of a variety of external and internal factors.

The two major and most obvious external factors that have affected FDI flows have been accredited to the general worldwide downturn in economic conditions and increasing competition for investment from other parts of the world. In regards to the former, as the economic cycle continued to head downwards the corporate sound bites and buzz words often heard in the late 1980s and early 1990s were *competitiveness, downsizing, a return to core competencies*, and *restructuring*. Given such poor economic conditions and the obvious affect they have had on business it is no surprise to see that many firms have not only been cutting back on new investments but have also been divesting themselves of some peripheral type business operations. In terms of the increased competition for FDI, well in recent years it has appeared to be a *buyers' market* as there has been a tremendous range of investment opportunities available to the would-be buyer. Since 1989, the competition for FDI has been great with the opening up of the markets of the CEC and the FSU, increased access to China which possesses the world's biggest population center, the *Tiger* economies of South-East Asia[55] are continuing to grow at a fast pace, some countries of Latin and South America are now more stable and open to foreign investment and offer some attractive privatization opportunities, and of course the developed nations of the world have also been putting on a sale of their own through various privatizations and divestments.

The internal factors accounting for the low levels of FDI in the CEC and the FSU mainly attributed to the general conditions for investment in the countries of the region, which are both real and perceived by foreign investors. These internal factors include the political risk associated with the instability of the region and uncertainty about the leadership of most of the countries; numerous economic problems like high levels of inflation and inadequate pricing mechanisms for goods and services; monetary risks such as the unreliable banking system and the issue of currency convertibility; restructuring problems with regard to the situation of the SOE system, an initial drop in production output and shortage of orders from the collapse of traditional CMEA markets, a run-down and in some areas non-existent infrastructure, the task of re-training the labor component at both the management and employee levels; a lack of institutional infrastructure like bankruptcy and insolvency laws that has been exacerbated by rising inter-enterprise debt, especially among SOEs still under government control, that has lead to a ripple effect of problems across local firms; an inadequate regulatory framework for concerns of ownership of land and property; and all the other numerous difficulties associated

[55] The term *Tiger* economies refer to the countries of South Korea, Singapore, Malaysia, and Taiwan.

with the tremendous process of economic transformation at hand.

However, once again we return to the fact that the legacy of over 40 years under the rule of the former communist apparatus and its centrally planned economic system has definitely left its mark upon the CEC and the FSU. Peter Kraljic (1990), a partner with the consulting group of McKinsey & Company, has described the differences between East and West as a series of *system gaps*: the technology gap, the productivity gap, the marketing gap, the capital gap, the environmental gap, the infrastructural gap, the motivation gap, the management gap, the legislative gap, and the democracy gap. Kraljic states that *"There is, in effect, a system gap between East and West, a disparity that results not from specific choices or actions but from long entrenched patterns of social, economic, and political organization."*[56] The result of these system gaps between the East and West has left the CEC and the FSU impeded by several key competitive disadvantages. Matija Rojec (1994), a noted Slovenian researcher of FDI in these transition economies, has characterized these competitive disadvantages in the region as a

> *"...lack of financial resources, lack of strong market segments with a high demand for products and sophisticated buyers, weak related and supporting industries and their interlinkages, deficiencies in the field of management and commitment to work/company. Theory suggests that FDI can offer distinctive contributions in a number of these fields. Therefore, FDI is potentially one of the relevant methods for speeding up the transformation process of former socialist economies."*[57]

Given these disadvantages it is understandable that levels of FDI into the CEC and the FSU have not yet lived up to earlier expectations. After all, as the saying goes *"Rome wasn't built in a day"* and the transformation of the countries of the region will take a considerable amount of time and investment before being completed. Therefore, it is clearly the case that FDI has a fundamental and important role to play in assisting the countries of the region in bridging some of the *gaps* that separate East from the West.

1.5.3 The Role of Foreign Direct Investment in the countries of the East: Eastern and Western Perspectives

The important role that FDI can play in the process of economic transformation has been described by numerous authors and organizations, both from the East and the West. From the Eastern perspective, Andras Koves (1992), the Hungarian economist, makes the point that *"Foreign direct investment is regarded as a powerful means for increasing macroeconomic efficiency, accelerating economic growth, and achieving integration into the international economy in many*

[56]All of these *system gaps* are more fully discussed in the article by Kraljic. See Krajlic, P. (1990), *The Economic Gap Separating East and West*, pp. 15.

[57]Rojec, M. (1994), *Foreign Direct Investment in the Transformation Process: Some Operational Characteristics of Foreign Subsidiaries and Joint Ventures in Slovenia*, pp. 24.

developing and industrializing countries."[58] Furthermore, Koves goes on to describe two additional factors related to the need for FDI in the CEC, mainly an inadequate supply of domestic savings to promote the process of economic transition internally as well as the high levels of external foreign debt and the associated problems of refinancing[59]

Another view from the eastern perspective has been expressed by Zbigniew Dobosiewicz (1992), a researcher of FDI in the CEC, who throws some light on the issue of FDI from the perspective of the governments of the region. From this point of view, the positive effects of FDI in the economies in transition are based on the premise that the foreign investor (the firm) will be able to assist in several areas of the economic structure of the economy. These areas include the modernization of the economy via the transfer of technology and Western organizational structures that can permeate through to domestic enterprises; growth of output, particularly given the present economic conditions in the region; balance-of-payment benefits given certain expectations (by the new democratic governments of the region) of export growth, import economies, and greater import substitution; increases in production of goods and services; and the creation of a competitive market system in an economic environment where *competition* was almost a completely foreign term.[60]

Marjan Svetlicic and Matija Rojec (1994), two Slovenian based researchers of FDI, have been more cautious about the proposed revolutionary role of FDI. In their view, the revolutionary role that FDI has been given in the process of economic transformation in the region is far beyond its realistically assessed role in the economic development of the region. One of the conclusions they reached was that FDI in the CEC is more of a supportive than a main instrument in the transition process. In their own words, *"FDI is an oil and not a gasoline of the structural transformation. The gasoline has to be supplied basically by local efforts both in terms of setting the right economic system and the creation of stimulative climate for the development of local entrepreneurship."* Still, the authors also fully acknowledge the important role of FDI in these transitional economies by adding that *"...it is well known, however, that the car can not run smoothly without oil."*[61]

From a Western perspective the role of FDI in the process of transition has generally been more optimistic than those previously expressed from the East and possibly even a little too much so in some cases. In an earlier joint publication by leading international institutions, namely the *International Monetary Fund (IMF)*, the *World Bank*, the *Organisation for Economic Coo-peration and Development (OECD)*, and the *European Bank for Reconstruction for Development (EBRD)*(IMF,

[58]Koves, A. (1992), *Central and East European Economies in Transition: The International Dimension*, pp. 52.

[59]*Ibid.*, pp. 52-57.

[60]Dobosiewicz, *op. cit.*, pp. 27-37.

[61]Svetlicic, M. and Rojec, M. (1994), *Foreign Direct Investment and the Transformation of Central European Economies*, pp. 307 and pp. 311 respectively.

World Bank, OECD, and EBRD [1991]), it was the concerted view that attracting substantial flows of foreign investment could be crucial in the transition to a market economy.[62] The United Nations, Economic Commission for Europe (UN/ECE [1992a]) asserted, on a more general level, that *"Foreign investment is expected to play a major role in the transformation of the Eastern economies."*[63] According to the research work of Carl H. McMillan, one of the pioneering academic explorers of East-West trade and investment, FDI has a substantial role to play in various aspects of the transition process in the transitional economies of the East: stabilization and recovery, marketization, privatization, and overall economic restructuring.[64]

1.5.4 The Role of the Transnational Corporation in the countries of the East: An International Perspective

Given the complex and difficult economic circumstances and conditions found in the CEC and the FSU the TNC seems to be the ideal economic agent to operate within this environment. As has been previously stated, the TNC possesses a multitude of resources that can be readily transferred into these economies in transition. In a sense, the TNC can act as a facilitator of the economic transition by assisting in filling in some of the *system gaps* that were previously eluded to by Kraljic. In this regard, several scholars have pointed out the positive role that the TNC can play in the economic transition of the CEC and the FSU.

According to John H. Dunning (1994a), a noted academic in the development of FDI theory, described the role of TNCs in the global economy, *"...TNCs are the main producers and organizers of the knowledge-based assets that are now primarily responsible for advancing global economic prosperity; they are also the principle cross-border disseminators of the fruits of these assets."*[65] Based upon this point of view it should be logical to assume that FDI by TNCs would be the ideal catalyst for assisting the CEC and the FSU in their process of economic transformation. Expanding upon this point, Terutomo Ozawa (1992) has characterized the role of TNCs as *"jump-starters for economic development."*[66] Ozawa points out that, *"Undoubtedly, TNCs are the prime movers behind the industrial dynamism of rapidly developing countries. Indeed, they (TNCs) are now increasingly counted upon to duplicate their role as development agents elsewhere in the world, especially in Eastern Europe, which is turning outward by adopting pro-market policies."*[67] However, it should be made clear that the TNC, despite any philanthropic activities in which it may be involved, is not a philanthropic organization and it is a misconception to believe it to be one.

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[62]For further details refer to IMF, World Bank, OECD, and the EBRD (1991), *A Study of the Soviet Economy* (in three volumes).

[63]See UN/ECE (1992a), *Economic Bulletin for Europe,* No 44.

[64]See McMillan, C. H. (1993), *The Role of Foreign Direct Investment in the Transition from Planned to Market Economies.*

[65]See Dunning, J. H. (1994a), *Re-evaluating the Benefits of Foreign Direct Investment,* pp. 28.

[66]See Ozawa, T. (1992), *Foreign Direct Investment and Economic Development,* pp. 51.

[67]These points are addressed in more detail by Ozawa. *Ibid.,* pp. 28.

The TNC is a business entity seeking to be competitive and adaptable in an ever competitive and changing global environment. In terms of this environment, Dunning (1994a), has described the changing world of FDI from the viewpoints of both the country and the firm. According to Dunning, from the host country's point of view, *"In the early 1990s, most governments are claiming FDI as 'good news', after a period of being highly critical - if not downright hostile - to these investments in the 1970s and early 1980s."*[68] From the host country's standpoint this change of heart and mind has been a result of several factors such as a renaissance of the market system; globalization of economic activity; the enhanced mobility of wealth-creating assets; a growing number of national economies that are approaching the *take-off* stage in their economic development[69]; a convergence of economic structures among developed countries and some developing countries; a change in the evaluation criteria utilized by host country's governments to assess the impact of FDI on the host country's economy; and overall a better understanding on the part of most host country governments, over the passage of time and as a result of experience, on the actual costs and benefits associated with FDI.

1.5.5 Capitalism Goes East!

While academics and organizations have each sought to provide their own perspective on the relevant roles of both FDI and the TNC within the process of transformation in the CEC and the FSU, actual investors have not stood idly by waiting for the blessings of such individuals and organizations. Instead, since the dramatic events of 1989 a wide array of investors, and a few even before 1989, have realized the opportunities and potential that these new markets have to offer and have taken the plunge via direct investment. In fact, the list of major foreign investors in the CEC and the FSU reads like a who's who of the world's top biggest firms, whether you are reviewing *Fortune* magazine's *"The Fortune 500," Business Week's "The Global 1000,"* the United Nations "*Top 100 TNCs," Hoover's Handbook of World Business "World's 500 Largest Industrial Corporations,"* etc.. Almost all of the widely known TNC names and economic giants of the global economy have all been active within the region via FDI. Some of these big name investors have included companies like *Allianz Holding* (Germany), *ABN-AMRO* (The Netherlands), *ABB Asea Brown Boveri* (Sweden/Switzerland), *Coca-Cola* (USA), *Fiat* (Italy), *Deutsche Telekom* (Germany), *General Motors* (USA), *Generali Group* (Italy), *ING Group* (The Netherlands), *Koninklijke PTT Nederland* (Netherlands), *McDonald's Corporation* (USA), *Nestlé* (Sweden), *Pepsi-Co* (USA), *Philips Electronics* (The Netherlands), *Philip Morris* (USA), *PTT Suisses* (Switzerland), *Royal Dutch/Shell Group* (The Netherlands/United Kingdom), *Rhône-Poulenc* (France), *Siemens* (Germany), *Unilever* (The Netherlands/UK), and the *Volkswagen Group* (Germany). Yet, besides such well known names there has also been a host of other lesser

[68]Dunning elaborates on these perspectives in greater detail on the basis of how a host country can utilize FDI and TNCs to upgrade their competitiveness and comparative advantage. Dunning (1994a), *op. cit.*, pp. 24 and pp. 30-40 respectively.

[69]Dunning points to such *take-off* economies like those in South East Asia: South Korea, Singapore, Malaysia, and Taiwan. See Dunning (1994a), *op. cit.*, pp. 26.

known major investors whom have established local operations in these emerging markets. For example, other major investors have included companies like *Booker* (UK), *Denver & Ephrata Telephone* (USA), *Glaverbel* (Belgium), *Hemingway Holdings* (Austria), *Indiana Foods* (USA), *Jotun Polymer* (Norway) *Kemira* (Sweden), *Lafarge* (France), *Leventis Group/Tria Epsilon* (Greece), *NKT Cables* (Denmark), *Pan Smak Pizza* (Canada), *Thomson* (France), *Sanvik* (Sweden), *VDO Adolf Schindling* (Germany), and *Wienerberger* (Austria) to mention a few. On the basis of such activities by private enterprise it was now clear that capitalism has finally made its way East.

Given both the immense level of interest by firms and their willingness to engage in FDI within the CEC and the FSU, especially with respect to Western based TNCs, it is now clear that quality research needs to be conducted in this area in order to create a better understanding of the situation.

1.6 A Requisite for Research

Prior to the fall of the Berlin Wall in late 1989 only a very small amount of research had been done on the economic and business environment in what was then the Soviet Union and its Eastern Bloc associates. Though, as events in late 1989 began to take shape and the wave of fundamental and historic change began to sweep the region, so too was there a dramatic shift in the interest level of both researchers and business practitioners to explore this subject area in much greater detail. This desire for knowledge and information on these newly opened economies of the East was most acute in the Western business community who saw the countries of the region as a vast new opportunity for expansion and development. So as events in the East were unfolding this subject became highly topical and slowly but surely this high demand for information created a sudden surge of articles, papers, and books from a variety of sources and of varying quality.

So far most of the literature has concentrated on the macroeconomic issues related to the process of economic transformation in the CEC and the FSU. The focus of such research efforts has primarily been directed towards such topics as appropriate fiscal policy and monetary stabilization policies, numerous discussions and opinions on the methods and sequencing of the privatization of the SOE sector, re-negotiation of foreign debt, price liberalization, currency convertibility and exchange rates, import liberalization, wage controls, reforms in the banking system, budget reforms, etc..

While these macroeconomic issues are critical to creating the stability that is essential to the restructuring process for these economies in transition it is equally important to properly focus on the microeconomic environment. One of the key focal points of such a research effort should be on providing a thorough and practical examination of the activities of individual foreign enterprises that have engaged in FDI within the environment of the CEC and the FSU during the period of transition. More precisely, several *exploratory* type questions need to be asked and answered which include ***Why do firms invest?***; ***How do they invest and how do the chosen modes of investment change over time?***; ***What means do these firms employ to evaluate the performance of their investments and subsequently what levels of performance have been achieved by these same firms?***; and ***What strategies are used by these firms in their operation?*** Furthermore, given the fact that some of these investments are now several years old it is also appropriate that this study examines some of these topics from a retrospective viewpoint to see how they have evolved within the context of the CE environment.

According to Stanley J. Paliwoda, an author of several books and papers on the CEC and the FSU, *"a conventional approach to a book of this kind* (this statement is also applicable to research on the business environment of the CEC and/or FSU) *would be to offer some sort of theoretical model, create some numbers, push those numbers through the model, et voila! - instant rankings of investment potential. Although this method may give rise to innumerable PhDs, it is of little practical use."*[70] Bearing this point in mind, the purpose of this research study is not merely to take a snapshot of FDI by foreign firms in the CEC and the FSU at a single point in time. While such an undertaking done properly would more than likely satisfy the requirements of a PhD it does not necessarily create a strong basis for a long-term research project. Hence, given such foresight this research study will not merely be just a single one-off project but the start of what is planned to be the beginning of a longitudinal research study of FDI by Western firms throughout the CEC and the FSU.

It is anticipated that the end result of this type of research will facilitate both a better understanding of the importance of FDI and the role of foreign enterprises, especially with respect to the role of the TNC, in assisting the CEC and the FSU in their process of economic transformation. Overall, this research work will greatly assist in filling in a fundamentally vital gap in the knowledge of this dynamic new area of international business studies and thus facilitate and enhance future research into these economies in transition.

1.7 Providing a Focus: The First Stage of the Research Study

In light of both the general shortcomings of many previous studies in this area of research and the enormous complexities involved in conducting such an immense study utilizing the above stated research questions as a basis, it was the decision of the researcher to implement the research study in a series of individual stages. In doing so, each stage of the study will concentrate efforts on a specific group of countries which possess a certain number of synergies and which have been defined by a set of pre-defined parameters. On the basis of the proposed

[70]Paliwoda, S. J. (1995), *Investing in Eastern Europe: Capitalizing on Emerging Markets*, pp. 1.

methodology it is the opinion of the researcher that the study will be more manageable and more prone to effectively ascertaining its stated objectives.

This decision was made primarily as a result of several mitigating factors which included, the vastness of the region as a whole, the unique nature of individual countries, and the obvious differences that exists between them; the shortcomings of previous academic and practitioner studies on this subject - many of which attempted to cover the region as a whole while only utilizing a very small and limited sample - to provide an accurate picture of FDI in the CEC and the FSU; the actual level of FDI within a particular host country of the region as well as the quality and availability of data on these investments; and the limitations restricting the researcher in terms of both time and the financial resources that were available.

Therefore, in providing a focus for this first stage of the research study a set of three basic parameters were adopted. These parameters included the type and origins of the firm making the investment, the individual host countries of the FDI forming the research site, and the time of the actual investment. On the basis of these three parameters the researcher was able to develop a *population stratum*[71] that served as the basis for this first stage of the research study.[72]

1.8 A Statement of Purpose (The Research Propositions)

The specific purpose of this first stage of the research study was to develop and implement a survey that would examine and interpret ***FDI by major Western firms that has occurred between 1989 and the end of the first quarter of 1996 within the context of the environment identified as Central Europe (CE)(the Czech Republic, Hungary, Poland, Romania, and Slovakia).*** In light of this statement the research propositions to be addressed were refined somewhat so as to allow them to function properly within the context of the countries to be studied. Hence, the four research propositions that formed the basis of this particular study were as follows:

Proposition One:

Why do major Western firms engage in FDI within a specific CE host country (locational and motivational factors of FDI)?

Proposition Two:

How have major Western firms invested within a specific CE host country (entry modes) and how have these modes evolved over time (evolution of ownership modes)?

[71]A *population stratum* refers to a subpopulation of the main population. As defined by Judd, Smith, and Kidder, *"A stratum* (referred to as a subpopulation, a population stratum, or simply a stratum) *may be defined by one or more specifications that divide a population into mutually exclusive segments."* See Judd, C. M., Smith, E. R., and Kidder, L. H. (1991), *Research Methods in Social Relations*, pp. 130-131.

[72]These parameters are each be described in greater detail within *Chapter 3, Research Methodology: A Travel Guide to "The Island of Research."*

<u>*Proposition Three:*</u>
What means are utilized by major Western firms to evaluate the performance of their FDIs (performance criteria) and consequently how have these direct investments performed within the chosen CE host country environment over time (relative performance)?

<u>*Proposition Four:*</u>
What strategies have been employed by major Western firms in the CE environment (geographical and functional strategies)?

1.9 Conclusions

The fall of the Berlin Wall in late 1989 marked not only the beginning of the end of Communist based regimes across the CEC and the FSU but also the signalled the collapse of the *Iron Curtain* as well as the end of the *Cold War* that had divided the East and the West for over 40 years. Just as equally important, this historic event also signified the beginning of a new and unprecedented period in modern history in which two former groups of adversaries were finally coming together in an effort to bridge the many *system gaps* that have so separated them.

Yet, despite the popular conception in the West, the demise of Communist regimes in the East were not so much a result of a failed ideology but more so a failure of the command economy system, via *The Plan*, to satisfy the wants and needs of the populace. In fact, while *The Plan* fulfilled the wants, needs, and aims of the *State* and that of the *Party* it greatly ignored those of the average citizen. In retrospect, from the perspective of the normal citizen *The Plan* was ill-conceived, poorly prepared, and badly implemented. Compounding the situation further was the fact that by around the end of the 1950s *The Plan* had to rely almost exclusively on a system of economic production which in many cases was poorly managed by politically appointed members of the *nomenklatura*, utilized antiquated technology, employed inefficient production techniques, underused and wasted scarce resources, was geared towards meeting quotas based on quantity with almost a complete disregard for quality, and thus the final products were often of questionable value. The end result for the consumer was an almost continuous shortage economy with no viable alternatives on offer.

Therefore, while the State appeared strong to the outside world the internal situation was quite different. The average citizen was forced out of necessity to wait in long lines just to have the opportunity to buy products of very low quality and limited utility. As the level of discontent and hardship continued to increase for the common people, manifesting itself through movements like *Solidarity*, the policy of *normalization* proved to be an ineffectual means of restoring order. While Gorbachev and some others attempted to reform the Communist system from within via programs like *perestroika* and *glasnost* ongoing events overtook them as these attempts were simply a case of too little too late. In the end the Communist system itself proved incapable of internal reforms and its collapsed was not only as a result of external pressures from a tidal wave of local popular discontent but also from the sheer weight of the system itself. Subsequently, as the new democratic regimes of the CEC and the NIS of the FSU each took power one of their first priorities was to replace their respective failed command economy structure with a more Western oriented market system.

In the wake of this revolutionary wave of change numerous Western firms, many of which are some of the world's largest TNCs, have each sought to take advantage of business opportunities in these new and transitional markets. In doing so, a number of Western firms have decided that the time was right to enter the markets of the East by establishing local operations via FDI. In 1989, the CEC and FSU received only $201.0 million dollars worth of FDI. However, by 1995 the amount of FDI inflows to the countries of the region had grown substantially to a total of $12,767.0 million. Overall, between 1989-1995 cumulative FDI into the region amounted to a total of $34,356.0 million. Yet, while this level of investment is still relatively small in comparison to international standards, it has had a much greater affect on the local economies than its size would indicate.

However, despite the avalanche of articles, books, and papers over the last few years on the CEC and the FSU only limited attention has been given to understanding the microeconomic environment, especially the unique role of Western firms in these economies in transition. Hence, in seeking to fill this gap in the base of knowledge by addressing several pertinent and topical questions aimed at providing an examination of Western enterprises that have engaged in FDI within the environments of the CEC and the FSU. The focus of the research is directed at creating a practical and thorough examination of the motivations, origins, entry modes, performance, and strategies of local firms with foreign capital participation operating within the environment of the CEC and the FSU via FDI. Furthermore, it is intended that this examination will form the cornerstone in what is intended to be a multi-stage longitudinal research study which will seek to address these issues and others as the environment of the region evolves and develops over time.

In this first stage of this study the researcher has focused on developing and implementing a survey that would examine and interpret FDI by Western firms within the context of the environment identified as Central Europe (CE)(the Czech Republic, Hungary, Poland, Romania, and Slovakia) that have occurred between the latter half of 1989 to the end of the first quarter of 1996. In the subsequent chapters of this thesis the researcher will provide a critical review of the pertinent literature in the subject area, detail how this first stage of the study was conducted, the results achieved, and how this particular research study has contributed to the base of knowledge on the subject.

Chapter 2

A Review of the Relevant Literature

2.1 An Overview

This chapter provides a review of the literature that is related to the issues addressed by the research propositions. While these research propositions cover a variety of areas and topics within the field of international business, it should be remembered that the general purpose of this review is to examine the existing literature related to FDI in the environment of the CEC and FSU, especially with regard to the business environment of CE. Moreover, given the exploratory nature of the research propositions the researcher has deemed it appropriate to provide only an overview of the main theoretical literature pertaining to this study.

The chapter itself has been divided into two distinct sections. The first main section of the review provides an overview of the pertinent theoretical literature on the TNC and FDI. This area of the review has been divided into several related parts. To begin with, a brief history of the development of the TNC and FDI are presented. Secondly, definitions for both the TNC and FDI are specified. Thirdly, an overview of the main theories pertaining to the TNC and FDI are presented outlining how our understanding of the two elements has evolved over time. Finally, this first part of the literature review concludes with a description of the various types of FDI which constitute the motivational factors affecting the firm's decision whether or not to engage in FDI within a given host country.

The remainder, and bulk, of the literature review focuses on research work that has been conducted on FDI by Western firms within the context of the CEC and the FSU. This area of the literature review has been divided into two component parts. The first of these elements concentrates on the relevant literature that has chronicled the pre-1989 environment for FDI in the countries comprising what was formerly referred to as Eastern Europe and the Soviet Union. The second part of the review focuses on the research literature pertaining to the subject of FDI in the CEC and FSU in the post-1989 environment. This section of the literature review is focused upon the research that has been done by both academics and practitioners in this particular field in the post-1989 period and which are closely related to the research propositions set out above.

The chapter concludes with a summary evaluation of the pertinent research literature. In doing so, special attention is given to those research studies that have examined FDI within the five CE countries forming the basis for this study. Some general points regarding the theoretical literature are also provided. This concluding section will demonstrate that, despite some previous efforts to address the subject matter, there still exists a pressing and important need for further in-depth research to be conducted so as to fill in the gap that currently exists in the base of knowledge. Research that is hopefully provided by this study.

2.2 The Transnational Corporation and Foreign Direct Investment: A Review of the Relevant Theoretical Literature

In any review of the theoretical literature pertaining to FDI it is appropriate to cover also the materials related to the TNC. This is because FDI is an integral element of the activities of the TNC. In the words of Root (1990), "*Direct foreign investment* (FDI) *is the distinctive feature of multinational enterprise* (TNC). *Hence, a theory of direct foreign investment is also a theory of the multinational enterprise as an actor in the world economy.*" Root continued by stating that FDI "*...is not simply (or even primarily) an international transfer of capital but rather the extension of an enterprise from its home country into a foreign host country.*"[1]

2.2.1 A Brief History on the Transnational Corporation and Foreign Direct Investment

The presence of international trade can be traced back to as early as 2800 B.C. when Egyptians and Phoenicians engaged in a wide range of commerce in the Phoenician city of Byblos. The level of international commerce continued to grow as civilization as we know it took root and flourished. By the middle ages several firms had expanded their international activities. Notable early international firms included several trade oriented organizations such as the *Commenda, Hanseatic League*, and *Merchant Adventurers*, as well as various financial operations based in Italy such as *Bardi, Acciauoli, and Peruzzi* and the *Medici* which offered banking services throughout the main capitals of Europe.

Yet, the origins of the international firm traces its roots more closely to the 16th and 17th centuries with the creation of various trading organizations. During this period FDI tended to be generally of two types: FDI to support the trading activities of a specific home country or to promote colonization and land development. Examples of the former included international firms such as the *Muscovy Company* that was established to pioneer the North East Passage; both the Dutch *East India Company* and British *East India Company* which were each created to

[1]See Root, F. (1990), *International Trade and Investments*, pp. 618.

develop their respective country's interests in India and the Far East; and the *Hudson's Bay Company* which was established as a major trading operation in North America, primarily in what is modern day Canada. In regards to the latter, the *Massachusetts Bay Company*, *Providence Company*, and *Virginia Company* were each set up to colonize and develop the Eastern seaboard of what is now the United States of America.

One of the first firms to become recognizable as a TNC as we know it today dates back to the mid-1800s when the *Singer Company* expanded internationally with the advent of the industrial revolution. In fact, the industrial revolution not only had a profound impact on the domestic economic environment but also paved the way for a much more comprehensive scope for international operations. The 19th century also witnessed leading European powers, and to a lesser extent the United States, establishing a variety of colonies throughout the less developed world. This was followed up by a wave of FDI in these new territories and markets from TNCs in the respective home countries.

By the 20th century new technological developments, especially in the industrial sectors, led to a second industrial revolution. The introduction of electricity, the internal combustion engine, and inter-changeable parts were instrumental in this process. This in turn resulted in another watershed period for both the TNC and FDI. For example, the story of the *Ford Motor Company* epitomizes this era. Ford's success was in the area of mass production which allowed the company to produce standardized automobiles at low costs which in turn were sold to customers at an affordable price. The company's initial good fortune allowed it to expand internationally via both licensing agreements with other producers as well as through the establishment of foreign subsidiaries through FDI. Ford also sought to expand its operations via vertical integration. For example, Ford established its own rubber plantations in Latin America to secure the necessary raw materials to produce car tires for its vehicles. The raw rubber supplies were transported back to the company's production facilities located in the United States on its own private fleet of ships. However, such vertical integration was not always a recipe for success as Ford itself experienced in the example provided.

The development of TNC and FDI activity continued as time progressed but were periodically disrupted by major international events. These disruptions included two major military conflicts of international proportion in the form of the First (1914-1918) and Second World Wars (1939-1945), as well as the Great Depression of the early 1930s that led to a global recession. These factors each contributed to a major shift in the origins of TNC activity and subsequent sources of FDI as a number of leading world powers suffered from shifts in their respective power bases.

Overall, the motives for early firms to expand internationally are generally the same as those attributed to today's TNCs, although as time has progressed these motives have become more and more intertwined with one another. More importantly, with the passage of time the role of the TNC in the global economy has increased dramatically to the point where it now stands as a major economic force. The TNC has the potential to be a major instrument for economic change, but it is not a philanthropic entity and should not be viewed as such. The TNC like any firm is driven by the profit motive and it seeks to be a dominate force within its respective industry.

2.2.2 The Transnational Corporation

Vernon (1994) has stated that, *"With about half of the world's business conducted by TNCs today, these institutions cannot fail to command the continued attention of politicians, poets, scholars, to be dissected, vilified or glorified according to the convictions of the observer."* Vernon goes on to state in the same paper that, *"Measured against the growing importance of TNCs over the past thirty or forty years, the contributions from leading economists and political scientists have been minimal. But the muted responses from the inner citadels of these disciplines is hardly surprising. Despite the existence of a few powerful TNCs before the Second World War, the fact is that they did not gain prominence as a major force in international economic relations until the post-war period."*[2]

According to the UNTCMD/DESD/ECE (1992a), a TNC can be defined as,

> *"An enterprise, irrespective of its country of origin and its ownership, including private, public or mixed, comprising entities in two or more countries, regardless of the legal form and fields of activity of these entities, which operates under a system of decision-making, permitting coherent policies and a common strategy through one or more decision-making centers, in which the entities are so linked, by ownership or otherwise, that one or more of them may be able to exercise significant influence over the activities of others and, in particular, to share knowledge, resources and responsibilities with the others."*[3]

For the purposes of this research study this TNC definition has been simplified to encompass all firms that control foreign assets via FDI. Furthermore, in this research study the term TNC has been used specifically to refer to Western based firms, i.e. those firms whose main company headquarters are based within Western Europe (excluding all of the CEC and the FSU) or North America (excluding Mexico). This last point is described in greater detail in *Chapter 3, Research Methdology: A Travel Guide to "The Island of Research."*

The TNC term, which is often used interchangeably with both the terms *Multinational Corporation (MNC)* and *Multinational Enterprise (MNE)* by most writers, only came into usage in

[2]See Vernon, R. (1994), *Research on Transnational Corporations: Shedding Old Paradigs,A Review of the United Nations Library on Transnational Corporations*, pp. 137.

[3]See UNTCMD/DESD/ECE (1992a), *World Investment Directory 1992, Foreign Direct Investment, Legal Framework and Corporate Data: Volume II, Central and Eastern Europe*, pp. 45.

the late 1960s and early 1970s. Before that time, the term *Multi-Territorial*, as applied by the French economist Bye (1958), was often used to refer to firms that were involved in value-adding activities outside of their own national boundaries. The Multi-Territorial term has frequently been used to identify firms that were engaged in some form of FDI, as found in the works by Hymer (1960) and Vernon (1966). In fact, there exists a very intimate and intertwined relationship between the TNC and FDI which is more than just one of common usage.

2.2.3 Foreign Direct Investment

According to the UNCTAD-DTCI (1996), *"Foreign direct investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest of a resident entity (foreign direct investor or parent enterprise) is an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate)."*[4] This general definition of FDI is based on a combination of definitions from the *Organisation for Economic Co-operation and Development (OECD)*[5] and the *International Monetary Fund (IMF)*[6].

Furthermore, with FDI the actual investment may be made via a transfer of resources including capital, technology, and personnel, or a combination thereof, into the host country enterprise that is resident outside the direct/strategic investor's home country. The purpose of the direct/strategic investor is to exert a significant degree/level of influence on the management of the host country enterprise resident in the other economy. More specifically, FDI occurs in an incorporated or unincorporated enterprise in which a single foreign direct/strategic investor either owns 10% or more of the ordinary shares or voting power of an enterprise (unless it can be proved that the 10% threshold of ownership does not allow the investor an effective voice in management) or owns less that 10% of the ordinary shares or voting power of the enterprise, yet still maintains an effective voice in management. An effective voice in management only implies that the direct/strategic investor is able to influence the management of the host country enterprise and does not imply that it has absolute control, although it is possible to gain absolute control as a result of the process. FDI involves both the initial transaction between the two entities and all subsequent transactions between them and among affiliated enterprises, both incorporated and unincorporated. FDI may be undertaken by individuals, as well as business entities. The most important characteristic of FDI which distinguishes it from portfolio investment is that it is undertaken with the intention of exercising control over the enterprise.

Yet, like the situation with the TNC, our understanding of FDI has also been fairly limited despite numerous studies on the topic. Barkema, Bell, and Pennings (1996) have expanded

[4]See UNCTAD-DTCI (1996), *World Investment Report 1996: Investment, Trade and International Policy Arrangements*, pp. 219.

[5]OECD (1992), *Detailed Benchmark Definition of Foreign Direct Investment.*

[6]IMF (1993), *Balance of Payments Manual.*

upon this further by stating that, *"To date, there is little theoretical or empirical convergence on the antecedents and consequences of foreign direct investment (FDI). Diversity of disciplines among researchers, the theoretical frameworks they adopt, and the national provenance of data they examine yield a disparate body of literature."*[7] Bearing this point in mind it is important to examine what progress has been made in the creation of a cohesive theory of the TNC and FDI.

2.2.4 The Development of Theories Focusing on the Transnational Corporation and Foreign Direct Investment

As the TNC business form has multiplied, grown, and developed over time numerous scholars have sought to develop theories that would explain the activities of these types of firms, especially with regard to FDI. These scholars have come from a variety of fields that include economics, political science, and business studies. Each has approached and examined the subject according to their respective background. For example, an economist examining the situation on the basis of economic theory and related models. Generally, the work of these scholars falls into one of the three main theoretical streams of thought on the subject. The first group of scholars has sought to examine the activities of the TNC from the macro-economic perspective and focused on understanding why countries engage in FDI. The primary focus of this line of research has been on location-specific variables and why firms of a particular nationality may have different propensities to engage in trade and foreign production.

The second main area of research has been more interested in the behavior of the individual business firm, drawing upon the theory of the domestic firm (which seeks to answer very different questions than that of international trade) to explain both the existence and growth of the TNC. This group of scholars has derived its methodology and approach utilizing as a basis both transaction cost economics and organization theory.

A third group of academics has addressed the question of why firms of one nationality are in a better position to gain access to foreign markets than local firms operating in that same market. This group has also sought to determine why these same foreign firms are motivated to set-up such operations outside their own respective country of origin.[8] Each of these three groups of theorists and researchers has sought to create a tenable theory based on explaining the TNC and the activities of the TNC, especially with regard to engaging in FDI to develop foreign production capabilities.

However, it should be pointed out that prior to the 1960s there was no single dominant established theory of the TNC or of FDI, despite some tinkering on the subject by various

[7]See Barkema, H. G., Bell, J. H. S., Pennings, J. M. (1996), *Foreign entry, cultural barriers, and learning*, pp. 152.

[8]These three main research strands have been aptly illustrated by Dunning. See Dunning, J. H. (1993b), *The Theory of Transnational Corporations*, pp. 1-16.

individuals (most with a background in economics) from the time of *"Mercantilism"* onwards. Most of these early attempts made by academics and practitioners to explain the activities of the firm outside its own national boundaries were based on an amalgamation of various work. For example, Iversen's (1935) theory of indirect (portfolio) capital movements. There were several empirical and country based studies focused on examining the factors that influence the location of FDI, which have included Southard (1931, 1936), Barlow (1953), Dunning (1958). There was also work by economists, most notably by Williams (1929) that along the line that the internationalization of some industries required a re-examination of neo-classical theories of trade. There was a growing appreciation by researchers like Plummer (1934), that firms doing business in a variety of different countries could not only be considered as a substitute for international cartels and combines, but according to Penrose (1956, 1958) and Bye (1958) that the situation could be explained, partly at least, by the perceived gains of vertical and/or horizontal integration.[9]

The 1960s and early 1970s saw the emergence of the first theories dedicated to explaining the international activities of the firm. These theories were primarily focused on explaining the motivation and/or logic of the firm to engage in FDI and the theories themselves were to evolve over time as the research had progressed. These early theories of FDI generally fall into four main groups that will be briefly discussed.

The first main body of work was that of Stephen Hymer (1960[10], 1968). His work is considered to be the first true attempt at explaining the motivation of the firm to engage in FDI. Hymer's work later became known as the *industrial organizational approach to the theory of foreign production.* Hymer, who was doing his own PhD thesis at the time at the *Massachusetts Institute of Technology (MIT),* expressed his own dissatisfaction with the theory of indirect (portfolio) capital transfers as a basis for explaining the foreign value-added activities of firms and he subsequently set about designing a better mousetrap. Hymer postulated that a firm operating in a foreign market must possess certain innate strengths such as a knowledge of the local host country environment that will enable it to compete effectively on equal terms with indigenous firms, i.e. to create that so-called clear and level playing field.

The result of Hymer's efforts was the creation of a foundation in the theory of the TNC and FDI and that was to be taken up by numerous other scholars in their own attempts to build upon his work. In fact it is quite ironic that despite the importance given to Hymer's work today it went virtually unnoticed for many years by the academic community. It wasn't until 1967, almost seven full years since Hymer completed his PhD Thesis, before his work began to gain some

[9]Many of these points are illustrated in greater detail by Dunning. See Dunning, J. H. (1993a), *Multinational Enterprises and the Global Economy*, pp. 66-95.

[10]Hymer's PhD Thesis was actuallly completed in 1960 at the *Massachusetts Institute of Technology (MIT).* However, it was not until 1976 that it was finally published by the MIT Press under the same title. See Hymer, S. H. (1960), *The International Operations of National Firms: A Study of Direct Investment.*

degree of prominence. First in 1967 via a series of lectures given by Charles Kindleberger, Hymer's own thesis advisor, and which was later on followed up by a set of lectures on the subject by Hymer himself during 1969. Still, despite the slowness of the academic community to respond to Hymer's ideas, his work was to be used extensively over the next couple of decades to expand the theory of FDI and the activities of the TNC.

The second main theory on FDI was developed by Raymond Vernon (1966) in conjunction with some of his colleagues at the *Harvard Business School* in the mid-1960s. Vernon's work was based on a major research project detailing the growth of TNCs from the United States during the post-war period. In later years this project was expanded to include both Japanese and European based TNCs. From this original research project Vernon formulated *"The Product Cycle,"* which was basically a micro-economic approach to addressing the macro-economic phenomenon of FDI and international production.

The product life cycle generally rests on four basic assumptions. First, that products are involved in predictable changes in terms of production and marketing. Secondly, there is only a very limited amount of information available with regards to technology. Thirdly, there are changes in production processes over time and economies of scale are the norm. Finally, because consumer tastes differ according to income products can be standardized to meet corresponding income levels.

The first product cycle model explained FDI based on the market-seeking investment of American TNCs. Yet, according to Dunning (1993a), *"Like Hymer, Vernon offered a theory which was partial in that it addressed itself to only some of the issues surrounding MNE activity. On the other hand, the product cycle was the first dynamic interpretation of the determinants of, and relationship between, international trade and foreign production."*[11]

The third theory seeking to explain FDI was postulated by Robert Aliber (1970), who had also taken his PhD along with Hymer at the *Massachusetts Institute of Technology (MIT)*, also under Kindleberger during the 1960s. Aliber developed a model of FDI that described both the logic behind the motivation of the firm to own and control assets in countries outside of its own home country and the preference of the firm to finance these investments utilizing their own home country currency. Aliber's model, labelled as the *macro-financial and exchange rate theory: the Aliber model*, postulated that firms engage in FDI as a result of market imperfections in the international financial and currency markets. More simply put, Aliber believed that firms were simply taking advantage of the strength of their own domestic currency over other currencies to allow them to acquire and/or set-up foreign production in a country where the currency was valued below their own, thus saving themselves a great deal of money in the process. However,

[11]Dunning (1993a), *op. cit.*, pp. 71.

over time Aliber's theory came under a great deal of criticism from the academic community and has so far also suffered from a general lack of empirical research to support the theory.

The fourth of these early theories of FDI was developed by a group of finance-oriented scholars who were seeking to address the question of to what extent a firm invested in countries outside its own home market as a means of diversifying capital and/or exchange risks. This theory was based upon international portfolio investment theory and proposed that international diversification of risks was the motivating force behind FDI. This theory of *risk diversification* was put forth by Grubel (1968), Rugman (1975, 1979, 1980a, 1980b), Agmon and Lessard (1977), and Lessard (1976, 1982). In this theory of risk diversification, this same group of researchers argued that the TNC offers investors a superior vehicle for geographically diversifying their investment portfolios than does the international equity market. Yet, Rugman (1980a) later acknowledged that the risk diversification hypothesis is best considered as a special case of a more general theory of international market failure based upon the desire and ability of TNCs to minimize cross-border production and transaction costs.

By the mid-1970s, the two theories developed by Hymer and Vernon became the primary focus of investigation on the activities of the TNC involved in international production via FDI. While the focus of Hymer's industrial organization approach and Vernon's trade/location approach still differed on the questions each sought to address, their general paths were beginning to converge by this time. The one main notable difference that remained between the two approaches was that Hymer viewed FDI as an aggressive strategy to advance monopoly power while Vernon and his colleagues perceived FDI as more of a defensive strategy, and subsequently placed more emphasis on the need of firms to protect their existing market positions. However, despite the convergence of these two theories no attempt was made to integrate them into a single tenable theory. There was also no explicit recognition at the time that the premises of each of the two theories, the decision of the firm to trade or engage in foreign production were alternative options for the same firm and that, therefore, any explanation of one must, of necessity, take account of the other.[12]

On the basis of these early theories of FDI and the activities of the TNC, numerous scholars have sought to expand upon this previous work in an attempt to create a more complete explanation of the internationalization of business activity. Since the 1970s the research on international production has so far generally taken five main directions. First, researchers have sought to extend the work of Hymer and his industrial organization approach. This work has focused on identifying and evaluating which of the advantages are most likely to explain patterns of FDI, especially in the manufacturing sector.

[12]This point is made by Dunning in his review of the theories on TNC activity and FDI. See Dunning, J. H. (1988b), *Trade, Location of Economic Activity and the Multinational Enterprise: A Search for an Eclectic Approach.*

Secondly, some researchers have sought to continue the line of investigation focusing on the financial aspects of firms engaging in activities outside their own national boundaries. These scholars have generally fallen into two distinct groups. The first sub-group has re-focused their attentions on further developing the *Aliber model* that concentrated on the imperfections of foreign exchange and capital markets. The second sub-group of scholars have sought to extend the *portfolio theory* as a means of explaining the industrial and geographical distribution of foreign activities to take account of risk diversification and the stability of earnings. This group of researchers has continued to be led by the work of Rugman and Lessard.

Thirdly, another group of scholars has sought to explain international production as an extension to the theory of the firm. This effort reflected a shift of focus from the act of FDI to the institution engaging in the FDI. The main approach here has been to apply the theory of market failure to explaining the activities of the TNC. Development of this area came to be known as the *theory of transaction costs* following the work of Oliver Williamson (1975, 1979, 1985, 1991), which itself was an extension of Ronald Coase's (1937) earlier work. In the mid-1970s and early 1980s using transaction cost economics as a base, other scholars developed the *theory of internalization* which sought to explain the tendency of firms to engage in FDI as a response to the failure of the markets. The basic premise behind internalization theory is that the failure of product markets and the firms need to take advantage of both vertical and horizontal integration, which in turn leads the firm to internalize certain activities and transactions within their own organizations, and to regulate such transactions by administrative fiat rather than subject them to market pricing mechanisms.

Fourthly, another theory developed to expand upon the theory of the firm focused on the firm-specific competitive advantages that enabled the individual firm to create a position for themselves where they could create a level of performance superior to that of their competitors. This theory became known as *strategic behavior theory*, but it became more well known as the theory of competitive advantage as put forth by Michael Porter in the late 1980s and the 1990s.

Fifth and finally, although more than likely not the last theory to be offered on the subject, the 1970s saw the first attempt of a scholar to try to create a more comprehensive theory explaining the international activities of the firm. This theory was developed by Dunning (1973, 1988a, 1988b, 1993a) and he titled it as an *eclectic theory* or an *eclectic paradigm*. The eclectic theory was basically a mixture of several other theories, being based on a combination of transaction cost theory, internalization theory, as well as business strategy theory. The main hypothesis of the eclectic theory is that a firm will engage in FDI, rather than serve foreign markets via direct exports, if the firm possesses certain ownership and internationalization advantages and the location-specific variables favor such investments. However, Dunning's eclectic theory is not simply just a repeat of these three theories but a more extensive and comprehensive attempt in explaining the international activities of the TNC.

However, by the mid-1980s the nature of the TNC and its activity had drastically changed as a result of a variety of factors such as the growth of new forms of economic cooperation, like TNCs engaging in cooperative ventures; the emergence and growth of TNCs from developing countries; the expansion of TNCs into service businesses and the growth of sequential investment rather than initial investment; and the beginning of a change of attitude towards TNC activity by host countries from negative to neutral or in some cases even positive.

In conclusion, in the 1990s these changing attitudes have become even more pronounced as a result of various changes that have occurred and are continuing to occur in the international environment in which these TNCs operate. Because of these changes many of the theoretical propositions previously made between the 1960s to the mid-1980s have begun to be questioned as to their validity in describing and explaining the activities of the TNC in this new environment. Hence, while the theory base on the TNC and FDI has developed significantly over the years - as a result of the diligence of a great many dedicated scholars in the field of economics, political science, and business studies - it still has far to go before it can satisfy the basic requirements of providing a comprehensive model.

2.2.5 Types of Foreign Direct Investment: An Examination of the Motivational Factors for Investment

A number of researchers have sought to classify the different types of FDI based on the firm's motivations to invest, often characterizing motivational factors for investment as *strategies.* Some of the more notable work in this area includes Root (1968, 1987), Reuber (1973), Brooke and Remmers (1978), Simmonds and Robuck (1989), Dunning (1993a, 1994a), and Dunning and Rojec (1993). Given the scope of this thesis it is appropriate that each of these works be reviewed in order to outline the main motivational factors that affect the FDI equation.

An earlier paper by Root (1968) examined the political risks involved in FDI utilizing a sample drawn from American based *Fortune 500* firms. The author suggested that firms handle risks in one of three ways: by avoidance, adaptation, or risk transfer. Based on his research Root noted that, *"The decision to invest may be viewed as a judgment by management that the perceived opportunities outweigh the perceived political and business risks."*[13] Furthermore, Root also stated that the decision not to invest was a result of the reverse scenario.

In his paper, Root characterized the main motivation of the firm to engage in FDI as either a *defensive* or *aggressive* strategy. According to Root, a *defensive strategy* of investment was

[13]See Root, F. R. (1968), *U.S. Business Abroad and the Political Risks*, pp. 74.

followed when the primary motivation of the firm to engage in FDI was to maintain its existing position within a specific market when this could no longer be achieved through direct exports. An *aggressive strategy* for FDI was implemented when the firm felt that market opportunities could not effectively and fully be exploited via direct exports. Root concluded that "*...American business enterprise is motivated by its own self-interests, but that it is above all, pragmatic in seeking their fulfillment.*"[14]

In a later work Root (1987) expanded upon this terminology by identifying what he considered to be the three basic reasons for a firm to establish foreign operations via FDI, namely to acquire raw materials (*extractive investors*), to acquire manufacturers at lower costs (*sourcing investors*), and to penetrate local markets (*market investors*). In Root's terminology, *extractive investors* established local operations in order to secure needed resources and this type of FDI constituted a form of vertical integration. *Sourcing investors* set up local firms to act as production bases that could export goods to the investor's own home country and/or other countries. Finally, *market investors* viewed the host country market as the main target and established local operations to ensure adequate penetration of that market. Root added that most foreign manufacturing investments were accounted for by market investors.[15]

Reuber (1973) classified three factors as the motivations of the TNC to engage in FDI, these included *export-oriented*, *market development induced*, or *government initiated*. Reuber postulated that in the *export-oriented* form of FDI the main motivation of the firm was to protect or improve its own competitive position via more cost effective vertical integration. This type of FDI was also closely linked to securing needed sources of inputs such as raw materials. The *market development induced* FDI was based on the TNC's desire to supply the needs of the local market. Reuber considered this particular type of FDI as a form of horizontal integration. Finally, the *government initiated* FDI was a result of a specific host country offering the firm favorable terms such as tax breaks, subsidies, special preferences and considerations in return for their engaging in FDI within that country. In this form of FDI the perceived benefits to the host country were seen as an increased level of employment, greater domestic output, and a more stimulated economy via the multiplier effect of the new investment.[16]

Brooke and Remmers (1978) in seeking to explain why firms engage in FDI defined three main categories of motivational factors, namely *defensive strategies*, *aggressive strategies*, and *other pressures*. This work was basically an extension of Root (1968) and uses the same terminology and definitions, although Brooke and Remmers delineated this by detailing specific reasons for each motivational factor as well as associating them with four basic forms of FDI: *market*,

[14] *Ibid.*, pp. 79.

[15] See Root, F. R. (1987), *Entry Strategies for International Markets*, pp. 123.

[16] See Reuber, G. L. (1973), *Private Foreign Investment in Development*.

manufacturing, natural resources, and *investment*. Yet, the significant addition Brooke and Remmers made to Root's previous work was the *other pressures* category that affected the firm's decision whether or not to engage in FDI. The *other pressures* included the level of influence of the host country government, of other companies, as well as internal issues pressuring the company to invest. Through their research study involving over 100 companies Brooke and Remmers found that the *defensive strategies* were the prevalent motivations for FDI, and that *aggressive strategies* and *other pressures* have only a minimal effect on the investment decision.[17]

Robuck and Simmonds (1989) in detailing their *Geobusiness Model* (theory) for international business activity identified what they termed as six motivation variables in the firm's decision to engage in FDI. The six motivational factors for FDI included the *market seeker, resource seeker, production-efficiency seeker, technology seeker, risk avoidance,* and *defensive or exchange of threat*. Under this terminology, Robuck and Simmonds defined the *market seeker* form of FDI as being associated with capturing the local host country market via horizontal integration. *Resource seeker* sought to secure or gain access to needed inputs and was seen as a form of vertical integration. The *production-efficiency seeker* was characterized as a firm shifting its production to a specific host country in order to take full advantage of lower labor costs. It is interesting to note that Robuck and Simmonds did not include other cost related savings to this type of FDI, like reductions in operating costs and/or input costs. The *technology seeker* was utilized to gain control and/or access to valuable technology, trained personnel, and/or specific expertise in product development and marketing. *Risk avoidance* was classified with diversification motives and was described as a firm's attempt to secure its operations in what Robuck and Simmonds called a *"basket of markets."* Lastly, the *defensive or exchange of threat* form of FDI was confined to firms operating within oligopolistic industries.[18]

The *raison d'etre* for the firm to engage in FDI has been classified by Dunning (1993a, 1994a) as well as by Dunning and Rojec (1993) into four main types of investment. This classification was based on an earlier taxonomy first used by Jack Behrman (1972), which was later extended by Dunning. According to Dunning's classification system, there are four main types of FDI which are *(natural) resource-seeking, market-seeking, efficiency-seeking,* and *strategic (created) asset-seeking.*

The first type of FDI, *(natural) resource-seeking,* involve enterprises that invest abroad in an effort to acquire certain needed resources at a lower cost than is available in the TNC's own home country. Dunning stated that, *"The motivation for the FDI is to make the investing enterprise more profitable and competitive in the markets it serves (or intends to serve) than it would otherwise be. Most of all, of the output of the affiliates of resource seekers is exported, and mainly, although not exclusively,*

[17]See Brooke, M. Z. and Remmers, H. L. (1978), *The Strategy of the Multinational Enterprise*, pp. 159-179.

[18]See Robuck, S. H. and Simmonds, K. (1989), *International Business and Multinational Enterprises*, pp. 54-56.

to developed industrialized countries."[19] Dunning also distinguishes three sub-types of resource-seeking FDI. First, those enterprises seeking physical resources of one type or another. Second, enterprises that are seeking to utilize bountiful supplies of skilled and semi-skilled labor that are well motivated but available at a relatively low cost to the firm. The third sub-group of resource-seeking FDI is driven by the need to acquire technological capabilities, business expertise in management or marketing, organizational skills, or a combination thereof.

Market-seeking firms are considered as the second main type of FDI, and are depicted by Dunning as *"...enterprises that invest in a particular country or region to supply goods or services to markets in these or in adjacent countries."*[20] According to Dunning there are five main reasons for an enterprise to engage in this type of FDI. First, the enterprise's main suppliers or customers have themselves located abroad and in order to retain their continued business they must follow them into the same market. Secondly, in market oriented FDI the need arises to adapt products to both the needs of the local market and based on the availability and type of production inputs found in that market. Thirdly, in supplying the local market using either a local or nearby production facility enables the enterprise to lower both the transaction and production costs associated with supplying the market from a distance. Fourthly, the firm may be under increasing pressure to have a physical presence in the leading markets of its competitors as part of its global production and marketing strategy. Finally, Dunning claims that action taken on the part of the host country government, via tariffs and import controls, is the most important reason for firms to engage in *market-seeking* FDI.

The third main type of FDI is classified as *efficiency-seeking* and this type of FDI involves enterprises that are motivated by their own desire *"...to rationalize the structure of established resource based or market-seeking investment in such a way that the investing company can gain from the common governance of geographically dispersed activities. Such benefits are essentially those of the economies of scale and scope and of risk to diversification."*[21] According to Dunning, *efficiency-seeking* FDI is generally of two main types, both of which seek to rationalize production to exploit economies of specialization and scope. The first type seeks to do this between or across value-added chains (product specialization) and the second type along value-added chains (process specialization).

The fourth type of FDI involves enterprises that are characterized as *strategic (created) asset-seeking*. This type of FDI involves enterprises that are *"...acquiring the assets of foreign corporations, to promote their long-term strategic objectives - especially that of sustaining or advancing their international competitiveness. The investing firms involved include both established TNCs*

[19]Dunning (1993a), *op. cit.*, pp. 57.

[20]*Ibid.*, pp. 58.

[21]*Ibid.*, pp. 59.

pursuing an integrated global or regional strategy and first time foreign direct investors seeking to buy competitive strength in an unfamiliar market." Dunning later goes on to state that the main motivation for this type of FDI is to *"...add to the acquiring firm's existing portfolio of assets, others which they perceive will either sustain or strengthen their own overall competitive position or weaken that of their competitors."*[22]

In terms of the firm's motives to engage in each of these types of FDI, Dunning (1993a, 1994a) and Dunning and Rojec (1993) consider both *resource-seeking* and *market-seeking* FDI to be the primary motives for initial FDI by a firm. On the other hand, both *efficiency-seeking* and *strategic asset-seeking* FDI are usually associated more with sequential FDI. In the latter case, Dunning points out that Wendt (1993) has illustrated that strategic asset-seeking FDI can also be considered as a motive for initial FDI because it is often the most expeditious way to acquire the kind of competitive advantages associated with this type of investment.[23]

Furthermore, in the case of sequential FDI, Kogut (1993[24]) has stated that *"FDI must be understood as largely sequential flows stemming from the advantages of flexibility of a multinational system. The empirical foundation for this argument can be seen in the change over the past 30 years of the dominant channels of US FDI from new intercompany outflows to reinvested earnings."*[25] In his article, Kogut draws upon the model developed by Hirsch (1976), which is an analysis of the effects of joint production and trade in intermediate goods in the context of subsequent investment decisions. Kogut goes on to state that, *"There is, in short, a tendency to view FDI as a decision made at a discrete point of time. This is a fallacy of genesis to which I previously alluded. The decision to transfer resources internationally is only one aspect of FDI. Given the structural outcome of this decision, the other aspect is the series of sequential decisions which determine the volume and direction of these transferred resources."*[26]

In viewing these types of FDI from a historical perspective[27], Dunning (1993a, 1994a) states that in the 1960s and 1970s, most FDI was related to both *resource-seeking* and *market-seeking* types, and that there were only trace amounts of *efficiency-seeking* and *strategic asset-seeking FDI*. Most of the efficiency-seeking FDI made during that time came from large US TNCs who were already active abroad and were seeking to rationalize their operations. As for *strategic asset-seeking* FDI, that involved US based firms motivated to invest in places like Europe because of both the

[22]*Ibid.*, pp. 60.

[23]See Dunning, J. H. (1994a), *Re-evaluating the Benefits of Foreign Direct Investment*, pp. 36.

[24]Originally published in 1983.

[25]Kogut's study is based on US FDI information covering the period from 1950 to 1979. See Kogut, B. (1993), *Foreign Direct Investment as a Sequential Process*, pp. 217.

[26]*Ibid.*, pp. 220.

[27]Dunning provides a very thorough history of the development of TNC in relation to these four main types of FDI. See Dunning (1993a), *op. cit.*, pp. 96-136.

actions of their competitors (themselves having already engaged in FDI in these same markets) and the overall potential of the European markets. Similar scenarios were found in a variety of international markets during that time period.

In the 1980s and early 1990s, Dunning claims that most FDI has been more oriented towards both *efficiency-seeking* and *strategic asset-seeking* types. These types of FDI have been very much prevalent among TNCs from the developed nations, like those based out of Japan, Western Europe, and the North America (basically TNCs located in the G-7 countries). The exceptions to this rule has been TNCs from developed countries that have been for one reason or another late getting out of the starting blocks and first-time FDI by TNCs from developing countries. Another exception that Dunning points out is the opening up of relatively new markets like the opportunities for FDI in the CEC and FSU.[28] In these transitional economies it should be the case of TNCs following a mixture of all four types of FDI.

2.3 Foreign Direct Investment by Western firms in the Central European countries and the former Soviet Union: A Prelude

The primary goal of this section is to review the relevant literature that has been produced by both academics and practitioners on the subject of FDI by Western firms in the CEC and FSU, especially the literature pertaining to the environment of CE. In doing so, this review will first outline the situation from the perspective of pre-1990 climate for investment in what was formerly Eastern Europe and the Soviet Union. The focus of the review then shifts to the post-1989 time period where some of the more pertinent literature is detailed. Throughout this section special attention is given to the literature that has employed the survey instrument as a means of investigation into this developing area of international business studies.

2.4 The Pre-1990 Economic Environment for Foreign Direct Investment in Eastern Europe and the Soviet Union

Prior to the historic events that occurred at the end of 1989, Western firms and those individuals researching their activities had paid scant attention to the business environment that existed behind the Iron Curtain. This general lack of literature on the subject was a result of a variety of factors but primarily due to the serious information gap caused by the tensions of the Cold War. Most of the research work that was done on the CMEA economies during this period came from various institutional and organizational think tanks, governmental agencies,

[28]See Dunning, J. H. (1994b), *The Prospects for Foreign Direct Investment in Central and Eastern Europe.*

and some economists that were interested in the planned economic system of the East. In the opinion of this researcher, it is quite probable that a great deal of this material never found its way to the general public and remained unpublished on the grounds of secrecy and national security issues prior to the changes of 1989 that occurred in Eastern Europe and later on in the Soviet Union. Most of the information disclosed was usually oriented towards macroeconomic issues. The primary groups researching the countries of the Eastern Europe and Soviet Union during the Cold War period included various divisions within the *United Nations (UN)*, the *Central Intelligence Agency (CIA)* of the United States of America, and no doubt from a variety of other sources such as governmental bodies of international origins that even today still keep their research listed as confidential and/or categorized as top secret.

In fact, although the Iron Curtain was established as a result of political and ideological differences between the East and the West, the real separation became more prominent on economic grounds. The citizens of the West became the *have's* and the people of the East the *waiting to have*. In effect, an economic Iron Curtain had developed as the rift between the East and the West grew over time. This economic divide became even more visible as the world economy developed and international investment and operation became more common place.

However, the Soviet Union and its Eastern Bloc satellites were not to follow suit with the emerging openness to FDI, especially with regard to the policies towards FDI being pursued by the developed nations of the West. According to a report by the UNTCMD/DESD/ECE (1992a),

> *"The origins of postwar FDI policies can be traced to the early years of the Soviet state. In the period of Lenin's New Economic Policy (1921-1927), the USSR permitted FDI under severely restricted conditions. With approval at the highest political levels, foreign business interests could participate for a limited term in 'concessions', to exploit natural resources or to engage in manufacturing, and in a limited number of joint trading companies."*[29]

In the period following the close of the Second World War the countries of Eastern Europe, which were dominated by the Soviets, and the Soviet Union followed an isolationist policy whereby they effectively sealed off their population from the rest of the world. In this new artificial environment, the ruling party leadership began to concentrate their efforts on developing what was termed as a *socialist world market*. During the period of Stalinism in which central planning and control permeated every layer of society, as well as the economy, the concept of foreign investment became a completely alien concept and subsequently inward FDI all but disappeared.

Towards the end of the 1960s it became apparent to some enlightened members of the Party leadership structures in the Eastern Bloc countries as well as a few in the Soviet Union that they

[29]See UNTCMD/DESD/ECE (1992a), *op. cit.*, pp. 2.

could not continue, let alone maintain, the desired level of economic growth utilizing only the domestic resources at their disposal. They therefore began to seek new links to the world economy as a possible solution to the problem. During that same time period the Soviet Union and its Eastern Bloc satellites were almost all attempting to enact a series of economic reforms to reinvigorate the historic system of *Five-Year Plans*. The plans had worked well in the past and some had been very successful at times, especially in the case of the Soviet Union after the end of the Second World War. A long series of *Five-Year Plans* had pulled the Soviet Union through what was to known as *The Thirty Years' Crisis*.

According to Woodford McClellan (1986), an author on modern Russian history, *"In the USSR, three successive crises of enormous dimensions had indeed seen the commissars perform economic miracles. The industrialization of the 1930s, the war economy, and the post-war reconstruction represented unparalleled triumphs."* Yet, this series of economic miracles was to come to an end because according to McClellan, *"The commissars had proved incapable of making the post-reconstruction economy function efficiently. The growth began to fall after 1951 and by the early 1960s the decline was a matter of grave concern."*[30]

The Soviet premier at the time, Nikita Khrushchev, had already sought to implement a broad spectrum of reforms, both in the area of foreign policy and internal affairs. Yet, Khrushchev's poor handling of matters in both areas along with heavy opposition from within the party system to his reform efforts, was to lead eventually to his downfall. Leonid Brezhnev, Khrushchev's successor, continued to pursue his controversial and difficult program of economic reforms, with various modifications of course. In 1965 another major effort was made at reforming the system from within but the reformers did not pursue the initiatives to there logical conclusion and consequently they met with little success. It was clear by the beginning of the 1970s that the reform efforts started under Khrushchev and re-focused under Brezhnev had simply failed to achieve the desired results. The economic downward spiral in the Soviet Union and the Eastern Europe continued relatively unabated as a result.

By the beginning of the 1970s the economic situation was becoming a crisis that could not be solved utilizing only home grown ingredients. The main problems facing the Soviet Union and the countries of Eastern Europe were that their respective economies simply could not longer keep pace with technological developments that were reshaping the developed world's economies, especially in the areas of automation and integration of computers into the overall economic system. At the time the various members of the CMEA did not possess the technological ability or resources to produce such systems sufficient for the tasks needed and

[30]See McClellan, W. (1986), *Russia: A History of the Soviet Period*, pp. 301.

certainly not in any great numbers.[31] Therefore, Eastern Europe and even the Soviet Union were forced to look to the West for assistance. The East sought to acquire badly needed technology utilizing a variety of approaches yet each yielding basically the same result.

One of the approaches used to acquire such systems involved taking advantage of soft lending policies from Western based creditors to borrow hard currency to import various machinery from the West to modernize their domestic means of production. Poland, Hungary, Yugoslavia, Romania, and Bulgaria all followed such a course of action. Unfortunately, this program was administered haphazardly by each of the respective country's ministries that were responsible for its implementation and the result was that these countries were each left with large foreign debts and virtually no improvement in their economic systems. The problem of heavy foreign indebtedness and the failure of the program became an acute economic disaster in both Poland and Romania. The economic situation in Poland deteriorated even further and the government proved incapable of even servicing the enormous amount of foreign loans let alone being able to repay the principle. As for Romania, a series of events caused Ceausescu's program to redefine the country as a *developing socialist country* to fail, leaving the country with a heavy burden of foreign debt and a serious lack of hard currency available to repay it.

The other major approach utilized by certain Eastern Bloc countries involved trying to attract Western firms to form cooperative ventures with local SOEs and/or *Foreign Trade Organizations (FTOs)* in their domestic economies. These new links were made at first through new forms of relationships referred to as *International Inter-Enterprise Cooperation*, or more commonly known as *East-West Industrial Cooperation (EWIC)*. As time progressed, a few Eastern European countries expanded these relationships to encompass the *Joint Venture (JV)*[32] mode of investment. Overall, these new relationships were very much restricted by both the legal and political systems in the host countries of the East and as well as by many of the investors' own

[31]According to McClellan,*"By 1970 there were about 5,000 computers in the USSR, or 20 per million of population. In the United States there were 344 computers per million in 1970; in Japan the figure was 96 and in Great Britain 91. Moreover, the most powerful Soviet computer of 1970 operated at only one-sixth the level of the most advanced American machine. Substantially more than half the American, Japanese, and British computers were third-generation, while that year there was not a single Soviet-manufactured third-generation machine; 23 percent of all Soviet computers were first-generation. Even in late 1975 second-generation computers comprised 83 percent of all Soviet machines."* See McClellan (1986), *op. cit.*, pp. 306.

[32]A *Joint Venture (JV)* involves the sharing of assets, risks, and profits and participation in the ownership (equity) of a particular enterprise or investment product by more than one firm or economic group. Yet, according to Cilento, *"The term 'joint venture' is used not only to denote certain economic regulations between Western and Eastern European countries, it is commonly employed in the language of business to denote almost any kind of functional integration between two or more firms....in the last 30 years the term has been used in practice as a close synonym for the terms 'mixed capital company' or 'company with foreign capital participation'....In the course of time, the term 'joint venture' has become commonly used to describe all sorts of foreign investment; so much so that even companies entirely owned by foreigners - a possibility only recently introduced in many former CMEA countries - are commonly called joint ventures."* This lack of clarity in defining this term in the context of the CEC and the FSU has often led to some ambiguity regarding which JVs should actually be considered as such. See Cilento, M. (1993), *Joint Ventures in Eastern European Countries: A Survey of Legislation*, pp. 151.

respective home countries in the West.[33]

However, it should be remembered that the motivation of the countries in the East to seek assistance from the West was not one of ideological preference or choosing but more as a result of necessity. The system of state economic planning used in the countries of Eastern Europe and the republics of the Soviet Union was simply not allowing their economies to keep pace with the growing domestic needs, let alone with the developed Western nations. According to a report by the UNTCMD/DESD/ECE (1992a), both Eastern Europe and the Soviet Union

> *"...were reacting pragmatically to the interrelated problems of diminishing factor productivity and lagging technical progress that were reflected in declining rates of economic growth, coupled with chronic balance-of-payments problems and a shortage of hard currency reserves. Foreign direct investment was also increasingly accepted as a way of advancing the 'scientific technical revolution', through the acquisition of otherwise unobtainable foreign technology and know-how."*[34]

So gradually and cautiously, some countries in the region decided to make available limited opportunities for foreign firms to invest in the domestic economy. In 1967, Yugoslavia became the first country in the region to allow foreign investment under a variety of restrictions. In 1971, Romania allowed FDI via minority interest JVs with state enterprises. In 1972, Hungary followed suit by permitting FDI in the form of JVs. In 1976, Poland allowed the establishment of small businesses by foreign nationals of Polish extraction, which were to become commonly known as *Polonia* firms.

There were two common elements in all these investments. Firstly, that the foreign capital participation was allowed only in a partnership with a host country enterprise (SOE) and/or trade organization (FTO) and was limited to a minority share (49% maximum shareholding). Secondly, that the foreign capital was restricted to certain industries within the host country, usually in those industries that were export oriented and non-strategic.

Overall, the process of allowing FDI into the domestic economy was very slow and arduous, the foreign response very limited due to the restrictive measures enacted by host countries, and the various foreign participation projects were either a disaster in some cases or marginal at best in others. Consequently, the creation of a basis for research on these new investments in the region was also very limited. Still, these countries persisted with their policies for seeking Western

[33]The story of the JV between the City of Moscow and *McDonald's* (USA) in the then Soviet Union is a case in point. While McDonald's and its hamburgers are certainly not a technological wonder, McDonald's decided to utilized its Canadian subsidiary to establish what would turn out to be its famous JV operation in Moscow in part to get around Cold War restrictions on investment in the USSR made by the USA and also to avoid any potential for negative publicity in its home market. McDonald's first started going to the Soviet Union to try and put a deal together in the late 1970s when relations between the Soviets and the Americans were still not healthy, although it was improving somewhat with the thawing of the Cold War under detente. It wasn't until 1988 when McDonald's Restuarants of Canada concluded its agreement to establish a McDonald's restaurant in Moscow. By the beginning of 1990, the world's largest McDonald's restaurant operation opened in the famous Pushkin Square. See Hertzfield, J. M. (1991), *Joint Ventures: Saving the Soviets from Perestroika.*

[34]UNTCMD/DESD/ECE (1992a), *op. cit.*, pp. 2.

know-how and capital and gradually over time their restrictions on FDI eased somewhat.

Yet, Albania, Czechoslovakia, Bulgaria, and most importantly the Soviet Union decided not to follow this course of action and did not allow FDI into their respective countries. These countries still sought to overcome the growing domestic economic problems from within using home grown remedies. This decision was mainly based on ideology. The desire for foreign capital and know-how clashed drastically with both the fundamental principles of the official communist ideology and was incompatible with its institutions. Even in those East European countries that did allow foreign participation, the more palatable JV term was used in place of FDI to circumvent ideological conflicts over any notion or reference to foreign intervention in the centralized state planning and management of the economy and the State's ownership on behalf of people of the means of production. However, despite the official ideological dogma and rhetoric put out by the Party leadership and its institutions, it was becoming apparent that the home grown remedies were failing to show satisfactory progress in resolving the economic crisis and that the situation was only deepening, especially in the vast expanses of the Soviet Union.

It was not until the mounting economic difficulties of the 1980s that the Eastern Bloc countries and the Soviet Union were forced by the severity of the situation to review and modify their ideological objections to the concept of FDI. It was under Soviet premier Gorbachev's program of *perestroika* that FDI was finally given a healthy environment in which to function.

The fact that the Soviet Union had finally realized the necessity to rejoin the world economy put almost all of the objections to FDI aside in the rest of Eastern Europe, with the only exception being Albania[35]. In 1980, Bulgaria decided to implemented a very liberal policy allowing for FDI in all areas of the economy and for unlimited durations. In 1986, Czechoslovakia, under the rule of the communist hardliners put into power by the Soviets after the failed rebellion of 1968, finally gave in to the economic reality of the domestic situation and allowed FDI, but only via minority interest JVs, and confined to operations in industrial production. Finally in 1987, under mounting economic pressures, the Soviet Union also agreed to allow the establishment of FDI via minority interest JVs.

Under this new environment, some Western firms began to engage actively in FDI in Eastern Europe and the Soviet Union, although all of these projects were confined to the JV mode of investment still under the heading of EWIC. Along with this renewed interest by businesses in FDI came a basis for studying these relationships. The academics and practitioners in the West, and even a few in the East, began to examine these cases of FDI in the countries of Eastern Europe and the Soviet Union and thus a base of articles and papers began to appear on the

[35]Until 1990, FDI in Albania was impossible as all forms of foreign ownership were specifically banned by the constitution. In was not until the latter half of 1990, under growing pressure from the Albanian public and in light of the dramatic changes that had swepted the rest of the region that the Albania leadership, under President Ramiz Alia, gave ground grudingly and introduced limited reforms including the introduction of FDI. See Dobosiewicz, Z. (1992), *Foreign Investment in Eastern Europe*, pp. 49-50.

subject. This literature primarily focused on the JV mode of FDI and usually the perspective of the Western investor.

2.5 A Review of the Literature Focusing on East-West Business Ventures in the Pre-1990 Environment

The literature[36] that began to appear about East-West business ventures was usually of a general nature, mainly done from the perspective of Western scholars and practitioners, and based on either the respective authors' own experiences or on data published from organizations like the *United Nations (UN)*(including the *United Nations, Economic Council for Europe [UN/ECE]* and the *United Nations Centre on Transnational Corporations [UNCTC]*) and/or the *Organisation for Economic Co-operation and Development (OECD).* The methodology utilized by these researchers varies greatly and includes research that was based upon a statistical analysis of published data from the UN and/or OECD (Stankovsky [1981]); research studies utilizing host and/or home country sources of information (Sukijasovic [1970], Boukaouris [1989], Bieszki and Rath [1989], Filar [1991], and Micinski [1992]); empirical research on the experiences of Western firms in the East came mostly from newspaper articles and/or postal questionnaires (UN/ECE [1973], Bolz and Plotz [1974], McMillan [1977], and Hisrich and Peters [1983, 1985]); from research based on personal interviews with individual firms (von Czege [1977], Högberg and Wahlbin [1984], Paliwoda and Liebrenz [1984], and Artisien and Buckley [1992]); and from a combination of both interviews and postal questionnaires with individual foreign investors (Watkins-Mathys and Hill [1995][37]).

This literature generally illustrated that the East's motives for entering into such agreements were based on their desire to acquire Western technology and to improve their own level and quality of exports - especially the commodity structure - without making demands on scarce hard-currency reserves. These were generally the motives expressed by a number of researchers, including the literature from the UN/ECE (1973), McMillan and St. Charles (1974), Bolz and Plotz (1974), McMillan (1977), Stankovsky (1981), von Czege (1977), Paliwoda (1981), Liebrenz (1982), Paliwoda and Liebrenz (1984), Högberg and Wahlbin (1984), Lebkowski and Monkiewicz (1986), McMillan (1986), UNCTC (1988), and Bieszki and Rath (1989). This same literature showed that the Western firms' motives for entering into such relationships were of a more diverse nature. The motives of Western firms ranged from the need to use the only means available to enter these markets, to taking advantage of cost and resource opportunities in the East.

[36]Please note that unless otherwise noted the studies indicated as being published after 1989 are work that is based on the pre-1990 environment.

[37]The paper by Watkins-Mathys and Hill is a retrospective study of JVs in Eastern Europe and the Soviet Union utilizing interviews with executives of Western firms to determine their experiences in this environment. See Watkins-Mathys, L. and Hill, M. R. (1995), *A Retrospective Study of Joint Ventures in Eastern Europe and the former Soviet Union.*

The article by Lebkowski and Monkiewicz (1986) clearly illustrated this obvious difference in motivational factors on the part of both the Western and Eastern partners in entering into such cooperation agreements. The focus of Lebkowski and Monkiewicz article was to review FDI in certain CMEA countries (with the exclusion of Yugoslavia) with regards to the size of the investment, its structure, and its relative impact on the economic development of the CMEA countries. The article detailed various FDI projects that were made via the JV mode in Romania (5), Hungary (50), Bulgaria (9), and Poland (712).[38] According to the conclusions drawn by Lebkowski and Monkiewicz, "*In none of the four countries have joint ventures become important in supplying local markets or exerting some competitive influence on the socialized sector.*"[39] The authors later went further to state that, "*The motives of the Eastern and Western partners were apparently quite different in this area* (with regard to the focus of the JVs production, whether it focused on the domestic market or was intended for export). *The first were looking West, the second on the other hand were looking more eagerly to the Eastern markets. The final outcome resulted from the interplay of these motivations, bargaining power of the partners and other relevant parameters.*"[40] This difference of objectives between the JV partners were a basic problem encountered in many of these early East-West relationships and often a reason for their subsequent lack of success, especially given the motivations of the Eastern European countries and the Soviet Union in both seeking and allowing FDI in the first place.

The article by Bieszki and Rath (1989) also chronicled these East-West JVs. Bieszki and Rath were quite comprehensive in their coverage of the literature that existed at the time on the subject of EWIC ventures. Yet, the main focus of their article lies on comparing and contrasting the new Polish JV law (The Law concerning companies with foreign capital participation, dated April 23, 1986) to the existing legislation on foreign investment in other countries of the region. Bieszki and Rath also pointed out some of the general shortcomings of these East-West JVs. One of these shortcomings of note was in the area of technology transfer from West to the East, where the authors showed that most of the so-called modern technology being supplied by the Western JV partner was usually more along the lines of mature technology. In this respect, the transfer of technology coming from the West may have been on the same par as the technology already existing in the host country. Hence, it may be concluded from Bieszki and Rath's study that the desire of Eastern European countries and the Soviet Union to gain new and modern technology from the West may well have been circumvented in practice.

In another country specific exposition, the research study by Artisien and Buckley (1992) focused on FDI via the JV mode within the context of Yugoslavia. Artisien and Buckley's study

[38]The number in the parenthesis following a country name represents the number of JVs examined in that country by the study. From the listed 712 cases of FDI in Poland, most of these are to be assumed to be small *Polonia* type firms as the article does not provide details on each of these ventures. Overall, almost all of these JVs involve the Western partner having a minority interest (49% or less), with only some exceptions in the case of Bulgaria.

[39]See Lebkowski, M. and Monkiewicz, J. (1986), *Western Direct Investment in Centrally Planned Economies*, pp. 637.

[40]*Ibid.*, pp. 638.

utilizes a multiple focus which includes determining the motivations of foreign enterprises to invest, using *aggressive* and *defensive* investment motives as described by Root (1968)[41]; a descriptive profile of the JV operations; the performance of the JVs using numerical measures such as exports, growth, and profitability; and an evaluation of the sample over time that provides an insight into the evolution of these types of JV over time. The data for the study was gathered from interviews with senior executives of a sample of 42 Western TNCs from 13 different countries that were involved in FDI in Yugoslavia via the JV mode of investment between 1968 to 1980. Some of the key findings of this survey are summed up by the authors, *"The method of entry into the Yugoslav market was predominately determined by the internal conditions prevailing at the time: the foreign firm's readiness to forgo a preference for total ownership and to adapt to the requirements of the host country illustrates a degree of flexibility prompted by market and growth criteria rather than by the profit motive."*[42] Yet, it should be noted that on the issue of performance the authors stated that many of the JVs surveyed were quite reluctant to disclose specific financial information owing to the issue of confidentiality. Those that did respond to performance related questions stated that measures such as return-on-investment (ROI) were not the only consideration of the firm or the basis for their investments. Instead, the authors proposed that TNCs were willing to accept lower profit levels due to both the legal restrictions placed on the level of profit repatriation and because they saw their investments in Yugoslavia as more of a long-term venture.

The article by Filar (1991) is also worth noting as it provides an excellent illustration of how changes in the legislative environment changed the business environment, especially with regard to foreign investment via the JV mode of investment. Filar's analysis covers the time period of 1949 to 1990 and illustrates how the system in Poland gradually changed from communist autarky to a more open post-communist economy that encouraged foreign participation in the local economy, although mainly through the JV mode of investment. Many of these changes chronicled by Filar in Poland were the same or similar to those experienced in other countries of the region during the same time period.

However, a great deal of the early literature on the subject of FDI in the East was focused not on what was still considered Eastern Europe but more on the Soviet Union, especially with regard to American-Soviet JVs. These studies included Hecht and Oliver (1988), Nigh and Smith (1989), Nigh, Walters, and Kuhlman (1990)[43], Hertzfield (1991), Rosten (1991), and Jecchinis

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[41]Root (1968), *op. cit.*.

[42]See Artisien, P. F. R. and Buckley, P. J. (1992), *Joint Ventures in Yugoslavia: Opportunities and Constraints*, pp. 128.

[43]This particular study used a sample of 105 US-USSR JVs, 13 of which had non-American, non-Soviet partners. In two of these 13 JV cases the non-American, non-Soviet partner was identifable as a company affiliated via the ownership with the American company. In the remaining 11 cases, in most instances the foreign JV partner was based out of Italy or one of the Scandinavian countries. See Nigh, D., Walters, P. and Kuhlman, J. A. (1990), *US-USSR Joint Ventures: An Examination of the Early Entrants*.

(1991).[44] A common thread among all these early studies of JVs in the Soviet Union was that they were almost all based on reviewing the situation from the perspective of the American partner.

Each of these works utilized a variety of methodologies. The methodologies employed included research based on the personal experiences and opinions of the authors (Jecchinis [1991] and Hertzfield [1991]); on information supplied by the partners of the JV via postal questionnaires (Hecht and Oliver [1988]); through face-to-face interviews with JV partners (Nigh and Smith [1989] and Rosten [1991]); and from desk research utilizing information supplied to the researchers from the host country (Nigh, Walters, and Kuhlman [1990]).

The literature also utilized a variety of viewpoints. Some have addressed the issues of *how-to* invest and related strategy concerns (Hertzfield [1991] and Rosten [1991]). Other studies have looked at the management of political risk involved in creating and operating JVs in the Soviet Union (Nigh and Smith [1989]). Finally, a couple of papers have provided a descriptive analysis of both the environment for FDI in the Soviet Union and the operation of JVs in that environment (Hecht and Oliver [1988], Nigh, Walters, and Kuhlman [1990], and Jecchinis [1991]).

Despite these early attempts by researchers and practitioners to chronicle the business relations occurring between the countries of the West and Eastern Europe and the Soviet Union, most of these articles and studies would be overtaken by the events of 1989. These historic events not only dramatically changed the political, social, and economic structures of these countries but also created a completely new business environment in which many Western firms were keen to enter via FDI.

2.6 A Review of the Literature on Foreign Direct Investment by Western firms in the Central European countries and the former Soviet Union in the Post-1989 Environment

Since the fall of the Berlin Wall in late 1989 there has been a near avalanche of research materials on the transitional economies now referred to as the CEC and FSU. While the vast bulk of these materials have concentrated on the macroeconomic environment, a number of studies have also been directed at the microeconomic conditions. Many of these macroeconomic studies have sought to examine the role of Western firms in the region via FDI. Providing a

[44]Please note that unless otherwise noted the studies indicated as being published after 1989 are work that is based on the pre-1990 environment.

critical review of these studies on FDI in the context of the CEC is the focus of this section.

The bulk of literature that has been directed at the development of the private sector's role via FDI within the CEC and the FSU has generally been the result of efforts of researchers from the field of business studies and economics. Although it should be noted that numerous practitioners as well as various international organizations and institutions have also significantly contributed to this line of research.[45] The literature that has been created by these individuals and organizations generally falls into three main categories. The first of these three categories includes the literature that is either descriptive in nature or written from the perspective of *how-to* invest. The latter being intended for use by company executives wishing to invest in the region. The second grouping consists of studies which have employed the survey instrument as a primary means of investigating the activities of firms within the CEC and/or FSU environments. The third set of materials has utilized the case study medium either as a primary or secondary means of investigation. The literature for each of these three categories is examined in greater detail. Given the focus of this study of the environment of the CEC only a little attention is directed at relevant studies pertaining to the FSU.

2.6.1 A Review of the Descriptive and Strategy Oriented Literature

The first of these strands of thought on the subject of FDI in the CEC includes a variety of articles, papers, and books that have primarily focused on describing the general conditions for investment in the CEC environment or provided a *how-to* invest strategy approach to the topic. Both the descriptive and strategy oriented literature can be further subdivided into two general types of work, namely host country specific in focus or those concentrating on groupings of host countries or the region as a whole.

In regards to the first type, there has been an abundance of literature which has sought to provide a description of FDI within the context of a specific host country of the CEC group (**Bulgaria:** Razvigorova, Nenov, Djarova, and Borrisova [1991], Marinov [1995], and Whitford [1996]; **former Czechoslovakia:** Sychrava [1990], Becvar and Vosicky [1991], and Drábek [1992, 1993]; **Czech Republic:** Charap and Zemplinerova [1994], Meth-Cohn [1995], Mifek [1995], and the Joint Ventures Club [1995]; **Slovakia:** Cernák [1994] and King and Murray [1994]; **Hungary:** Benedek [1991, 1992], Csáki [1992], Markoczy [1993], Child and Markoczy [1993], Hamar [1993a, 1993b, 1994], Marton [1993], Young [1993], Lane [1994], Houde [1994], Hunya [1996], Vissi [1994], and Török [1994a, 1994b]; **Poland:** Brietkopf [1991],

[45]For example, the *European Bank for Reconstruction and Development (EBRD)* has been quite active in producing their own series of Working Papers as well as Quarterly and Annual Economic Reviews and the annual *Transition* report detailing various topics related to these transitional economies, notably on the subject of economic transformation; *The Economist Intelligence Unit (EIU)* produces an extensive series of country reports that covers all of the CEC and the FSU and the EIU also produces a variety of other papers and books detailing a variety of topics related to the business environment in the CEC and FSU; *The Institute for World Economics, Hungarian Academy of Sciences* has also produced several good Working Papers on the subject of FDI and related areas; *The United Nations, Economic Commission for Europe (UN/ECE)* has provided information on FDI in the region through its publication *East-West Investment and Joint Venture News*; and numerous other sources have also contributed to this field of study.

Maciejko [1991], Guzek [1992], Jermakowicz [1993], Bochniarz and Jermakowicz [1993], Kubielas [1994], Markowski and Jackson [1994], and Stoever [1995]; **Romania:** Romanian Development Agency [RDA][1992], Birsan [1993], Guyon [1993], Ferris, Thompson, and Valsan [1994], and Beck [1996]; and **Slovenia (part of the former Republic of Yugoslavia):** Rojec [1993], Stanovnik and Banic [1993], and Gray [1993]).

However, despite the apparent abundance of such materials it should be pointed out that this literature is somewhat varied in the quality of the coverage, in content, and the means of investigation utilized. In terms of coverage, some of the literature has focused on the factors associated with the attractiveness of specific host country for FDI (motivations for FDI), such as Gabrisch (1993), Young (1993), Kubielas (1994), Markowski and Jackson (1994), Ferris, Thompson, and Valsan (1994), Houde (1994), and Haiss and Fink (1995). A few studies have concentrated on the issue of privatization and FDI, like Jermakowicz (1993), Hamar (1993a, 1994), Marinov (1995), and to a somewhat lesser degree the paper by Charap and Zemplinerova (1994). A number of papers have addressed the role of FDI within a specific host country in economic terms[46], including Drábek (1992, 1993), Rojec (1993), Stanovnik and Banic (1993), Marton (1993), Hamar (1993b), Lane (1994), Török (1994a, 1994b), Vissi (1994), Stoever (1995), and Hunya (1996). A handful of the materials have taken a promotional approach in hopes of attracting FDI to their respective host country, such as Romanian Development Agency (RDA)(1992) and Mifek (1995). Some of the literature have detailed the general conditions for FDI including Sychrava (1990), Brietkopf (1991), Guzek (1992), Cernák (1994), Birsan (1995), and the Joint Ventures Club (of the Czech Republic)(1995). A few papers have taken the investors' perspective in relation to FDI in a given host country, like the works by both Benedek (1992) and Csáki (1992). Finally, a number of materials have been written in the journalistic style which are descriptive in nature yet also seek to play the role of devil's advocate with the topic at hand, including Guyon (1993), Gray (1993), King and Murray (1994), Meth-Cohn (1995), Beck (1996), and Whitford (1996).

As for content, a review of some of the host country specific descriptive literature is also in order. The article by Guzek (1992) concentrates on describing changes in the area of Polish international trade in relation to the opportunities for FDI within Poland. Brietkopf's (1991) paper outlines Polish legislation on FDI (current at the time of publication), the functioning of FDI under these conditions, and the key factors determining the future inflow of FDI into Poland. The articles by both Young (1993) and Houde (1994) detail the situation for FDI within Hungary and how that country has been able to establish a favorable climate for investment over the last few years. The three papers by Hamar (1993a, 1993b, 1994) also examine FDI within Hungary, two (Hamar [1993a, 1994]) examining FDI via the privatization process in that country and the other paper (Hamar [1993b]) provides a comparative study of the performance

[46]The role of FDI in the restructuring process of a specific host country has been a common theme in a number of these types of papers.

of joint ventures and local Hungarian SOEs during the first few years of the process of economic transformation within Hungary. Markoczy (1993) examines JVs with foreign participation in Hungary in regards to the extent to which Hungarian and foreign managers show substantial differences in their business thinking. The paper by Charap and Zemplinerova (1994) examines FDI in the Czech Republic and seeks to describe the linkages between FDI, privatization, and restructuring process in that country. Birsan (1994) provides a general overview of the conditions for FDI within Romania in regard to the motivations for FDI, the present situation for FDI in that country, possible problem areas for foreign investors, and a fairly comprehensive listing of FDI in Romania by both country of origin, showing both capital amounts invested per home country and the number of companies engaged in FDI in Romania from each respective home country.

One of the more relevant articles from this group of country specific literature is the research work by Lane (1994), which provides a fairly good overview of the trends in FDI via the JV mode of investment in Hungary. Lane utilizes a technique of comparing data on FDI and JVs from the *Hungarian Central Statistical Office (KSH), State Property Agency (SPA), National Bank of Hungary*, and the *Hungarian Joint Venture Association* as a basis for establishing trends on FDI and JV formation in Hungary. Based upon this review of host country data on FDI and JVs, she identifies trends with regard to the amount of FDI relative to the local economy; the ownership structure of JVs; the distribution of JVs by industry classification; and the size of the JV investment in terms of capital invested.

Of special interest to this thesis are the points that Lane makes on the ownership structure of JVs in Hungary. Lane states that, based on the data she reviewed, there is a general trend for foreign firms to increase their shareholding positions in their JVs relationships. She then attributes this increase in share ownership to two main factors. First, that newly formed ventures are more likely to be established as wholly-owned subsidiaries or JVs with a majority foreign ownership.[47] Secondly, that existing JVs are moving to either buy-out their Hungarian partners or undertake share capital increases that are not matched by their Hungarian partner and which subsequently reduce the Hungarian partner's equity and say in the venture. This change in ownership patterns in JVs will be one area which this present research study will investigate as part of the evolutionary process of the JV relationship over time.

Another study that bears recognition is the paper by Marton (1993), which analyzes FDI flows into Hungary between 1988 and 1990. This study is interesting because it spans the transition period of 1989 and illustrates just how changes in the host country environment and legislation

[47]Lane expands upon this issue of changing ownership patterns further by stating that, *"The overall trend toward majority ownership is the result of both positive and negative political and economic developments in addition to the changes in legislation. On the positive side, the willingness* (of the foreign firm that is a partner to the JV) *to assume majority foreign ownership suggests that there is increased confidence in the political and economic stability of the country."* Lane goes on to state that *"On the negative side, firms have found that it is difficult to work with Hungarian JV partners and where possible have chosen to take control."* See Lane, S. J. (1994), *The Pattern of Foreign Direct Investment and Joint Ventures in Hungary*, pp. 355.

have affected FDI flows. The primary focus of this article is on reviewing the legislation on FDI in Hungary and the subsequent response of TNCs to engage in FDI based on these policies. Marton's review of registered companies with foreign participation in Hungary shows a dramatic increase in the number of registered firms between 1989 (1,350) and 1990 (5,693). Marton says this increase in the number of new foreign entries is justified by the more comprehensive opening up of the Hungarian market as a result of the events of late 1989. However, despite this dramatic increase in the creation of new firms, Marton points out that many of these registered companies are non-operational[48] or paper investments. However, Marton does not indicate in the article, if the information was even available to her in the first place, exactly or even approximately how many of these listed operational JVs are actually bona fide foreign JVs as opposed to *phantom joint ventures*[49] set-up by Hungarian citizens to take advantage of loopholes in the system. This point only reinforces the belief that there is a question of reliability in using such information to establish a true and accurate picture of the actual level and impact of FDI on the host country environment.

Finally, another important area which Marton addresses in her paper is on the topic of strategies that have been utilized by TNCs in their investments within Hungary. Marton suggests that TNCs are motivated to enter the Hungarian market on the basis of several factors such as first- or early-mover advantages, to establish a foothold in the market, and to take advantage of opportunities for FDI via the country's privatization program. However, the basis for these claims by Marton seems to be based on her interpretation of various press announcements rather than on original field research. This criticism has been made not to fault Marton for her efforts in this area but rather to illustrate the need for further investigatory research on the subject.

The second group of materials which can also be classified as descriptive in nature focuses on outlining the environment for FDI within the CEC and FSU as a whole or specific groupings of host countries within the region (Tullis and Bouin [1990], Dobosiewicz [1992], Welfens [1992], Lang and Ofek [1992], UNCTAD-DTCI [1996, 1995, 1994], UNTCMD/DESD/ECE [1991, 1992a, 1992c, 1992d, 1993a], Alter and Wehrle [1993], Artisien, Rojec, and Svetlicic [1993], Dunning and Rojec [1993], Dunning [1993c, 1994b], Cilento [1993], Jermakowicz and Drazek [1993], Ernst & Young [1993], McMillan [1993], Odle [1993], Árva [1994], Buckley and Ghauri [1994], Hood and Young [1994], Hunya [1994], Jain and Tucker [1994], Meth-Cohn, Kasriel, Klopf, Komlev, Simpson, and Thorniley [1994], Valencia, Simpson, and Kraft [1994], Meyer [1994, 1995a, 1995b], SIGMA [1994], Svetlicic and Rojec [1994], Brewer [1995], Horton [1995], Paliwoda [1995], Konings [1996], Marinov and Marinova [1996], and Meth-Cohn, Calbreath, Grandsen, Kapoor, Lee, and Straunik [1996]).

48In 1989, of the 1,350 registered firms, 582 were classified as operational ventures.

49These so-called *phantom joint ventures* are defined the Hungarian researcher Gyorgy Csáki, in a similar paper by him that focused on FDI in Hungary via the JV mode. See Csáki, G. (1992), *East-West Corporate Joint Ventures: Promises and Disappointments.*

Similar to the country specific literature described previously, these articles, papers, and books[50] also deal with a variety of issues related to FDI in the CEC environment as well as some references to the FSU. For example, the papers by Welfens (1992), McMillan (1993), and Svetlicic and Rojec (1994) each discuss the role of FDI in the transition process within both the CEC and FSU. Dunning's (1993c, 1994b) paper also addressed the role of FDI but with regard to the potential benefits of FDI, especially those benefits provided through FDI by TNCs, in assisting the CEC and FSU host countries through the transition process. The article by Alter and Wehrle (1993) offers a general assessment of FDI in the CEC and FSU and some possible explanations for the differences between expected levels of FDI in the countries of the region and actual FDI inflows. Tullis and Bouin (1990) described the changes in the CEC environment brought about as a result of the events of late 1989. The papers by Cilento (1993) and Jermakowicz and Drazek (1993) each compare the various legislation on the JV mode of FDI in the CEC and FSU. Hood and Young (1994) examines the characteristics of FDI within a select grouping of CEC host countries (Czechoslovakia, Hungary, and Poland) in regards to the process of internationalization of business activities in these countries. The relevant sections of each of both theUNCTAD-DTCI (1996, 1995, 1994) and the UNTCMD/DESD/ECE (1991, 1992a, 1992c, 1992d, 1993a) reports provide a general overview of FDI in the CEC and FSU outlining some of the key impacts these investments have on the region as a whole, especially with regard to their role in the process of economic transition. Some of the literature within this group of work deserves special attention and therefore is reviewed in greater detail.

The UNTCMD/DESD/ECE (1992a) report represents one of the most comprehensive works to date in its coverage of the numerical aspects of FDI flows to and from the CEC and FSU, although this is now quite outdated. However, even this report has its shortcomings, most notably in its lack of adequate coverage of other useful sources of information, such as the various materials that are reviewed within this chapter. The report begins by giving a basic overview of the situation for FDI in the CEC and FSU. On the inward investment side of things, the report discusses the ways in which policy regarding FDI has evolved in the region over time and the response that the rest of the world has had to these conditions; the regulatory framework for FDI in the CEC and most of the FSU; and the structure of FDI flows on the basis of inflows, the importance of activities of TNC in the region, the geographical and sectorial distribution[51] of FDI flows, and a very brief profile of some of the TNCs active in the region. The report then goes on to detail how the information and statistics were collected and which sources of information were utilized in the process. In this part of the report it is stated that there are several problems with respect to both the collection of the necessary data on FDI flows

[50]Some of these research works that are in book form are actually an amalgamation of articles and papers done by various authors. Some examples of these types of work include the publications by Razvigorova and Wolf-Laudon (1991), Artisien, Rojec, and Svetlicic (1993), Dunning and Rojec (1993), Buckley and Ghauri (1994), and Fogel (1994).

[51]For sectorial distribution, the UN Report uses the *International Standard Industrial Classification (ISIC)* system, i.e. primary, secondary, and tertiary sectors. See UNTCMD/DESD/ECE (1992a), *op. cit.*.

and the level of reliability of this information.[52] The balance of this report then details the numerical information associated with FDI flows (inward and outward) to and from the CEC and FSU on a country by country basis, as well as providing a brief outline of the host country's associated legal framework and legislation on FDI.

Three other works worthy of note include the individual works of Dobosiewicz (1992), Artisien, Rojec, and Svetlicic (1993), and Buckley and Ghauri (1994), which are all very comprehensive in their own respective coverage of FDI in the CEC and FSU, especially the first two offerings. Of these three works, Dobosiewicz's book is a stand alone effort while the other two publications are actually amalgamations of papers from other authors[53], some of which have been published in other literature sources. The focus of each of these works is also different in several respects.

Dobosiewicz's (1992) research looks at FDI from the perspective of the big picture focusing strictly on what was then still considered Eastern Europe. Dobosiewicz's effort is also more oriented towards describing the nature of FDI in relation to the evolution of legislation on FDI and its impact on FDI flows within each respective country of the CEC; the motivation for foreign firms to invest in the CEC; the structure of foreign investments by economic sector; the geography of FDI with respect to host and home country; portfolio investment; and the author's own opinion on the future prospects for FDI in the region given these conditions. Yet, while Dobosiewicz's work was one of the first major comprehensive attempts at addressing the topic of FDI in the CEC, much of the information and points made have become outdated due to the passage of time and the changing conditions of the environment.

The books by Artisien, Rojec, and Svetlicic (1993) and by Buckley and Ghauri (1994) are also fairly comprehensive works, although each one takes a slightly different focus on the subject of FDI.[54] The book by Artisien, Rojec, and Svetlicic focuses specifically on the contextual and thematic aspects of FDI combined with several empirical country studies[55] of FDI. Buckley and Ghauri's book describes the changes in the CEC and the FSU and, as the title states, how these events have affected international business. However, unlike the other two books previously described, Buckley and Ghauri's book is more concerned with the economic implications of the

[52]According to the same report, *"The main sources of data on inward investment are the records of registration of newly-formed joint companies under host-country legislation. There are several problems with the data from this source. First, in some Central and Eastern European countries, registration is voluntary for small scale investments and, therefore, these are excluded from the data. A more serious problem is that the data supplied upon registration of a joint ventures are only expressions of intent. Subsequent changes in the plans of an affiliate, such as a change in activity or the time when it begins to operate, are generally unrecorded."* This research project will circumvent these problem areas by only examining operational firms with foreign capital participation located within the specified CE environment. See UNTCMD/DESD/ECE (1992a), *op. cit.*, pp. 32.

[53]Some of the papers found in these types of books will also be reviewed as individual research works within this literature review chapter. This will be the case for the papers and articles by Jermakowicz and Drazek (1993), Bochniarz and Jermakowicz (1993), Rojec (1993), Young (1993), Benito and Welch (1994), de Mortanges and Caris (1994), Hood and Young (1994), Dunning (1994b), and Jain and Tucker (1994).

[54]Both of these books are actually an amalgamation of papers from other authors, for which Artisien, Rojec, and Svetlicic and Buckley and Ghauri are are the editors.

[55]The empirical country studies examine cases of FDI in the Commonwealth of Independent States (CIS), Hungary, Poland, and Slovenia.

opening up of what they describe as *East and Central Europe*. These economic and business concerns of the editors are mainly directed at how changes in the CEC and FSU will impact upon international trade, technology development and movement, and investment flows to and from the countries of the region. More simply stated: *How will the countries of the East integrate with those of the West and what will the impact of this integration be on the global economy?*

In summary, all three of these works are very useful resources for providing a fairly reasonable overall view of the environment for FDI in the CEC and the FSU. However, as it has been stated previously, some of these materials are now outdated and thus are only useful for historical background purposes. Yet overall, these works do provide a good starting point for anyone wishing to delve deeper into the subject matter.

The paper by Odle (1993) is also worth reviewing in detail because it discusses the role of FDI within the process of privatization as well as providing details of actual examples of FDI by TNCs via the privatization programs of individual countries within the CEC. This work is pertinent to this particular research project because of the number of TNCs that have actually used the privatization process as a means of entering the markets of the CEC. Odle's article is also useful because it addresses some of the strategic motivations of TNCs to participate in privatizations. These strategic concerns of TNCs are categorized by Odle into four main areas: cutting starting-up costs, building regional and global networks, gaining market share, and seeking low-cost investment opportunities. Odle's four categories of strategic concerns are very similar in many respects to the *raison d'etre* for the firm to engage in FDI which have been classified by Dunning (1993) earlier in this chapter.

The third group of general literature on FDI in the CEC is generally of a *how-to* nature and is concerned primarily with detailing various strategic options available to firms in entering these markets as well as the motivations of investors to do so. This literature is also both country specific and regional in its approach to outlining investment strategies and motivational factors of firms to invest within the CEC (Alpert [1990], Hermann and Hermann [1990], Tully [1990], CJWB [1991], de Rouffignac [1991], Dickie [1991], Gabrisch [1991], Gatling [1991], Olivier [1991], Quelch, Joachimsthaler, and Nueno [1991], Armstrong [1992], Neale and Pass [1992], Samonis [1992], Harwit [1993], Pitt-Watson [1993], Nelson [1994], Blishen [1995], Haiss and Fink [1995], Luthans, Patrick, and Luthans [1995], Keay [1995], Paliwoda [1995], Papp [1995], Springer [1995], and Thomson [1995][56]).

This type of literature generally discusses the strategic aspects of FDI, but each of them is

[56]There has also been an abundance of various other titles pertaining to both the *how-to* invest and strategy areas of concern related to the CEC and FSU. Some of these other materials have been produced by consultancy services (*Price Waterhouse, KPMG, Ernst & Young*, etc.), by investor's home country (the United States of America's Department of Commerce *East European Business Information Center [EEBIC]*, the United Kingdom's *Department of Trade and Industry [DTI]* and the *East European Trade Council [EETC]*, etc.), by host country promotional agencies for FDI (*CzechInvest, Romanian Development Agency [RDA]*, etc.), and a variety of other sources.

somewhat diverse in its approach to the topic. For example, the works by de Rouffignac (1991), Gatling (1991), Olivier (1991), Quelch, Joachimsthaler, and Nueno (1991), Armstrong (1992), and Paliwoda (1995) focus almost exclusively on providing a step-by-step guide to investing in the markets of the East. The article by Harwit (1993) concentrated on the automobile industry in the CEC with regards to the investment strategies utilized by Western manufacturers (mainly German and American) within this sector as well as investigating why Japanese automobile producers have been reluctant to engaged in similar investments in the region. Neale and Pass (1992) examined the role of countertrade and strategic alliances as a means for Western firms to ensure hard currency payments via barter arrangements for their products and services in the transitional economies of the East. Hermann and Hermann's (1990) paper talked about the differences between East and West with regards to business practices, the mentality of managers, and institutions. Hermann and Hermann's paper also provided a brief checklist on what Western firms should do to overcome these problems which is similar to the approach taken by Paliwoda (1995).

Within this group of literature, two interesting articles by Alpert (1990) and the CJWB (1991) are worth noting because of the way they approach the subject of FDI in the CEC and FSU. The focal point of both of these articles is on the surveying the views of CEOs with regard to their opinions on investing in the region. While both articles are not to be considered to be very scientific in their methodology, they do provide some valuable insights as to why TNCs are motivated to invest in the CEC and FSU.

Some of the excerpts from the CJWB (1991) article sheds some light on these issues via informal interviews with key executives of American based TNCs. For instance, Reuben Mark, the Chairman & CEO of the *Colgate-Palmolive Co.*, states in the article that, *"The operative word is long-term. Eastern Europe ventures will demand commitment, patience and flexibility."* According to George Suter, Vice President of Operations of *Pfizer International*, *"It has been our experience in recent months that the situation in Eastern Europe is changing so rapidly that anything we say today might become irrelevant tomorrow."* Joseph Williams, Chairman & CEO of the *Warner-Lambert Company*, notes that,

> *"Our experience in Eastern Europe tells us that the biggest stumbling block for American firms that are contemplating trade there may be the American penchant for seeking quick returns - what our friends in Europe refer to as our 'Wall Street' mentality. To be successful in Eastern Europe, we're going to have to exercise patience. We're going to have to understand that while we must act quickly to get into business there, it will be three, four or five years before we can expect any real return on our investment."*[57]

The findings by Alpert (1990) are similar to these, but his article is based upon the results of a somewhat more scientific survey of CEOs of *Fortune 500* companies, many of which are also

[57] CJWB (1991), *What is your greatest concern about expanding into Eastern Europe?*, pp. 18-19.

TNCs. According to Alpert's article outlining the main findings of the survey,

> *"Two-thirds of the CEOs interviewed believe Eastern Europe will emerge as a major new market within the next 20 years. The chief executives say East Germany has the greatest economic potential - half of them ranked it as the most promising Eastern European country for U.S. companies. Next-best bets in order: Hungary, Poland, and Czechoslovakia....Two-thirds say they expect to do more business with the U.S.S.R. in the next two years."*[58]

Another report which is a more typical example of this type of *how-to* and strategy focused literature is the report by Gatling (1991), done of behalf of the *Economist Intelligence Unit (EIU)*. Gatling's report begins by describing the general environment for investment in what the report terms as Eastern Europe and then goes on to offer advice to the reader[59] on how to best (in the opinion of the author) enter these transitional markets. The report then concentrates on describing the various aspects of doing business in the region with regard to local accounting practices, the tax structure and planning for it, and the finance and banking system. Gatling then shifts the attention of the report to the environment for investment within the Soviet Union, providing advice on a step-by-step basis on how to structure investments in that environment. The report concludes with a spattering of brief case studies illustrating various experiences of companies that are already active in the CEC and the Soviet Union. These case studies will be addressed in a later subsection within this part of the review. On a critical basis, Gatling's report covers most of the material in a very superficial manner, only bullet pointing the main topics, and then adding in some brief comments by company executives related to their firm's experiences with their own investments in the region. As a result of this type of approach, the report substantially lacks the substance that it purports to possess.

This problem is also shared by many of the other materials of a similar nature (de Rouffignac [1991], Olivier [1991], Quelch, Joachimsthaler, and Nueno [1991], Armstrong [1992], and Paliwoda [1995]). This point is acknowledged by Paliwoda (1995) in his own book, *"Anything written on the markets of Eastern Europe in the last few years is almost certainly out of date. Political and economic changes have combined to make any commentary obsolete almost upon publication."*[60]

Yet, in the case of Gatling's work (as in others that were written in the period just after 1989), this shortcoming of her report may partially be a result of the severe shortage of information on the subject that was available at the time the report was written. This also might account for why Gatling draws so much upon the experiences of other firms as a way of describing the environment for investment in the East. Nevertheless, much of what Gatling's report addresses has now been greatly outdated by the vast changes that the transitional economies of the East

[58]Alpert, M. (1990), *Wary Hope on Eastern Europe*, pp. 75.

[59]This report, like many others of its type that are based on describing and advising the reader on the strategy issues related to the investment process, is aimed at the corporate/company executive that is in the process of contemplating whether or not to invest in some form or another in the CEC and/or FSU.

[60]Paliwoda, S. J. (1995), *Investing in Eastern Europe: Capitalizing on Emerging Markets*, pp. 154.

have experienced over the years since the events of late 1989.

The article by Samonis (1992) is also worth reviewing in greater detail because it sheds light on the strategic considerations of Western firms related to FDI in the East. While Samonis's article focuses specifically on FDI in both the Soviet Union and FSU via the JV mode of investment, it can still be considered useful material in relation to the CEC environment because of the strategic issues it addresses. In his paper, Samonis details several strategies, in what he labels as their pure form, which have been adopted by Western JVs in the FSU. Samonis profiles three strategies: the *Quick Buck Strategy*, *Enclave Strategy*, and *Learning Strategy*.[61] Apparently, Samonis has derived these three strategies of Western JVs in the FSU from his own review of previous research studies and articles as well as from information supplied via the commercial print media (newspapers and magazines) on the subject of FDI via JVs in the FSU. All three of these strategies are defined and expanded upon in the paper.

Samonis characterizes the *Quick Buck Strategy* by the statement, *"They* (Western firms, especially those originating out of North America) *thought they could step into the Soviet market, quickly go through the motions of joint venturing based primarily on supplies imported from the West, then exit, hopefully having made a 'quick buck' on the operation."*[62] However, Samonis does point out that the *Quick Buck Strategy* defeats the whole premise for forming a JV in the first place and has no beneficial function for the firm outside of the short-term.

The *Enclave Strategy* is based upon the former state trading system that was previously used extensively throughout the region, which utilized *Foreign Trade Organizations (FTOs)* as a funnel for almost all foreign trade arrangements.[63] Samonis offers less clarity on this strategy but does purport it to be geared towards a foreign firm forming a JV as a means of replacing these now mostly defunct FTOs, thus ensuring that the foreign firm is able to obtain both hard currency payments for its products and access to the necessary resources for production. Ideally, this strategy would be much better if it was categorized as a vertical integration strategy for FDI.

The last of Samonis's strategies is called the *Learning Strategy* and it is based on the foreign firm's desire to form JVs with local partners as a means of bridging the East-West knowledge gap. The paper states that this strategy enables foreign firms, that utilized JVs, to obtain a higher level of knowledge in a shorter time span in comparison to other foreign firms that are either engaged in trade or which have used the wholly owned subsidiary as a mode of investment. In support of this claim Samonis states that JVs offer this capability to foreign firms

[61]Samonis acknowledges that, *"As invariably happens in real life, actual JVs may combine elements of two or more strategies. However, for analytical reasons it seems worthwhile to present them in pure form."* See Samonis, V. (1992), *Earning or Learning? Western Direct Investment Strategies in Post-Soviet Economies*, pp. 102.

[62]*Ibid.*.

[63]Samonis states that this strategy is not just restricted to the FSU but also bears relevance to the situations in Hungary, Poland, Czechoslovakia, Yugoslavia, Romania, Bulgaria, and the former GDR during the 1970s and 1980s.

because *"Such a formula virtually guarantees learning-by-doing, the most comprehensive way of learning, encompassing even tacit knowledge."*[64] Samonis concludes that the *Learning Strategy* enables the firm to establish a foothold in the market without the requirement for a large scale capital investment. Therefore, Samonis considered this strategy to be the most sensible and viable option of the three alternatives available to the firm for its operations within the environment of the CEC and the FSU.

2.6.2 A Review of the Survey Based Literature

The greatly increased level of interest of private firms in pursuing investment opportunities in the CEC and FSU via FDI subsequently led to a dramatic increase in the number of both academics and practitioners seeking to investigate this phenomenon. The primary tool used in these investigations into FDI behind the former Iron Curtain has been the survey instrument. However, due to the diversity of the situation, many of these survey instruments have been directed at different aspects of the FDI within the region. Some of these surveys have focused on investigating FDI throughout the entire region encompassing both the CEC and FSU (Deloitte Touche Tohmatsu International [1992][65], Collins and Rodrik [1992][66], Gatling [1993][67], Genco, Taurelli, and Viezzoli [1993][68], Stern, Bunt, and Thomas [1993][69], OECD [1993, 1994][70], Welch [1993][71], Benito and Welch [1994][72], de Mortanges and Caris [1994][73], Meyer [1995c][74], and Shama [1995]). Other studies have utilized specific groupings of host countries as a platform for investigation (Holmes [1993][75], Rojec, Jermakowicz, Illes, and Zemplinerova [1995][76], Franko

[64]*Ibid.*, pp. 107.

[65]Actual research survey conducted during April and September 1992. See Deloitte Touche Tohmatsu International (1992), *Successfully Managing Investments in Eastern Europe.*

[66]Actual research survey conducted between the Winter of 1990-1991. See Collins, S. M. and Rodrik, D. (1991), *Eastern Europe and the Soviet Union in the World Economy.*

[67]Actual research survey conducted in the Summer of 1992. See Gatling, R. (1993), *Foreign Investment in Eastern Europe: Corporate Strategies and Experience.*

[68]Actual research survey conducted between September 1991 and March 1992. See Genco, P., Taurelli, S., and Viezzoli, C. (1993), *Private Investment in Central and Eastern Europe: Survey Results.*

[69]Actual research survey conducted between October and November 1991. See Stern, J., Bunt, K., and Thomas, N. (1993), *Foreign Direct Investment to the Countries of Central and Eastern Europe.*

[70]The research survey was conducted between March and May 1993. Also, the OECD (1993) is a draft version of the actual report. See OECD (1993, 1994), *Assessing Investment Opportunities in Economies in Transition.*

[71]Actual research survey conducted in 1990. See Welch, J. B. (1993), *Investing in Eastern Europe: Perspectives of Chief Financial Officers.*

[72]Actual research survey conducted in 1990. See Benito, G. R. G. and Welch, L. S. (1994), *Norwegian Companies in Eastern Europe: Past involvement and reaction to recent changes.*

[73]Actual research survey conducted in 1992. See de Mortanges, C. P. and Caris, W. B. (1994), *Investment in Eastern Europe: The Case of the Netherlands.*

[74]Actual research survey conducted between October 1994 and February 1995. See Meyer, K. E. (1995c), *Business Operations of British and German Companies with the Economies in Transition: First Results of a Questionnaire Survey.*

[75]Actual research survey conducted between October 1992 and May 1993. The focus of the study was on FDI by TNCs within the Czech Republic and Hungary. See Holmes, C. (1993), *Global Strategies in the Transition.*

[76]This research study focused on FDI within the Czech Republic, Hungary, Poland, and Slovenia.

[1996][77], and McCarthy, Puffer, and Simmonds [1993][78]).

Furthermore, a number of surveys have examined FDI in the context of a single host country (**Czech Republic:** Möllering, Rádl, and Zimmermann [1994][79] and Ali and Mirza [1996]; **Hungary:** Benedek [1992], MIS [1992], Wang [1993][80], Szanyi [1994][81], and Rekettye [1995][82]; **Poland:** Bluszkowski and Garlicki [1993], and Bellas, Bochniarz, Jermakowicz, Meller, and Toft [1994]; **Romania:** Romanian Development Agency [RDA][1994]; **Slovenia:** Rojec and Svetlicic [1993][83], and Rojec [1994, 1996]); **Kazakhstan:** Charman [1996a, 1996b][84]; and **Russia:** Lawrence and Vlachoutsicos [1993], Fey [1995b][85], and Randall [1995][86]). As apparent from this listing, the host country specific research is fairly concentrated within Czech Republic, Hungary, Poland, and Russia with research focusing on other CEC and NIS of the FSU very limited.

Some of these surveys have been done from the perspective of an investors' own home country (**Austria:** Rojec [1996]; **Germany:** Möllering, Rádl, and Zimmermann [1994]; **the Netherlands:** de Mortanges and Caris [1994]; **Norway:** Benito and Welch [1994]; **United States of America:** Welch [1993], McCarthy, Puffer, and Simmonds [1993], and Shama [1995]; **United Kingdom:** Ali and Mirza [1996]; and the **United Kingdom and Germany:** Meyer [1995c]). Once again, these types of studies are extremely limited in their scope of coverage, with only some home countries being specifically targeted while others are omitted. For example, individual studies of German based FDI have thus far been very much neglected despite the fact that as a single country Germany is an important source of investment for the CEC, especially for the CE group of countries.

It should also be noted that several of these studies are of the one-to-one variety, that is to say,

[77]This study examined FDI by North American, European, and Japanese based firms into Hungary, Poland, Slovakia, Russia, Ukraine, and Lithuania.

[78]Actual research survey conducted in 1992. See McCarthy, D. J., Puffer, S. M., and Simmonds, P. J. (1993), *Riding the Russian Roller Coaster: U.S. Firms' Recent Experiences and Future Plans in the Former USSR.*

[79]Actual research survey conducted between August and September 1993. See Möllering, J., Rádl, R., and Zimmermann, Jörg-Mark (1994), *Deutsche Direktinvestitionen in der Tschechischen Republik: Motive, Erfahrungen, Perspektiven (German Direct Investment in the Czech Republic: Motive, Experience, and Perspective).*

[80]Actual research survey conducted in 1992. See Wang, Z. Q. (1993), *Foreign Investment in Hungary: A Survey of Experiences and Prospects.*

[81]Actual research survey conducted between August and October 1993. See Szanyi, M. (1994), *Experiences with Foreign Direct Investment in Hungary.*

[82]Actual research survey conducted in June 1993. See Rekettye, G. (1995), *Market Orientation of the Hungarian Manufacturers.*

[83]Actual research survey conducted in 1991. See Rojec, M. and Svetlicic, M. (1993), *Foreign Direct Investment in Slovenia.*

[84]The two papers by Charman should really be viewed as one work as the first paper (1996a) outlines the legislative background for FDI in Kazakhstan and the other (1996b) reports on the findings of a survey of foreign parent/partner organizations that have invested in the country.

[85]Initial research for the survey conducted in July 1993 which was followed up by further data collection from the sample in March 1995. See Fey, C. F. (1995), *Important Design Characteristics for Russian - Foreign Joint Ventures.*

[86]Actual research survey conducted between 1991 and 1992. See Randall, L. M. (1993), *Determinants of Joint Venture Success in Russia.*

research that examines FDI from one investor's own home country into a specific host country. Examples of these types of studies include Möllering, Rádl, and Zimmermann (1994), which covers German FDI within the Czech Republic; Ali and Mirza (1996), that examines British based investments in the Czech Republic; and the paper by Rojec (1996), which investigates FDI from Austrian firms into Slovenia.

Almost as diverse as the perspectives of these surveys have been the methodological means that have been utilized by the respective researchers to collect the necessary data. Almost all of these studies relied on structured questionnaires, which utilized four basic means of data collection: written postal questionnaires, personal interviews, telephone interviews, or a combination of these methods.[87] Primary methods that have been utilized by these surveys on foreign investors have included postal questionnaires sent to company officials (Benedek [1992], Collins and Rodrik [1992], Genco, Taurelli, and Viezzoli [1993], Wang [1993], Welch [1993], Bellas, Bochniarz, Jermakowicz, Meller, and Toft [1994], Benito and Welch [1994], Romanian Development Agency [RDA][1994], Meyer [1995c], Rekettye [1995], and Ali and Mirza [1996]); via face-to-face interviews with executives and/or experts (Bluszkowski and Garlicki [1993], Lawrence and Vlachoutsicos [1993], Rojec and Svetlicic [1993], Holmes [1994], Randall [1994], Rojec [1994], Szanyi [1994], and Franko [1996]); telephone interviews with company executives using a structured questionnaire (Shama [1995]); or using a combination of research instruments (Deloitte Touche Tohmatsu International [1992], MIS [1992], Stern, Bunt, and Thomas [1993][88] Gatling [1993], McCarthy, Puffer, and Simmonds [1993], OECD [1993, 1994], de Mortanges and Caris [1994], Rojec, Jermakowicz, Illes, and Zemplinerova [1995], Fey [1995b], and Rojec [1996]).

According to a European Bank for Reconstruction and Development (EBRD)(1994) report, which reviews and critiques a number of the investor surveys listed above, *"Comparing and interpreting these surveys is problematic, since they cover different groups of countries and respondents with different characteristics. They also sometimes use radically different methodologies."* On this last issue, the EBRD report also comments that the quality of some of the methodologies used in these surveys is also quite questionable. It then goes on to state that, *"Nevertheless, keeping these shortcomings in mind, the combination of surveys reveals some interesting patterns regarding locational factors and investor strategies."*[89]

Bearing these thoughts in mind, it is interesting to note that a number of the researchers conducting surveys have not adequately addressed the issue of the methodology employed in their own research. This is especially the case in regards to response rates, sample selection, and

[87]Judd, Smith, and Kidder discuss these modes of data collection with regard to the advantages and disadvantages of each mode. See Judd, C. M., Smith, E. R., and Kidder, L. H. (1991), *Research Methods in Social Relations*, pp. 215-223.

[88]This survey also employed face-to-face interviews of an hour or more with some of the members of the sample population.

[89]EBRD (1994), *Transition Report 1994: Economic transition in eastern Europe and the former Soviet Union*, pp. 125 and 132 respectively.

composition of the sample. It can only be assumed that these shortcomings in the reporting of the methodology in the survey results are just an oversight on the part of the researcher and not what is referred to by social scientists as *"cooking the data,"* or by economists and academics in the area of business studies as *"data mining."* The lack of adequate information on the methodology utilized in a specific survey is somewhat of a problem in the works by Charman (1996b), Collins and Rodrik (1991), Benedek (1992), Deloitte Touch Tohmatsu International (1992), MIS (1992), Gatling (1993), Holmes (1993), Lawrence and Vlachoutsicos (1993), Rojec and Svetlicic (1993), Rojec (1994, 1996), and Fey (1995b). However, it should also be noted that this situation may also be a result of the severe limitations of available space in published articles or the working nature of some papers.

The remainder of this subsection of the literature review is devoted to providing a descriptive and critical review of some of these surveys of the activities of foreign investors in the CEC and FSU environment or parts thereof. In doing so, the review examines some of the more relevant surveys within the field. This is done wherever possible according to the date when the research was actually conducted rather than when it was published and/or presented.[90] Furthermore, for those surveys that are to be reviewed in greater detail, the reviewer will identify the areas of importance, such as the focus of the survey, the methodology employed, a description of the sample and the actual response rate achieved, the main findings of the survey, and finally an overall critique of the work.

It was not long after the events of 1989 before the first group of surveys targeting foreign investors within the CEC started to appear. Towards the end of 1990, almost a full year after the wave of change had swept the region, the first of these early research studies on FDI within the region began to appear. These early surveys were generally aimed at investigating the case of FDI in what was then still termed by the West as Eastern Europe and the Soviet Union. Some of these early surveys in the post-1989 environment included works by Benito and Welch (1994) and Collins and Rodrik (1991).

The survey by Benito and Welch (1994) was classified by its authors as a *company survey*. The survey sought to examine Norwegian firms doing business in what the researchers referred to as Eastern Europe[91], many of which had a long history of dealings within the region. The focus of the survey was on identifying the general characteristics of the Norwegian firms active in the CEC and/or the Soviet Union; their motivations for activity in the region; experiences they have had thus far; and future plans within the region.

[90]The publication date will be used as a reference point in cases where it is not possible to ascertain what the exact date was when the research study was conducted.

[91]*Eastern Europe* being classified by the authors of this survey as containing the CEC, the GDR (East Germany), and the then Soviet Union.

The survey was based upon a postal questionnaire that was sent out to 182 Norwegian firms (100%) that were identified by the authors as either probable exporters to the region or those with other business dealings in the region. The researchers reported receiving a total of 98 replies, four of which were actually refusals to participate in the study, bringing the actual response rate to 94 firms (52%). A further breakdown of these responses indicates that out of these 94 replies received, 51 firms (28%) stated that they were indeed active in the CEC and/or FSU either through export and/or other dealings; 10 firms (6%) returned incomplete questionnaires but stated that they were planning to be active in the region sometime in the future; and 33 firms (18%) stated they had either limited or no experience in these new markets. While it can be stated that both the response level (52%) and sample size (182 firms) seem fairly adequate for evaluation purposes, only 51 (28%) firms actually stated that they conducted some form of business within the region. From those active, there were only 12 instances (7%) of subsidiary operation being identified, a total of 9 cases (5%) of contractual JVs, and the others stating that they were involved in exports, brokerage, and/or other related activities.

Overall, this survey is interesting not so much because of its focus on Norwegian business activity in the CEC and the then Soviet Union but rather due to the fact that it chronicled foreign business activity, even if only primarily export activity, in the region during the very early days of dramatic change in the region. However, the survey's sole focus on Norwegian firms, low response rate of actual investors, and subsequent lack of focus on FDI does not provide a good basis for comparison with other surveys done in this area. This is a point that will become more obvious as this part of the literature review progresses.

Another early research survey was conducted by Collins and Rodrik (1991) and was one of the first truly comprehensive attempts at identifying FDI by European, Japanese, and American firms within CEC[92] and the Soviet Union. Although Collins and Rodrik are rather vague about the methodology in the study, some pertinent items can be pointed out. The survey utilized a postal questionnaire that was sent to the headquarters unit of a sample of large *Fortune 500* type firms[93] during the Winter of 1990-1991. This type of methodology can be classified at the *shotgun approach*, where survey instruments are sent out to a wide array of firms that may be active investors, potentially active, or inactive within the target environment. In doing so, the researchers were seeking and hoping to hit as many firms as possible that had activities within the CEC and the Soviet Union. Unfortunately, the authors of the survey do not provide any specific details on how many questionnaires were actually mailed to such potential investing firms nor do they state to whom the survey was directed at within the parent company. A total of 53 firms returned a questionnaire, of which only 21 firms were identified as active investors

[92]Also including the GDR (East Germany).

[93]Based on the fact that Collins and Rodrik contacted *Fortune 500* type firms it is quite probable that a great number of firms surveyed were of the TNC variety.

in the CEC and/or the Soviet Union. While at face value this might seem like a reasonable number of responses we do not know how many questionnaires were actually sent out by the authors of the survey in the first place.

The survey questionnaire was multifaceted in its approach and it sought to question firms[94] on both their existing investments, anticipated FDI activity within the region over the next five year period, and the potential obstacles and attractions to FDI in the CEC and Soviet Union. The respondents indicated that existing investments commonly comprised the setting-up of a local branch or office with only a minimal outlay of capital. On the issue of anticipated investments over the next five years, respondents indicated that they would be shifting from branches or offices to either the JV or *Wholly-Owned Subsidiary (WOS)* mode of investment. On the issue of the perceived obstacles to investment in the region, the respondents rated highly a great many areas of concern which included the political and economic uncertainty of the environment, a lack of legal protection for private property, restrictions on the repatriation of earnings and/or capital gains, and/or the poor economic prospects of the host countries in which investments were targeted. The main motivational factors influencing the firms' decision to invest in the region were specified by the respondents as the opportunities of being a first- or early-mover in these new markets, the proximity of the EC markets, and to a lesser degree the availability of a workforce that is relatively inexpensive and which also possessed a fairly high skill level.

In critiquing this survey, it is difficult to evaluate the research methodology of this work since so little of it has been made available and/or clarified by the authors. Yet, the limited size of the sample of this survey is also not encouraging. As a result of these shortcomings in the survey method and sampling information, this type of survey can only be considered as an example of some early research in the area as well as a lesson to other researchers on points that should be addressed in future research on the subject.

By 1991, the research work on the subject of FDI in the CEC and what was now the FSU was beginning to be expanded upon by others, such as Welch (1993), Rojec and Svetlicic (1993), and Stern, Bunt, and Thomas (1993). At the same time other researchers were just beginning the process of implementing their own research studies that would carry over into 1992, like the studies by Genco, Taurelli, and Viezzoli (1993) and de Mortanges and Caris (1994). Each of these surveys also took a varied approach to investigating FDI in the CEC and FSU environments.

The primary focus of the research study by Rojec and Svetlicic (1993) was on motivational and locational factors for FDI in Slovenia and what policy options the country should adopt so as to strengthen their competitive position within the region. To facilitate this, interviews were

[94] The researchers used a 5-point scaling system to rate responses.

conducted with a combination of executives of firms with foreign capital participation and in some cases with executives at their respective foreign parent/partner company.[95] A total of 11 local firms with foreign capital participation in Slovenia comprised the sample. However, the response rate can not be determined for this sample because the researchers do not provide any details of how many firms were originally contacted.

The general findings of this study indicate that firms were motivated to engage in FDI in Slovenia because of the local market (in Yugoslavia as a whole); increasing profit levels, although this is not deemed as important due to changes in Slovenian legislation; and the use of Slovenia as an export base for the region. Furthermore, given Slovenia's small domestic market, foreign investors viewed their FDI as a means of market penetration into Yugoslavia as a whole. Yet, while this survey provides some interesting findings, the very limited sample size represents a serious problem as it does not seem to be representational of the actual population of foreign investors active within Slovenia.

Welch's (1993) survey posed the question: *What degree of risk or uncertainty do chief financial officers view FDI within the CEC and FSU?* Based upon this focal point, Welch conducted a survey utilizing a postal questionnaire method that was sent out to 297 firms mostly located in the New England[96] area of the United States of America. Of these 297 firms (100%) contacted, 39 firms (13%) returned a completed questionnaire, and of these only 14 firms (5%) were identified as actual investors in the CEC and FSU.[97] Welch states that a response rate of 13% falls within the expected response rate levels of 10-20%, but acknowledges that *"Had the entire population of companies surveyed been involved with the subject being investigated, a higher response rate might have been expected."*[98]

Welch detailed the survey findings on two distinct levels, one comprising the views of all 39 responding firms and the other comprising a subset of the 13 firms that were classified as current investors in the CEC and/or FSU.[99] The results of the survey indicated that first-mover advantages and follow-the-leader strategies dominated the concerns of survey respondents. On this issue, Welch concluded that, *"The advantages of 'being first' are multiple. Those firms already doing business in Eastern Europe either have solved or avoided some of the problems perceived to loom*

[95]Of the 11 firms in the sample, six interviews were conducted with both the executive of the local firm and its respective parent/partner firm, three with just the local firm, and two with only the foreign parent/partner firm.

[96]Welch's survey sample targets the membership of the Board of Directors of the Boston Chapter of the *Financial Executives Institute*, MA, USA. Welch also adjusts the response rate to account for not-for-profit memberships, retirees, and multiple corporate memberships.

[97]Welch also included FDI in the former GDR (East Germany).

[98]Welch (1993), *op. cit.*, pp. 49.

[99]While it is not specically stated by Welch in his paper, of the 14 actual investors in the region, one apparently is no longer an active investor. Hence, the subset of only 13 firms that are current investors is the subject of the analysis.

large by other respondents."[100] As for future investments in the region, the respondents stated they believed that there was a window of opportunity for investment in the region over the following five years (1991-1995).

Overall, Welch is to be commended for detailing his methodology and in providing copies of both his questionnaire and the survey's findings within the paper. However, the extremely small number of actual investors brings into question the value of the survey findings and the issue of *"armchair quarterbacking"*[101] by non-investors. Another problem area is that Welch focuses exclusively on New England based companies which is a source of bias. There is also no breakdown of actual investment by host country, only by product/service of business activity of the respondent firms. Finally, the fact that Welch targets only senior financial executives at the parent/partner headquarter level for the survey instead of managers at a more functional operational level only brings to light the issue of comparability with other surveys as well as the merit of some of the survey findings.

The working paper by Stern, Bunt, and Thomas (1993) represents a compilation of work by the *National Economic Research Associates (NERA)* in conjunction with *IFF Research Ltd.*, the latter which conducted the actual research survey. The survey was directed at what was labelled by the authors as *"Top 500"*[102] companies from Europe, Japan, and the United States and these firms' *investment intentions* in the CEC and FSU[103]. The focus of this survey was not only concerned with how much FDI was actually flowing into the region but also how these investments affect FDI flows to the so-called *Lagging Regions* of the European Union (EU).[104]

The research methodology consisted of two stages, although both parts were interdependent of one another. The first stage of the study involved what the authors described as *"...free-ranging face-to-face discussions of around one hour each were conducted with investment managers and corporate strategists in major companies."*[105] The second stage of the survey involved structured telephone interviews with executives at the headquarter level of 144 firms (18%), 55 (7%) of which were actual investors in the CEC and/or FSU and a further 28 firms (4%) characterized as likely investors. The overall sample totalled some 810 firms (100%). The questionnaire used in the second stage of the survey was fairly well scripted but due to the type of questions

[100]Welch (1993), *op. cit.*, pp. 56.

[101]*Armchair quarterbacking* can be defined as making statements when in reality you are not the one actually doing the job and/or part of the real action. It can also be referred to as pure speculatation. The term is synonymous with individuals who watch sporting events which possess little or no personal experience of their own of how the game is played at the level and who from the comfort and safety of their seats set about second guessing the play of the game, the players, and coaches.

[102]Being defined by the researchers of the survey as based on the company's level of financial turnover. Under this definition almost all companies in the financial sector failed to meet this criteria and were thus excluded from the sample population.

[103]This study also included the GDR (East Germany).

[104]These *lagging regions* of the EU were defined as including all of Greece, Portugal, Ireland (both Eire and Northern Ireland), southern Italy, and most of Spain.

[105]Stern, Bunt, and Thomas (1993), *op. cit.*, pp. 19.

utilized one can not be certain of the actual level of response or the forthrightness of the respondents to these types of questions.

Overall, this working paper does not read like a cohesive document and it probably would have been better to make it into two separate papers. This is mainly a result of the fact that the two halves of the paper fail to come together cohesively. In the first part of the paper Stern of the NERA discusses the economic considerations affecting FDI inflows into the CEC and the FSU from the macro economic perspective. In the second section of the paper the focus shifts from the macro view to the micro environment as Bunt and Thomas of IFF Research Ltd. report the results of the survey on investment intentions of the population surveyed. The major problem of the paper is that it is focused more on the lagging regions of the EU then on FDI in the CEC and FSU. Yet, despite all of these problem areas the information contained in this report is useful and does tend to lend itself to promoting future research in this area.

The work by de Mortanges and Caris (1994) focused on why Dutch firms choose to invest in the CEC and FSU; individuals that influenced the investment decision; the environmental factors influencing FDI as a mode of market entry; and the problems associated with investing. In this study the researchers employed a framework of international market entry strategy as defined by Root (1987). The data for the survey was collected via personal interviews (two cases) as well as mailed questionnaires to parent/partner firms with known operations in the region (another 12 cases). Therefore, the actual sample size was just 14 firms (100%), of which only seven firms (50%) responded to the survey. The activity of the sample members was mostly related to export activity.

Overall, the survey should be considered as one of the more unsuccessful efforts in this area of study. This is primarily a result of the poor methodology employed combined with the extremely small sample size of just 14 firms, of which only seven actually participated in the survey. Thus the responses from just seven Dutch investors, which are mostly involved in export related activity in the region and are concentrated with a couple of host countries (Hungary: four firms, former GDR: two firms, and Poland: one firm), can not be construed as a valid representation of Dutch FDI in the CEC.

Another survey of foreign investors in the CEC and FSU was conducted by Genco, Taurelli, and Viezzoli (1993). The focus of the survey was on actual investors in the CEC and/or FSU with regards to the general characteristics of the firms, operational problems encountered, restructuring issues, motivations of the foreign parent/partner for FDI, alternatives for FDI, and FDI as part of the process of privatization.

Based on this mandate, the researchers identified approximately 304 firms (100%) that were based in either France, Germany, United Kingdom, or Italy and which were already operating[106] within the CEC and/or FSU. The methodology utilized in the survey was a dual questionnaire, with the first questionnaire being sent out to the firms' respective operation in the CEC and/or FSU, of which 82 replies (27%)[107] were received. Based upon this sample of 82 firms (100%)[108], a second questionnaire was sent out to the respective firms' company HQ located in Western Europe, of which 34 firms (41%)[109] replied. A point that should be mentioned is that the authors note that, *"The sample of 82 companies cannot, of course, be considered statistically significant in relation to the universe of thousands of different small and large companies that are already operating in the East."*[110] While, the sample size may not be considered statistically significant by the authors of this research study the main results of the survey are still worth reviewing.

The findings of the survey indicated that respondents rated significantly the problem areas of weaknesses in both the host countries legislative framework, especially in the area of obtaining permits for operations and registering companies, and the domestic economic problems and conditions associated with individual host countries. However, these problems did not seem to deter investors from investing in the region. The authors of the survey stated that, *"Most companies have invested in the full knowledge of the risks and realising that they should not expect any substantial returns in the short term. To limit risks, volumes of investment have been reduced and the companies being managed in loco [sic] are usually small in size."* On operational issues, respondents noted five main areas of concern that were encountered by their respective companies once their operation was up and running, which were stated as, *"...difficulties in relations with local partner; the lack of an efficient financial system; the weakness of certain market mechanisms (particularly the one-sided price system); and inadequacy of the bureaucratic/administrative systems; and, once again, the shortcomings of the legislative system."*

Two other areas of note on these operational problems are also worth mentioning. First, the survey findings suggest that a positive correlation exists between the size of the company and the amount of problems which the firm encounters, or more simply put the bigger the firm the bigger the problems. Second, many respondents stated that they had experienced problems with their local JV partners after registering the company in the host country, so much so that Western investors indicated that a greenfield site would have been the preferred mode of investment. However, this point contradicts the learning benefits derived from what the authors

[106]The companies are divided into six groups depending upon their particular investment activity: JV, branch, representative office, commercial agreements, direct investment, and technical assistance.

[107]According to the authors of the survey, *"Other questionnaires arrived with information too patchy to be able to taken into account. Some of the companies returned incomplete questionnaires, pointing out that they were unable to answer many of the questions because of the need for confidentiality; others said that they had not yet had enough experience in the markets of the east to be able to respond adequately to the questionnaire. The incomplete questionnaires, which were not taken into account in the analysis, constitute a further 15 per cent of the total number mailed."* See Genco, Taurelli, and Viezzoli (1993), *op. cit.*, pp. 4.

[108]A further breakdown of these 82 firms indicates that 22 were French, nine German, 20 Italian, and 31 British.

[109]A further breakdown of these 34 parent/partner firms indicates that 10 were French, seven German, 11 Italian, and six British.

[110]Genco, Taurelli, and Viezzoli (1993), *op. cit.*, pp. 3.

state as *"There seems to be a significant correlation between the time spent in the country and the awareness of the risks involved and the whole range of problems encountered."*[111]

In conclusion, this particular survey is very interesting because the survey focuses on a specific grouping of investing countries that are active investors in the CEC and FSU rather than passive spectators, thus avoiding the problem of *armchair quarterbacking*. In doing so, the survey provides a more focused view of both the nature of firms investing as well as the conditions of the host countries.

In 1992 a wide array of studies were conducted on the subject of FDI in the CEC and FSU. These studies included the works by Benedek (1992), Deloitte Touche Tohmatsu International (1992), MIS (1992), Holmes (1993), Lawrence and Vlachoutsicos (1993), McCarthy, Puffer, and Simmonds (1993), Randall (1993), Gatling (1993), and Wang (1993). These works covered a variety of topics related to FDI in the CEC and/or FSU environments.

For example, the MIS (1992) study conducted interviews via a mixture of telephone, personal, and fax contacts with the individuals of large firms that were responsible for negotiating specific investments in the context of Hungary to examine their experiences; describe the JV process, evaluate the negotiation process and discern any lessons learned, and identify any relevant success factors. Holmes (1993) interviewed 60 firms, mostly American based TNCs, that were active in the Czech Republic and Hungary to see what sort of difficulties were being experienced by businesses operating in an environment in which only a basic legal system functioned. Randall's (1993) own PhD research work[112] addressed three primary research propositions, *"Why is the JV the preferred organizational form for Russian manager?; Why are Russian manager's goal expectations concerning JV and what structures do they envision for these ventures?*; and *Do we find that these expectations are in line with the transaction cost analysis, resource dependence and/or other institutional theory?"* The survey by McCarthy, Puffer, and Simmonds (1993) also focused on FDI in the FSU by utilizing both interviews (16 firms) and postal questionnaires (42 firms) to investigate firms located in the New England area of the United States that were active in the FSU.[113] Lawrence and Vlachoutsicos's (1993) study investigated Western-Russian JVs by interviewing head Russian managers of 33 JVs with Western capital participation and concluded that it was better to put a good Russian manager in charge of the JV operation than a Western manager. Benedek's (1992) paper describes the problem areas associated with Western JVs in Hungary based on interviews with members of the Hungarian Joint Venture Association. Some of the other surveys deserve greater attention in this review.

[111]Genco, Taurelli, and Viezzoli (1993), *op. cit.*, pp. 35-36.

[112]Randall's research work focuses on FDI in the Russia, but this work is not a survey of foreign investors but rather an examination of the situation from the perspective of the local Russian JV partners. See Randall (1993), *op. cit.*.

[113]The authors of the survey sent out a total of 80 questionnaires (100%) to firms that were potentially active in the FSU, of which 42 responses (52%) were received, 35 firms (44%) were identified as being active investors.

The survey by Deloitte Touche Tohmatsu International (1992) sought to identify and analyze the major practical problems of operating in the CEC and FSU environments and highlight the success factors in terms of markets, staffing and financing, and the use of the JV mode of FDI. The study was based on face-to-face interviews and in-depth questionnaires with 168 firms that were operating as either JVs (113 firms [67%]) or as WOSs (55 firms [33%]) in Bulgaria (12), Czechoslovakia (36), Hungary (42), Poland (43), Romania (19), and Russia (16). However, it should be noted that the study suffers from numerous problems with regards to its methodology. For example, a response rate can not be calculated because the population is not properly identified. There are also some problems in the use of specific terminology.

The main findings of the survey suggest there is a serious problem with the region's lagging infrastructure, the regulatory framework is not clear or coherent in many instances, and the general economic conditions are not favorable at present. On the issue of motivations for FDI via the JV mode, from the Western perspective the study sites the desire to gain knowledge of the local market, access to the same market, and various financial incentives in utilizing the JV mode. On the Eastern side of the equation, local parent firms looked to gain access to new sources of capital, products, training, and technology. The study concludes by stating that the keys to successful operations in this environment include having good local managers, keeping up to date with changes in the regulatory system, and developing coherent short-term plans to build towards a successful long-term future.

However, despite some of the shortcomings in this report previously noted, it is still of value because it examines only active investors in the region and utilizes both Eastern and Western JV partners perspectives to create a view of the overall situation for FDI. Although with respect to this last point the focus seems to be primarily aimed at the Western partner perspective and due to the previously mentioned problems of methodology this area must also be evaluated with care.

The survey by Wang (1993), focused on a number of issues including the motivational factors affecting the Western firm's decision to engage in FDI in Hungary via the JV mode of investment; the reasons why investors seem to prefer to utilize the JV mode and why they choose a particular partner; performance of local firms; problems experienced; and changes and prospects for JVs in Hungary. Wang describes his methodology as, "*...a large-scale survey of concerning investing in Hungary, sending complicated questionnaires to 300 Western firms, located mainly in Western Europe, which were reported to be involved in manufacturing or service activities in Hungary.*"[114] Of these 300 firms (100%) contacted, 90 valid responses (30%) were received.

The major findings of this survey show that the three main motivations of respondents to invest

[114]Wang (1993), *op. cit.*, pp. 245.

in Hungary were to gain better access to the local market, expand product exports and take advantage of these new markets, and establish a foothold in the market. On the subject of problems encountered in the Hungarian market by Western firms, the respondents identified a wide variety of problem areas, but the most highly rated problem areas were the inconsistent rules and poor infrastructure. Another key finding of the survey is that a majority of Western firms preferred the JV route over other forms of what Wang describes as *"industrial cooperation."* However, this comparison of investment modes is based on the JV route versus the alternatives of import/export, technological transfer, and long-term production cooperation. Moreover, the issue of whether or not the Western firm would have preferred to invest in Hungary via other alternatives such as a WOS, a greenfield site, and/or a privatization acquisition are not addressed by Wang. On the issue of JV performance, Wang measures the JVs performance based upon profitability, primarily return-on-investment (ROI); export sales performance; the firms' own perception of success based on achieving their own objectives; and the firms' overall level (including profitability, exports, and the firms' own perception of success) of success of their JV in Hungary. Since many of these types of measurement are subjective in nature to the firm it is difficult to get an accurate picture of the performance of these JVs in Hungary.

Overall, Wang's survey covers some interesting points on JV activity in Hungary. It is also one of the few studies employing the survey method to obtain what seems to be a fairly representative sample of firms from a clearly defined populaiton of actual investors. Furthermore, since Wang targeted only firms in Hungary that were active investors his results have much more creditability than do other studies that have used non-investors to bolstered the size of their samples and response rates. The only real problem with Wang's research is that it seems to rely too much upon the *EWIC* concept of the JV as it was used in the post-1990 environment rather than on the JV concept as it pertains to the current situation in the CEC environment.

Gatling's (1993) second attempt at investigating FDI in the CEC and FSU, also on behalf of the EIU, certainly proved to be more successful than her previous effort that was reviewed earlier on in this section (Gatling, 1991), but once again the report seems to fall short of its billing. Gatling's survey examined a number of areas including investment history and a profile of respondents; experiences and key concerns of investors; the motivations for FDI in the CEC and FSU and modes utilized for market entry; the valuation and pre-negotiation process; the negotiating process; financing; investment incentives; restructuring and management issues; investment plans; and reasons for not investing.

The survey's methodology for data collection involved postal questionnaires sent to executives at the headquarters level as well as some 30-40 interviews with selected respondents and so-called experts working in the field for the creation of brief case studies. In July of 1992 questionnaires were sent out and 87 firms responded by returning a questionnaire, of which 48 firms were categorized as actual investors in the region, just over half of the all responses. Many of these 48 investing firms were involved in multiple investments within the CEC and/or FSU that amounted to 191 investments[115] by 107 investors[116] (allowing for multiple investments by the same parent/partner firm). It should be noted that detailed information on the nature of the sample population and the total number of firms actually contacted is not provided in the survey report, hence it's not possible to calculate the response rate achieved. This seems to be a chronic problem with almost all of the practitioner oriented surveys and is also evident in a couple of the more academic related pieces.

The findings of Gatling's survey show that primary motivations of foreign companies to invest were to establish market share, tap the regional market, take advantage of low-cost sourcing, and to tap the markets of Western Europe. On the subject of key investment concerns of investors, these were the economic and the political environments. Most FDIs were a mixture of greenfield or acquisition modes, although the terminology used by Gatling in this area is somewhat incorrect.[117] Furthermore, most of the respondent firms possessed majority ownership structures (57 firms). Finally, it is also interesting to note that over half of the respondents had increased their plans regarding initial investment levels.

In general, Gatling's work has some interesting points and has been quoted on a number of occasions by other researchers when reviewing the key literature on the subject of FDI in the CEC and FSU. However, the fact is that the survey possesses a number of flaws in its methodology, especially with regard to the design of the questionnaire and the proper use of terminology. These types of problems tend to be common with other surveys in this area conducted by practitioners, in that they seek to offer readers some sort of quick fix list for successful investment. Given this situation, the findings from Gatling's study should be treated with a certain degree of skepticism.

As time progressed the number of researchers directing their attentions to the issue of FDI in the CEC and FSU continued to gradually grow. In 1993 surveys were conducted by Bluszkowski and Garlicki (1993), Möllering, Rádl, and Zimmermann (1994), OECD (1993, 1994), and Fey (1995b). Each of these surveys took a different approach to investigating FDI in the CEC and/or FSU. In brief, Möllering, Rádl, and Zimmermann (1994) utilized questionnaires to survey some 300 German based firms, of which 149 were identified as active investors in the Czech Republic to profile German business activity in that particular host country. Fey (1995b)

[115]A breakdown of these 191 investments shows six in Bulgaria, 34 in Czechoslovakia, 44 in Hungary, 34 in Poland, five in Romania, 51 in the FSU, and 17 in the former Yugoslavia.

[116]A breakdown of these 107 investors shows four in Bulgaria, 22 in Czechoslovakia, 22 in Hungary, 20 in Poland, five in Romania, 24 in the FSU, and 10 in the former Yugoslavia.

[117]Gatling lists four modes of FDI: JV, acquisition, JV-acquisition, and greenfield. However, the literature shows that there are basically two main modes of FDI, either acquisition or greenfield, of which the JV is a sub-type of greenfield and the JV-acquisition part of the acquisition route.

conducted structured interviews with general managers of some twenty Russian-Foreign JV firms located in Russia in an effort to identify several areas: characteristics that were considered important to the success of the venture; relations with the foreign parent firm; the relative performance of the JV firm; and the motivations for selecting this particular mode of FDI. Fey followed up his early field work done in July of 1993 with telephone interviews with executives in March of 1995.

In greater detail, the survey by Bluszkowski and Garlicki (1993) restricted its focus to FDI that has occurred within Poland. The research was sponsored by the *Friedrich Ebert Foundation* in Poland and the *Polish Agency for Foreign Investment (PAIZ)*. The actual study was conducted by *The Marketing Research Centre 'Indicator'* during the summer of 1993. The study concentrated on a number of issues, such as the motivations for FDI in Poland; the perceived attitudes of the Polish authorities to FDI; an assessment of the investment laws in the country; infrastructure issues; staffing issues; factors that discourage FDI in Poland; difficulties experienced by investors; and future plans. The methodology employed was face-to-face interviews with key executives of local firms with foreign capital participation.

However, what is truly unique to this study is the way in which the population was identified and the sample extracted. Due to the nature of the sponsorship the researchers were able to gain unprecedented access to specific host country data from PAIZ and the *Polish Central Statistical Office (CSO)*. The population of foreign investors to be sampled was thus identified using data from PAIZ in conjunction with *F-01* forms furnished by the CSO. The *F-01* form listed key data about local firms with foreign capital participation and was required by Polish law to be completed and submitted by such firms. Thus, unlike all studies, as well as many since, Bluszkowski and Garlicki were able to identify properly the actual population. From a population stratum of 1,669 firms that were characterized by the authors as *"Poland's largest companies with foreign capital,"* a sample of 570 firms were selected by a system of lot drawing.[118] All 570 sample members were interviewed using a structured questionnaire, a copy of which the authors provide in their report.

The findings of this work indicate that the main motivations for FDI in Poland were the country's economic growth potential, local market size, and advantages in low labor costs. Secondary motivations cited were the labor supply, opportunities to reduce production costs, price levels overall, advantageous conditions for foreign investors to do business in Poland, and the possibility of profit transfers. On the other side of the coin, respondents listed several factors as negative influences on their operations including Poland's lack of adequate infrastructure, economic instability, shortage of business services, poor attitude of local

[118]Bluszkowski and Garlicki sampled the population of large Polish companies with foreign capital by creating a screening device. Using this device companies were chosen that had, *"...a staff of over 50 persons in the industrial and building sectors or of over 20 persons in other businesses, except those where farming is the main business."* See Bluszkowski, J. and Garlicki, J. (1993), *Social Conditions of Foreign Investor Operations in Poland*, pp. 8-9.

authorities to investors, and general lack of information on the country.

Bluszkowski and Garlicki's work truly represented the first major study of FDI in a specific host country that has to this date yet to be replicated. The researchers and their countless number of assistants whom conducted the actual interviews with local firms are all to be commended for the creation of such thorough and meaningful work. Yet, it should be remembered that this survey could not have been so successful if it had not been for the unprecedented access the researchers received from PAIZ and especially the use of CSO documents. It should also be noted that under existing data protection laws enacted throughout many of the CEC and FSU use of such documentation from respective CSOs has been made an illegal act. Hence, repetition of the kind of work done by Bluszkowski and Garlicki in Poland, or other host countries, is highly unlikely without similar high level support from a respective host country government.

The research survey by the OECD (1993, 1994) utilized a multidimensional approach in its investigation of FDI in the CEC and FSU. The objectives of this survey were to,

> *"...first, obtain a better understanding of the decision-making process of investors; secondly, discern whether patterns or outward investment are specific to individual home and/or host countries; thirdly, to identify both the major attractions of the Central and Eastern European Countries (CEECs) and the New Independent States (NIS) as investment locations and the problems which may either deter new investors from entering the market, or existing investors from making further commitments; and finally, draw conclusions that are relevant for policy makers."*[119]

In seeking to address these questions the authors[120] surveyed an unspecified number of firms from Austria, France, Germany, Japan, the UK, and the USA, from which some 291 firms replied. Of these 291 firms, a 162 were identified as actual investors in the CEC and/or FSU and the remaining 129 were categorized as non-investors. However, upon closer examination of the data it becomes apparent that the out of the so-called 162 firms that were identified as actual investors, only 118 firms had existing investments in the region; 14 firms were in the process of negotiating investments; and 30 firms were supposed to be in the process of considering investments. Such shortcomings in the forthrightness of the authors of the survey mean that this work and its findings should be treated with a certain degree of caution.

Between 1994 and the end of 1996 more research studies on FDI in the environment of the CEC and FSU were undertaken. These surveys were conducted by Ali and Mirza (1996), Bellas, Bochniarz, Jermakowicz, Meller, and Toft (1994), Charman (1996a, 1996b), Franko (1996),

[119] OECD (1993, 1994), *op. cit.*, pp. 8.

[120] Most of the research for this survey was conducted by Ania Glodowska of *Arthur Andersen Consulting*. The survey was commissioned by the *Advisory Group on Investment (AGI)* of the *OECD* for the purpose of providing the AGI with country-specific information on the attitudes, concerns and experiences of corporations of each investor country in order to provide a forum for discussion with AGI members (which comprises senior policy makers from the CEC and the FSU) and assist them in their policy decisions. See OECD (1993, 1994), *op. cit.*.

Meyer (1995c), Rojec, Jermakowicz, Illes, and Zemplinerova (1995), Rekettye (1995), Romanian Development Agency (RDA)(1994), Rojec (1994, 1996), Shama (1995), and Szanyi (1994). As would be expected, the focus of each of these studies has varied in many respects. In reviewing this grouping of survey literature, some works are covered briefly while others that are deemed to be more relevant studies are reviewed in greater detail.

In brief, the survey by Ali and Mirza (1996) focused exclusively[121] on British based investors in the Czech Republic in regards to their experiences, motivations for FDI, entry strategies employed, and an assessment of their performance. To investigate these issues the authors utilized a postal questionnaire sent to 165 firms (100%), of which 52 firms (32%) actually participated in the study but only 48 of these were considered usable. The study made use of some interesting techniques to address the issues, especially in the section on performance of local firms. Still, the quality of the research falls down in some places because of poor questionnaire design and improper use of terminology, notably in the section of motives for FDI.[122]

The two papers by Charman (1996a, 1996b) examine FDI in Kazakhstan. As such the work is interesting as research into this part of the FSU has been severely limited despite it attracting a great deal of attention by both the media and investors because of the country's wealth of natural resources. Charman's two papers should actually be viewed as one piece of work, for in one paper (1996a) Charman outlines the existing legislation on FDI in Kazakhstan and in the other (1996b) he reports the findings of a survey of foreign firms which have invested in the country. In terms of the latter, the survey findings are based upon 41 questionnaire responses from foreign firms that have engaged in FDI in Kazakhstan via the JV mode. Unfortunately, details on the nature of the population and the means of sampling are not provided by the author. The focus of the study was on the motivations for the firm to engage in FDI; the process of finding a local partner and contract negotiation; ownership and management structures utilized; and the foreign partners' appraisal of their JV. Overall, while the study is interesting for its focus on this important Central Asian NIS it lacks real quantitative details on the survey results supporting the findings. Given that this work is communicated via a discussion paper it is hoped that the author will rectify these problem areas in a future publication of the study.

Franko's (1996) survey, done as part of a larger project in conjunction with the *Foreign Investment Advisory Service (FIAS)* of the *World Bank* and the *International Finance Corporation*

[121]Ali and Mirza do point out in their paper that this survey is part of what they term as a much larger research project aimed at examining both British and German investment strategies in the Czech Republic, Poland, and Hungary. Ali, S. and Mirza, H. (1996), *Market Entry Strategies in the Czech Republic: A Preliminary Report.*

[122]In carefully examining Ali and Mirza's paper it becomes apparent that they placed a number of motivational factors in incorrect categories. For example, under market-oriented factors they place profit related, overcome tariffs and import barriers, pre-empt competitors, and follow competitors. In the literature the first two motives are shown to be associated with financial-efficiency (cost type) factors while the latter two motives are clearly part of strategic position factors. Unfortunately, there are several other misuses of terminology in the paper that demonstates a poor understanding of the existing literature on the subject. *Ibid.*, pp. 250.

(IFC), utilized face-to-face interviews with a small sample of parent company executives to compare and contrast the CEC and FSU as an investment location with developing Mediterranean countries. Franko also looks at characteristics and differences of specific industries and factors associated with host country attractiveness for FDI. The study is aimed more at shaping host country policy towards FDI than considering the firms' situation.

Meyer (1995c) surveyed British and German investors in the CEC and FSU via a postal questionnaire to determine forms of investment and differences between home and host countries; entry strategies with regards to modes of entry and sequence; how labor costs influence corporate strategies; motivations for and against FDI; and the performance of British firms versus other home countries. While on the surface Meyer's response rate of 268 firms (40%) seems impressive, only 190 of these firms (28%) were active in the CEC and/or FSU and only half of these had engaged in FDI. Also, the statistical means used by the researcher to report the survey results are in many cases not user friendly.[123] Therefore, given these problems Meyer's comments and results regarding FDI should be treated with a certain degree of caution.

The Romanian Development Agency (RDA)(1994) study, which was done in conjunction with a survey by the *National Bank of Romania (NBR)*, is one of the rare attempts that has been made to investigate FDI in the context of Romania. The focus of the RDA survey was on eliciting information on investment financing structures; amounts of FDI; the use of JVs; and the general economic conditions experienced by foreign investors in Romania. The RDA uses a sample of 89 firms (100%) with foreign capital greater than or equal to $500,000, of which 24 firms (27%) responded by completing and returning a questionnaire.

Finally, Rekettye's (1995) study employed the use of postal questionnaires to key executives of local manufacturing firms in Hungary, some of which have foreign capital participation to examine the impact of transition on Hungarian companies. Rojec (1994) once again examined FDI in Slovenia by surveying 47 active firms[124] in order to ascertain *"What is the real situation regarding FDI* (in Slovenia)*? Does the existing FDI in former socialist countries make such contributions* (with regard to strengthening Slovenia's national competitive advantage) *and what can be expected in the future?"*[125] In his other paper, Rojec (1996) analyzed a mixture of information drawn from a variety of sources of FDI by Austrian firms in Slovenia. The paper by Shama (1995) conducted telephone interviews with the managers of 125 firms, mostly from the

[123]The problem of Meyer's reporting is that percentages are often used in tables without any reference to the whole numbers they are suppose to represent. A case in point, in *Table 16: Direct Foreign Investment: Ownership,* the totals reported show 16% of the sample used the minority JV ownership structure, 26% the majority JV, and 74% the WOS. This would make the total equal 116% which shouldn't be possible and also not knowing the whole number it represents makes the results unintelligible. Considering that this paper is in the format of a working paper in can only be hoped that Meyer has corrected such problem areas in his final PhD thesis for which this was part of. See Meyer (1995c), *op. cit.*, pp. 39.

[124]A breakdown of these 47 firms surveyed shows that 18 were German, 12 Italian, 11 Austrian, two American, one French, one British, one Dutch, and one Belgian.

[125]See Rojec, M. (1994), *Foreign Direct Investment in the Transformation Process*, pp. 6.

United States, to outline different market entry strategies in the CEC and FSU; present details of US firms in this environment; and to determine any implications of the findings pertaining to market entry theory.

In greater detail, Szanyi's (1994) survey concentrated on trying to understand the motivations behind the firm's decision to engage in FDI in Hungary as opposed to other neighboring countries like the Czech Republic and Poland. The main premise behind this line of research was that by knowing the reasons why firms decide to invest in a given country, then the host country could adapt its own economic policy measures to encourage FDI. According to Szanyi, *"It is essential to understand why the same incentives, promotion structures do or do not work in different countries, and to learn the expectations of foreign investors and how they view investment in the region."*[126] In investigating this issue, Szanyi uses information gathered from interviews with what he classifies as *"persons in possession of broad overall knowledge of FDI in Hungary and well informed about the specific features and problems of investors of their home country"*[127] and interviews with chief executives of 14 foreign subsidiaries[128] that are operating in Hungary.

These interviews were conducted in two distinct stages. In the first stage, Szanyi interviewed the so-called experts and questioned them in regards to determining which economic-policy measures they believed best attracted and encouraged FDI; the motives of foreign firms to invest in Hungary; barriers to FDI; and ways and means of improving the conditions for FDI within a host country, like Hungary. The expert group of respondents from this first stage made numerous suggestions, both explicit and implicit, on how the conditions for FDI could be improved within a host country, in this case Hungary. Their suggestions included increasing the level of promotion of FDI by the state not only for large firms, but also for small and medium sized enterprises; creating an optimistic and positive atmosphere for FDI within Hungary, similar to the environment found in the Czech Republic[129]; promoting regional development, especially in Eastern Hungary; providing security to investors on the issue of property ownership, most notably real estate; promoting business and investment opportunities in Hungary via promotional agencies; and reducing the level of employer contributions made to welfare programs.

In the second stage of the interview process involving a group of 14 chief executives of foreign

126See Szanyi, M. (1994), *Experiences with Foreign Direct Investment in Hungary*, pp. 4.

127These individuals included trade representatives, embassy officials, bankers, and business consultants. These experts were drawn from those countries which had made sizeable investments in Hungary, including the USA, Austria, Germany, France, Italy, and the UK. Szanyi (1994), *op. cit.*.

128A further breakdown of these 14 shows that three were French, two American, two German, two Italian, one Japanese, one Canadian, one Dutch, one Swiss, and one a British/Dutch JV. The main criteria for selecting these firms was that each of these investors has had to have invested more than USD $1.0 million in Hungary.

129On this issue, Szanyi states that, *"...one reason for the macroeconomic success of the Czech Republic has been the optimism inherent in Czech society ever since the first hours of the 'velvet revolution'. Positive thinking about the problems and tasks is also crucial, because positive expectations have a stimulating effect on the efforts being carried out."* See Szanyi (1994), *op. cit.*, pp. 17.

subsidiaries in Hungary, a structured questionnaire was utilized which *"enquired about the motives and determinants of the general investment behaviour of the firms, in particular the motives that had generally prompted respondents' firms to move abroad in recent years, and the determinants of the specific investments they had made in the CEE* (Central and Eastern European)[130] *region since 1989...the determinants of the investments actually implemented in Hungary and in other CEE countries."*[131]

Based upon these two stages of interviews, Szanyi concluded that firms investing in the CEC and FSU region are doing so primarily because, *"They are seeking new markets, either as pioneers in a new region or as quick followers in the path of competitors....Its pioneer status* (referring to Hungary) *was rewarded by investors making it a CEE regional centre for multinational affiliates....above which defensive investors feel it necessary to follow pioneers into the region."*[132] Overall, Szanyi's research poses some interesting findings and it also draws attention to an area of FDI that has had little attention given to it in the literature on the subject.

The study by Bellas, Bochniarz, Jermakowicz, Meller, and Toft (1994) concentrated on the role of FDI via acquisition mode in the Polish privatization process. The purpose of the study was to recognize the different roles of institutional players (like PAIZ, the Ministry of Privatization, and the executive boards of Polish firms) in the process of FDI; motivations for FDI, with special attention given to the use of the privatization route as opposed to greenfield FDI; methods and techniques used during the FDI through the acquisition mode; and identify types of government incentives given investors to encourage FDI in Poland. As part of this study, the authors surveyed 160 large Polish firms (100%) with foreign participation using postal questionnaires, from which a total of 57 responses (36%) were received. Given the strict focus of the study on FDI via the acquisition mode (privatization route) some sample members were removed prior to analysis leaving a total of 28 valid responses (18%) available for evaluation.

The findings of this survey were divided between what the authors characterized as small and large firms.[133] The motivations of foreign parent company to engage in FDI in Poland were divided into four main groups using the types of FDI distinguished by Dunning (1993a) and Dunning and Rojec (1993). The dominant motivation for large firms to engage in FDI was market seeking reasons such as focusing on the local market and establishing a regional export base in Poland for neighboring countries of the region. Most of this export activity was in the

[130]Based upon the research materials provided by Szanyi it is not possible to determine which countries within the CEC and/or FSU apply to the term CEE that he uses in his research. However, it is clear that Hungary, the Czech Republic, and Poland are all included under this term.

[131]Szanyi (1994), *op. cit.*, pp. 19.

[132]Szanyi (1994), *op. cit.*, pp. 25-26.

[133]Large firms were characterized as having annual sales of more than USD $20.0 million, equity of more than $3.0 million, and more than 200 employees. Small firms were those that has less than all these numbers. See Bellas, C. J., Bochniarz, Z., Jermakowicz, W. W., Meller, M., and Toft, D. (1994), *Foreign Privatization in Poland*, pp. 61.

form of assembling goods from component parts provided by the foreign parent/partner organization. For small firms FDI was mainly of the efficiency seeking type, with operations of the local firm focused on export activities.

Although this study concentrated only on the acquisition mode of FDI via privatization it offers some invaluable insight on the subject of how to make a survey an effective research tool in the CEC environment. Moreover, the authors utilized means of reporting that are both clear and concise allowing for better communication of the survey results. Still, there are a couple of shortcomings in the survey in terms of the use of a general rather than specific approach to some of the issues surveyed[134] and the use of a three-point attitude scale that lends itself to inaccuracies in responses[135]. Yet, all in all this survey represents one of the better works in this area of study and provides a good basis on which future research can be conducted.

Another study that examined foreign acquisition strategies in the privatization process is the paper by Rojec, Jermakowicz, Illes, and Zemplinerova (1995). In fact, this study was actually part of the work by Bellas, Bochniarz, Jermakowicz, Meller, and Toft (1994) just reviewed, both studies being sponsored by the *Center for Social & Economic Research (CASE) Foundation* based in Poland. The purpose of this survey by Rojec, Jermakowicz, Illes, and Zemplinerova was to

> *"...recognize the role of different institutional players (like the State Foreign Investment Agency, Ministry of Privatization, management boards of firms) in the foreign acquisition process, to recognize the motives laid down by foreign partners' decisions to acquire a firm instead of making a greenfield investment, to recognize what methods and techniques are used during the foreign acquisition process, and to find out what type of governmental incentives are offered to the foreign partners entering the Central European market."*[136]

In seeking to ascertain the answers to these questions, the authors of the survey contacted 370 firms (100%) in the Czech Republic, Hungary, Poland, and Slovenia. Of the 370 firms contacted, some 75 firms (20%) agreed to participate in the survey[137]. The means of data collection in this survey was differentiated by host country, postal questionnaires being sent to the samples in the Czech Republic and Poland and direct interviews used with the sample of firms in Hungary and Slovenia. In both means of data collection, the on-site executive of the local firms with foreign capital participation was the source of information.

[134]Most of these shortcomings are in the number of alternatives made available to respondents in the questionnaire. For example, for motivational factors for FDI the categories are rather general, such as strategic reasons. This type of category is to general and does not allow for a more in-depth understanding of what specific strategic factors influenced the decision to invest, like to gain first mover advantages, follow competitors/customers, etc..

[135]The researchers employ a three-point scale to measure attitudes of respondents to specfic questions using measures of *unimportant*, *important*, and *very important*. However, this tends to force respondents to select a specific point that may or may not portray an accurate picture of the respondents views. In fact, in hindsight it might have been better to use a four or even a five point scale to measure such attitudes. This point was reaffirmed by Wladyslaw Jermakowicz, the project leader for the study, in a direct communication with this researcher during the questionnaire design phase of this particular study.

[136]Rojec, M., Jermakowicz, W. W., Illes, M. and Zemplinerova, A. (1994), *Foreign Acquisition Strategies in the Central European Privatization Process*, pp. 1.

[137]These 75 firms include 23 firms in the Czech Republic, 14 in Hungary, 10 in Slovenia, and 28 in Poland.

The findings of this survey were almost identical to those of Bellas, Bochniarz, Jermakowicz, Meller, and Toft (1994). This is also the case with regards that were problems previously listed in their survey. Overall, this work by Rojec, Jermakowicz, Illes, and Zemplinerova (1995) and that of Bellas, Bochniarz, Jermakowicz, Meller, and Toft (1994) represents some of the better quality survey research that has been conducted in the environment of the CEC. As such, it provides a good platform on which future studies can be done. This is necessary because this study only focuses on one aspect of FDI in the CEC, namely the acquisition mode via the privatization route. Hence, the need for more comprehensive research into FDI in the CEC.

2.6.3 A Review of the Case Study Based Literature

The final element of this section of the review will detail those research studies which have employed case studies as a means of investigating FDI within the CEC. In doing so, special attention has been given to case studies related to FDI within the CE environment.

According to Yin (1989), *"The case study has long been stereotyped as a weak sibling among social science methods. Investigators who do case studies are regarded as having deviated from their academic disciplines; their investigations, as having insufficient precision (that is, quantification), objectivity, and rigor."*[138] However, in its defence Yin argues that the case study instrument is both a relevant form of investigation for specific research strategies, mainly for *how* and *why* type research questions, and when done correctly utilizing proper methodology can be a powerful means of research.[139]

In the context of the environment of the CEC a number of researchers have utilized case studies as either a primary or secondary means of investigation. The case study format has been used as a primary means of research by a number of researchers. including Savary (1991, 1992), Elenkov (1992), Roos, Veie, and Welch (1992), Collins (1993), Hamill and Hunt (1993), Harwit (1993), Fogel (1994)[140], Somogyi and Woodside (1994), Pendergast and Kreft (1995), Woodward, Hefner, Arpan, Kuhlman, and Folks (1995), Vahlne, Nordström, and Torbacke (1996), Estrin, Hughes, and Todd (1996a, 1996b), and Estrin, Todd, and Hughes (1996a, 1996b, 1996c, 1996d, 1996e, 1996f, 1996g, 1996h). As a secondary or supporting means of investigation the case study medium has been employed by Gatling (1991, 1993), Razigorova and Wolf-Laudon (1991)[141], Smith and Rebne (1992), Pye (1993), Charap and Zemplinerova

[138]See Yin, R. K. (1989), *Case Study Research: Design and Methods*, pp. 10.

[139]Yin explains these points in detail throughout his book, especially within the introductory chapter. *Ibid.*, pp. 13-26.

[140]Fogel's work is actually in the form of a book for which he is the editor. The book provides a collection of 11 case studies written by various other authors on firms located in the Czech Republic and Slovakia with regard to the experiences of these firms during the period of economic, social, and political transformation. See Fogel, D. S. (1992), *Managing in Emerging Market Economies: Cases from the Czech and Slovak Republics.*

[141]This work by Razvigorova and Wolf-Laudon is in the form of a book for which they are the editors. The case studies section is presented as a separate *Appendix* and the case studies themselves are from a variety of other authors. See Razvigorova, E. and Wolf-Laudon, G. (1991), *East-West Joint Ventures: The New Business Environment*, pp. 261-304.

(1994), OECD (1994), and Shama (1995).

In terms of composition and structure, almost without exception the case study materials on the CEC have been in the form of a classic single case study using a variety of structures, but mostly linear-analytic, comparative, or unsequenced structures. Both chronological or theory-building have been used to a much lesser extent.[142] However, it should be noted that some of the work that has been labelled as case studies do not really meet the basic technical definition as such. To be more specific, Yin (1989) defines a case study as *"...an empirical inquiry that: investigates a contemporary phenomenon within its real-life context; when the boundaries between the phenomenon and context are not clearly evident; and in which multiple sources of evidence are used."*[143] Yin then goes on to state that a case study is based on six sources of evidence, namely documentation, archival records, interviews, direct observation, participant-observation, and/or physical artifacts. Of these, Yin points out that, *"Overall, interviews are an essential source of case study evidence, because most case studies are about human affairs."*[144]

However, in thoroughly reviewing the case study literature is becomes apparent that some studies have relied exclusively on a single source of data and therefore the research is very much flawed in terms of being considered as a real case study. For example, both Gatling (1991, 1993) seem to rely solely on open-ended interviews with executives to create mini-case studies; Smith and Rebne (1992) utilize only published journalistic documentation to conceive their own mini-case studies; and Charap and Zemplinerova (1994), OECD (1994), and Shama (1995) employ the use of some vague illustrative type case studies, which are actually more in the form of examples, to describe FDI by Western firms in the CEC environment.

In regards to scope, just as the studies utilizing the survey mode of investigation have taken either a host country specific or regional approach to the subject so to have the case study works. Case based research studies that have focused on the CEC or parts thereof include Gatling (1991, 1993), Razvigorova and Wolf-Laudon (1991), Smith and Rebne (1992), Harwit (1993), OECD (1993, 1994), Fogel (1994), OECD (1994), Shama (1995), Woodward, Hefner, Arpan, Kuhlman, and Folks (1995), and Vahlne, Nordström, and Torbacke (1996). The other main grouping of cases study materials examine a firm in a single host country of the CEC, like **Bulgaria:** Elenkov (1992); **Czech Republic:** Roos, Veie, and Welch (1992), Pye (1993), Charap and Zemplinerova (1994), and Estrin, Todd, and Hughes (1996c, 1996d); the **Czech Republic and Slovakia:** Pendergast and Kreft (1995)[145] and Estrin, Todd, and Hughes (1996a); **Hungary:** Hamill and Hunt (1993), Somogyi and Woodside (1994), Estrin, Hughes, and Todd (1996a),

[142]Yin discusses each of these compositions and structures for case studies. See Yin, *op. cit.*, pp. 133-141.

[143]Yin, *op. cit.*, pp. 23.

[144]Yin, *op. cit.*, pp. 90.

[145]Pendergrast and Kreft's case study examined the French firm Alcatel and its operations in both the Czech Republic and Slovakia.

and Estrin, Todd, and Hughes (1996e, 1996f, 1996g); and **Poland:** Savary (1991, 1992), Collins (1993), Estrin, Hughes, and Todd (1996b), and Estrin, Todd, and Hughes (1996b, 1996h). As in other literature on the subject, each of these studies has examined the situation from a different perspective. A review of these materials is given in either brief or depth on the basis of the study's relevance to this research.

In brief, in the two reports by Gatling (1991, 1993) on FDI in the CEC and FSU, Gatling used a variety of mini-case studies to illustrate the points made in her reports but the brevity of these cases and a shortage of substance leaves much to be desired. Razvigorova and Wolf-Laudon (1991) also use case studies to illustrate the points made within their book but the way that these case studies are presented offers readers a much more in-depth analysis of the situation for FDI in the CEC and FSU.[146] Harwit (1993) examined two cases of FDI in the automobile industry within the CEC and FSU made by Western automobile manufacturers in an effort to determine whether or not Japanese-style *lean production* methods have been adopted by local operations. Elenkov's (1991) own PhD thesis used case studies based on three Western TNC subsidiaries located in Bulgaria in order to examine the patterns of international business activity in that country as well as to test three theories - *institutional*, *strategic behavior*, and *transaction cost* - within the context of Bulgaria. Although not focusing on FDI in the CEC, the paper by Roos, Veie, and Welch (1992) is of interest as it used multiple interviews with executives of Norwegian firms and local Czech officials to create a single case study describing the issues involved in doing business in the then Czechoslovakia with regards to purchasing of environmental protection equipment. The paper by Charap and Zemplinerova (1994) used three loose format cases involving major FDI projects in the Czech Republic in an effort to describe the linkages between FDI and the privatization and restructuring process in that particular host country. Hamill and Hunt (1993) also utilized three case studies - all based on British firms - but for the purpose of illustrating the so-called key success factors for creating JVs in Hungary. The paper by Pendergast and Kreft (1995) is a descriptive case study that examines the French firm *Alcatel* and its joint venture operation covering both the Czech Republic and Slovakia using firsthand information accessed through one of the principle authors[147]; Pye (1993) examined FDI in the Czech Republic by employing a series of brief mini-case studies based on print media documentation as well as one larger case study on *Volkswagen* of Germany and its *Skoda Automobilová* operation that was created through a combination of direct interviews with executives of the local firm and other sources of data. Somogyi and Woodside (1994) examined a single Japanese-Hungarian JV operating in Hungary to focus on what the authors state as, *"The 'realized strategies' (Mintzberg 1979) of joint venture idea generation, design, and implementation - that is, the strategies that actually occur in the streams of decisions, interactions and*

[146]A country breakdown of these case studies shows that three are based on Bulgarian firms, two on Hungarian firms, one on a Czechoslovak firm, two on Hungarian firms, one on a Polish firm, and four on firms located in the Soviet Union.

[147]Klaus-Peter Kreft is the Chairman of *Alcatel SEL TLH*.

behaviour of persons when committing organizations to an action."[148] Collins (1993) provided a detailed case study on the Japanese electronics firm *Sony* and its strategy in Europe, with special emphasis on Sony's distribution channels in Poland. Finally, the study by Vahlne, Nordström, and Torbacke (1996) looks at five TNCs from the United States, Japan, and Sweden that have established local operations in selected elements of the CEC and FSU[149] to determine and explain the mode of FDI, type of activities intensity, and the types of control applied on the local operations by the parent firms.

In greater detail, the primary purpose of Smith and Rebne's (1992) research work is stated in the abstract section of the article as *"...to examine patterns of FDI across the East Central European states of Poland, the Czech and Slovak Republics and Hungary as a jumping-off point in the search for explanations of national differences, in terms of both FDI origins and locations."*[150] The authors then go on to state that the main focus of this research is in addressing the question *"What are the central challenges facing American firms which invest or seek to invest in East Central Europe and how do such firms respond?"*[151] Smith and Rebne then provide a review of the aggregate data on FDI flows into the countries in question using a variety of sources as well as outlining the main tenants of Dunning's *Eclectic Theory*. The remainder of the article is then devoted to detailing 12 mini-case studies that illustrate FDI by TNCs that have been selected by Smith and Rebne. The authors review these 12 mini-case studies within the framework of *eclectic theory*. It should be pointed out that these case studies are not based on actual field research, instead the information comes from two print media sources, *Business Eastern Europe (BEE)* and *Eastern Europe Report (EER)*. Smith and Rebne conclude that based upon this review of case studies that *"The centrality of the JV to FDI in East Central Europe is clear. However, its origins are obscure. It would appear that the phenomenology of the JV entry mode involves detailed reference to it as a negotiated outcome in a political economic context."*[152]

Overall, while Smith and Rebne have often been used as a prominent reference in other reviews of the literature on FDI in the CEC, this does not seem to be warranted by the merit of the work itself. In their paper Smith and Rebne simply use some published data to produce some brief outlines of TNC activity in the Hungary, the Czech and Slovak Republics, and Poland. There appears to be no attempt made by the authors to contact the firms identified in the case studies for first hand information nor does it appear that any other serious attempt was made to substantiate the information provided by the media sources used from other sources of

[148]See Woodside, A. G. and Somogyi, P. (1994), *Creating International Joint Ventures: Strategic Insights from Case Research on a Successful Hungarian-Japanese Industrial Enterprise*, pp. 169.

[149]The study only focuses on FDI by these TNCs in the context of the Czech Republic, Hungary, Poland, Russia, and the Ukraine.

[150]See Smith, N. and Rebne, D. (1992), *Foreign Direct Investment in Poland, the Czech and Slovak Republics and Hungary: The Centrality of the Joint Venture Entry Mode*, pp. 190.

[151]*Ibid.*, pp. 190-191.

[152]This last comment refers to host country restrictions on FDI that necessitated FDI via the JV mode of investment.

documentation, such as corporate reports of companies listed in the case studies, other relevant research in the field, host and/or home country resources, and/or the financial press. Therefore, while this research has a few interesting points its complete reliance of desk research does not make it a truly valuable study. However, in defence of the authors, it should also be noted that Smith and Rebne first submitted this paper in 1991, which was a time when there was still a shortage of reliable information on the subject of FDI in the CEC. It therefore may be the case that Smith and Rebne simply utilized the materials available to them to formulate this article. As such, the article offers some interesting points, but it is not a substitute for actual field research on the subject.

Savary's (1991, 1992) research paper examines French-Polish JVs by addressing several questions, *"What is the real importance of these ventures? How can their relative weakness be explained? What role are they playing in Polish development? Will their numbers increase in the near future?"*[153] In addressing these questions, Savary conducted an extensive field study of the situation of French FDI in Poland by interviewing various officials from both home and host countries as well as executives from firms that had invested in Poland. Savary then alludes to what he describes as *"Three types of international strategies for setting up production in a country can be described: supply-oriented (access to raw materials), market-oriented (access to markets) and production-oriented (search for low costs)."*[154] These same three strategies are very similar to those suggested by Dunning as the *raison d'etre* and/or types of FDI, namely *resource-seeking, market-seeking*, and *efficiency-seeking*.

The paper then proceeds to outline a couple of cases of French TNC activity in Poland via the JV mode, notably the telecommunications company *Alcatel* and the electronics firm *Thomson*, using the three strategies previously described by the author. Savary concludes from his case based research that Alcatel's operations in Poland follows a market-oriented strategy whereas Thomson's strategy in the country resembles more of a mixed strategy.

Unfortunately, while this paper is quite good in several areas ithere appears to be a number of faults within it. The paper is hard to follow, especially with regard to Savary's attempt to review the data on French JVs in Poland using host country sources of information. Bearing these defects in mind this paper can only be used as an example of the difficulty of combining so many elements into one brief document. It should also be noted, that it is quite possible that so many points could simply not all be adequately addressed in a single paper of restricted length due to the format that it was presented in.

153See Savary, J. (1991, 1992), *The International Strategies of French Firms and Eastern Europe: The Case of Poland*, pp. 70 in the 1992 version.

154These three strategies represent the motivational factors affecting a firm's decision whether or not to invest. They are apparently based on one of Savary's earlier works in 1984. See Savary, *op. cit.*, pp. 72 in the 1992 version.

The case studies by Estrin, Hughes, and Todd (1996a, 1996b) and Estrin, Todd, and Hughes (1996a, 1996b, 1996c, 1996d, 1996e, 1996f, 1996g, 1996h) represent some of the best work available.[155] Although each of these case studies is a stand alone effort, they all share not only common authors but a common case study design. Each of the case studies in this body of work are of the descriptive classic single case study variety. The format of each of these case studies also follows a similar structure and sequence including the following sections: overview or abstract; background on the foreign parent/partner firm including its history, structure, core competencies, and its decision to engage in FDI; details on the local firm with foreign capital participation such as the structure of the firm, strategy employed, the nature of the restructuring process, human resource issues, performance, etc.. The foreign parent/partner firms covered by the case studies include three American companies (*Guardian Industries Limited*, *United Technologies [Obis Division]*, and *Whitman Corporation [Pepsi-Cola General Bottlers]*), four British based firms (*British Vita*, *Glaxo-Wellcome*, *Lycett Industries*, and *United Biscuits [McVitie's Group]*), and three German companies (*Pyramid Junger*, *Schöller*, and *Volkswagen*). The only real problems to be mentioned in these cases studies is the lack of clarification on the precise methodology employed and a severe lack of quantitative data such as financial information on the respective companies involved. Even despite these problem areas these case studies offer some invaluable insights into the activities of a select group of TNCs in some individual CEC.

The last of these case studies to be reviewed is the research work by Woodward, Hefner, Arpan, Kuhlman, and Folks (1995). Although not labelled by its authors as a case study, the focus of this work was on the impact of the American based soft drinks firm *Coca-Cola* and its various FDIs in both Poland and Romania since the period of transition. The stated motives of the study were to discern the effect of FDI in transitional economies; assess the impact of TNC activity on specific host countries; and provide an assessment of Coca-Cola's FDIs on the economies of the respective host countries. In terms of methodology, the study employed a number of means for data collection including documentation, archival records, interviews, and direct observations. The results from all these efforts showed that Coca-Cola's activities in Poland and Romania created forward and backward linkages, mainly backward linkages in Poland via suppliers and forward one in Romania through marketing. Overall, this study represents an important step in the study of FDI in the CEC, and for that matter FDI in general, as it clearly substantiates with empirical evidence the existence of some of the perceived benefits associated with the entrance of TNCs into a local host country economy.

[155]These case studies were made possible through a research grant from the Economic Social Reseach Council (ESRC) of the European Union (EU), which accounts for the apparent wealth of resources made available to the authors to conduct such a good size study. The research was also facilitated through the resources of the publishers of the case studies, the CIS - Middle Europe Centre at the London Business School (LBS), London, United Kingdom.

2.7 Concluding Remarks

In the proceeding sections of this chapter this researcher has provided an overview of the relevant theoretical literature and a fairly comprehensive review of the literature pertaining to FDI by Western firms within the CEC and FSU, with special attention given to the five CE countries forming the basis for this particular study. The purpose of this section is to highlight the main issues addressed in the literature review. In doing so, emphasis is given to those studies that have utilized a research survey and/or case study means of investigation.

In general, the theoretical literature shows that our understanding of both the international firm, referred to as the TNC, and FDI have been progressing over time. Yet, despite the considerable efforts on the part of a number of researchers in the academic community we can still not lay claim to having an all purpose workable theory for either the TNC or FDI. It is a fact that just as theories have developed and evolved over time so too has the nature of international business. Thus, while Hymer's early work in the field may have possessed a certain degree of relevance at the time in explaining the international activities of the firm the passage of time and circumstances has outdated his theory in many respects.

This has also been the case in regards to other theories in the field that have been developed over the years. For example, Dunning (1995) challenges the validity of his own *eclectic paradigm* in what he terms the dramatic change in the business environment that has seen a shift from hierarchical capitalism to alliance capitalism. As a result of this change Dunning points out that his *eclectic paradigm* needs to be adjusted somewhat in order for it to take account of the new reality of the business environment.[156]

Therefore, while it is important that research efforts continue to be devoted to finding a comprehensive and tenable theory of the international firm and FDI, it is also paramount that researchers continue to conduct studies of an exploratory nature in an effort to identify whether or not changes in the business environment have occurred. For instance, *Are the activities of international firms the same in the CEC and FSU as they are in other parts of the world? Does the existing base of theoretical literature adequately explain the activities of firms in this environment? Which theories are most applicable to this situation?* While each of these areas are of interest the point of this study is to gather the necessary data on the activities of firms in a select group of five CE countries. This in turn will provide a platform on which future research may be conducted.

[156]Dunning concludes that his *eclectic paradigm* needs to take into account three main changes in the world's new business environment. *"First, the role of innovation in sustaining and upgrading the competitive advantages of firms and countries needs to be better recognized. Secondly, the paradigm needs to better recognize that a 'voice' strategy for reducing some kinds of market failure...is a viable alternative to an 'exit' strategy of hierarchical capitalism....Third, the eclectic paradigm needs to acknowledge that the traditional assumption that the capabilities of the individual firm are limited to its ownership boundaries...is no longer acceptable whenever the quality of a firm's efficiency-related decisions is significantly influenced by the collaborative agreements they have with other firms."* See Dunning, J. H. (1995), *Reappraising the Eclectic Paradigm in an Age of Alliance Capitalism*, pp. 481.

Finally, in regards to the theoretical literature, a review of the motivational factors affecting a firm's decision of whether or not to invest shows a concerted leaning towards the use of Dunning's four main types of FDI: *(natural) resource-seeking*, *market-seeking*, *efficiency-seeking*, and *strategic (created) asset-seeking*. However, it is also apparent from the literature that these four categories are in many ways too general in their scope and thus do not adequately provide for different motivations for FDI. Other motivational factors that should be taken into consideration in the FDI decision include issues pertaining to the workforce (*employment*) and investments driven by the need to gain access to specific technology (*know-how/technology*). Furthermore, several other motivational factors should be taken into account in relation to the specific host country of the FDI, such as the general climate for investment within the host country (*investment climate*) as well as its location and surroundings (*geographic location*). In including these other categories along with Dunning's own four motives for investment may we be able to appreciate fully the motivational factors affecting the firm's decision to engage in FDI within a specific host country.

Moving on, a number of points should be made with regards to the pertinent literature on FDI by Western firms in the CEC and FSU environments during both the pre-1990 and post-1989 periods. The literature covering the pre-1990 environment in what was then Eastern Europe and the Soviet Union illustrated the two very different perspectives that both East and West had towards FDI. It also clearly showed the dearth of research focusing on the business environment in a region of the world which contains over 400 million inhabitants. However, the events that began in Poland during the latter months of 1989 dramatically changed not only the political, social, and economic structures of the region but also the interest level of the West, especially that of Western firms that were interested in reaping the benefits associated with the opening up of these relatively untapped markets. Yet, forty years of communist rule left a severe shortage of business information. Consequently, as the countries of the CEC and the NIS of the FSU adopted a new economic system, not only did the level of Western business activity increase, but so did the volume of literature pertaining to the subject area.

Yet, much of the research literature to date has been descriptive and/or strategy oriented in nature, especially in the case of many of the early materials. The focus of a great many efforts were either in trying to paint a picture of an environment that was in a state of transition or in providing advice to investors which purportedly gave readers meaningful insight on *how to* best operate in the region. Yet, due to the transitional nature of the environment a great deal of the literature on some individual host countries within the region was often outdated well before even being published, such was the rate of change. In some other countries of the region, the general state of confusion caused by an almost paralysis on the part of the respective government to implement a cohesive program of change usually resulted in the same situation.

Overall, a general problem with much of this descriptive and strategy oriented literature is that it generally relies too much on secondary data and/or the personal impressions of the respective author as opposed to hard scientific evidence gained through actual field research. As for the former, the problem with the use of secondary data being that most of the materials were generated by the host countries themselves which had some forty years of experience in statistical/data manipulation. While this situation has improved dramatically in almost all of the countries of the region it did have a profound effect on much of the earlier literature on the subject. In regards to the latter, the use of personal impressions has often been a form of what this researcher has termed *armchair quarterbacking*, whereby literature is based more on the opinion of the author than on hard evidence or actual experience. A number of articles seem to suffer from this problem, especially those published within the first few years after 1989 when demand for information on the business environment and conditions in the CEC and FSU was high and supply extremely limited. Yet, of more relevance to this study is the literature that has employed the survey and/or case study instruments as a means of investigation into FDI by Western firms in the CEC and FSU.

In terms of the literature using the survey instrument, while some quality research has been done on the topic utilizing this means of investigation, the majority of this type of work seems to suffer from one problem or another, and in some of the studies from a number of problems. There are three main areas of concern in the studies that have employed a survey, namely the use of poor methodology, inadequate coverage of the subject, and insufficient information provided in the reporting phase of the study. Each of the problem areas is discussed in greater detail in the order presented.

Firstly, the problems associated with using poor methodology in some surveys are numerous and in some cases widespread. Frequent problem areas include poor or improper use of terminology, a noted problem in many of the practitioner generated studies; poor questionnaire design, that in some cases included a complete lack of proper pre-testing and/or piloting of a questionnaire; and poor selection of respondents/contacts, with many studies directing their surveys to some executive at the headquarters unit of a parent/partner company that may or may not have the necessary knowledge of the local situation in the CEC and/or FSU. However, the main source of problems in regards to research methodology stems from the use of poor sampling techniques that often yield samples that are unfocused in relation to the topic of investigation, too small in size and scope to be considered significant, and therefore unrepresentative of the actual population.

According to Judd, Smith, and Kidder, "*When we select some of the elements with the intention of finding out something about the population from which they are taken, we refer to that group of elements as a sample. We hope, of course, that what we find out about the sample is true of the* *population as a whole."*[157] Still, the underlying premise behind sampling is to select population elements that are appropriate to the context of what is being investigated.

However, this is not the case in a number of studies that have used the survey method. In most of these problem studies at least one of the stated purposes of the research was to investigate why foreign firms engage in FDI in the CEC and/or FSU or parts thereof (motivational factors for FDI). Yet, when identifying the population these same researchers often used population elements that are drawn from *Fortune 500* firms, many of which often turn out not to be active investors in the specified region or host country under investigation. For example, Collins and Rodrik (1991) sampled an unspecified number of *Fortune 500* firms in their own survey for which they reported 54 firms responded, but only 21 firms from this group, less than half the total number of responses, were stated to be actual investors in the CEC and/or FSU. The study by the OECD (1993, 1994) sampled an unspecified number of firms drawn from six OECD countries, for which 291 firms participated in an interview. Of these 291 respondents, only 162 firms, just over half, were identified by the authors as being actual investors in the region. Yet, upon closer examination of the data provided in the OECD report it becomes evident that of these 162 alleged actual investors only 118 firms had operational investments at the time. As for the other 44 firms, 14 of these were reportedly in the process of negotiating investments and another 30 were considering investments in the region. Gatling (1993) also surveyed an unspecified number of firms for the stated purpose of *"...to explore in greater depth the motives for EE* (Eastern Europe) *investment and the experience to date of those who have made a direct investment in the region."*[158] Gatling reported receiving 87 replies to her survey, of which only 48 firms, just over half, were considered actual investors in the region. Moreover, some of these same studies often base their findings on the combined responses of both actual investors and non-investors.

Overall, the problem of poor sampling in a number of the works utilizing the survey method has greatly distracted from the value of such studies by watering down the results and thus challenges the validity of their findings. As shown, this problem has been most acute in the surveys directed at the CEC and FSU region as a whole. Although, it should be noted that while this problem also exists in some of the host country specific studies it tends to be of a lesser degree in terms of the ratio of actual investors to non-investors, with higher percentages of the former.

Secondly, another major shortcoming of the literature is its inadequate coverage in terms of the geographic spread of the sample and in relation to the use of limited sample sizes that yield unrepresentative results for some host countries studied. For example, in returning to Gatling's

[157] See Judd, Smith, and Kidder, *op. cit.*, pp. 131.

[158] Gatling (1993), *op. cit.*, pp. 4.

(1993) survey, of the 48 firms identified as actual investors, these same firms reported making a total of 191 different investments in the CEC and/or FSU: six in Bulgaria, 34 in Czechoslovakia, 44 in Hungary, 34 in Poland, five in Romania, 51 in the FSU, and 17 in the former Yugoslavia. While the sample sizes for Czechoslovakia, Hungary, and Poland are acceptable the same can not be said of the samples from other host countries. For instance, the sample sizes used for both Bulgaria and Romania are too small to be considered representational of FDI in these host countries. The same is also true in the case of the sample from the former Yugoslavia, although to a somewhat lesser degree. As for the 51 cases in the FSU, no effort has been made by the researcher to delineate in which of the NIS these population elements are located. Not knowing the geographic spread of the population one can not assume that this sample is representative of anything. The bottom line of the situation is that based upon a sample that has been shown to be unrepresentative of some host countries, Gatling makes broad brush stroke statements on the population of investors in the CEC and FSU as a whole which is not necessarily substantiated by the sample used.

Another chronic problem with regards to coverage is the lack of clarification of exactly what types of operations are being sampled. From a number of the surveys it is difficult, and in some instances impossible, to discern if an investment is just in the form of a branch or representative office of the foreign parent company or a major local operation. Obviously there would be some potential differences in data collected from either a small or large operation in regards to certain questions asked.

For instance, take two firms, one a firm like *ABB Asea Brown Boveri*, the Swiss/Swedish engineering concern, which has made numerous investments throughout the CEC and FSU region over the years involving many hundreds of millions of dollars. In contrast, take as a second firm a small company, regardless of origin or industry, that has invested only a few thousand dollars in a country like Hungary to establish a small local business. The question of importance here is: *Are these two investors similar enough for comparison?* In the opinion of this researcher the answer is clearly no. Comparing data from apples and oranges may make for a nice fruit bowl but does not create beneficial research. Therefore, it is paramount that research studies set some sort of minimum criteria in the selection of a sample that accurately represents not only the population but also covers the types of investments under investigation.

Lastly in terms of coverage, a thorough review of the survey literature, and for that matter the literature on FDI in the region overall, shows that some host countries have received a great deal of attention while others have been fairly neglected. For instance, the research literature on FDI in Hungary, Poland, and Russia is fairly substantial in its volume. On the other hand, the amount of literature focusing on host countries like Bulgaria, Romania, Slovakia, the NIS of the FSU (except Russia), and the former Yugoslavia (except Slovenia) is minimal at best. In the case of Albania there seems to be a dearth of literature with the exception of a few brief descriptive articles. Given this situation it is important that research efforts be directed at those host countries where there still exists a severe gap in the literature.

Thirdly, the issue of reporting of survey data also needs to be addressed. In a number of cases the survey literature fails to provide such basic details on the research methodology with regards to response rates, how the sample was selected, means of analysis used on the data, etc.. Furthermore, in some cases, mainly in the practitioner generated studies, the authors misuse some basic terminology related to FDI that indicates a failure on their part to conduct a proper and thorough review of the existing literature on the subject.

Finally, some brief comments need to be made regarding the use of the case study medium as a means of investigation into FDI in the CEC and/or FSU. Except for some recent works, many of the case study literature has been of a somewhat superficial nature with little depth of investigation of individual companies except. Also, some of the literature labelled as containing case study materials actually falls short of meeting the basic requirements as such as specified by Yin (1989). Furthermore, some of the case studies have suffered from poor methodology, mainly in the area of data collection where a few researchers seemed to have relied solely on interviews with executives of local firms with foreign capital participation for their evidence rather than on a combination of sources.[159] Given the usefulness of the case study medium not only as a means of education but also as a form of research these issues need to be properly addressed by any future research in this area of study.

In conclusion, over the years our understanding of the business environments in the CEC and FSU has been greatly expanded by a number of pioneering research works in the field. Still, in relation to this particular study the literature focusing on FDI by Western firms within the CEC and FSU has been a mixture of both good and bad in terms of quality and content. However, that is not to say that researchers themselves are to blame for the shortcomings in the literature that have been identified by this review. The difficulties of doing beneficial research on the CEC and FSU business environments are numerous, and mainly a direct result of the severe shortage of business related information available and the pace of changes that have been taking place in the region. Subsequently, unlike some other research projects that can be conducted in ones own home country by simply accessing the necessary data base via a personal computer such luxuries in the CEC and FSU are not as yet so readily available if available at all. Therefore, it is necessary that further in-depth exploratory research be conducted on the subject of FDI by Western firms in the CEC and FSU that can help fill in these gaps in the base of knowledge on the subject.

[159]Yin states that the first principle of data collection is in using multiple sources of evidence. Yin identifies six major sources of evidence: documentation, archival records, interviews, direct observation, participant-observation, and physical artifacts. See Yin, *op. cit.*, pp. 84-95.

However, given the problems of coverage mentioned earlier a more methodical and focused approach to the study is necessary. Hence, this particular first stage of the study has sought to avoid many of the problems noted in the literature review by concentrating its investigation on FDI by major Western firms in the CE group of countries. In doing so, the researcher has elected to utilize an amalgamation of research tools to implement the study including desk research, questionnaires, and case studies. The remainder of this thesis details the means employed in order to facilitate the study, a description of the findings, some selected case studies, and the general conclusions that can be drawn from the research.

Chapter 3

Research Methodology: A Travel Guide to *"The Island of Research"*

3.1 An Overview

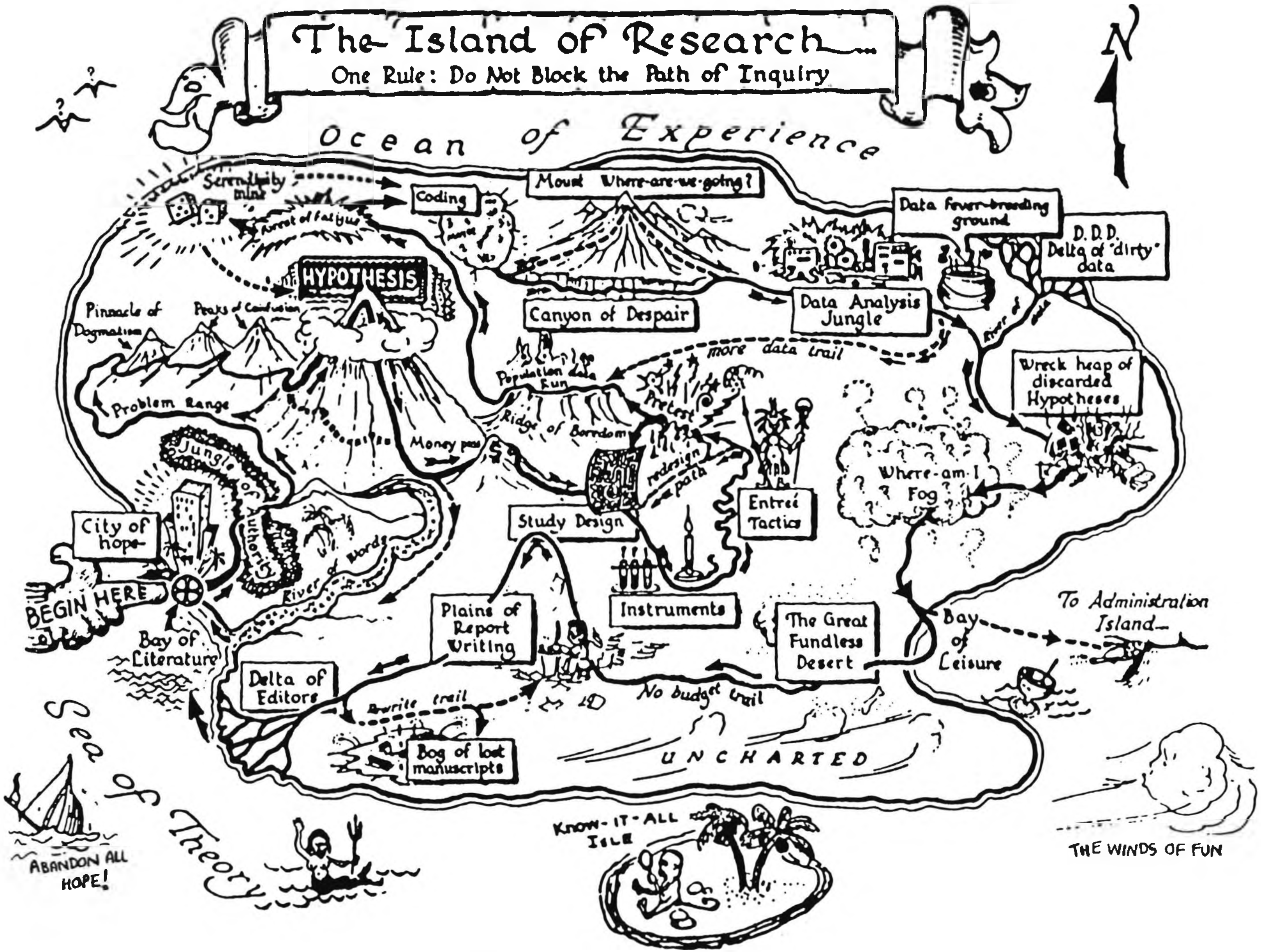
This chapter focuses on the research methodology which was employed in the implementation of this particular study. Accordingly, the chapter will proceed by providing a retrospective overview of the research methodology in terms of the strategy that was employed, the parameters established, the selected site forming the basis of the study, a profile of the population sampled, and the research methods and instruments which were utilized.

In covering these various topics on the research methodology the reader will accompany the researcher on an metaphorical journey to *The Island of Research* (See **Figure 3.1**) where almost all explorers begin their search for knowledge. This fictitious island represents many of the challenges and considerations that a researcher has to face when undertaking a scientific study on a specific subject, with regards to the study's conception, design, implementation, means and methods of analysis, process of data interpretation, and final presentation or writing-up. Consequently, the primary purpose of this chapter is to provide the reader with a description of all of the stops that have been made by the researcher on *The Island of Research* and which have constituted this first stage of the investigation.

3.2 The Research Strategy

The primary goal of almost any research strategy is to be able to address the selected propositions in an effective and efficient manner within the chosen environment so as to allow for the best possible results. On *The Island of Research* this means beginning the adventure at the *City of Hope* and negotiating ones way across the island in order finally to conclude the expedition by having something of value to add to the *Bay of Literature*. Yet, it should be pointed out that the route from start to finish around this island is an arduous journey full of many unforeseen obstacles and difficulties that can easily derail the unsuspecting and unprepared traveller. Still, for an individual who is armed with fortitude and competent in overcoming adversity these obstructions and snarls are not as insurmountable as they may seem. One of the

Figure 3.1, A Map of *"The Island of Research"*



Source: The Social Statistics Research Unit (SSRU), City University.

keys to getting around this island unhindered, or at least with a minimal amount of delays, is to come prepared by having a clear and cohesive research strategy prior to starting the journey. In essence, the strategy performs like a road map as well as serving as an action plan for getting from point *'A'* to point *'B'* in a timely and effectual manner, where point *'A'* could be defined as the research propositions, and *'B'* a set of answers to these questions.[1]

Ultimately, at the root of this researcher's own strategy was the need to address four main propositions, which were as follows: *Why do major Western firms engage in FDI within a specific CE host country (motivational and locational factors of FDI)?; How have major Western firms invested within a specific CE host country (entry modes) and how have these modes evolved over time (evolution of ownership modes)?; What means are utilized by major Western firms to evaluate the performance of their FDIs (performance criteria) and consequently how have these direct investments performed within the chosen CE host country environment over time (relative performance)?*; and *What strategies have been employed by major Western firms in the CE environment (geographical and functional strategies)?*

In addition to answering these four main questions, the research strategy also needed to obtain more general information pertaining to: *What fields of economic activity have major Western firms invested in within the CE environment?; What are the origins of these major Western firms?; What is the timing and level of the investments that have been made by these major Western firms?; What have been the motivations of major Western firms in entering the market via the joint venture/joint venture acquisition modes of investment?; etc..*

One of the main goals of the research strategy in seeking to address all of these questions put forth was to bridge the gap between the academic point of view and that of the practitioner. In attempting to realize this goal the researcher has sought to apply the rigorous disciplines of the academic scientist in tandem with the more flexible practical analysis techniques of the practitioner. The intention of the researcher in utilizing such a methodology was to make the study both more manageable and more effective in ascertaining its objectives.

In light of these previous points, the researcher exercised due diligence by planning ahead as best as possible through the creation of a concise and cohesive research strategy. The two essential elements of this strategy were robustness and flexibility given the environment in which is was to function. Robustness was essential given both the dynamic and challenging environment of the countries to be studied as well as the perceived and real difficulties involved in obtaining accurate information on the host countries. The element of flexibility was needed in order for the researcher to be able to meet and adapt quickly to the needs and requirements of any situations that might arise during the course of the study. For instance, given the dramatic changes that have occurred within the region, and which are continuing to occur, the element of

[1]Yin makes a similar point in reference to research strategy. See Yin, R. (1988), *Case Study Research: Design and Methods*, pp. 28-29.

flexibility was essential in the formulation of the means of data collection. Consequently, the combination of this robust yet flexible strategy has facilitated the creation of the necessary environment that has enabled the aims of the research to be realized.

Given these circumstances, the research strategy employed in this investigation was based on three interdependent and determining factors. These factors included the exploratory nature of the propositions posed, the relative strengths and weaknesses of the existing literature pertaining to the subject, and the parameters established to define the population to be sampled. Since the first two factors have already been adequately addressed in previous chapters it is appropriate now to focus attention on detailing both the research parameters and the research site. Moreover, it should be noted that while the site was determined in conjunction with the established parameters defining the population to be examined in this first stage of the study, the researcher has elected to cover each of them separately.

In terms of *The Island of Research*, in the middle of the island one comes to the realization that the destinations of *Study Design*, *Instruments*, and *Entreé Tactics* are invariably linked to one another in a double circle, firstly by the *Redesign Path* and secondly via the act of the *Pretest*. The three destinations and the two circles that join them together metaphorically mirror different aspects of the research methodology: the research parameters represent the process of *Study Design*, the research methods are the actual *Instruments*, and the chosen means of the study's implementation embody the *Entreé Tactics*. The *Redesign Path* and the *Pretest* that form the two loops that connect these three elements respectively personify the ongoing process of refinement and re-design that come from the pre-testing and/or piloting stages of the research methodology. Each of these destinations and the paths that join them will be covered in the proceeding sections.

3.3 The Research Parameters

In light of both the overall aims of the research and on the basis of the four main propositions postulated the ideal *population*[2] to be sampled would be the one that comprises all foreign firms that are operating in the CEC and the FSU via FDI since 1989. However, given the numerous complexities and problems involved in such an undertaking it has been decided to implement the study in a series of individual stages. The focus of each of these stages cover a distinct *subpopulation*, or *population stratum*,[3] that is drawn from the overall population on the basis of a set of a pre-defined parameters.

[2]A *population* is defined by Judd, Smith, and Kidder as *"...the aggregate of all the cases that conform to some designated set of specifications."* Judd, C. M., Smith, E. R., and Kidder, L. H. (1991), *Research Methods in Social Relations*, pp. 130.

[3]A *population stratum* refers to a subpopulation of the main population. As defined by Judd, Smith, and Kidder, *"A stratum* (referred to as a subpopulation, a population stratum, or simply a stratum) *may be defined by one or more specifications that divide a population into mutually exclusive segments." Ibid.*, pp. 130-131.

To reiterate, the decision to implement the research in a series of stages has been made primarily as a result of several mitigating factors which include, the vastness of the CEC and the FSU region as a whole, the unique nature of individual countries, and the obvious differences that exist between them; the shortcomings of previous studies on this subject - many of which attempted to cover the region as a whole while only utilizing a very small and limited sample - to provide an accurate picture of FDI in the CEC and the FSU; the actual level of FDI within a particular host country of the region as well as the quality and availability of data on these investments; and the limitations restricting the researcher in terms of both time and financial resources available.

It should also be pointed out that it is conceived and anticipated that some of the parameters used in this first stage of the investigation may not remain constant in other future stages of the study. Therefore, it is acknowledged that due to the longitudinal nature of the study some of the parameters may either evolve or change over time in response to changes in the environment and/or changes in the overall characteristics of the population studied.

However, one of the parameters used to define each population stratum is intended to remain constant for the duration of the study. In this respect certain groupings of host countries will serve as the research site for each individual stage of the study. Moreover, the selection criteria used in choosing individual host countries of the FDI will continue to be based upon the need to obtain a certain degree of synergy among the host countries as a group. These synergies will allow for comparative analysis among similar environments of FDI as well as ease the labor and time intensive task of the researcher in being able to adequately cover the necessary background materials.

Three main parameters were used to define the population stratum. These included the type and origins of the investing firm, the individual host countries of the FDI comprising the research site; and the time period of the actual investment. On this basis a population stratum was created which is characterized by the following statement:

The population comprises all major Western firms that have actively engaged in FDI within one or more countries in CE between 1989 and the end of the first quarter of 1996.

Along with these three parameters defining the population stratum, several subordinate provisions were also established in respect to the selection of each *population element*[4] (participants of the study) for inclusion in the sample. The combination of the defined parameters and their respective provisions served as a screening mechanism allowing the researcher to determine the eligibility of each population element. On the basis of this screening

[4]A *population element* refers to a single member of the population. *Ibid.*, pp. 131.

process individual population elements were selected from the population stratum to form a *sample*[5] which served as the focal point for addressing the research propositions. In addition, given the possibility of errors in the original screening process these same methods of screening were also rigorously applied to responses received from individual population elements in order to ensure commonality amongst the sample. The three parameters and their subordinate provisions are each outlined in greater detail.

3.3.1 The Type and Origins of the Firm Making the Investment

The first parameter was designed to define the particular type of foreign firms engaged in FDI within a specific host country. In this regard, the study concentrated on FDI by *major Western firms*. For the purposes of determining the population stratum the term *major Western firms* was given two main provisions as well as several subordinate provisions.

Provision One: The term *major Western firms* was interpreted on the basis of both the level of FDI and/or the type of investing firm. In regards to the former, the term was used to refer to local firms with foreign participation established via FDI within the specified host countries that met or exceeded a threshold of $1.0 million dollars worth of FDI. According to the available statistical data these types of investments constitute the bulk of FDI within respective host countries of the CE group.[6] For example, according to information reported by the *Polish Agency for Foreign Investment/Panstwowa Agencja Inwestycji Zagranicznych (PAIZ)* (Durka [1995] and PAIZ [1995]), which is the government agency responsible for both promoting and monitoring FDI in Poland, a group of 267 individual major foreign investors accounted for a total of $4,321.0 million dollars worth of FDI between 1989 to 1994, with future investment commitments made for a further $4,932.0 million.[7] In its terminology, PAIZ defined a major foreign investor as a firm engaged in FDI equalling or exceeding the $1.0 million threshold. According to the statistics previously presented[8], cumulative FDI in Poland during this same period of time amounted to $4,668.0 million.[9] Hence, based on a comparison of both the PAIZ figure and the official statistics on FDI it is apparent that major foreign investors, those investing over $1.0 million, accounted for almost 88% of all cumulative FDI in Poland between 1989-1994. A similar situation is also found in the other four countries of the CE group.

[5]According to Judd, Smith, and Kidder, a *sample* is used *"When we select some of the elements with the intention of finding out something about the population from which they are taken...." Ibid.*, pp. 131.

[6]This is also the case for almost all of the FDIs in the CEC and the FSU.

[7]This information on major foreign investors in Poland is listed in a joint publication by the Foregin Trade Research Institute (IKC) and the Polish Agency for Foreign Investment (PAIZ). See Durka, B. (1995), *Foreign Investments in Poland*, pp. 121-135 and via direct communication with PAIZ (1995).

[8]See *Table 1.2, FDI Inflows into the CEC and the NIS of the FSU, 1989-1995* in *Chapter 1, The Rise and Fall of the Iron Curtain: Capitalism Goes East!*

[9]See UNCTAD-DTCI (1995), *World Investment Report 1995: Transnational Corporations and Competitiveness*, pp. 101.

Continuing the interpretation of the *major Western firm* term, special preference was given to investing firms that were able to meet the criteria of being considered a TNC. In light of this point, the TNC definition used to determine the eligibility of the population element for the sample was that the *major Western firm* had to be operating in more than one country. In a re-examination of the PAIZ materials it becomes self-evident that there is a high correlation between firms engaging in FDI of $1.0 million or more and those same firms meeting the criteria of being considered a TNC. For example, 95 out of the top 100 major foreign investors in Poland would be classified as meeting the definition of being a TNC, many of which are common company names within the business community.[10] Subsequently, the researcher decided to use TNCs as one of the key focal points of this study because of the obvious dominance and importance of these *major Western firms* as the primary source of FDI in the countries of CE.

Subordinate Provision: As a subordinate provision to these two interpretations, some smaller amounts of FDI by *major Western firms* that did not meet the stated threshold of $1.0 million or more worth of investment were also included within the sample provided that they met the criteria of being considered as a TNC. However, a key exception to this last statement was made in reference to representative/trade offices of TNCs. Because of the limited nature and role that these types of operations play within a given host country they were excluded from the population surveyed.

Provision Two: The term *major Western firms* was used to reference those firms which originated in or whose main company headquarters were based in a home country within one of the following regions: Europe (excluding the CEC and/or FSU) or North America (excluding Mexico). To be more precise, individual firms that were considered to meet the requirements of the *major Western firms* definition were based out of the following countries: Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, and the United States of America.

These 24 home countries were selected for the study because as a group they represent the source of the vast majority of FDI in the CEC and the FSU as well as being the main progenitor of international flows of FDI. With regards to the CE group of countries, the data on origins of foreign investors clearly illustrates this point to be the case. For instance, according to the PAIZ data previously mentioned, from the top 267 major foreign investors (100%) in Poland only 11 cases (4%) were classified as originating from a country outside of the 24 home countries defined in this parameter.[11] A similar situation exists in the Czech Republic, Hungary, and

[10]Firms that were not deemed to be TNCs in their own right included international insititutions like the *European Bank for Reconstruction and Development (EBRD)* and the *International Finance Corportion (IFC)* of the *World Bank* as well as investments made by funds like the *Polish-American Enterprise Fund* (US), the *Swiss Government Fund* (SW), and *Fortrade Financing* (IT). See Durka and PAIZ, *op. cit*, pp. 121-135 and via direct communication with PAIZ (1995).

[11] See Durka and PAIZ, *op. cit*, pp. 121-135 and via direct communication from PAIZ (1995).

Slovakia. The only exception to this rule is the case found in Romania which has slightly more foreign investors originating from home countries falling outside of this parameter, most of which are from Romania's more traditional trading partners in the countries of the Middle East. Overall, it should be noted that firms originating from countries outside these specified regions were not included in the first phase of this study because they have so far not been a significant source of FDI into the CEC and/or the FSU.[12]

In illustrating how this particular parameter functioned in determining the population stratum of the study, let us examine the case of the American foods company *Sara Lee* (US). Sara Lee has utilized *Sara Lee Douwe Egberts* (NL), its Dutch subsidiary, in order to establish an operation in Hungary via FDI under the name of Compack Douwe Egberts Rt.. In this particular case, and for the purpose of this research, despite the use of its Dutch subsidiary the Sara Lee investment in Hungary was deemed to have originated from the United States of America and thus met the criteria set by the *major Western firms* definition. Furthermore, in this example Sara Lee's Dutch subsidiary Douwe Egberts was considered to play the role of the *Intermediary Firm*[13] involved in this act of FDI within Hungary.

In another example, *Coca-Cola Company* (US), the internationally known soft drinks giant, has often utilized some of its foreign subsidiaries and franchisees as intermediaries for their investments into the CEC and the FSU. These intermediary firms include *Coca-Cola Amatil* of Australia (AU), *Ringnes* of Norway (NW), *Leventis Group/Tria Epsilon* of Greece (GR), and the *Ozgorkey Group* of Turkey (TR). On the surface, it would seem clear that both Coca-Cola Amatil and the Ozgorkey Group fall outside the prescribed definition of a *major Western firm* and therefore it would not be included in the population. Yet, since these two firms and the others mentioned all operate on behalf of Coca-Cola (US) they would be considered to meet the criteria of being a Western based firm and would also be classified as a FDI originating from there. Thus they were included in the population sample.

Subordinate Provisions: In support of this research parameter there were several subordinate provisions that were utilized in determining the eligibility of each population element for the study. Firstly, the term *major Western firm* had to meet the criteria of being active, operational, and functioning within the specified environment. For instance, FDI by *major Western firms* in CE which were only plans, commitments, announcements via the media, still in the process of negotiation, and/or non-operational were not considered to be active and thus not included within the population to be sampled by the research study. It should be noted that several scholars have pointed out the existence of large discrepancies between the total number of

[12]For example, Asian FDI into the CEC and the FSU has so far been extremely limited with the only exceptions being FDI by some of Korea's conglomerates (like *Daewoo's* automobile manufacturing in Romania and Poland) and Japan's car manufacturers (like *Suzuki's* auto assembly facility in Hungary). See Valencia, M., Kraft, P., and Simpson, P. (1994), *Toe-dipping Asia*, pp. 7-10.

[13]An *Intermediary Firm* is a firm that engages in FDI on behalf of another firm and/or a parent company.

registered firms with foreign participation in the CE group of countries and those that are actually operational, with the number of firms that are physically up and running being much less than the number registered. In light of this point, the researcher did not seek to target or use firms with foreign participation that were considered non-operational (simple paper investments) as part of the sample. Furthermore, the sample also did not include firms established by FDI that were considered to be *phantom joint ventures*.[14]

Another subordinate provision used to determine the population referred to the number of partners a local firm with foreign participation could have in it ownership structure. Given both the capital requirements of some FDI projects and/or the continued growth of strategic alliances between firms it was quite likely that some firms with foreign participation would have multiple foreign partners/parents. For example, in the Hungarian government's sale of a 30% shareholding in *Magyar Tavkozlesi Vallalat (MATAV)*, the national telecommunications operator, a variety of foreign and local communication companies formed their own consortiums to participate in the bidding process. The winning bid for the shareholding in MATAV came from a foreign joint venture named *MagyarCom* that was jointly owned by *Deutsche Bundespost Telekom* (BD), the German state telecoms operator, and *Ameritech* (US), an American based regional operator, for $875.0 million dollars. In this instance, both Deutsche Telekom and Ameritech would be considered as two distinct investors in a single firm and thus represent a single population element. Moreover, since each of these firms met the criteria set forth they were included as part of the population to be sampled for the purposes of the study. However, this would have been the case even if only one of the foreign investors had met the criteria of being a *major Western firm*.

Finally, given the parameters of this research study it was possible that an individual *major Western firm* may have established numerous local firms via FDI within one or more of the CE group of countries. For example, *ABB Asea Brown Boveri* (SW/SD), the Swiss/Swedish engineering giant, is engaged in numerous investments throughout the CE region. In the Czech Republic alone ABB operates six primary companies, namely *Asea Brown Boveri s.r.o.* - a holding company for all of ABB's operations in the country, *ABB Lummus Global s.r.o.*, *ABB Energo s.r.o.*, *ABB První Brnenská Strojírny (ABB-PBS) Brno s.r.o.*, *ABB EJF a.s.*, and *ABB Elektro-Praga s.r.o.*. In this respect, each of ABB's operations in the Czech Republic was considered to be a separate entity since they were each created through an individual act of investment and were thus eligible to be included in the population to be sampled.

[14]For example, a paper by Csáki illustrates this problem in the case of firms registered with foreign participation in Hungary during the late 1980s and early 1990s. According to Csáki, *"One of the 'adverse consequences' of the legal authorization for the establishment of relatively small firms has been the spread of so-called 'phantom joint venture' in great numbers. These are very small ventures which are often established in the private sector in such a way that the Hungarian partner buys the convertible currency necessary for the establishment of the venture on the black market and asks one of his or her foreign partners (or relatives) to enter into a formal association with this money. In this case the Hungarian will be the real and only owner of the firm....More then half of the joint ventures are small firms with a total capital of USD 20-30,000 and many of them could be considered as phantom joint ventures."* See Csáki, G. (1992), *East-West Corporate Joint Ventures: Promises and Disappointments*, pp. 10.

3.3.2 The Individual Host Countries of the Foreign Direct Investment Comprising the Research Site

The primary focus of the first phase of this research study w as aimed at a selected group of countries within the CEC which generally more advanced in their transition process and/or more attractive to FDI. This group included the *Czech Republic* (part of former Czechoslovakia), *Hungary, Poland, Romania,* and *Slovakia* (part of former Czechoslovakia). As previously noted, these five countries are referred to as *Central Europe (CE)* throughout this study. The motivation for selecting these individual countries will be discussed in the forthcoming section on the research site.

3.3.3 The Time Period of the Actual Foreign Direct Investment

For the purpose of this first stage of the study the time period was set to include all FDI by Western firms within the selected host countries that have occurred *between 1989 to the end of the first quarter of 1996*.[15] This time period allowed for the creation of a population of foreign firms that had *engaged*[16] in FDI within a respective host country since the beginning of the period of transition up until the time of the study's implementation. By doing so the study focused on a population that had entered these respective host countries via FDI after the dramatic changes that began in the region in the latter half of 1989.

3.4 The Research Site

Of the three research parameters described in the previous section, the research site was considered by the researcher to be the most important element in defining the population stratum to be used as the basis for the first stage of the research study. Therefore, it is appropriate that the researcher clearly justifies the logic behind the selection of the CE group of countries comprising the Czech Republic, Hungary, Poland, Romania, and Slovakia as the research site. There were four primary factors that dictated the selection of these particular countries as the research site, some of which have already been mentioned previously within this thesis. These factors included the CE group's economic balance; its shared experiences and common history over the last 75 years; the researcher's personal connections and contacts in these countries; and the amount, availability, and quality of information on these countries. Each of these factors will now be described in greater detail.

[15]The end of the first quarter of 1996 coincides with the implementation date of the actual field study.

[16]This term *engaged* refers to the actual date of registration of the FDI within the respective host country.

3.4.1 Economic Balance

While it is not within the realm of this thesis to detail the economic situation in each one of the countries of the CE group, some general points should be noted. Firstly, in general terms these five selected host countries represent a fairly well balanced and dynamic group in respect of their overall progress in relation to the process of economic, political, and social transformation. In comparison to the other CEC and the FSU as a whole they represent some of the most advanced countries of the region. In terms their individual status in the process of transformation within the CE group, Hungary heads the top of this list and the region overall having made the most progress in this area of transition, followed closely by the Czech Republic and Poland, and finally in the lower half of this group are Slovakia and Romania due to a variety of contributing factors.

This general pattern is reflected by corresponding amounts of FDI inflows into each of these respective countries. As a result of the positive progress of these five countries in the process of transformation they have each been able to attract substantial amounts of FDI since the events of 1989. Individually, according to cumulative FDI statistics from 1989-1995[17], Hungary once again leads the CE group, as well as the entire region, by having attracted the greatest amount of FDI with $10,432.0 million. Following Hungary's clear lead are the Czech Republic and Poland with $5,713.0 million and $7,169.0 million respectively. However, it is anticipated that future levels of FDI in both countries will increase over the next few years allowing them to catch up with Hungary and possibly surpass its leading position. Finally, once again at the bottom of this grouping are Romania which has attracted $924.0 million worth of FDI and Slovakia having attracted slightly less with $910.0 million. While the amount of FDI directed at both Romania and Slovakia is only a tenth that of Hungary's, both countries have a great deal of potential for future improvements in this area given more resolve on the part of their respective governments to actually implement measures for economic reform. Overall, the CE group as a whole has attracted $25,148.0 million dollars worth of cumulative FDI between 1989-1995, which in comparison represents 95% of all FDI going into the CEC as a whole and 73% of total FDI from the combined grouping of the CEC and the FSU. Thus the sheer scale of FDI within these five particular countries mandated their inclusion as the research site.

3.4.2 Shared Experiences and Common Histories

Secondly, another criterion for selecting these five individual countries was the shared and common history of the region over the last 75 years. While the researcher acknowledges that every country has its own unique character there are grounds on which comparisons can be made between countries or groupings of countries. In the case of CE, despite some clear and

[17]For sources of the statistical data presented here see *Table 1.1* in *Chapter 1, The Rise and Fall of the Iron Curtain: Capitalism Goes East!*

obvious cultural and language differences, the five host countries possess a high degree of synergy with regards to their shared experiences and common histories since the 1920s. Although some other researchers have claimed that the countries referred to as CE, or the entire CEC region for that matter, does not constitute a homogeneous grouping of countries[18], it is this researcher's contention, based upon his own thorough analysis of the evidence, that this is not the case. Yet, given the somewhat controversial nature of this point it is appropriate to detail some of the evidence supporting the researcher's position.

To begin with the First World War (1914-1918) lead to the downfall of the bureaucratic empires that had long dominated most of the CEC. In the context of the countries of CE, the Bolshevik Revolution of 1917 in Russia forced the ruling Tsar Nicholas II and his Romanov family out of power and in front of a firing squad but also gave both Poland and Romania the chance to seize some of their lost and disputed territories; a defeated Imperial Germany under the Kaiser Wilhelm II was forced to give up much of its Prussian territory with the creation of Poland's western boundary; and the defeated Austro-Hungarian Empire under the long ruling Hapsburgs was officially dissolved resulting in the creation of a much smaller and independent Austria and Hungary, the creation of Czechoslovakia (a conglomeration of Czech and Slovak lands), and Romania regaining its lost territory of Transylvania.

Furthermore, as the new boundary lines of CE were established at the Paris Peace Conference (1919-1920) under the terms of the treaties of Versailles (1919), Saint-Germain (1919), and Trianon (1920) the countries of the region had finally gained their full independence.[19] As newly formed nation-states most of the countries of the region adopted the Wilsonian principles of national self-determination as well as a Western style parliamentary democracy in an effort to established their legitimacy. In the case of the former, nationhood lead to a resurgence of nationalism which had previously been oppressed, often brutally, under the regimes of the Romanovs, Hapsburgs, and Hohenzollerns.

In regards to the latter principle of the countries of CE adopting a parliamentary based democracy, this turned out to be a decision with very mixed results.[20] In Czechoslovakia efforts were made at unifying the country through the democratic process under the strong presidency of Tomas Masaryk with some positive results. However, the ethnic composition of the newly

[18]Both Csåki and Lawrence claim that the CEC does not represent a homegeneous group. According to Csåki, *"The countries of Eastern and Central Europe...do not constitute a homogeneous region in terms of their geopolitical situation, history, or level of economic development."* See Csåki, *op. cit.*, pp. 5. In the words of Lawrence, *"...in fact this homogeneity, meaningful though it is, never was 'the whole truth'. These communist countries were different before communism, having different histories, speaking languanges from different language groups, having different levels of pre-war industrialization."* See Lawrence (1995), *Eastern Europe: Exploring Discontinuity*, pp. 1.

[19]The Treaty of Versailles, signed 28 June 1919 and took force on 10 January 1920, concluded World War One (WWI) with Germany; the Treaty of Saint-Germain, signed 10 September 1919 and came into force on 16 July 1920, ended WWI with Austria and officially registered the breakup of the Hapsburg Empire; and the Treaty of Trianon, signed 4 June 1920, concluded Hungary's part in WWI. It should be noted that the Trianon Treaty was not actually agreed to and signed by the Hungarians until after the conclusion of the Paris Peace Conference.

[20]Many of these points are detailed in greater length in the book by Zonis and Semler. See Zonis, M. and Semler, D. (1992), *The East European Opportunity: The Complete Business Guide and Sourcebook.*

formed Czechoslovakia was a recipe for ethnic tensions, with a third of the population comprising Sudeten Germans and Hungarians. Furthermore, compounding this problem was the fact that as time progressed the Slovaks were to become increasingly alienated with the Czechs due to economic and political differences between the two partners. The end result was that by the end of the 1930s Czechoslovakia was in a weakened state with little unity.

In Hungary, democracy started its brief stint in the country in October 1918, a few days before the armistice ending hostilities in the First World War, with a bloodless *coup d'état* by Count Mihaly Karolyi under a five-party coalition. Karolyi and his colleagues hoped to save Hungary's half of the Austro-Hungarian Empire by both abandoning its military alliance with Germany and forsaking its Austrian partner. However, Karolyi was unable to deliver on such promises and the five political parties backing him lacked both unity and the support of the populace. Taking advantage of the turmoil in Hungary the extreme left under Béla Kun and his communists staged their own *coup d'état* in March 1919, less than five months after the first coup. Kun and his communist forces formed their own government and quickly moved to join the Soviet Union in a bid for world communism which in turn was followed up by military operations against both Slovakia and Romania to regain lost territories. Yet, by August 1919 Kun's *red terror* and communist government were completely overwhelmed by both counter attacking Romanians seeking revenge for Hungary's aggression and anti-communist Hungarian forces under Admiral Miklos Horthy looking to restore the country to conservatism. The Romanian military forces left Budapest after they had sacked and burned the city, leaving Horthy and his Hungarian nationalist forces to establish a *white terror* that set about the task of liquidating all vestiges of Kun and his communists' brief tenure. In November 1920, Hungary ended its part in the First World War by signing the Trianon Treaty with the Allied powers. Under the terms of the treaty Hungary was now left with only a third of its former territory, isolated from its traditional markets, and faced with open hostilities by three out of its four neighbors. Given this precarious situation Horthy was able to seize power and appoint himself *regent* with kinglike powers and so ended the brief experiment of democracy in Hungary.

For newly liberated Poland, democratization went overboard in the early 1920s with an over abundance of political parties that resulted in an almost total lack of effective government. Hence, the first five years of constitutional democracy in Poland were marked by a wide array of coalition governments that came and went with thirty-one changes of government. Marshal Josef Pilsudski, a war hero of the Polish people, seeing his fledgling country weakened by such political problems and wide spread corruption stage a *coup d'état* in May 1926 with the firm backing of the military. Pilsudski set about a program to restore Poland's health while also operating the country on near marshall law principles that suppressed non-Poles as well as those believed to be potential insurrectionists. Pilsudski, whom was keenly aware of Poland's dangerous strategic position of being stuck in the middle between its German neighbors in the

West and the Russians in the East signed nonaggression treaties with both countries in the mid-1930s in an effort to safeguard the country's territorial integrity. However, in 1935 Marshall Pilsudski died leaving Poland without a strong leadership capable of steering the country through the troubles that were waiting as Germany and Russia continued their unprecedented military buildup. In 1939, on the eve of the beginning of the Second World War, Germany and the Soviet Union concluded a nonaggression pact between each other that was to seal Poland's fate as an independent country.

In the case of Romania, an internal struggle for power between the monarchy, under both King Ferdinand and his son King Carol II, with the major political groups in the country led to a period of turmoil and political indecision. Overshadowing Romania's internal power struggle was the external problems that the country faced with most of its neighbors. On one hand Bulgaria and Hungary resented Romania for the gains it had made at their expense after the First World War while on the other hand the Soviet Union was threatening war over some disputed territories in the north of the country. Further compounding these problems was Romania poor economic situation and a growing radical fascist movement called the *Iron Guard*, almost identical to Germany's Nazi movement, which sought to establish racial purity in the country. The combination of all these factors eventually led to the end of the era of a Greater Romania with the loss of 40% of its territories and 50% of its population. Moreover, at the same time Romania had also been coerced to take-up arms alongside Hitler's Nazi Germany and her Axis powers as the world edged towards open conflict.

At the heart of these problems facing the newly formed nation-states of CE was the fact that they had each inherited a shared set of problems which had also greatly plagued their predecessors. Probably the most important of these shared factors was the ethnic diversity found in each of the countries comprising CE. Under the newly established borders, the countries of CE found themselves with around 30-40% of the population whom were considered by the new nationalist governments as non-nationals, or in the case of each respective country non-Poles, non-Hungarians, non-Czechs, non-Slovaks, and non-Romanians. However, rather than exploit the potential of mixing the cultures into a new national identity, non-nationals were often persecuted and excluded from the societies in which they lived. Hence, ethnic diversity became a contributing factor to increasing tensions in the region. For instance, probably one of the worst affected groups were the millions of ethnic Hungarians who separated from what was once greater Hungary now found themselves subject to the Czechs and Slovaks, Yugoslavs, and Romanians who greatly resented their former ties and associations with the Hapsburgs. In general, as time progressed the level of prejudices against certain non-national ethnic groups in the region continued to grow stronger and stronger and can still be found persisting today.

The countries of CE also possessed a shared economic history during the inter-war years, although once again with mixed results from country to country. The period between the First and Second World Wars the countries of the CE group and their respective economies functioned under a capitalist system, with some of these countries, like Czechoslovakia, establishing a strong economic foundation. Zonis and Semler (1992) described this period as, *"...a golden age for much of Eastern Europe. Nations that had long been dominated by imperial powers, including Hungary, reveled in their independence as the global economic boom of the 1920s fostered their development."*[21] During this golden age the seeds of capitalism and an entrepreneurial spirit had been firmly planted in some of the countries of CE. However, unfortunately a series of historical events foreshadowed the development and growth of these seeds and thus they were not allowed to naturally mature. The combination of events that shaped the region as well as the world included the Great Depression of the late 1920s which wrecked havoc on the countries of the CE group and their respective economies as it did with the world's economies; the upheaval and devastation of the entire region as a result of hostilities during the Second World War; and the subsequent domination of the region by the Soviets and their Communist ideologies for over forty years after the war's end.

In light of the last two points made, the countries of CE also shared very similar experiences during both the Second World War (1939-1945), under Communism (1946-1989), and after the period of Communism in the region (1989-Present). Some of these shared experiences are worth mentioning. Firstly, as it is with most armed conflicts, strong nationalism, religious differences, ethnic division, political and racial extremism, and a struggling economy are often recipes for war. All these factors were present in the Second World War which ravaged many of the countries of the world for almost seven years. In regards to the countries of CE, Czechoslovakia was the first victim to fall in 1938. This was followed by a German invasion of western Poland in 1939 (the official start of the war) which in turn was follow-up by a invasion of the eastern half of the country by the Soviet Union according to the terms in the German-Soviet non-aggression pact signed earlier. In mid-1940, the Soviet forces seized the north-eastern section of Romania (Bessarabia and Moldova) under the conditions of the German-Soviet non-aggression pact. Seeing their neighbors fall around them both Hungary and a reluctant Romania sided with the Axis powers lead by Nazi Germany. Towards the war's end Romania switched sides and joined the Allied powers fighting alongside the Soviets, Hungary was thoroughly defeated, and both Poland and Czechoslovakia were liberated. However, liberation soon turned into occupation by the Soviet forces as it became clear that the independence of the countries of CE was not to be resurrected.

As it has been previously described in this thesis, under 40 years of Communism each of these five countries shared the same ideology, the same command economic system, were each

[21] *Ibid.*, pp. 171.

members of the Warsaw Pact military alliance, were all active members of the CMEA trading bloc, and were all subject to domination by the Soviets. Although there was some notable exceptions to this rule, each of the countries of CE are today very much a product of the Communist rule which they experienced.[22]

After the demise of Communism in 1989 the similarities continued as each of the countries of CE began its own process down the road of economic, political, and social transformation. As it has been stated several times previously within this thesis, each of the CE group has met with different levels of success based upon their respective starting points as well as their plans and actions in implementing the transformation process. Yet, once again the countries of CE share a common bond in that these changes have been very much similar in nature. Furthermore, the CE group of countries have each sought to change not only their economic, political, and social base but also the more profound changes aimed at ideology, system, and geo-political alignment.[23]

Overall, while there has been some differences between the countries of CE over the last 75 years the fact remains that this region has a strong base of shared and similar experiences that have created a common historical bond that makes the region a unit. Although, there are strong and obvious dissimilarities that one would find with any two or more nations, the synergy of this CE group of countries can not be overlooked and subsequently is one of the grounds for their selection as the basis for this first stage of this research study.

3.4.3 The Researcher's Personal Contacts and Connections

Fourthly, a set of personal oriented factors was another reason for selecting the CE group of countries as the basis for the first part of the study. These personal factors included numerous trips by the researcher throughout the countries of CE as well as personal contacts made with academics, executives of leading firms, institutions, organizations, and government officials and ministries. An example of the impact of these personal factors on the selection process of the research site is worth illustrating.

After a great deal of exploratory work on refining and defining the countries to be considered in the research site the researcher had elected to utilize only the *Visegrad Four* countries (the Czech Republic, Hungary, Poland, and Slovakia) for the study. However, this group of four was to have an addition when the researcher had the opportunity to visit Romania in mid-1994 as a guest of the *"Crans-Montana Forum in Bucharest: The Emerging Markets"* conference, co-hosted by the Crans Montana Forum and the Romanian Government. The conference's list of participants read like a who's who of political figures in the CEC and the FSU, not to mention leading

[22]Despite Lawrence's earlier claims he does state that under communism the CEC shared many on the same experiences. See Lawrence, *op. cit.*, pp. 1.

[23]Lawrence, *op. cit.*, pp. 2-3.

political figures from the Middle East. This conference gave the researcher the opportunity to meet with a variety of political dignitaries, company executives, and local officials. Based on this particular trip Romania was placed under consideration for use as part of the research site. Thus Romania was investigated further along the same criteria that the Visegrad Four countries had been evaluated. After careful consideration it was decided to include Romania as part of the research site along with the four Visegrad countries. This decision was made primarily as a result of the contacts and subsequent discussions at the conference.

3.4.4 The Amount, Availability, and Quality of Information

Finally and probably most importantly, the countries comprising the CE group were also selected as the research site for this particular study because of the amount, quality, and availability of information on them, especially with regards to data on FDI by major Western firms. This was a crucial factor in terms of creating the necessary enabling environment in which the aims of the research study could be fully realized. For without such information the process of bringing the research propositions through to fruition would have been a very difficult task indeed. In fact, a lack of information has more than likely been a contributing factor to the shortcomings found in some previous research studies on this subject.

After the fall of the Iron Curtain, getting information on the countries of the former Eastern Bloc was an extremely difficult task and what little information available was both very costly and of varying degrees of quality and reliability. However, as time progressed and the countries of the region began their process of transformation this problem began to diminish somewhat. Moreover, the amount, quality, and availability of information on these countries can be directly associated with the level of progress on the economic transformation front in each of these respective countries as well as by the greatly increased interest level of firms looking to do business in these emerging economies via direct and/or portfolio investment. Subsequently, this increased interest in these emerging economies has created a high demand for reliable information on these countries. Therefore, like almost all supply and demand situations this chronic information gap has been filled by a variety of sources such as consultants, lawyers, international institutions, market research agencies, business information firms, academic researchers, various host country organizations and ministries established to promote their own country as an ideal place for investment[24], etc.. The end result of this cycle is that there has been a dramatic increase in the availability and volume of information on these countries in transition, especially with regard to business information. Although the issue of the reliability and quality of such information has in some cases remained questionable.

[24]It should be noted, that in the past the former communist countries of the East were often more associated with supplying disinformation than reliable information, both externally and internally, but over the years this attitude has change dramatically as the entire system was re-directed towards market oriented considerations.

Besides the amount, availability, and quality of information needed to identify the population stratum, the issue of the lack of information was also a key point in the selection of the research site. For example, the amount of materials currently available on the subject of FDI in the CEC and the FSU has been primarily concentrated within a few individual host countries. These countries include Hungary, Russia, Poland, Slovenia (former Yugoslavia), and the Czech Republic. From this group of host countries, both Hungary and Russia seem to have been the focus of a large number of studies. It should also be pointed out that from this list of host countries a strong correlation exists between the relative amount of FDI in a specific host country and the actual amount of literature focused at that same country. In the context of the CE group of countries, while FDI in Hungary has been covered before in previous studies the other four CE host countries have only had limited research directed at them with the lack of research being most acute in regards to both Romania and Slovakia. Accordingly, this shortage of research was another contributing factor in the selection of the CE group of countries as the research site.

3.5 The Population Sampled

3.5.1 The Process of Identifying the Population

On the basis of the three stated research parameters and their respective subordinate provisions the researcher was able to determine the population stratum, henceforth simply referred to as the population. This population comprised approximately 1,400 local firms with foreign participation that had been established via the act of FDI within the CE environment between 1989 and the end of the first quarter of 1996. Out of this overall population of 1,400 the researcher was able to screen and properly identify 1,222 population elements for use in the study. In the context of this statement the term *properly identified* was used in reference to firms with foreign participation located within one of the CE group of countries whose contact details were located and verified using available resources. The actual process of properly identifying each of the 1,222 population elements in the sample proved to be one of the most arduous and laborious tasks in the entire study and necessitated the use of every possible resource and investigatory means available to the researcher. Therefore, some details on how this process was undertaken are appropriate.

Yet, before proceeding further it should be clearly noted that in the clear majority of cases information required to identify population elements and their respective details is not readily accessible via on-line services such as computerized databases. In fact, while this situation is slowly improving, in general there is a serious lack of such business information in a computerized format on firms doing business in the CEC and/or the FSU. Also, what little data does exist in this format is often very limited in its scope as well as very expensive to obtain.

From the Western side of the equation, this situation was supported via the researcher's numerous contacts with both leading private suppliers of business information, including the likes of *Dun & Bradstreet, Reed Information Services, Information Access Services, Kompass,* and the *Economist Intelligence Unit (EIU),* as well as more public sources such as the *United Nations, Economic Commission for Europe (UN/ECE),* and the *United Nations Conference on Trade and Development (UNCTAD)*[25]. While most of these organizations offered the researcher access to their respective databases without charge they also specified the limited nature of their resources in this area. On the Eastern side of the equation, the researcher was able to identify numerous sources of company information, which included both the respective *Central Statistical Offices (CSOs)* and *Foreign Investment Agencies* in each of the host countries of CE. The former possessed much of the needed information but this was not available to the public due to legal requirements in the host countries on data protection. The latter group of agencies proved most useful in supplying printed data drawn from their own databases, especially in the cases of Poland and Romania. Still, even this information was not always complete and suffered from a number of inaccuracies.

Overall, given these circumstances the researcher had to rely heavily on various sources of printed data on FDI in CE. Moreover, in seeking to rectify somewhat the shortage of computerized data and facilitate the management of this study all of the data collected by the researcher was input into a specially designed and constructed database.

The process of identifying the population elements involved two distinct phases. This division of activities was necessitated by the nature of the data and the format in which it was available. In the first phase of the identification process the researcher sought to locate and collect specific details on the population elements within each of the five host countries. These details included the name of the investor and its country of origin, the name of an intermediary firm if utilized and its home country, the name of the local partner/target firm, the name of the local firm with foreign capital participation, types of investment utilized (acquisition or greenfield), both initial and total amounts of FDI in the local firm, relative shareholding positions in the local firm, the local firm's field of economic activity (by *Standard Industrial Classification [SIC] codes*), and the date of the local firm's establishment via FDI. The sources of the data were also listed.

Most of these details on the population elements were collected through various publications and other sources of data. In doing so, the researcher employed what could be termed as a *focused approach* where by every potential source of required data was located, carefully examined, and information transcribed into the database. The process of locating the data proceeded on two levels. First, the researcher utilized various internal sources of data collected

[25]Formerly the *United Nations Transnational Corporations and Management Division (UNTCMD).*

through the research process. The primary internal sources of information included: *East-West Investment News (formerly East-West Investment and Joint Ventures News)(UN/ECE), Central European* magazine, *World Investment Directory 1992: Central and Eastern Europe, Volume II (UNTCMD/DESD/ECE), Business Eastern Europe (BEE),* and the *Budapest-, Prague-,* and *Warsaw Business Journals*. Secondly, various external sources of data were identified, appropriate contacts made, and information obtained. The main sources of external sources of data included: *CzechInvest: The Czech Agency for Foreign Investment/Agentura pro zahranicní investíce, The Hungarian Investment and Trade Development Agency/Magyar Befektetési és Kereskedelmfejlesztési Részvénytársaság (ITD Hungary)*[26], the *Polish Agency for Foreign Investment/Panstwowa Agencja Inwestycji Zagranicznych (PAIZ),* the *Slovak National Agency for Foreign Investment and Development (SNAFID)/Slovenská národná agentúra pre zahranicné investície a rozvoj (SNAZIR),* the *Romanian Development Agency (RDA)/Agentia Romana De Dezvoltare (ARD),* the *Economist Intelligence Unit (EIU), Top Gewinn: Der Osteuropa Almanach, Resources,* and the *Joint Venture Association (Hungarian Chamber of Commerce).* Other external sources of company information were also contacted but the information supplied often only proved to be of limited value.

In the second phase of the process of identifying the population elements, information critical to the research was vigorously located, collected, and input into the appropriate files in the database. This vital information included the respective name of the senior executive of the local firm and their appropriate title, the local firms complete address including telephone and fax numbers, and any other important additional pertinent information on the local firm discovered via the investigation process. Furthermore, during this phase data collected in the first phase of the process was verified wherever possible, especially with regards to the population elements fulfillment of the set parameters for inclusion in the sample.

This process of data retrieval involved what could be described as a *shotgun approach*, where every potential source of information was contacted via a written request for assistance in the research. In all, well over a hundred sources were found and contacted, such as foreign embassies of respective investors in each of the five host countries, various host country government agencies, foreign investor organizations, etc.. Furthermore, wherever possible population elements had their details, especially contact details, either verified or input utilizing company information sources, like *Hoppenstedt Bonnier, Kompass, Resources,* and the *Budapest-, Prague-,* and *Warsaw Business Journals.*

Finally, all the population elements were screened against the defined parameters of the study to verify their eligibility in the population to be sampled. As a result of this lengthy investigatory process the researcher was able to properly identify the details of 1,222 local

[26]*ITD Hungary* was formerly known as *InvestCenter - TradeInform.*

firms with foreign capital participation. It should also be noted that in retrospect of this exercise it is the researcher's opinion that some of the general shortcomings of previous studies associated with the issue of sampling can be attributed to the serious problem of data availability. However, while this is a noted problem in some other studies the due diligence exercised by the researcher in this study greatly alleviated this situation.

3.5.2 Characteristics of the Population

Overall, the population had several distinguishing characteristics that should be pointed out. By host country location, out of this total number of 1,222 local firms (100%) operating in the CE group of countries, 253 firms (21%) were based in the Czech Republic, 322 firms (26%) in Hungary, 360 firms (29%) in Poland, 193 firms (16%) in Romania, and 94 firms (8%) in Slovakia. As a single group these 1,222 population elements represented the vast majority of FDI in each of the countries of CE, accounting for as much as 70-80% of total cumulative FDI in these host countries between the 1989 to 1995 period. Therefore, this group as a whole is extremely significant in terms of FDI inflows into the CE group of countries since the time of transition in 1989. Given the obvious importance and balance of this population the researcher elected to use all of the 1,222 population elements as the basis for this first stage of the research study.

However, it should be pointed out that when the research plan was originally conceived the researcher had only intended to take a sample from such a population of around 300-400 population elements. At the time of this decision the sample size was felt to be both fairly representative of the overall population and within the constraints of the researcher's own available resources. However, as time progressed this situation was carefully re-evaluated it was duly decided that it would be prudent to significantly expand upon the size of the sample so as to get the most representational group possible. This decision to increase the sample size was primarily based upon the serious shortcomings of some other research studies in this area, as was noted previously with regards to very low response rates, the problem of limited and restricted sample sizes, and the inadequate coverage of FDI within individual host countries. On the basis of these deficiencies, the determination was made to try and gather as many population elements as possible that fulfilled the requirements set out in the stated research parameters. In essence, rather than relying on the element of chance to obtain a representative sample of the population the researcher sought to *census*[27] it so as to maximize both the response rate and the range of respondents. The underlying logic of this decision was to avoid potential bias in the selection of the sample while achieving the maximum precision given available

[27]A *census* is defined by Judd, Smith, and Kidder as *"...a count of all the elements in a population and/or a determination of the distributions of their characteristics, based on information obtained for each of the elements."* See Judd, Smith, and Kidder, *op. cit.*, pp. 131.

resources.[28] Still, the key to making this survey a success laid in the choice of research methods that were to be utilized, or more precisely the choice of instruments that were used to elicit responses from the population sampled.

3.6 The Research Methods

The *research methods*[29] that were utilized in this study were based on both quantitative and qualitative means of investigation. It was felt that by combining these two different approaches the study would be able to provide a more accurate and well rounded analysis of the population stratum under investigation. Hence, the research methods that were selected for this first stage of the research study utilized a multi-layered approach that encompassed an amalgamation of desk research, postal research questionnaires, and descriptive case studies. An outline of each of these selected research instruments follows.

3.6.1 Desk Research

The desk research element played an essential role in the research project, as it more than likely is the case in most other studies. In brief, the desk research efforts primarily concentrated on providing both in-depth and breadth coverage of the subject matter so as to give the researcher a strong grasp of the situation. Subsequently, most of the desk research activities focused on analyzing the existing literature resources available on the subject of FDI in the environment of the CEC and the FSU before and after the events of 1989. However, the desk research activities were not confined solely to academic related materials. Other literature materials that were covered by these efforts included various print media resources, like newspapers and magazines, as well as conference and seminar notes.

The desk research also featured prominently in the choice of the research instruments. In this regard, desk research methods were utilized in both the creation of the research questionnaire as well as collecting data to be used in the case studies. In the case of the former, desk research served two important functions. Firstly, desk research methods were used extensively in the questionnaire design phase through the development of a strong understanding of the methodological issues involved in this process. Furthermore, desk research was also used to collect and analyze actual questionnaires that were used by other researchers in similar previous studies. The logic behind this was to minimize potential problems and errors in the design of the questionnaire while at the same time seeking to maximize the validity of the questions.

[28]Moser and Kalton state that the two major principles that underlie sample design are bias in the sample selection procedure and seeking to maximize precision of the sample for a given outlay of resources. See Moser, C. A. and Kalton, G. (1992), *Survey Methods in Social Investigation*, pp. 79-80.

[29]*Research methods* are defined by Judd, Smith, and Kidder as "*...the form of the measurement - paper-and-pencil questionnaires, face-to-face interviews, unobstrusive observations, census records, and so on.*" See Judd, Smith, and Kidder, *op. cit.*, pp. 58-59.

Secondly, desk research was employed extensively in the collection and verification of data on the population to be sampled. In this regard, the researcher depended on desk research almost exclusively for identifying individual population elements within the stated parameters and for gathering specific information on these same firms details.

As for the latter element, the case study instrument made extensive use of desk research for the collection of all the necessary background materials on both the specific firm that was the subject of the case study as well as information on that same firm's respective industry as well as the host country environment it was operating within. This information was an essential ingredient in making the selected case studies both interesting and informative reading as well as factually accurate.

3.6.2 Research Questionnaires

The research questionnaire was selected as the primary instrument used to pose the research propositions to the population under investigation. In doing so, the questionnaire was targeted at local firms with foreign participation located within the CE group of countries that had been established via FDI between 1989 and the end of the first quarter of 1996. These local firms formed the basic unit of analysis in the research. The questionnaire was addressed to the respective top executive in charge of the local firm with foreign participation, be it the general manager, president, chief executive officer, the chairman of the board of directors, etc.. It was strongly felt that given the nature of the research propositions this individual would be the best source to complete the questionnaire and provide the necessary data given his/her intimate knowledge of their respective firm and its operation within the CE environment.

Overall, the design and implementation of the research questionnaire for use in the study followed a step-by-step process in which numerous decisions and issues were considered and addressed.[30] Given the nature of this process and the importance of the questionnaire as the primary vehicle for data collection each step is discussed in the order in which they were taken.

Step One: In choosing the type of data collection instrument, the researcher had three different options: the written questionnaire, the personal interview, and the telephone interview. After carefully weighing the pros and cons of each of method it was decided that the mailed written questionnaire would be used as the vehicle for obtaining the data from the target population. The primary motives of the researcher in selecting this particular method over the other two means of data collection included the actual size of the sample (1,222 firms), the nature of both the sample and the CE environment, the general shortcomings related to the other two methods,

[30]In their book, Judd, Smith, and Kidder recommend the use of a multiple step approach for questionnaire based research. A modified version of this outline was adopted and used by this researcher for this particular study. See Judd, Smith, and Kidder, *op. cit.*, pp. 224-226.

and the limited resources available to the researcher, especially financial resources.

Step Two: In the next step the researcher identified the specific content areas to be covered in the survey instrument. This activity was based upon a variety of factors including the creation of questions that were in accordance with both the general theme of the research propositions and the general aims of the study; on the basis of questions that had been used by other researchers in previous studies which were considered to be relevant to the research propositions and the aims of this study; and in response to feedback and suggestions made by both academics and practitioners during the pre-test stage of the questionnaire design process.

Overall, the bulk of the questions included in the questionnaire were either created or adapted by the researcher using the research propositions as a basis. Hence, key sections within the questionnaire included questions on the motivation of the foreign parent/partner organization to invest within a specific CE host country, a profile of the company's history and its present status, the use of the joint venture and joint venture acquisition modes of market entry, and company performance and strategy. In designing this questionnaire the researcher employed questions in each of these sections which sought to establish what had been the situation in the past (original) as well as what was the current (present) situation. This technique allowed the researcher to be able to trace the evolution of certain factors over time, such as changes in ownership status, levels of investment, performance, etc..

All of the questions in the research questionnaire were formulated with consideration to the general principles of questionnaire design, which included question content, wording, type (both open- and close-ended question types), order, and overall questionnaire layout and format. The most important of these factors was the use of both open- and close-ended questions types in the questionnaire. The use of open- and closed-ended questions facilitated limited responses to specific categories (close-ended questions) while at the same time allowing for flexibility (open-ended questions) within the areas covered. Moreover, the use of both question types enabled the study to possess a qualitative aspect which was invaluable in verifying the quantitative responses.

Step Three: The next step in the design of the research questionnaire involved both the process of actually writing the questions as well as the preparation of a complete draft copy of the actual questionnaire. However, an important precursor to this step was the researcher's choice of language type to be used in the questionnaire. Originally it was conceived that the questionnaire would be written solely in the English language given its use as a universal language of commerce and the fact that it is the researchers native tongue. The decision at hand was whether or not the questionnaire should be translated from English into the respective language of each of the host countries (Czech, Hungarian, Polish, Romanian, and Slovak) forming the study and/or into secondary languages other than English which would be common to respondents (like German and French). At the heart of this matter was the desire of the researcher to maximize the response rate and quality of data while at the same time seeking to minimize any respondent error and/or bias caused by language problems. After careful consideration of the issues it was determined that English would be the standard language of the questionnaire given its prominence as a key language of commerce. This decision was made on the basis of several factors including the use of expert opinion (drawn from the pre-testing of the questionnaire), an extensive review of related past studies in the field that had utilized other languages in collecting data, and the limited financial resources of the researcher. Still, given these language concerns every effort was made to make the question wording as simple and user friendly as possible, especially with regards to respondents whose primary language was not English.

On another related issue, it should also be noted that a total of five different versions of the questionnaire were prepared with a specific version created for each host country involved in the study. While the content of the questionnaires remained constant in all five versions subtle changes were made in each one in reference to the host country that was being addressed. For example, the Hungarian version of the questionnaire made specific reference to Hungary when asking why major Western firms had selected that particular host country as the location of their FDI.

Step Four: The fourth step in the design and implementation process involved a *pre-test*[31] of the research questionnaire with selected groups of experts and practitioners. As it has been aptly stated by Hoinville, Jowell, and Associates (1989) in reference to questionnaire design and construction, *"It is fortunate, perhaps, that the creation of good questionnaires does not have to rely solely on perceptive researchers. At some stage in the design process the questionnaire should be subjected to a field test. Such pilot work is extremely useful in refining the wording, ordering, layout, filtering, and so on, and in helping to prune the questionnaire to a manageable length."*[32] Given that previous research in this field and others have shown positive benefits in using such techniques, pre-testing was considered to be an integral part of the questionnaire design process in this particular study. Based upon the comments, feedback, and suggestions from interviews with these experts and practitioners the questionnaire was revised accordingly.[33] The point of this exercise was to eliminate, or at least minimize, any errors or faults within the questions, clarify any misunderstandings, and add any relevant or pertinent questions that the researcher did not previously envision. The end result of this activity was the creation of a more focused and

[31]The purpose of a *pre-test* is to both clarify and rectify potential problems in the questionnaire design process before commencing with the actual main survey. See Moser and Kalton, *op. cit.*, pp. 47-51.

[32]Hoinville, G., Jowell, R., and Associates (1978), *Survey Research Practice*, pp. 51.

[33]Judd, Smith, and Kidder suggest that, *"As much as possible, the experts should represent different theoretical approaches or social orientations to maximize the chance of identifying biases and blind spots due to the researcher's personal values as well as simple technical defects."* See Judd, Smith, and Kidder, *op. cit.*, pp. 225.

cohesive final version of the questionnaire.

Given this mandate a first draft version of the questionnaire was prepared for circulation to various individuals in the pre-test stage of the questionnaire design process. For this study the pre-testing process was covered by three separate stages. Firstly, the draft questionnaire was tested with two distinct groups of individuals, one a small group of respected and knowledgeable members of staff at the researcher's own institution and the other with a group of individuals (fellow research students and friends) whose native language was not English. The former pre-test group was tapped to address areas of concern specific to the content of the questionnaire as well as its design. The latter group was used solely to clarify language, vocabulary, and contextual issues related to the wording and sequencing of the questions. The feedback from participants in both of these pre-test groups was collected via personal interviews. The comments and suggestions received were carefully scrutinized culminating in the creation of a second draft version of the questionnaire.

The second part of the pre-testing involved circulating the second draft to a group of experts specifically selected by the researcher. The individuals forming this second pre-test group were selected on the basis of their knowledge and expertise in the field of study under investigation as well as their expressed interest and desire to assist the researcher with this endeavor. This group of experts included both some leading academics whose work within this field of study had been notable as well as practitioners representing firms, international institutions, government ministries, and other organizations active in the CE environment. All of the individuals within this group were sent various materials, including a cover letter explaining the aims of the research and requesting their assistance in the pre-test stage, letters of introduction (that would also be included in the actual mailed survey), a copy of the second draft version of the questionnaire for their review and feedback, and a copy of the research propositions. A total of 32 experts and practitioners were contacted and requested to participate in this pre-test stage, of which 24 responded positively (See **Table 3.1**).

Once again, the interactive interview method was chosen by the researcher as the means of eliciting the pre-test group's responses to the questionnaire's design, content, sequencing, wording, etc.. However, given the vast geographical dispersion of this second pre-test group it was not feasible to conduct all of the interviews on a face-to-face basis. Hence, where circumstances and proximity permitted personal interviews were conducted with group members but the vast majority of interactive interviews were conducted via lengthy telephone interviews.

The interviews with this group of experts and practitioners were conducted according to a set of pre-designed questions that were themselves developed by the researcher based on a variety

Table 3.1, Research Questionnaire Pre-Test Group of Experts and Practitioners

Name of Participant	Position of Participant	Organization of Participant	Location
Dr. K. Alec Chrystal	Professor of Monetary Economics	City University Business School (CUBS), City University (CU)	London, UK
Dr. Paul Marer	Professor of International Business	Indiana University	Bloomington, Indiana, USA
Dr. Wladyslaw Jermakowicz	Professor of Business	University of Southern Indiana (USI)	Evansville, Indiana, USA
Dr. Matija Rojec	Senior Research Fellow	Centre for International Cooperation & Development (CICD)	Ljubljana, Slovenia
Dr. Miklos Szanyi	Senior Research Fellow	Institute for World Economics of the Hungarian Academy of Sciences	Budapest, Hungary
Dr. Carol Holmes	Research Fellow & Consultant	Templeton College & XATROS Ltd.	St. Charles, Illinois, USA
Dr. Susan Collins	Senior Fellow, Economic Studies Program	The Brookings Institution	Washington, D.C., USA
Dr. Carol Cosgrove-Sachs	Director, Trade Division	United Nations, Economic Commission for Europe (UN/ECE)	Geneva, Switzerland
Mr. Claudio Viezzoli	Associate Banker, Banking Department	European Bank for Reconstruction and Development (EBRD)	London, UK
Dr. Hans Peter Lankes	Economist, Chief Economist Office	European Bank for Reconstruction and Development (EBRD)	London, UK
Dr. Dale Weigel	Director	Foreign Investment Advisory Service (FIAS), The World Bank	Washington, D.C., USA
Dr. Joel Bergsman	Manager	Foreign Investment Advisory Service (FIAS), The World Bank	Washington, D.C., USA
Dr. Elliot Kushell	Professor of Management	California State University, Fullerton (CSUF)	Fullerton, California, USA
Mr. William Filbert	President (& Part-Time Lecturer at CSUF)	International Diversified Technologies, Inc.	Anaheim, California, USA
Dr. Ayo Salami	Teaching Fellow	City University Business School (CUBS), City University (CU)	London, UK
Dr. Richard Wiggins	Director	Social Research Methods and Statistics (SSRU), The City University (TCU)	London, UK
Ms Lenka Betincova	Marketing Associate	CzechInvest: Czech Agency for Foreign Investment	Prague, Czech Republic
Mr. Tomas Mifek	Marketing Executive	CzechInvest: Czech Agency for Foreign Investment	Prague, Czech Republic
Ms. Monika Varga	Adviser	The Hungarian Investment & Trade Development Agency (ITD)	Budapest, Hungary
Ms. Anna Mazowiecka	Information Assistant	Polish Agency for Foreign Investment (PAIZ)	Warsaw, Poland
Ms. Ruxandra Rusescu	Researcher, Strategy Department	Romanian Development Agency (RDA)	Bucharest, Romania
Ms. Adina Filip	Researcher, Strategy Department	Romanian Development Agency (RDA)	Bucharest, Romania
Mr. Michael Price	Advisor	Slovak National Agency for Foreign Investment and Development (SNAFID)	Bratislava, Slovakia
Mr. Luc Jacobs	Counsellor, Commercial Section	Embassy of the Kingdom of Belgium	Prague, Czech Republic
Ms. Sabina A. H. van der Laan	Commercial Attaché, Commercial Section	Embassy of the Kingdom of the Netherlands	Bucharest, Romania
Mr. Ivan Toldy-Osz	Executive President	Joint Venture Association (JVA) of Hungary	Budapest, Hungary

of issues under consideration. These considerations included the questionnaire's content, its length and time required for completion, the wording of questions, the clarity of instructions, the language used, areas of difficulty, sequencing of questions and sections, etc.. Still, despite the structured nature of the interviews the members of this second pre-test group were given full latitude in their responses so as to facilitate discussion and discovery. Overall, the feedback and responses received via these interviews proved to be invaluable in the further revision of the questionnaire. On the basis of this feedback the research questionnaire was edited and revised accordingly leading to the creation of a third version.

The third and final phase in the pre-test involved the re-submission of the newly revised questionnaire to a much smaller and select group of experts and practitioners that were also involved in the previous second pre-test group. This third pre-test group was also asked to review the materials that would accompany the actual questionnaire in the mailer. This complete package included an individualized cover letter that would be used to request the population element's assistance in completing the questionnaire, letters of introduction supporting the researcher and his research, a self-addressed envelope for returning the completed questionnaire, and the envelope that would enclose all of the survey materials. The motivation of the researcher in pre-testing this new version of questionnaire was to avoid any potential problems resulting from changes with wording or respondent comprehension of the questions.[34] Hence, once again questionnaires were distributed and interviews conducted. The end result of all three of these pre-test steps was the creation of a final version of the research questionnaire which was more focused, compact, cohesive, and user friendly.

Step Five: Ordinarily, the next step in the procedure would be to conduct a *pilot study*[35] using a final draft version of the questionnaire with a selection of population elements drawn from the actual population. However, this step was deemed to be inappropriate and unnecessary due to several mitigating factors. These factors included the nature of the sample, the previously mentioned low response rates found in similar studies, and the enormous amount of time and resources that had been dedicated to properly identifying individual population elements. Yet, the decision to forgo the pilot study step was based primarily on two main circumstances, the cost of the pilot study in terms of lost population elements and the overall success of the previous pre-test steps in refining the research questionnaire. In regards to the former, it was anticipated that if the research questionnaire was to be properly piloted then it would require the expenditure of at least half of the identified population in order to receive a viable response

[34]Judd, Smith, and Kidder make the point that if alterations are made in the structure and/or design of a questionnaire then it is essential that further pre-testing be conducted as a low-cost insurance against potential problems that might have been created as a result of the revisions. See Judd, Smith, and Kidder, *op. cit.*, pp. 225-226.

[35]Moser and Kalton characterize the *pilot study* as a *"....small-scale replica of the main study. The pilot study is the dress rehersal and, like a theatrical dress rehersal, it will have been preceeded by a series of preliminary tests and trials."* The two authors go on to state that, *"The pilot study will certainly help to clarify many of the problems left unsolved by previous tests, but it will not necessarily throw up all the troubles of the main survey; the much bigger scale of this is almost a guarantee of snags and headaches of which the pilot study gave no warning."* See Moser and Kalton, *op. cit.*, pp. 48 and pp. 51 respectively.

rate.[36] Given the potential loss of several hundred population elements this was not deemed to be a viable alternative.[37] In terms of the latter, the positive benefits associated with the three aforementioned pre-test steps in the design of the questionnaire were such that it negated the need to conduct a costly and time consuming pilot study that was not assured of success. Finally, it should be noted that the decision to bypass the pilot study phase was not made lightly. In fact, only after the researcher had carefully weigh the pros and cons of implementing the pilot study was the judgment made to omit this stage in the questionnaire design process and rely solely on the feedback received from the previous pre-testing steps.

Step Six: Armed with the final version of the questionnaire the actual administration of the study was begun. The process of administering the survey was basically done in two separate phases, each one based on the host country location of the population element. The decision to implement the survey into two phases was made due to the sheer size of the sample, the amount of effort required to properly implement the study, and the limited resources available to the researcher. The first phase of the study's administration involved contacting all of the population elements located within the Czech Republic, Hungary, and Slovakia (the survey was mailed between the 26-29 February, 1996). In the second phase of the implementation process all of the population elements in Poland and Romania were contacted (the survey was mailed between 20-25 April, 1996).

While the administration of the survey was done in two individual phases, each of the phases involved roughly the same procedures. To begin with, each of firms in the sample was sent an envelope containing a personally addressed and signed cover letter on University stationary requesting their assistance in completing the questionnaire, three letters of introduction, a numbered copy of the research questionnaire, and a self-addressed envelope to aid in the firm in responding. A first reminder letter was sent out to each and everyone of the firms in the sample ten days after the original packet was mailed to them. It is important to note that in this first reminder letter firms were asked to fax and/or telephone the researcher directly if they had still not yet received the original package containing the questionnaire and supporting materials. An unexpectedly high percentage of firms in the sample replied in this manner stating that they had not yet received the original packet and therefore requested a replacement set.[38] Subsequently, each of these firms was sent via fax a new personalized cover letter, the three

[36]In their book Hoinville, Jowell, and Associates state that, *"For most purposes a pilot study of between thirty and a hundred interviews* (completed questionnaires) *is adequate."* In the discussions with the second group in the pre-testing stage it was suggested that the researcher should only expect a 10-20% response rate given the nature of the both the questionnaire and the population to be sampled. Based upon a 20% response rate and the need for a minimum of 30 completed questionnaires from each country the researcher would have to use up approximately half of the population. See Hoinville, Jowell, and Associates, *op. cit.*, pp. 51-53.

[37]The decision to omit the pilot study step in certain situations has been justified by several authors of research methodology. For example, according to Oppenheim, *"...in the rare instances in which our total population is very small and highly specific so that we cannot afford to 'use up' any part of it for pilot samples, we must seek alternative samples that should be comparable in their knowledge and ways of thinking."* See Oppenheim, A. N. (1992), *Questionnaire Design, Interviewing and Attitude Measurement*, pp. 62.

[38]The difficulties involved in using mailed surveys in the CEC and the FSU has been eluded to by numerous researchers working in the field. For example, Mueller and Mueller state that, *"East European mail is notoriously slow and, in some case, very ineffectual."* See Mueller R. D. and Mueller J. D. (1995), *Methodological Issues in Central and East European Research*, pp. 40.

letters of introduction, and a research questionnaire. Approximately forty days after the date of mailing the original package a second and final reminder package was sent out to those firms that had still not responded to the previous requests. This package contained a cover letter making a final impassioned plea for the firms participation in the study, another copy of the research questionnaire, and a new self-addressed envelope. This final plea for assistance seems to have been very successful in achieving a positive response from firms that otherwise would have been added to the non-response category.

Step Seven: In brief and general terms, the last step in this process involved taking the data received from the research questionnaires, coding the responses, and inputting them into the computer for analysis. The computer program used for data input and analysis was the Statistical Package for Social Sciences (SPSS for Windows). Given that the study proceeded smoothly as planned, conclusions were drawn about the issues related to both the research propositions and the general aims of the study. In doing so, all of the preceding steps are thus justified by their respective contribution to the validity of these conclusions. This concluded the questionnaire based stage of the research study.

However, it should be pointed out that the researcher does not consider the process of data analysis to be the last step in a series of steps. Rather, data analysis should be considered as a means of generating new ideas and identifying areas that need further research. In this manner, the whole process should be considered as circular in nature. The outcome of the data analysis simply leading to future research.

3.6.3 Case Studies

The case study instrument was utilized as a secondary means of investigation. In brief, the case study medium was chosen to illustrate the actions and activities of a small select group of firms within the CE environment tracing their evolution from the time of their establishment to the present. In doing so, the researcher elected to use the *descriptive single-case study* format written in a *linear-analytic structure* to cover each one of the firms chosen for this part of the study. The individual case studies were based on various sources of data including the firm's completed research questionnaire, documentation (letters, memos, announcements, internal company reports, newspaper articles, etc.), archival records (company annual reports, company histories, etc.), and focused open-ended style interviews with key local executives of each respective firm (in most cases with the same respondent that had completed the research questionnaire). Wherever possible, data was verified using multiple sources of evidence. Furthermore, data for each case study was collated using a specially created database system incorporating case study notes, documents, and tabular materials. In an effort to increase the reliability of the information in each of the case studies, as well as its readability, the researcher made every effort to maintain an element of cohesion throughout the case study, thus establishing a chain of evidence.[39]

In selecting individual firms to participate in the case study phase of the research several key factors were considered, such as the size of the foreign parent/partner organization; the actual amount of FDI; the home country of the investor, mode of market entry utilized; the size of local firm; its field of economic activity; etc.. All in all, the selection of suitable candidates for the case study phase required careful assessment as the researcher sought to select a well balanced group of firms. Yet, the key determining factors in the selection process was the willingness of the firm to participate actively in the creation of the case study (via personal interviews), the availability and quality of information on the local firm and its foreign parent(s) (information provided by both the firm and through desk research activities), and the perceived interest level of telling the firm's story via the medium of a case study.

In total, over 132 local firms with foreign capital participation indicated through the questionnaire that they would be willing to assist in the creation of a case study detailing their experiences in the environment of CE. These 132 local firms comprised 96 different foreign parent/partner organizations as a result of both multiple investments within CE as well as some local firms possessing multiple foreign partners. Given the nature of the study the foreign parent/partner organization formed the basis of the case study selection process.

Based upon the aforementioned selection criteria each of the potential case study participants was carefully screened, thus reducing the number under consideration to a smaller group of 23 foreign parent/partner organizations. These 23 candidates were subjected to a second screening process that was more meticulous then the first one, thus resulting in the removal of a total of 13 firms from the list of suitable case study candidates. Each of the remaining 10 candidates for the case study had their respective senior executive(s) contacted requesting their active participation in the case study phase of the research. Based upon the responses a further three firms were removed from the group, one due to confidentiality on the part of the parent organization, a second because of its impending sale to another foreign firm, and the last as a result of the senior manager's lack of available time. The necessary background information was collected on each of the remaining seven case study nominees. A lack of available information for one firm resulted in its omission from the selection process.

In the end, given the constraints faced by the researcher in terms of limited financial resources and available time it was elected to actually conduct just four case studies, each utilizing on-site personal interviews with respective executives in their host country of operation. Furthermore, it was decided that of these four cases only two were to be fully completed and

[39]The case study methodology was primarily based on the writings of Yin. See Yin, *op. cit.*.

presented in the thesis. The four firms selected for the case study stage of the research included ***ABB Asea Brown Boveri***, the Swiss/Swedish engineering firm with its multiple investments operating throughout CE; the ***Generali Group***, the Italian based insurance and financial services organization via its two operations in Hungary, namely ***Generali Budapest Biztosító*** and ***Providencia Osztrák-Magyar Biztosító***; the American automobile producer, ***General Motors (GM)***, through its European subsidiary ***OPEL***, and its activities in Hungary with their two local operations ***Opel Hungary Automotive Manufacturing (OHM)*** and ***Opel Hungary Distribution***; and the Dutch/Swiss telecommunications consortium ***TelSource***, which is jointly owned by ***PTT Telecoms (Koninklijke PTT Nederland [KPN])*** and ***Swiss Telecoms (PTT Suisses)***, and its involvement in ***SPT Telecom***, the public telephony operator of the Czech Republic. The two case studies that were finalized and reviewed by company executives were based on ***ABB Asea Brown Boveri*** and the ***Generali Group***. These two firms were selected as they were fairly representational of the sample, the former a prime example in the field of manufacturing as well as being a (technical) services provider and the latter a choice selection in the area of financial services.

3.7 Closing Statement

In retrospect, this chapter began by outlining the route that a researcher must take when travelling around *The Island of Research*. The researcher commenced his journey fresh and full of exuberance at the *City of Hope* and headed inland hoping to eventually emerge back near where he started with something of value to add to the *Bay of Literature*. Along the trail numerous obstacles and difficulties had to be traversed that required a great amount of diligence and fortitude. At times the going was good, at others is was not. However, the research strategy provided a guide that allowed the researcher to travel from point to point by the shortest possible means and with the least amount of problems. Overall, the trip around *The Island of Research* took nearly three years to complete and at times represented a true labor of love as well as a test of stamina. However, despite the many hardships that were endured during the excursion the lessons and skills learned by the researcher on this island proved to be invaluable. For the trip was not merely about this particular research project but about learning what it takes to become a good researcher capable of doing quality work based upon sound methodology. So as the researcher now comes to the end of his long trail it becomes evident that the trip to *The Island of Research* is just one in what surely will be many.

Chapter 4

Foreign Direct Investment in Central Europe: Results from a Survey of Major Western Investors

4.1 An Overview

This chapter focuses on presenting a detailed description of the results from a survey of major foreign investors that have engaged in *foreign direct investment (FDI)* within *Central Europe (CE)(the Czech Republic, Hungary, Poland, Romania, and Slovakia)* between the beginning of 1989 and the end of March 1996. In doing so, the results from the survey are presented in a series of stages. First, a brief introduction to the research is provided covering the nature of the population stratum, the research propositions, and the means of data collection. Second, an overview is furnished on how the survey was actually administered as well as statistics on the actual response rate obtained from the defined target population sampled. Thirdly, a detailed presentation of the results from the survey is provided. The presentation of the survey results covers the following areas: the general characteristics of the survey respondents, with regards to both the local firms surveyed and their respective foreign parent/partner organizations; the locational and motivational factors affecting the foreign parent/partner organizations decision to invest within a specific firm and host country within the CE group; the mode, timing, and evolution of the FDI; the motivations of the foreign parent/partner organizations in utilizing the *Joint Venture (JV)* and/or the *Joint Venture Acquisition (JVA)* modes of FDI; performance and strategy issues related to the local firm; and lastly, final points covered in the survey. The chapter concludes by briefly outlining the significance of this study in terms of its contribution to the existing base of knowledge on the activities of foreign firms in the environment of CE.

Finally, prior to proceeding with the actual report, it should be noted that in light of the methodological shortcomings and inadequacies found in some previous studies in this subject area, which have already been aptly illustrated within the literature review chapter, this researcher has done his utmost to present the survey findings in a clear and concise manner. Still, given both the confidential nature of the information provided by individual respondents and the ethical considerations associated with protecting their anonymity the reporting of the survey findings have been based upon aggregated statistics drawn from the database.

4.2 An Introduction to the Study

Since 1989, *foreign direct investment (FDI)*[1] has played an ever increasing role in the transitional economies of the *Central European countries (CEC)*[2] and the *New Independent States (NIS) of the former Soviet Union (FSU)*[3]. At the end of 1990, a full year after the fall of the Berlin Wall, FDI inflows into the countries of the region as a whole amounted to only $597.0 million dollars or a mere 0.3% of the worldwide total for that year. However, by the end of 1995 the region's share of worldwide FDI inflows had grown significantly to 4% of the overall total with $12,767.0 million dollars having been invested during the course of the year. The cumulative total for the period of 1989-1995 amounted to almost $34.4 billion dollars worth of FDI inflows.[4] The primary driving force behind these inflows of FDI has been individual firms, many of which are some of the world's leading and best known *Transnational Corporations (TNCs)*[5].

Subsequently, this dramatic increase in FDI over the last seven years and its growing importance in the transition process of the region's economies has necessitated the need for meaningful research to be conducted into this relatively new area of international business studies. Given the abundance of literature directed at the macroeconomic environment the time has come to concentrate on examining the microeconomic level by providing an analysis of the activities of individual foreign firms that have engaged in FDI within the environment of the CEC and the FSU. More precisely, several basic questions need to be asked and answered. These questions include *Why do firms invest?*; ***How do they invest and how do the chosen modes of investment change over time?***; *What means do these firms employ to evaluate the performance of their investments and subsequently what levels of performance have been achieved by these same firms?*; and *What strategies are used by these firms in their operation?* Yet, despite a few previous quality in-depth research efforts in this area our understanding of the activities of foreign firms operating in the CEC and the FSU via FDI is still very limited. Hence, this research study has sought to fill

[1]*Foreign Direct Investment (FDI)* is defined by Dunning as *"The investment is made outside the home country of the investing company, but inside the investing company. Control over the use of resources transferred remains with the investor. It consists of a 'package' of assets and intermediate products, such as capital, technology, management skills, access to markets and entrepreneurship."* See Dunning, J. H. (1993), *Multinational Enterprises and the Global Economy*, pp. 5.

[2]The term *Central European countries (CEC)* refers to the following countries: Albania, Bulgaria, Czech Republic (formerly part of Czechoslovakia), Hungary, Poland, German Democratic Republic (GDR)(East Germany), Slovakia (formerly part of Czechoslovakia), Romania, and the former Yugoslavia Republic (FYR)(which is comprised of: Bosnia/Herzegovina, Croatia, the Federal Republic of Yugoslavia [a union of the former republics of Serbia and Montenegro], FYROM [the former Yugoslav Republic of Macedonia], and Slovenia).

[3]The *New Independent States (NIS) of the former Soviet Union (FSU)* refers to the following newly created and/or liberated countries that use to comprise the Soviet Union: Russia (including Kaliningrad), Ukraine, Belarus, Republic of Moldova, Latvia, Lithuania, Estonia, Georgia, Armenia, Azerbaijan, Kazakhstan, Turkmenistan, Uzbekistan, Tajikistan, and Kyrgyzstan. For purposes of this research the shorter term of *FSU* is used throughout this thesis to refer to the NIS of the FSU.

[4]These figures are based upon FDI statistics presented in *Table 1.2, FDI Inflows into the CEC and NIS of the FSU, 1989-1995* in *Chapter 1* of this thesis.

[5]A *Transnational Corporation (TNC)* is an enterprise, irrespective of its country of origin and/or its ownership, including private, public, or mixed, comprising entities in two or more countries, regardless of the legal form and fields of activity of these entities, which operates under a system of decision-making, permitting coherent policies and a common strategy through one or more decision-making centers, in which the entities are so linked, by ownership or otherwise, that one or more of them may be able to exercise significant influence over the activities of others and, in particular, to share knowledge, resources and responsibilities with the others. The term TNC is often used interchangeably with *Multinational Enterprise (MNE)* and *Multinational Corporation (MNC)*.

this gap in the base of knowledge by providing answers to the aforementioned questions.

However, given the shortcomings of many previous studies in this subject area and the enormous complexities involved in the actual implementation of such an immense study it was decided to divide the research into a series of stages. In doing so, each stage of the study will concentrate efforts on a specific group of countries which possess a certain number of synergies and which have been defined by a set of pre-defined parameters. On the basis of the proposed methodology it is the opinion of the researcher that the study will be more manageable and more prone to effectively ascertaining its stated objectives.

This decision to implement the study in a series of stages was made primarily as a result of several mitigating factors which included, the vastness of the CEC and the FSU region as a whole, the unique nature of individual countries, and the obvious differences that exists between them; the shortcomings of previous academic and practitioner studies on this subject - many of which attempted to cover the region as a whole while only utilizing a very small and limited sample - to provide an accurate picture of FDI in the CEC and the FSU; the actual level of FDI within a particular host country of the region as well as the quality and availability of data on these investments; and the limitations restricting the researcher in terms of both time and the financial resources that were available.

In this first stage of the investigation a select set of parameters were established and utilized to define a *population stratum*[6] drawn from the main population. This population stratum was defined by three main parameters[7], as follows:

- *The FDI had to come from a major Western firm, which was defined by the following criteria:*

    a. The amount of FDI had to be ≥ $1,000,000.00, although there were some limited exceptions.

    b. The major Western firm had to be based (location of the parent company) in one of the following countries: Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, and the United States of America.

- *The FDI had to occur within either the Czech Republic, Hungary, Poland, Romania, or Slovakia.*

[6]A *population stratum* refers to a subpopulation of the main population. As defined by Judd, Smith, and Kidder, *"A stratum* (referred to as a subpopulation, a population stratum, or simply a stratum) *may be defined by one or more specifications that divide a population into mutually exclusive segments."* See Judd, C. M., Smith, E. R., and Kidder, L. H. (1991), *Research Methods in Social Relations*, pp. 130-131.

[7]In conjunction with these parameters several subordinate provisions were also applied in the process of determining the eligibility of individual population elements for use in the study. Details on these subordinate provisions as well as a thorough explantion of the key parameters are provided by the author in *Chapter 3, Research Methodology: A Travel Guide to "The Island of Research."*

- *The actual date of the FDI had to occur between 1989 and the end of the first quarter of 1996.*

Given these parameters the research propositions were modified slightly so as to allow them to function properly with the population stratum. The propositions were as follows:

- *Why do major Western firms engage in FDI within a specific CE host country (motivational and locational factors of FDI)?*

- *How have major Western firms invested within a specific CE host country (entry modes) and how have these modes evolved over time (evolution of ownership modes)?*

- *What means are utilized by major Western firms to evaluate the performance of their FDIs (performance criteria) and consequently how have these direct investments performed within the chosen CE host country environment over time (relative performance)?*

- *What strategies have been employed by major Western firms in the CE environment (geographical and functional strategies)?*

On the basis of the preceding propositions a questionnaire was designed, tested, and utilized in a survey of a selected sample of firms drawn from the defined population. This population comprised approximately 1,400 local firms with foreign participation that had been established via the act of FDI in one of the countries of CE between 1989 and the end of the first quarter of 1996. From this overall population of around 1,400 population elements, a sample totalling 1,222 individual firms was selected for use in the study.[8] The questionnaire itself was targeted at the respective senior executive of these individual local firms with foreign participation operating within the environment of CE via FDI. The nature and conditions of this survey, its results, and an interpretation of the findings are the subject of the subsequent sections of this chapter.

4.3 The Survey

The survey was conducted between late February and the latter half of August 1996[9], almost seven years after the historic fall of the Berlin Wall and the beginning of the transformation

[8]Given the fact that the sample used in the study represented just over 87% of the total population it should be considered more of a census of the population then an actual sample of it. Hence, many of the problems associated with sampling do not necessarily apply in this situation.

[9]The actual process of implementing the survey was broken into two separate groupings based upon host country due to the sheer size of the sample and the limited resources available to the researcher in terms of manpower and time. The first phase of the study's administration involved contacting all of the population elements located within the Czech Republic, Hungary, and Slovakia (the survey was first mailed between the 26-29 February, 1996). In the second phase all of the population elements in Poland and Romania were contacted (the survey was first mailed between 20-25 April, 1996). The final closing date for all responses was 22 August, 1996.

process in the countries of CE. The questionnaires were sent by mail to a total of 1,222 firms (100%) with foreign participation operating within the CE environment: 253 firms (21%) in the Czech Republic, 322 firms (26%) in Hungary, 360 firms (29%) in Poland, 193 firms (16%) in Romania, and 94 firms (8%) in Slovakia. In almost all cases, the survey packet was personally addressed by name to the attention of the local chief executive of the respective firm.[10] Furthermore, the contact details of each of the firms was verified in the clear majority of cases using all available resources. It should also be noted that every effort was made to increase the actual response rate as well as the completeness of questionnaires. Finally, all participants in the study were given a personal written guarantee of complete confidentiality in their responses. Hence, in keeping with this confidentiality clause the data presented in this chapter is based upon the summary statistics drawn from the database of survey respondents. The researcher's strict adherence to disclosure rules and ethics do not allow for the data to be made public.[11]

4.4 The Sample

From the 1,222 firms originally contacted, a total of 484 firms (40%) responded to the survey, of which 334 firms (27%) returned completed questionnaires and the other 150 firms (12%) replied that they were either unable or unwilling to participate in the study.[12] A further 44 questionnaire packets to firms (4%) were returned unopened. Based upon the total number of responses received and letters returned unopened, 694 firms (57%) out of the total 1,222 firms in the sample failed to respond to the survey in any manner. Thus, the actual survey response rate comprised 334 firms with foreign participation, or 27% of the overall sample. This group was fairly balanced across each of the individual host countries with a high response rate of 34% (85 firms) in the Czech Republic and a low of 23% (44 firms) in Romania. A detailed summary of the survey response rate is presented in **Table 4.1**.

In terms of the reasons given by firms for their non-participation in the study, these covered a variety of factors which were duly divided into eight classifications including: confidentiality issues, company policy, felt the survey was not applicable to their situation, not interested in participating, no time available, the firm had been liquidated, too many other questionnaires already received, or other reasons that could not be explained or classified and were simply referred to as an X-file. Still, it should be noted that the vast majority of firms that stated that

[10]The top executives of a total of 953 firms (78%) in the sample were personally identified by name for this purpose. In terms of individual host countries, company information for firms based in Romania and Slovakia proved to be the most difficult to obtain and confirm. Information on company executives and contact details (addresses) were only available for 32% of the sampled firms based in Romania and 57% of those firms operating in Slovakia. In the case of the former, due to the severe shortage of business information on Romania the researcher had to rely heavily on data (names of local firms, names of the foreign partner/parent organizations, amount of FDI, contact addresses, etc.) which was kindly supplied by the *Romanian Developement Agency (RDA).*

[11]A more thorough and complete explanation of the methodology utilized in this study is provided in *Chapter 3, Research Methodology: A Travel Guide to "The Island of Research."*

[12]Please note that due to rounding the percentages for returned completed questionnaires and respondents unable or unwilling to participate in the study do not equal the percentage associated with total responses received.

Table 4.1, Survey Response Rate

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Category	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Completed Questionnaires Returned	85	34%	93	29%	88	24%	44	23%	24	26%	334	27%
Replied Unable/Unwilling to participate in the study because of:	33	13%	39	12%	47	13%	14	7%	17	18%	150	12%
Confidentiality Issues	16				23		7		7		65	
Company Policy	9		10		9		2		2		32	
Not Applicable	1		2		2		1		3		9	
Not Interested	1		7		2		1		1		12	
No Time Available	1		3		3		0		2		9	
Firm Liquidated	2		2		3		1		2		10	
Too Many Other Questionnaires	1		1		2		0		0		4	
X-File	2		2		3		2		0		9	
Return-to-Sender	4	2%	8	2%	13	4%	16	8%	3	3%	44	4%
Non-Response	131	52%	182	57%	212	59%	119	62%	50	53%	694	57%
Total Number of Questionnaires Mailed	**253**	**100%**	**322**	**100%**	**360**	**100%**	**193**	**100%**	**94**	**100%**	**1,222**	**100%**

they were unable or unwilling to participate in the study did express both their interest in the research and best wishes for its success.

In regards to the 44 questionnaires to firms (4%) returned unopened, given the fact that more than half of these same packets were sent to confirmed contact addresses it can only be assumed that these firms had recently relocated, been liquidated, etc.. It should be stipulated that originally the actual number of packets returned-to-sender was slightly higher with 51 cases. However, all of the packets that were returned unopened had their contact details checked again using available resources and wherever possible another questionnaire packet was sent to the firm via fax and/or mail. The result of this action was that a further five firms responded to the survey.

Overall, some observations encompassing the three main areas of the survey response rate are worth mentioning. These include the actual response rate of firms that actively participated in the survey, the group of firms that were unable or unwilling to participate, and the non-response rate covering those firms that simply failed to reply.

Firstly, in terms of the actual response rate, a total of 334 firms (27%) did complete and return the research questionnaire. In terms of a percentile ranking, the response rate achieved in this survey was very much in line with those found in other similar studies within the same subject area. However, the clear and deciding difference between this study and most previous studies in the same subject area is the fact that this particular one had a much more concise focus and covered a far greater number of the actual population elements. In terms of the former, given the focused nature of this study in concentrating only on active major foreign investors rather than inactive ones, the survey succeeded in addressing the research propositions to the proper audience, namely those firms actively involved in FDI in CE not those passively observing from the sidelines. As for the latter, the use of a targeted population greatly benefited the research as it yielded a fairly representative sample. This last point will become more evident in the following sections of this chapter as the results from the survey are illustrated.

Secondly, it is interesting to examine why 12% (150 firms) of the population sampled replied that they were either unable or unwilling to participate in the study. The issue of *"confidentiality"* was the most cited reason for non-participation, with 65 firms, accounting for nearly half of all known cases. This was typically the posture taken by some firms based in Poland and the Czech Republic. This was despite clear and repeated written guarantees of the researcher to treat all responses with strict confidentiality. The second main reason given by firms for their non-participation, identified with 32 firms, was stated as *"company policy"* of the foreign parent/partner organization and/or the local firm. Yet, it should be pointed out that in the vast majority of cases company policy on restricting information on the respective firm to outsiders often stemmed from the aforementioned issue of confidentiality. Therefore, in grouping together all of the cases in which firms cited confidentiality or company policy issues for their non-participation in the study it becomes clear that together these two factors accounted for 65% of all cases of non-participation.

Another key area of interest with regard to both the response and non-response rates is the issue of overlapping samples. It is plausible to assume that other researchers would have targeted some of the same population elements and that some of these firms might have actively participated in the respective study. Yet despite this, many senior managers of local firms were still willing to volunteer their time to participate in such studies. On the other hand, it should also be pointed out that a few major investors with very well publicized investments located in CE failed to respond to this researcher's request for their assistance in the survey. A couple of these non-responsive local firms included *Skoda Automobilová* of the Czech Republic, part of the *Volkswagen Group (VW)* of Germany, and *Tungsram* of Hungary, which is owned and operated by *General Electric (GE)* of the United States. While it is only conjectural, it may well be the case that these types of firms have simply received far too much scrutiny with regards to their operations in the region as well as too many requests for information and/or assistance.[13] This in turn may have resulted in their non-compliance with such investigations. This was the scenario suggested by several individuals within the pre-test group of experts and practitioners

[13]This point is supported by the fact that several population elements stated that they had already received too many other questionnaires and this was their reason for non-participation in the survey. All four of these elements could be classified as major investors.

involved in refining the survey instrument, many of whom also possessed first hand experience in this subject area via their own activities.

One final observation on the subject of the survey response rate that should be mentioned is the issue of language skills as a mitigating factor on responses. More precisely, it should be assumed that the use of the English language as the sole means of communication in the study may have also affected both the response and non-response rates. While the English language is often claimed as the international language of commerce some of the executives targeted by the study may not have possessed the skills necessary to allow them to understand and/or complete the questionnaire. Therefore, it must be presumed that some degree of bias exists in the study towards executives of local firms with English language skills and possibly even with firms with English language cultures.[14]

Finally, given the study's purpose all of the completed questionnaires were subjected to a careful and thorough screening process that checked responses both for their completeness as well as the respondent firm's fulfillment of the requirements established by the parameters defining the population. Other factors were also taken into consideration in this process, such as the appropriateness of the responding firm to the study. Based upon this screening process a total of ten questionnaires were removed from the survey sample prior to analysis. Thus, for the purposes of analysis the survey sample contained a total of 324 firms (100%) with foreign participation active within the CE environment: 82 firms (25%) in the Czech Republic, 88 firms (27%) in Hungary, 87 firms (27%) in Poland, 44 firms (14%) in Romania, and 23 firms (7%) based in Slovakia.

4.5 Characteristics of the Survey Respondents

As previously stated, in the clear majority of cases the survey packet was personally addressed to a named individual that was usually in the position as the top senior executive of the local firm within the population sampled. Subsequently, the individual respondents participating in the survey on behalf of their respective firms had the title of president, chairman of the board, chief executive officer, managing director, general manager, general director, chief financial officer, etc.. Hence, the respondents represented the top echelon of each local firm's organizational structure. As such they were deemed to be not only an authoritative source of information on the subject matter under investigation but also the most reliable source of such data.

Besides being asked to state both their name and position within the firm, information was also

[14]In several instances firms, especialy TNCs, often use English as a universal means of communication within their own company. For example, *ABB Asea Brown Boveri*, the engineering firm with both Swiss and Swedish origins, utilizes English as its official company language.

Table 4.2, Nationality of the Respondents

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Nationality	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Czech (Czech Republic)	49	58%									49	15%
Hungarian (Hungary)			59	64%					1	4%	60	18%
Polish (Poland)					37	42%					37	11%
Romanian (Romania)							22	49%			22	7%
Slovak (Slovakia)	1	1%							13	57%	14	4%
Austrian (Austria)	7	8%	3	3%							10	3%
Belgian (Belgium)	1	1%	1	1%	3	3%					5	2%
Canadian (Canada)			1	1%	1	1%	1	2%	1	4%	4	1%
Danish (Denmark)	1	1%	2	2%	1	1%					4	1%
Finnish (Finland)											0	0%
French (France)			9	10%	2	2%	3	7%	1	4%	15	5%
German (Germany)	6	7%	4	4%	2	2%			5	22%	17	5%
Greek (Greece)							3	7%			3	1%
Irish (Ireland)			1	1%	1	1%					2	1%
Italian (Italy)	1	1%			1	1%	3	7%	1	4%	6	2%
Luxembourger (Luxembourg)											0	0%
Dutch (The Netherlands)	1	1%	1	1%	3	3%	1	2%			6	2%
Norwegian (Norway)	6	7%			1	1%					7	2%
Portuguese (Portugal)											0	0%
Spanish (Spain)					4	5%	1	2%			5	2%
Swedish (Sweden)	3	4%	2	2%	5	6%			1	4%	11	3%
Swiss (Switzerland)	2	2%	1	1%							3	1%
British (United Kingdom)	2	2%	5	5%	15	17%	7	16%			29	9%
American (United States of America)	3	4%	3	3%	11	13%	3	7%			20	6%
Others Not Listed	1	1%			1	1%	1	2%			3	1%
Total*	**84**	**100%**	**92**	**100%**	**88**	**100%**	**45**	**100%**	**23**	**100%**	**332**	**100%**

Note: *While the total number of members in the sample was '324', there were a total of '332' responses to the question of nationality due to the fact that eight respondents reported having dual nationality/citizenship.

requested on the ***respondents' nationality*** (See **Table 4.2**). From the data available on this question three trends seem to emerge. First, in terms of the CE group as a whole, just over half of the respondents, with 182 mentions (55%), stated that they were host country nationals, i.e. either Czech, Hungarian, Polish, Romanian, or Slovak. This trend was fairly country specific in nature. For example, firms based in Hungary the majority of respondents were Hungarian nationals. Secondly, only eight of the respondents claimed dual nationality which somewhat clarifies the issue of foreign firms employing expatriate executives to run their foreign operations. Yet, not being able to determine whether or not the foreign executive has local roots to a particular host country this situation can not be clarified fully. For instance, an executive of a local firm with a French parent who is an American citizen with Polish heritage and family connections. Still, the evidence does clearly indicate that foreign firms believe in employing host country nationals to run their local operations. Thirdly, the other trend that emerges from the data is that British based firms tend to place British nationals in the top positions of their local firms in CE host countries, with the exception of Slovakia. However, this situation can not be generalized for all local firms with British based foreign participation given the limited number of cases available. Overall, with the exception of the British case cited, there appears to be very little correlation between the nationality of a top executive and the nationality of their respective firm.

4.5.1 A Profile of the Local Firms with Foreign Capital Participation

In terms of the ***legal status of the local firms*** (See **Table 4.3**), the sample is slightly dominated by *Limited Liability Companies* with 174 firms (54%), followed closely by *Companies Limited by Shares* with 144 firms (44%), and with the remaining six firms (2%) claiming the *Other* legal status category. These trends are fairly constant across each of the host countries, except for Poland and Slovakia where *Limited Liability Companies* have a ratio of 2:1 over *Companies Limited by Shares.*

Table 4.3, Legal Status of the Local Firms

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Legal Form*	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
Company Limited by Shares	39	48%	47	53%	30	34%	22	50%	6	26%	144	44%
Limited Liability Company	41	50%	41	47%	56	64%	19	43%	17	74%	174	54%
Other	2	2%	0	0%	1	1%	3	7%	0	0%	6	2%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Note: *The legal forms of a *Company Limited by Shares* and a *Limited Liability Company* for each of the respective host countries are as follows: the Czech Republic and Slovakia (a.s./s.r.o.), Hungary (Rt./Kft.), Poland (S.A./Sp. z o.o.), and Romania (S.A./S.R.L.).

The local firms comprising the sample represent a fairly diverse cross section of ***economic fields of activity***[15] (See **Table 4.4a** & **Figure 4.1a**). Although the group is very much dominated by *Manufacturing* oriented operations (SIC-D) which accounted for 185 firms (57%) from the overall sample, the two other main concentrations of economic activity were in *Wholesale and Retail Trade* (SIC-G) and *Financial Intermediation* (SIC-J) with 40 firms (12%) and 33 firms (10%) respectively.

In examining ***manufacturing operations by their specific type of activity*** (See **Table 4.4b** & **Figure 4.1b**), two categories emerge as the most pronounced within the CE group, namely *Food Products and Beverages* (SIC-D15) with 36 firms (19%) and *Machinery and Equipment Production* (SIC-D29) with a total of 37 operations (20%). Manufacturing of food and beverage products tends to be very high in both Poland (29%) and Romania (45%) while machinery and equipment production runs fairly high throughout each of the host countries (ranging from 10% to 37%).

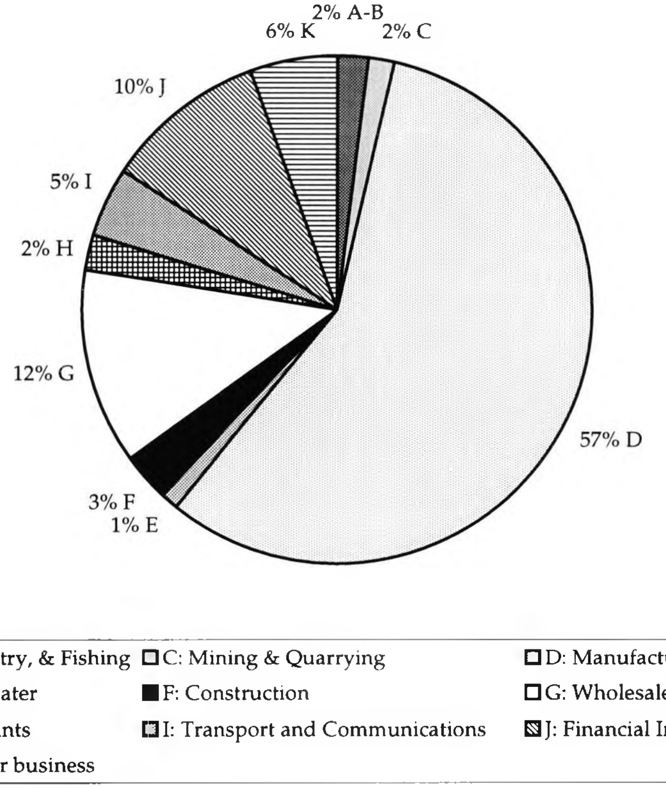
[15]The area of economic activity of each firm was classified using the *Standard Industrial Classification (SIC)* system.

Table 4.4a, Primary Field of Economic Activity of the Local Firms by Standard Industrial Classification (SIC) Code

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
SIC Section Code	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
A-B: Agriculture, Forestry, & Fishing			6	7%							6	2%
C: Mining & Quarrying	1	1%			2	2%	3	7%			6	2%
D: Manufacturing*	49	60%	46	52%	59	68%	20	45%	11	48%	185	57%
E: Electricity, Gas, & Water	1	1%	3	3%							4	1%
F: Construction	3	4%	4	5%	2	2%			1	4%	10	3%
G: Wholesale and Retail Trade	14	17%	4	5%	9	10%	9	20%	4	17%	40	12%
H: Hotels and Restaurants			1	1%	2	2%	4	9%			7	2%
I: Transport and Communications	2	2%	8	9%	2	2%	1	2%	2	9%	15	5%
J: Financial Intermediation	8	10%	9	10%	9	10%	4	9%	3	13%	33	10%
K: Real Estate and other business	4	5%	7	8%	2	2%	3	7%	2	9%	18	6%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Note: *A breakdown of Manufacturing into its respective SIC code subsections is provided in **Table 4.4b**.

Figure 4.1a, Primary Field of Economic Activity of the Local Firms by Standard Industrial Classification (SIC) Code: The CE Group

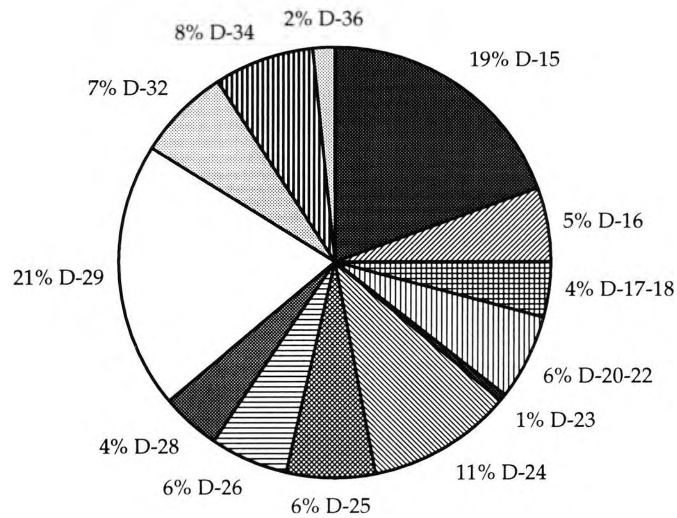


Note: *A breakdown of Manufacturing into its respective SIC code subsections for the CE Group as a whole is provided in **Figure 4.1b**.

Table 4.4b, Manufacturing Activity, SIC Code 'D'

SIC Section Code 'D' Manufacturing, of which	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
15: Food Products & Beverages	4	8%	5	11%	17	29%	9	45%	1	9%	36	19%
16: Tobacco Products	1	2%	3	7%	5	8%	1	5%			10	5%
17-18: Textiles & Wearing Apparel			2	4%	2	3%	3	15%	1	9%	8	4%
20-22: Wood, Paper, Publishing, & Printing	3	6%	6	13%	2	3%			1	9%	12	6%
23: Coke, Refined Petroleum Products, & Nuclear Fuel			1	2%							1	1%
24: Chemicals, Chemical Products, & Man-Made Fibres	3	6%	5	11%	7	12%	1	5%	4	36%	20	11%
25: Rubber & Plastic Products	4	8%	4	9%	3	5%	1	5%			12	6%
26: Non-Metallic Mineral Products	6	12%			5	8%					11	6%
28: Fabricated Metal Products	2	4%	3	7%	2	3%	1	5%			8	4%
29: Machinery & Equipment	18	37%	9	20%	6	10%	2	10%	2	18%	37	20%
32: Radio, TV, & Communication Equipment and Apparatus	2	4%			9	15%	1	5%	1	9%	13	7%
34: Transport Equipment	6	12%	5	11%	1	2%	1	5%	1	9%	14	8%
36: Other Forms of Manufacturing			3	7%							3	2%
Total	**49**	**100%**	**46**	**100%**	**59**	**100%**	**20**	**100%**	**11**	**100%**	**185**	**100%**

Figure 4.1b, Manufacturing Activity, SIC Code 'D': The CE Group



15: Food Products & Beverages
16: Tobacco Products
17-18: Textiles & Wearing Apparel
20-22: Wood, Paper, Publishing, & Printing
23: Coke, Refined Petroleum Products, & Nuclear Fuel
24: Chemicals & Man-Made Fibres
25: Rubber & Plastic Products
26: Non-Metallic Mineral Products
28: Fabricated Metal Products
29: Machinery & Equipment
32: Radio, TV, & Communication Equipment
34: Transport Equipment
36: Other Forms of Manufacturing

It is interesting to note that the sample of firms based in Hungary seems to be somewhat well balanced across the various fields of economic activity. It is a possibility that this may be due to the more mature nature of both the economic environment in that country as well as the associated high level of FDI.

Members of the sample were also asked to provide details on basic financial characteristics of their respective local firms, namely data on ***total annual turnover in 1994, total equity in 1996, total foreign equity invested in 1996,*** and the ***total number of employees in 1996*** (See **Table 4.5**). It should be noted that some executives did not provide information on each of these questions often clearly stating the issues of confidentiality and/or company policy restricting the disclosure of such data to non-company persons.

Table 4.5, Characteristics of the Local Firms*

		Basic Characteristics of the Local Firms				
Host Country of the Local Firms		Annual Turnover, 1994 (in millions US$)	Total Equity, 1996 (in millions US$)	Total Foreign Equity, 1996 (in millions US$)	Foreign Equity Share %	Level of Employment, 1996
Czech Republic	**Sum**	$4,080.0	$4,048.5	$2,265.3	56.0%	79,921
	Mean	$62.8	$75.0	$45.3		999
	Std. Dev.	$127.0	$360.0	$204.0		3,029
	# Firms	65	54	50		80
Hungary	**Sum**	$5,532.2	$1,721.6	$1,395.2	81.0%	41,841
	Mean	$73.8	$24.2	$20.2		504
	Std. Dev.	$137.0	$41.9	$40.2		802
	# Firms	75	71	69		83
Poland	**Sum**	$6,889.8	$3,555.6	$1,978.4	55.6%	82,245
	Mean	$102.8	$51.5	$29.5		1,003
	Std. Dev.	$308.0	$107.0	$60.3		1,988
	# Firms	67	69	67		82
Romania	**Sum**	$643.7	$494.1	$330.3	66.8%	13,672
	Mean	$20.8	$15.0	$8.9		380
	Std. Dev.	$39.7	$35.6	$12.9		596
	# Firms	31	33	37		36
Slovakia	**Sum**	$978.5	$188.0	$106.9	56.8%	8,299
	Mean	$51.5	$11.1	$5.6		361
	Std. Dev.	$94.7	$10.5	$5.4		659
	# Firms	19	17	19		23
Total CE Group	**Sum**	**$18,124.2**	**$10,007.8**	**$6,076.1**	60.7%	**225,978**
	Mean	**$70.5**	**$41.0**	**$25.1**		**743**
	Std. Dev.	**$188.0**	**$181.0**	**$101.0**		**1,942**
	# Firms	**257**	**244**	**242**		**304**

Note: *Almost all of the respondents whom did not complete the questions within this section of the questionnaire did so stating reasons of confidentiality and/or company policy prohibiting the disclosure of such information.

From the available data, the sum of the ***total annual turnover in 1994*** for 257 members of the CE group amounted to $18.1 billion dollars with a mean of $70.5 million. Total annual turnover ranged from a high in Poland with $6,889.8 million and a mean of $102.8 million to a low in Romania with $643.7 million with a mean of $20.8 million. The ***total equity in 1996*** for 244 local firms was $10.0 billion with a mean of $41.0 million. The range of total equity in 1996 covered a high in the Czech Republic with $4,048.5 million and a mean of $75.0 million to a low in Slovakia at $188.0 million with a mean of $11.1 million. ***Total foreign equity in 1996*** for 242 local firms was nearly $6.1 billion and had a mean of $25.1 million. This represented an average of nearly 61% of the sum of total equity within the local firms. The range of foreign equity showed a high in the Czech Republic at $2,265.3 million, or 56% of the total equity in the local firm, with a mean of $45.3 million and a low in Slovakia with $106.9 million, or 56.8% of total equity, and a mean of $5.6 million. In terms of the amount of ***foreign equity as a percentage of total equity***, local firms based in Hungary showed the highest level of foreign ownership with 81%, followed by Romania with almost 67%, and enterprises within the other three host countries being grouped together with between 55% to 57%. Finally, data on the ***level of employment in 1996*** for the local firms was available for a total of 304 firms[16], for which their total sum amounted to 225,978 employees with a mean of 743 employees. The highest total number of employees was located in Poland with 82,245 and a mean of 1,003, followed closely by the Czech Republic with 79,921 and a mean of 999, and the lowest sum found in Slovakia at 8,299 with a mean of 361.

Table 4.6, Employment Levels of the Local Firms in Different Bands

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Number of Employees	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Small Firms:												
1-10 employees	4	5%	4	5%	1	1%	2	5%	1	4%	12	4%
11-50 employees	6	7%	13	15%	9	10%	14	32%	5	22%	47	15%
51-100 employees	14	17%	9	10%	9	10%	2	5%	4	17%	38	12%
Medium Firms												
101-250 employees	13	16%	18	20%	14	16%	8	18%	5	22%	58	18%
251-500 employees	14	17%	17	19%	12	14%	2	5%	6	26%	51	16%
501-750 employees	6	7%	7	8%	15	17%	2	5%			30	9%
Large Firms:												
751-1,000 employees	2	2%	5	6%	6	7%	1	2%			14	4%
1,001-2,000 employees	14	17%	7	8%	7	8%	4	9%	1	4%	33	10%
2,001-3,000 employees	2	2%	1	1%	2	2%	1	2%	1	4%	7	2%
Very Large Firms:												
> 3,000 employees	5	6%	2	2%	7	8%					14	4%
Non-Response*	2	2%	5	6%	5	6%	8	18%			20	6%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Note: *From the sample of '324' firms surveyed, a total of '20' firms either did not complete this question or the number of employees could not be extrapolated from the data provided (Company Annual Reports). Also in the case of the latter, some respondents gave a combined group total for all of their respective firms operating within the specific host country.

The ***level of employment in 1996*** (See **Table 4.6**), was examined further by grouping the number of employees in the local firms into a series of bands. The bands themselves were grouped together to represent the different sizes of the local firms. Hence, small firms were categorized as possessing between 1-100 employees (bands 1-10, 11-50, and 51-100), medium firms having

[16]Data on the other '20' firms was not available because some executives listed a combined group total for all of their respective firms operating within a specific host country instead of data on employment for each individual firm.

Table 4.7, Home Country of the Foreign Parent/Partner Organizations

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Home Country (Abbreviation)	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Austria (OE)	12	13%	13	12%	4	4%			3	11%	32	8%
Belgium (BG)	3	3%	2	2%	3	3%	1	2%			9	2%
Canada (CN)					1	1%	1	2%			2	1%
Denmark (DK)	2	2%	3	3%	4	4%					9	2%
Finland (FN)			1	1%	2	2%					3	1%
France (FR)	10	11%	16	14%	10	10%	6	12%	4	15%	46	12%
Germany (BD)	25	27%	11	10%	9	9%	3	6%	8	30%	56	15%
Greece (GR)							9	18%			9	2%
Ireland (IR)			1	1%							1	0%
Italy (IT)	2	2%	9	8%	2	2%	3	6%	2	7%	18	5%
Luxembourg (LX)					1	1%	2	4%			3	1%
The Netherlands (NL)	5	5%	5	4%	7	7%	3	6%			20	5%
Norway (NW)	2	2%	1	1%	1	1%					4	1%
Portugal (PT)*											0	0%
Spain (ES)			1	1%	1	1%	1	2%			3	1%
Sweden (SD)	11	12%	6	5%	10	10%	1	2%	2	7%	30	8%
Switzerland (SW)	10	11%	6	5%	6	6%	3	6%	1	4%	26	7%
United Kingdom (UK)	3	3%	8	7%	12	12%	6	12%	1	4%	30	8%
United States of America (US)	7	8%	29	26%	30	29%	10	20%	6	22%	82	21%
Total**	**92**	**100%**	**112**	**100%**	**103**	**100%**	**49**	**100%**	**27**	**100%**	**383**	**100%**

Notes: *There were no reported cases of a foreign parent/partner organization originating from Portugal. **The total number of local firms surveyed was '324', for which there was '363' actual foreign investors reported by respondents since some local firms possessed multiple partners (Joint Ventures and/or Consortiums). From these '363' actual foreign investors, '20' firms possessed dual nationalities and have thus been counted once for each respective home country for which they belong. For example, firms like *Unilever* (NL/UK) and *ABB Asea Brown Boveri* (SD/SW). In compiling these numbers we arrive at an overall total of '383' home countries of foreign parent/partner organizations, as shown.

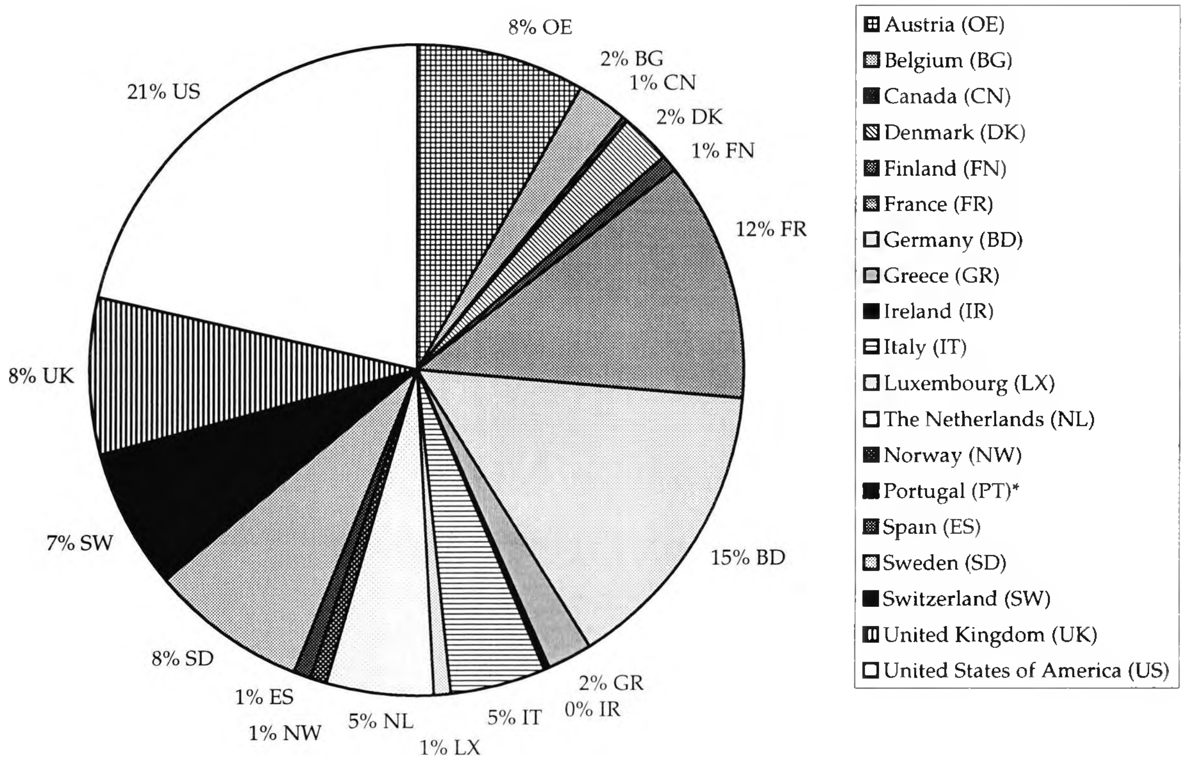
101-750 employees (bands 101-250, 251-500, and 501-750), large enterprises with between 751-3,000 employees (bands 751-1,000, 1,001-2,000, and 2,001-3,000), and very large firms with over 3,000 employees.

The data on employment for the CE group as a whole indicates a strong concentration within the five bands encompassing the 11-750 employee level which accounted for 224 firms (74%). There was also a strong showing in the 1,001-2,000 band with 33 local firms (11%). These two trends were fairly steady throughout each of the host country samples. The only partial exception to this was the employment level of local firms in Slovakia which possessed only two large employers with the rest mostly being concentrated within the 11-500 employee bands.

4.5.2 A Profile of the Foreign Parent/Partner Organizations

The executives of local firms were asked a series of questions relating to basic details on their respective foreign parent/partner organizations, such as the name(s) of the foreign parent/partner, its home country, total annual turnover worldwide for 1994, the total number

Figure 4.2, Home Country of the Foreign Parent/Partner Organizations: The CE Group



Note: *There were no reported cases of a foreign parent/partner organization originating from Portugal.

of employees worldwide in 1994, operations in other countries, whether or not an intermediary firm was utilized when establishing the local firm via FDI, and if so, the intermediary firm's name and home country. Wherever possible, the data on turnover and employment were verified or completed using information from external sources accessed from other databases.

In response to questions on the ***name and home country of the foreign parent/partner organizations*** (See **Table 4.7** & **Figure 4.2**) a total of 363 actual investors were identified, of which 20 firms possessed dual nationality. In analyzing the origins of the foreign parent/partner organizations of the sample it becomes evident that the main investor nation is the United States of America with 82 firms (21%) overall, followed by Germany with 56 investors (15%), and France showing 46 cases (12%). The origins of other key investors within the sample included Austria, Sweden, and the United Kingdom each with 8% and closely followed by Switzerland with 7%.

In examining the origins of the foreign parent/partner organizations associated with each individual host country some other interesting patterns emerge. In the Czech Republic, Hungary, Poland, and Slovakia the pattern of home country of investors mirrors that of the CE group

Table 4.8, Characteristics of the Foreign Parent/Partner Organizations

Host Country of the Investment		Worldwide Annual Turnover, 1994 (in millions of US$)*	Worldwide Employment, 1994**	Operate in more than one country? Yes	Operate in more than one country? No	Utilize Intermediary Firm for Investment? Yes	Utilize Intermediary Firm for Investment? No
Czech Republic	**Sum**	$469,840.0	2,172,944				
	Mean	$7,963.4	36,216				
	Std. Dev.	$19,670.0	82,410				
	# Firms	59	60	83	3	25	61
	%	68.6%	69.8%	96.5%	3.5%	29.1%	70.9%
Hungary	**Sum**	$1,014,000.0	3,564,328				
	Mean	$15,363.6	50,919				
	Std. Dev.	$28,370.0	86,503				
	# Firms	66	70	98	8	33	73
	%	62.3%	66.0%	92.5%	7.5%	31.1%	68.9%
Poland	**Sum**	$914,893.0	4,446,025				
	Mean	$19,060.3	85,500				
	Std. Dev.	$15,580.0	83,100				
	# Firms	48	52	93	4	41	56
	%	49.5%	53.6%	95.9%	4.1%	42.3%	57.7%
Romania	**Sum**	$335,980.0	1,767,985				
	Mean	$13,999.2	70,719				
	Std. Dev.	$12,610.0	70,088				
	# Firms	24	25	40	8	12	36
	%	50.0%	52.1%	83.3%	16.7%	25.0%	75.0%
Slovakia	**Sum**	$447,800.0	2,138,953				
	Mean	$27,987.5	133,685				
	Std. Dev.	$14,900.0	78,888				
	# Firms	16	16	24	2	10	16
	%	61.5%	61.5%	92.3%	7.7%	38.5%	61.5%
Total CE Group	**Sum**	**$4,225,741.5**	**10,093,713**				
	Mean	**$19,932.7**	**45,263**				
	Std. Dev.	**$21.0**	**81,953**				
	# Firms	**213**	**223**	**338**	**25**	**121**	**242**
	%	**58.7%**	**61.4%**	**93.1%**	**6.9%**	**33.3%**	**66.7%**

Notes: *Data on *Worldwide Annual Turnover, 1994* for a total of '49' foreign parent/partner organizations has not been included in this table because the information was not provided by respondents and it could not be found using other available resources. Furthermore, some data on the *Worldwide Annual Turnover, 1994* has been omitted because the foreign parent/partner organizations had multiple investments in the same country and/or the CE group overall. In an effort to maintain the reliability of the statistics these types of cases have only been counted once. **Data on *Worldwide Employment, 1994* for a total of '38' foreign parent/partner organizations has not been included in this table because the information was not provided by respondents and it could not be found using other available resources. Furthermore, data on the *Worldwide Employment, 1994* for foreign parent/partner organizations that had multiple investments in the same country, and the group overall, were only counted once so as to maintain the reliability of the statistics.

overall. Yet, in Romania, FDI by Greek firms plays an important role comprising 18% of the sample in that country, just behind direct investment by American based firms with 20%.

The next series of questions posed to the members of the sample sought to identify basic information on the foreign parent/partner organizations associated with the local firm (See **Table 4.8**). The first of these inquiries was directed at establishing the ***worldwide annual turnover in 1994***. Data on the foreign parent/partner organizations' worldwide annual turnover in 1994 was available or utilized for only 213 out of the overall total of 363 cases identified.

The sum for worldwide turnover for these foreign firms was a colossal $4,225.7 billion dollars with a mean of $19.9 billion. The range for this characteristic showed a high in Hungary at $1,014.0 billion with a mean of $15.4 billion and the low in Romania at $335.9 billion and a mean of almost $14.0 billion. However, it is interesting to note that the means for turnover were higher in both Slovakia and Poland with $18.7 billion and $13.8 billion respectively. Furthermore, the mean for the bottom end of the range was much lower in the parent/partner organizations associated with the Czech Republic with nearly $7.9 billion worth of total turnover being reported for the sample of local firms.

In terms of the level of ***worldwide employment in 1994***, data were provided for 223 foreign parent/partner organizations. The sum for the CE group equalled 10,093,713 employees with a mean of 45,263. On the high side of the range was Poland with a total of 4,446,025 employees with a mean of 85,500 and at the low end was Romania with 1,767,985 employees and a mean of 70,088. Yet once again, there were some differences in the ranges at both ends of the spectrum. The mean for worldwide employment was higher in Hungary with 86,503 and lower in the case of Hungary with 36,216 employees reported.

The data on ***worldwide employment level in 1994*** of the foreign parent/partner organization was grouped together in a series of bands (See **Table 4.9**). As was the case of the local firms, the bands themselves were grouped together to be representative of the size of the firm. Accordingly, small firms were categorized as possessing between 1-1,000 employees (bands 1-100, 101-500, and 501-1,000), medium firms having 1,001-20,000 employees (bands 1,001-5,000, 5,001-10,000, and 10,001-20,000), large enterprises with between 20,001-150,000 employees (bands 20,001-50,000, 50,001-100,000, and 100,001-150,000), and very large firms with in excess of 150,000 employees.

For the CE group as a whole, employment was concentrated within five of the bands, three of which together represented a total of 154 firms (43%) out of the sample. These three main bands covered the 10,001-100,000 levels and thus represented a fairly wide dispersion in terms of size and numbers. The other two main concentrations were located within the 1,001-5,000 band with 41 cases (11%) and the band categorized as greater than 150,000 employees embodying 62 firms (17%). In regards to the latter, it should be pointed out that 25 of the 62 large scale employers were part of the sample in the Czech Republic. Overall, from this evidence it can be concluded that in terms of employment most of the foreign parent/partner organizations could be classified as big medium and large sized firms.

The executives of the local firms were asked if the foreign parent/partner organization ***operated subsidiaries and/or joint ventures in more than one country*** (See **Table 4.8**). Data for this question were available for all of the designated 363 foreign investors within the sample. A total of 338 foreign parent/partner organizations (93%) were characterized by executives of the local firms as operating in more than one country versus 25 cases (7%) which were not active outside their own home country and the respective host country of investment within the CE group. These types of responses were well balanced throughout the five host countries.

Table 4.9, Worldwide Employment Level of the Foreign Parent/Partner Organizations in Different Bands

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Number of Employees	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
Small Firms:												
1-100 employees			4	4%	6	6%	1	2%	1	4%	12	3%
101-500 employees	5	6%	5	5%	3	3%	6	13%			19	5%
501-1,000 employees	1	1%	5	5%	1	1%	1	2%			8	2%
Medium Firms:												
1,001-5,000 employees	11	13%	12	11%	5	5%	9	19%	4	15%	41	11%
5,001-10,000 employees	10	12%	8	8%	3	3%	1	2%	1	4%	23	6%
10,001-20,000 employees	9	10%	11	10%	17	18%	2	4%	3	12%	42	12%
Large Firms:												
20,001-50,000 employees	11	13%	21	20%	18	19%	3	6%	4	15%	57	16%
50,001-100,000 employees	8	9%	14	13%	23	24%	6	13%	4	15%	55	15%
100,001-150,000 employees	1	1%	2	2%					1	4%	4	1%
Very Large Firms:												
>150,000 employees	25	29%	11	10%	14	14%	5	10%	7	27%	62	17%
Non-Response	5	6%	13	12%	7	7%	14	29%	1	4%	40	11%
Total*	**86**	**100%**	**106**	**100%**	**97**	**100%**	**48**	**100%**	**26**	**100%**	**363**	**100%**

Note: *The total number of local firms surveyed was '324', for which there was a total of '363' actual foreign investors owing to the fact that some local firms possessed multiple partners (Joint Ventures and/or Consortiums).

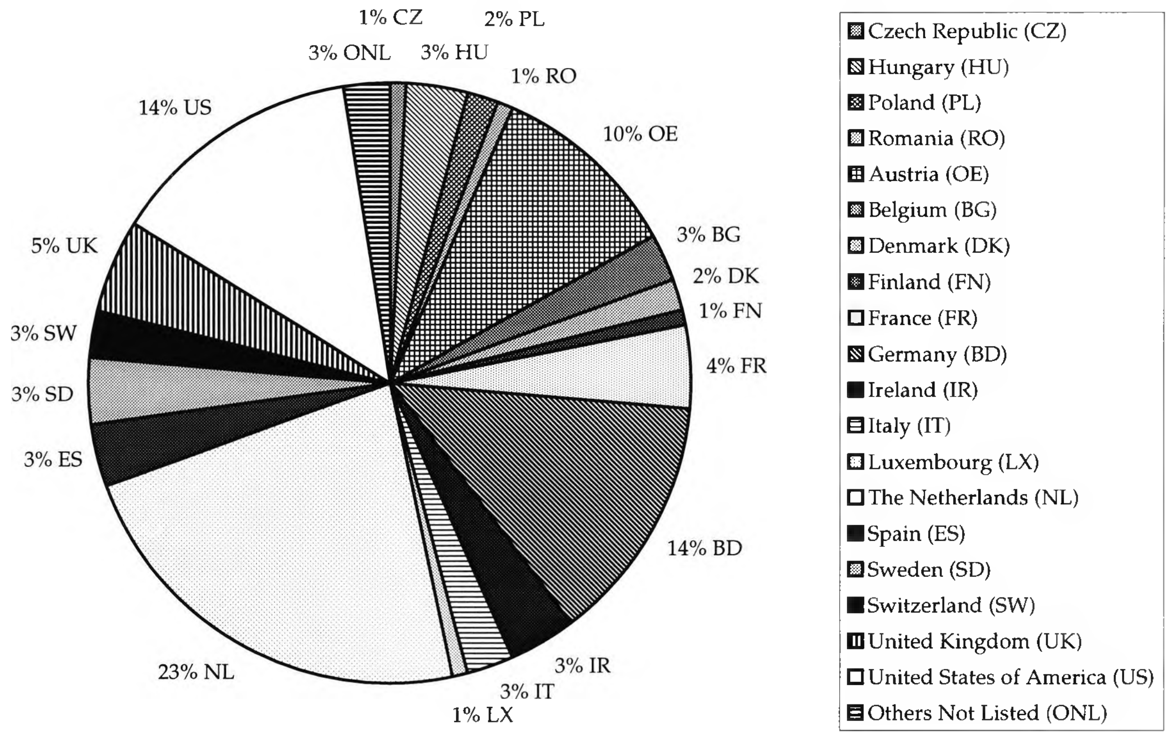
Executives of the local firms were also asked if their respective foreign parent/partner organization ***utilized an intermediary firm in establishing their firm via FDI*** (See **Table 4.8**) An intermediary firm was defined as a firm that engages in FDI on behalf of another firm and/or parent company. The relationship between the foreign parent/partner organization and the intermediary firm was characterized as being a subsidiary, affiliate, or franchisee. In response to this question, 121 respondents (33%) of the overall CE group indicated that their foreign parent/partner organization did employ an intermediary firm to establish their firm. The other 242 firms (67%) stated that this was not the case.

Following up on the use of intermediary firms, executives were also asked to identify the respective ***home country*** of these same firms (See **Table 4.10** & **Figure 1.3**). A total of 118 intermediary firms was identified by senior executives as being used as a vehicle for FDI in CE. For many European based TNCs these intermediaries were either affiliates/subsidiaries while for the majority of North American based TNCs they were often classified as the European headquarters. Upon a closer examination of the data it becomes evident that The Netherlands is the primary home country of these intermediary firms with 27 cases (23%), followed by the United States and Germany each with 16 firms (14%), and Austria with 12 examples (10%). Moreover, a number of American parent/partner organizations also tended to favor the use of intermediaries located within their own home country to engage in FDI. The concentrations of intermediaries in Germany and Austria were mainly the result of several individual investors repeatedly utilizing their subsidiaries or affiliates in these countries to establish local firms in multiple host countries within the CE group. It is also interesting to note that Dutch based intermediaries were a major conduit of FDI into the CE group ranging from a high in Poland with 12 firms (30%) followed closely by the Czech Republic with seven cases (29%) of usage to a low of four firms (12%) found in Hungary.

Table 4.10, Home Country of Intermediary Firms utilized by the Foreign Parent/Partner Organizations for their FDI

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Home Country (Abbreviation)	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Czech Republic (CZ)	1	4%									1	1%
Hungary (HU)			4	12%							4	3%
Poland (PL)					2	5%					2	2%
Romania (RO)							1	8%			1	1%
Slovakia (SK)											0	0%
Austria (OE)	2	8%	8	24%			1	8%	1	11%	12	10%
Belgium (BG)					2	5%			1	11%	3	3%
Canada (CN)											0	0%
Denmark (DK)					2	5%					2	2%
Finland (FN)					1	3%					1	1%
France (FR)	2	8%	1	3%	2	5%					5	4%
Germany (BD)	7	29%	4	12%	3	8%			2	22%	16	14%
Greece (GR)											0	0%
Ireland (IR)							4	33%			4	3%
Italy (IT)			1	3%					2	22%	3	3%
Luxembourg (LX)	1	4%									1	1%
The Netherlands (NL)	7	29%	4	12%	12	30%	2	17%	2	22%	27	23%
Norway (NW)											0	0%
Portugal (PT)											0	0%
Spain (ES)					4	10%					4	3%
Sweden (SD)					4	10%					4	3%
Switzerland (SW)	1	4%			2	5%					3	3%
United Kingdom (UK)	2	8%	1	3%	2	5%	1	8%			6	5%
United States of America (US)	1	4%	8	24%	4	10%	2	17%	1	11%	16	14%
Others Not Listed			2	6%			1	8%			3	3%
Total	**24**	**100%**	**33**	**100%**	**40**	**100%**	**12**	**100%**	**9**	**100%**	**118**	**100%**

Figure 4.3, Home Country of Intermediary Firms utilized by the Foreign Parent/Partner Organizations for their FDI: The CE Group



Note: *In the sample, there were no reported cases of foreign parent/partner organizations utilizing intermediaries firms from Canada, Greece, Norway, Portugal or Slovakia to engage in FDI on their behalf.

4.6 Locational and Motivational Factors Affecting the Foreign Parent/Partner Organizations' Decision to Invest within a specific Host Country in Central Europe

In this section questions were addressed to the members of the sample regarding the locational and motivational factors affecting their respective foreign parent/partner organizations' decision to invest within the specific host country and local firm. These inquiries included both open- and closed-ended questions. To be more specific, locational questions were of the open-ended variety while motivational ones employed both open- and closed-ended questions. Furthermore, a set of eight factors were used to either group responses or create statements regarding both locational and motivational issues pertaining to the investigation. These eight categories were labelled as market, resource, employment, financial efficiency, know-how (technology), strategic position, geographic location, and investment climate factors.

These eight factors each had their own defining characteristics. ***Market factors*** relate to the size and dimensions of the market, its growth potential, maintaining the firm's share of the market, and the opportunity to create an export base for other markets. ***Resource factors*** focus on the issue of gaining access to raw materials or needed inputs. ***Employment factors*** concentrate on issues pertaining to the workforce, such as the availability of skilled and/or educated workers, the general attitude of the workforce, and its reliability. ***Financial efficiency factors*** examine monetary related issues, like comparative material and/or labor cost advantages, avoidance of tariff and/or non-tariff barriers, the opportunity to reduce operating costs, and to increase the firm's level of profit, dividends, rate of return, etc.. ***Know-how (technology) factors*** include access to local technology, the technical skill level of employees, utilization of the local firm as a learning vehicle for doing business in the respective host country/region, and the opportunity to access local modern facilities/equipment. ***Strategic position factors*** are associated with the desire to gain first mover advantages, to follow competitors and/or customers, and to pursue opportunities for acquisitions. ***Geographic location factors*** are based upon the proximity of the host country to potential export markets, the desire of the investor to be active in every country of the region, proximity to buyers and/or suppliers, and the general geographic location of the host country. Finally, ***investment climate factors*** refer to various aspects related to the host country, such as its general attitude towards foreign investment, the level of stability in the home country, historical trading links, the regulatory environment, the low degree of psychic distance between the host country and the investor's own home country (language, cultural, business and custom differences), etc..

These eight factors affecting FDI were primarily based upon an existing taxonomy created by some noted scholars. The first six factors were generally an expansion of the terminology developed by Dunning (1993a)[17], which itself was partially based upon the previous work of Behrman (1972). The remaining two factors, namely geographic location and investment climate, were developed from a variety of sources related to previous studies on the subject of TNC activity and FDI.[18]

4.6.1 Locational Factors of Foreign Direct Investment

Members of the sample were asked what do you consider to be the three most important location-specific advantages of the respective host country versus other countries as locations for direct investment. Responses to this series of questions were grouped into each of the categories associated with the investment decision of the foreign firm. Moreover, given the open-ended nature of the questions some individual responses embodied multiple replies, each of

[17]Dunning identifies four main types of TNC activity (FDI is stated to be a fundamental part of this activity), namely resource seeking, market seeking, efficiency seeking, and strategic asset or capability seeking. See Dunning (1993), *op. cit.*, pp. 56-63.

[18]The investment climate factor was mainly sourced from the earlier work of Dunning, in which it was used to describe country-specific advantages (CSAs) related to FDI. Dunning defined these CSAs as market factors, trade barriers, cost factors, and the investment climate. Therefore, it seems fairly evident that his later terminology for TNC activity, as previously described, stemmed from these aforementioned factors. See Dunning, J. H. (1973), *The determinants of international production*, pp. 297.

which was counted accordingly. For example, one respondent cited *"the large domestic market of the host country and the need to gain first mover advantages"* as the primary location-specific advantage of that specific host country. In this example, both market and strategic position factors would each receive one observation under the primary listing.

The ***primary location-specific advantage*** (See **Table 4.11a** & **Figure 4.4**) specified by respondents regarding the host country versus other countries as locations for FDI was clearly market factors with 137 replies (40%), followed almost equally by both strategic position and investment climate factors each with 16% of the responses. Some of the most frequently stated market factors included *"the growth potential of the local market," "to gain market share,"* and *"capturing the local market."* It is interesting to note that export oriented market factors were seldom mentioned. The strategic position factors mentioned most often were *"to gain first mover advantages," "to follow customers," "to follow clients"* (in the case of financial institutions), and *"to serve international markets."* For investment climate factors often cited, these included *"overall stability of the host country," "historical trading links with the host country,"* and the *"general attitude of the host county towards FDI."* These were fairly common statements found throughout each of the three parts of this question.

On a host country basis, market factors were the most pronounced location-specific advantage noted in the case of both Poland with 55 observations (61%) and Romania with 22 citations (45%). Local firms in Hungary stated investment climate factors just as many times as market oriented ones, obviously a reflection of the country's more liberalized business environment which has attracted the most FDI in the CE group and the region overall. In the Czech Republic market factors were noted as being important but both strategic position and investment climate factors also had a strong showing with 23 (26%) and 16 replies (18%) respectively. The situation in Slovakia was somewhat different than that found in the other host countries with market and geographic factors each with an equal seven responses (27%), followed by strategic position with five mentions (19%).

The responses to the ***secondary location-specific advantage*** (See **Table 4.11b** & **Figure 4.4**) associated with the host country were almost an exact reproduction of those in the primary example. Once again, market factors rated the highest with 71 replies (21%), followed by investment climate factors with 58 acknowledgments (17%).

Overall, market factors statements were fairly balanced across each of the five host countries with a top range of 12 cases (27%) in Romania and the bottom end of the scale showing four mentions (15%) in Slovakia. The only exception to this was found in the Czech Republic where market factors had 20 replies (24%), but was slightly surpassed by investment climate factors which received a total of 22 mentions (26%). Yet, it should be noted that non-response played a

Table 4.11a, Primary Location-Specific Advantage of the Host Country

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Factor	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Market (MF)	27	31%	26	29%	55	61%	22	45%	7	27%	137	40%
Resource (RF)			1	1%			4	8%			5	1%
Employment (EMF)	2	2%	7	8%			5	10%	1	4%	15	4%
Financial Efficiency (FEF)	10	11%	9	10%	9	10%	4	8%	5	19%	37	11%
Know-How (Technology) (KHF)	1	1%	3	3%							4	1%
Geographic Location (GLF)	8	9%	7	8%	4	4%	6	12%	7	27%	32	9%
Strategic Position (SPF)	23	26%	11	12%	11	12%	6	12%	5	19%	56	16%
Investment Climate (ICF)	16	18%	26	29%	10	11%	2	4%	1	4%	55	16%
Non-Response (NR)					1	1%					1	0%
Total	**87**	**100%**	**90**	**100%**	**90**	**100%**	**49**	**100%**	**26**	**100%**	**342**	**100%**

Table 4.11b, Secondary Location-Specific Advantage of the Host Country

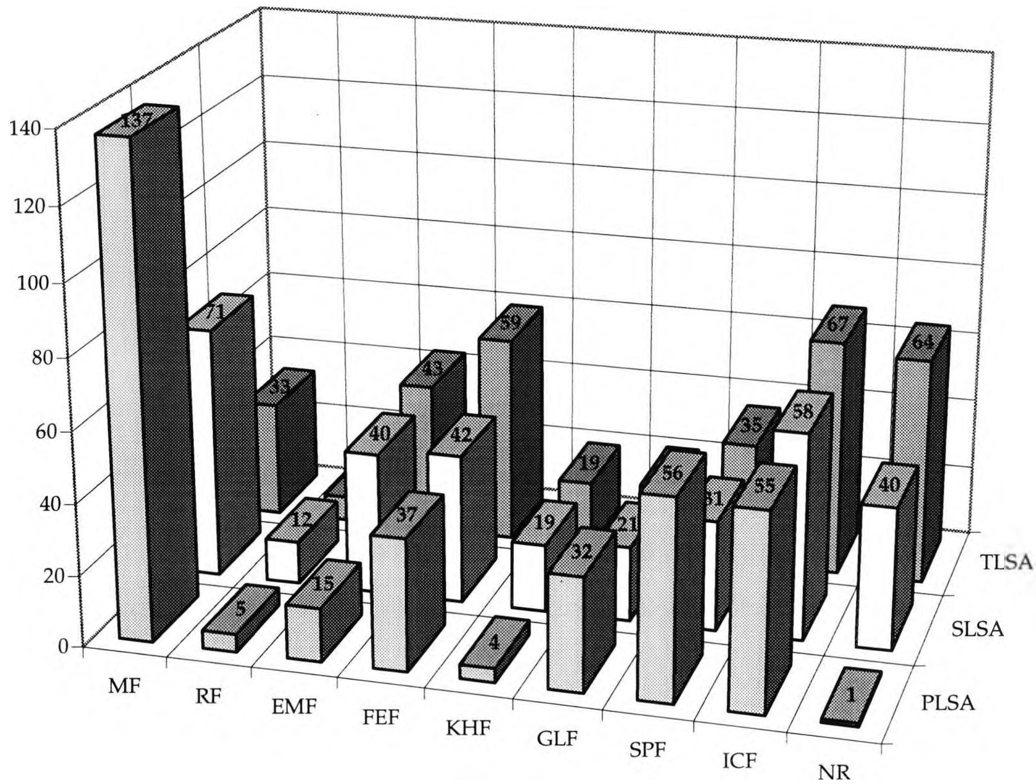
	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Factor	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Market (MF)	20	24%	19	21%	16	18%	12	27%	4	15%	71	21%
Resource (RF)			4	4%	6	7%	2	5%			12	4%
Employment (EMF)	11	13%	11	12%	6	7%	8	18%	4	15%	40	12%
Financial Efficiency (FEF)	11	13%	13	15%	11	12%	4	9%	3	12%	42	13%
Know-How (Technology) (KHF)	8	9%	5	6%	2	2%	1	2%	3	12%	19	6%
Geographic Location (GLF)	4	5%	5	6%	7	8%	2	5%	3	12%	21	6%
Strategic Position (SPF)	6	7%	7	8%	12	13%	3	7%	3	12%	31	9%
Investment Climate (ICF)	22	26%	17	19%	13	14%	4	9%	2	8%	58	17%
Non-Response	3	4%	8	9%	17	19%	8	18%	4	15%	40	12%
Total	**85**	**100%**	**89**	**100%**	**90**	**100%**	**44**	**100%**	**26**	**100%**	**334**	**100%**

Table 4.11c, Tertiary Location-Specific Advantage of the Host Country

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Factor	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Market (MF)	7	8%	11	12%	10	11%	4	9%	1	4%	33	10%
Resource (RF)	3	3%			3	3%	1	2%			7	2%
Employment (EMF)	16	17%	10	11%	7	8%	4	9%	6	24%	43	12%
Financial Efficiency (FEF)	16	17%	17	18%	12	13%	6	13%	8	32%	59	17%
Know-How (Technology) (KHF)	6	7%	9	10%	1	1%	2	4%	1	4%	19	5%
Geographic Location (GLF)	3	3%	8	9%	4	4%	4	9%	1	4%	20	6%
Strategic Position (SPF)	7	8%	6	6%	16	18%	5	11%	1	4%	35	10%
Investment Climate (ICF)	22	24%	19	20%	17	19%	7	15%	2	8%	67	19%
Non-Response	12	13%	14	15%	20	22%	13	28%	5	20%	64	18%
Total	**92**	**100%**	**94**	**100%**	**90**	**100%**	**46**	**100%**	**25**	**100%**	**347**	**100%**

Note: Please note that due to multiple responses from respondents the totals in the three tables shown above do not necessarily equal of the actual number of firms surveyed, which was '324'.

Figure 4.4, Location-Specific Advantages of the Host Countries: The CE Group



Notes: On the **X-Axis**, the location-specific factors are **MF** = market factors, **RF** = resource factors, **EMF** = employment factors, **FEF** = financial efficiency factors, **KHF** = know-how factors, **GLF** = geographic location factors, **SPF** = strategic position factors, **ICF** = investment climate factors, and **NR** = non-response. The **Y-Axis** shows the number of citations for each factor per question. On the **Z-Axis**, **PLSA** = Primary Location-Specific Advantages, **SLSA** = Secondary Location-Specific Advantages, and **TLSA** = Tertiary Location-Specific Advantages.

major mitigating element in regards to this question. The non-response rate in the case of the primary location-specific advantage was far less than one percent (0.3%). However, the situation for the secondary advantage was quite different with a total of 40 firms (12%) failing to respond to this question.

Finally, the responses to the question of what was the ***tertiary location-specific advantage*** (See **Table 4.11c & Figure 4.4**) of the host country was a very different case than the primary and secondary advantages. Yet, this time around investment climate factors had the most acknowledgments with 67 replies (19%) but was followed closely by financial efficiency factors with 59 citations (17%). Most of the financial efficiency factors focused on *"comparative labor cost advantages," "to reduce overall costs,"* and *"to increase profits."*

By individual host country, both market and investment climate factors were fairly well represented throughout the CE group, with only a slight deviation identified in the case of

Slovakia which had only two examples (8%) associated with investment climate. However, it should be pointed out that once again there was a severe problem with the non-response rate to this question with 64 firms (18%) declining to make a statement.

Overall, the lack of replies to both the questions of secondary and the tertiary location-specific advantages seem to indicate that executives only really saw one real advantage in association with the host country versus other host countries as locations for FDI. Still, it is quite clear from the results that market factors were key as the primary as well as secondary location-specific advantages associated with the respective host country. Furthermore, investment climate factors were noted as being important as both a partial secondary and full tertiary advantage. Finally, the subject of financial efficiency was also very much associated with the tertiary category. In regards to the prominence of market factors in the data, it can be said that these kinds of results are to be expected given the opening up of these relatively new markets in CE.

4.6.2 Motivational Factors of Foreign Direct Investment

An investigation of the motivational factors affecting the foreign parent/partner organizations' decision to invest within a specific host country was undertaken using both open- and close-ended questions. In doing so, the local firm's management was first asked to identify both the primary and secondary motives of the foreign parent/partner organization in making a direct investment in their firm. The types of statements made by executives were almost a replica of those cited in the prior questions on the location-specific advantages of the host country.

For the CE group the responses given for the ***primary motive of the foreign parent/partner organizations to engage in FDI*** (See **Table 4.12a** & **Figure 4.5**) indicate that market factors were the key motive associated with 118 statements (34%). Strategic position factors placed second with 99 observations (29%). On a host country basis, market factors were the highest rated factors in the Czech Republic (41%), Poland (39%), and Hungary (28%) while the most citations associated with strategic position factors were posted by local firms in Romania (33%) and Slovakia (33%).

When asked to provide data for a ***secondary motive*** (See **Table 4.12b** & **Figure 4.5**) 103 firms (31%) out of the sample simply failed to reply suggesting that foreign firms may have actually been driven to invest by only a single factor. If this is indeed the case, then the two factors postulated as being the primary motive for investment should be considered as the driving force behind the foreign parent/partner organizations' decision to invest. Still, of the sample members that did respond to this inquiry, there was a group total of 88 acknowledgments (27%) for strategic position factors, followed by market factors with 39 citations (12%), and financial efficiency factors collecting 33 replies (10%).

Table 4.12a, Primary Motive of the Foreign Parent/Partner Organizations to Invest within the specific Host Country

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Factor	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Market (MF)	38	41%	25	28%	35	39%	14	29%	6	22%	118	34%
Resource (RF)	1	1%			1	1%	1	2%			3	1%
Employment (EMF)					2	2%	2	4%	2	7%	6	2%
Financial Efficiency (FEF)	19	21%	11	13%	9	10%	4	8%	4	15%	47	14%
Know-How (Technology) (KHF)	3	3%	3	3%			1	2%	1	4%	8	2%
Geographic Location (GLF)	1	1%	6	7%	6	7%	4	8%	5	19%	22	6%
Strategic Position (SPF)	26	28%	22	25%	26	29%	16	33%	9	33%	99	29%
Investment Climate (ICF)	3	3%	16	18%	9	10%	6	13%			34	10%
Non-Response	1	1%	5	6%	1	1%					7	2%
Total	**92**	**100%**	**88**	**100%**	**89**	**100%**	**48**	**100%**	**27**	**100%**	**344**	**100%**

Table 4.12b, Secondary Motive of the Foreign Parent/Partner Organizations to Invest within the specific Host Country

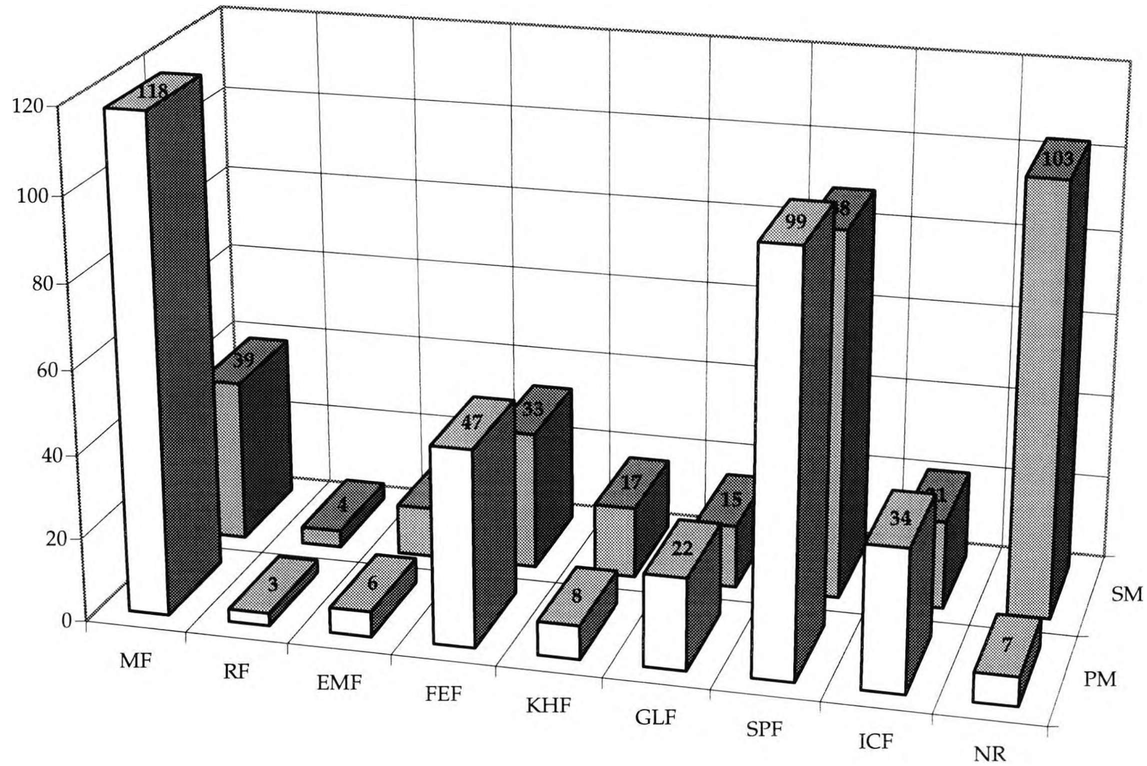
	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Factor	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Market (MF)	10	12%	14	15%	11	12%	2	5%	2	8%	39	12%
Resource (RF)	2	2%	1	1%	1	1%					4	1%
Employment (EMF)	3	4%	3	3%	1	1%	5	11%			12	4%
Financial Efficiency (FEF)	9	11%	11	12%	4	4%	9	20%			33	10%
Know-How (Technology) (KHF)	1	1%	7	8%	6	7%	1	2%	2	8%	17	5%
Geographic Location (GLF)	3	4%	2	2%	6	7%	2	5%	2	8%	15	5%
Strategic Position (SPF)	23	28%	21	23%	26	29%	9	20%	9	38%	88	27%
Investment Climate (ICF)	4	5%	4	4%	9	10%	4	9%			21	6%
Non-Response	27	33%	29	32%	26	29%	12	27%	9	38%	103	31%
Total	**82**	**100%**	**92**	**100%**	**90**	**100%**	**44**	**100%**	**24**	**100%**	**332**	**100%**

Note: Please note that due to multiple responses from respondents the totals in the two tables shown above do not necessarily equal of the actual number of firms surveyed, which was '324'.

In examining together both the primary and secondary motives identified by the survey results it seems likely that in the majority of cases market factors may have originally drawn the foreign parent/partner organizations to consider investment in the CE environment but that strategic position factors were the actual catalyst behind the actual decision to enter these markets via the act of FDI.

In pursuing this topic of motivation further, executives were asked to assess the ***relative degree of importance for a variety of motivational factors in regards to the foreign parent/partner organizations decision to engage in FDI within the respective CE host country*** (See **Table 4.13**). The question was of the close-ended variety and the degrees of importance were based upon a four point scale, using *very unimportant (1), unimportant (2), important (3), and very important (4)*. The motivational factors were presented in the format of individual statements

Figure 4.5, Motives of the Foreign Parent/Partner Organizations to Invest: The CE Group



Notes: On the **X-Axis**, the location-specific factors are **MF** = market factors, **RF** = resource factors, **EMF** = employment factors, **FEF** = financial efficiency factors, **KHF** = know-how factors, **GLF** = geographic location factors, **SPF** = strategic position factors, **ICF** = investment climate factors, and **NR** = non-response. The **Y-Axis** shows the number of citations for each factor per question. On the **Z-Axis**, **PM** = Primary Motive for FDI and **SM** = Secondary Motive for FDI.

based upon the factors previously utilized with the only exception being geographic location. The geographic location factor was not used as part of this question because it was felt that this area had already been adequately covered in the previous two questions of this section.

The responses to this series of statements yielded some very interesting results. Once again, for the CE group overall market factors scored highly but only in some specific areas. The areas that were rated by the management of the local firms as important or very important included *"to access/supply the local market"* with the highest ranking mean in the CE group at 3.37, the *"growth potential of the local market"* with a mean score of 3.32, and *"to develop the local market"* at 3.03. Moreover, for individual host countries the *"growth potential of the local market"* had the uppermost mean group score in Poland with a 3.72 followed in second place by *"to access/supply the local market"* possessing a mean of 3.67 and also located in Poland.

However, it should be noted that the other three export oriented market factors did not fair so well. In fact, market factors focusing on export activity were mostly deemed by respondents to

Table 4.13, Motivation of the Foreign Parent/Partner Organizations to engage in FDI within the specific Host Country

Factor: Category	Czech Republic Mean (82 firms)	Hungary Mean (88 firms)	Poland Mean (87 firms)	Romania Mean (44 firms)	Slovakia Mean (23 firms)	CE Group Mean (324 firms)
	Factor's level of importance: (1) very unimportant; (2) unimportant; (3) important; and (4) very important.					
	Host Country					Total
Market Factors (MF):						
a. to access/supply the local market	3.30	3.25	3.67	3.32	3.05	3.37
b. growth potential of the local market	3.20	3.07	3.72	3.45	2.96	3.32
c. to develop the local market	2.94	2.90	3.25	3.18	2.74	3.03
d. to create an export base for countries within Central and Eastern Europe and/or the former Soviet Union	2.53	2.63	2.51	2.35	2.65	2.53
e. to create an export base for countries within the European Union (EU) and/or the European Free Trade Agreement (EFTA)	2.18	2.11	1.91	2.09	2.17	2.08
f. to create an export base for countries outside Europe	1.99	1.78	1.64	1.95	1.70	1.81
Resource Factors (RF):						
g. to gain access to supplies of raw materials	1.96	1.77	1.94	2.09	1.83	1.91
h. to secure needed inputs	2.04	1.90	1.87	2.00	1.91	1.94
Employment Factor (EMF):						
j. availability of a skilled workforce	3.15	3.09	2.85	3.07	3.35	3.06
Financial Efficiency Factors (FEF):						
i. comparative material cost advantages	2.60	2.07	2.32	2.67	2.17	2.36
k. comparative labor cost advantages	3.42	3.05	2.93	3.05	3.22	3.12
l. an opportunity to reduce operating costs by transferring production facilities to the host country	2.46	2.23	2.15	2.52	2.55	2.33
m. to reduce costs in general	2.95	2.58	2.42	2.63	2.82	2.65
n. to increase profit levels	3.30	2.93	2.98	3.33	3.14	3.11
x. avoidance of tariff and non-tariff barriers	1.90	1.98	2.38	2.33	2.14	2.12
Know-How (Technology) Factor (KHF):						
o. to gain access to local technology	1.62	1.69	1.52	1.55	1.55	1.59
Investment Climate Factors (ICF):						
p. the low degree of psychic distance (language, cultural, business, and custom differences)	2.36	2.24	1.96	2.16	2.55	2.21
q. overall stability of the host country for investment	3.33	3.09	2.88	2.68	2.68	3.01
r. the general attitude of the host country to foreign direct investment	2.79	2.97	2.76	2.77	2.55	2.81
s. historical trading links with the host country	2.56	2.46	2.21	2.59	2.35	2.43
Strategic Position Factors (SPF):						
t. to gain first mover advantages	3.03	2.89	3.16	3.56	3.00	3.10
u. to follow competitors	2.42	2.12	2.25	2.28	2.36	2.27
v. to follow customer firms (firms we supply)	2.33	2.25	2.16	2.05	2.41	2.23
w. acquisition opportunities	2.81	2.47	2.51	2.55	2.82	2.61

be unimportant. Although there was a modest degree of interest expressed in regards to the opportunity to use the local firm as an export base for the countries of the CEC and/or FSU with a mean for the CE group of 2.53.

These trends in market factors were roughly constant in each of the host countries. This was indeed an interesting finding because it seems to dispel the myth that foreign firms are simply exploiting the East as a low cost production base to export to the West. This situation could be viewed as very positive for the region as a whole because it indicates that foreign firms see the local markets as very promising. However, on the other hand the lack of substantial export activity by the host countries could be a long-term problem as it is a crucial ingredient to the stability of these transitional economies.

Employment and financial efficiency factors also rated favorably in the opinion of sample members. The one and only employment factor listed in the statements, namely *"availability of a skilled workforce"* was viewed as important with a mean of 3.06. The financial efficiency factor stating *"comparative labor cost advantages"* had a mean of 3.12 and should be examined in conjunction with the previous finding as both of them are interdependent elements. Considered together, these two points show a desire on the part of the foreign parent/partner organizations to benefit from the availability of skilled workers at advantageous prices, both of which are considered as *"traditional"* attractions of the region. The data illustrates that both of these statements were considered as important by executives of local firms based in the Czech Republic and Slovakia and to a slightly lesser extent in the other three host countries.

The only other financial efficiency factor to show favor with local executives was the statement *"to increase profit levels,"* which had a mean of 3.11. This finding illustrates both the potential that foreign parent/partner organizations sees in the markets of CE and the subsequent drive these same firms are instilling in their local executives to achieve these types of results.

The strategic position factor statement *"to gain first mover advantages"* had a strong showing in almost every host country and had the third highest score of all statements found in Romania with a 3.56 mean. This particular finding is quite interesting in that it represents the senior executive's view that his/her firm was first, or possibly the first major foreign entity, into their respective field of economic activity within the specific host country.

The only other statement to receive an important rating was the investment climate factor *"overall stability of the host country for investment"* with a group mean of 3.01. This factor was especially strong in the Czech Republic and Hungary with means of 3.33 and 3.09 respectively and to a somewhat lesser extent in Poland with a mean of 2.88. Moreover, this finding is supported by the fact that each of these three host countries has been a major destination of

FDI.

At the other end of the spectrum, the lowest CE group rating was given *"to gain access to local technology"* with a mean of 1.59 in reference to the sole know-how (technology) factor. The low mean scores for this factor were consistent throughout each of the host countries, but rising above the high found in Hungary with a 1.69 mean. In Poland this statement captured the title as the overall group low with a mean of 1.52. Still, this finding does not come as any surprise given the antiquated technology utilized in many local operations and the desire of these same firms to obtain more modern technology.

All of the remaining statements either fell somewhere between the mean scores necessary to achieve an unimportant or important classification. It should also be noted that several respondents only replied to certain statements, often clearly indicating in writing that some statements were not applicable to their particular situation. Without exception, these areas of non-response were made by local firms engaged in the area of financial intermediation activities, such as banking and insurance. Furthermore, the instances in which these same local firms omitted replies siting that they were not applicable to their situation, were usually in the areas of manufacturing oriented statements. Yet, it should be stipulated that because of the nature of these types of non-response they were not used in the calculation of mean scores.

Finally, when examining together all of the degrees of importance to statements and their associated factors it becomes clear that no one of the seven individual factors utilized was dominant in motivating the foreign parent/partner organizations to engage in FDI within a specific host country. In terms of the CE group, the evidence tends to indicate that certain parts of a given factor were the actual motivators for investment, such as the market factors associated with the local host country market, the availability of skilled low cost employees, the chance to increase profit levels, in some cases the stability of the host country for FDI, and the opportunity to gain first mover advantages in the clear majority of host countries.

However, on a host country basis the findings suggested a different picture. In the case of the Czech Republic labor cost advantages were rated by executives as the most important motivations of the foreign parent/partner organization for their engaging in FDI along with the country's overall stability for investment, the chance to increase profit levels, and the local Czech market. In Hungary, all of the common group trends were evident but with somewhat lesser degree of importance attached. For Poland, local market factors in association with first mover advantages were listed as the key motivations for investment. The situation in Romania was almost the same as that found in Poland but with the opportunity to gain first mover advantage slightly more prominent then local market factors. Lastly, the motivational factors found in Slovakia almost mirrored those found in the Czech Republic, but with the country's stability for investment receiving a lower rating of importance.

4.7 Modes of Foreign Direct Investment and their Evolution

4.7.1 Timing and Mode of Investment

In this section, senior managers were asked a series of questions pertaining to the local firm's company history and present status. These included data on the local firms date of establishment with foreign capital participation, the mode of FDI utilized, the legal classification of the firm's ownership, details on the original and present shareholding position of the foreign parent/partner organization in the local firm, and details on the financial aspects of the original and present levels of FDI.

Data provided on the ***year of the local firm's establishment with foreign capital participation*** (See **Table 4.14** & **Figure 4.6**) reveals an interesting pattern. For all but one host country, Hungary, there was a consistent showing of FDI occurring between the years of 1991-1993 within the sample. The CE group had a total of 224 firms (69%) establishing local firms via FDI over the course of these three years. Although, there were some discrepancies in this pattern of data in four out of the five host countries.

In Hungary, the period of 1989-1992 was identified as the watershed years for FDI for that sample with 76 local firms (86%) being observed. The situation in Poland was similar to that of Hungary, but the trend started a year later in 1990. Hence, during the period of 1990-1993 a total of 71 firms (82%) participating in the survey were established in Poland via FDI. In Romania, the sample showed a surge of FDI that began in 1991 but slackened considerably after 1994 with a total of 39 operations (89%) being set-up during this time frame. Both the Czech Republic and Slovakia were very similar to the trend associated with the CE group. Yet, in 1995 the Czech Republic had 10 firms (12%) registered indicating that the country is still considered as an attractive location by foreign investors.

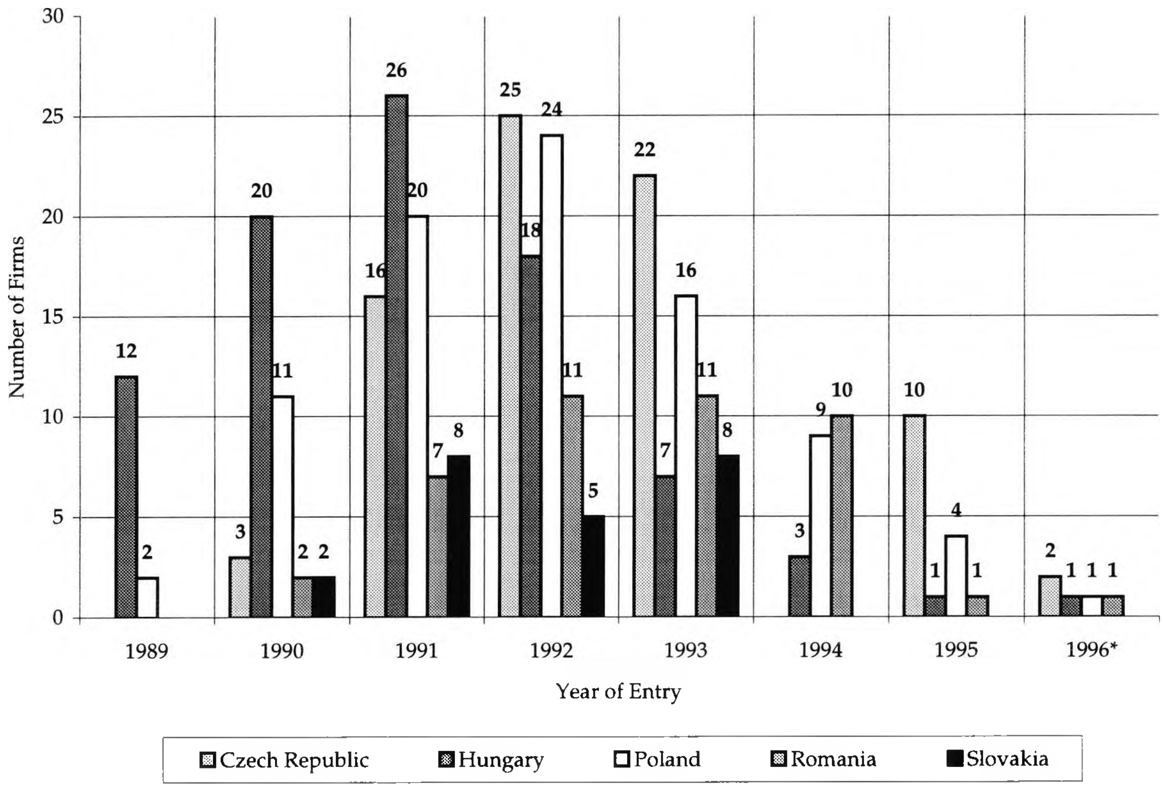
However, a word of caution is due about the interpretation of this type of data. This is because the overall sample of 1,222 local firms tended to be fairly concentrated within the 1989-1994 time period. This was the situation mainly a result of two factors. Firstly, information on the contact details of local firms with foreign participation was not always readily available, especially for more recent investments by foreign firms. Still, being full aware of this problem the researcher did target a significant number of local firms with foreign participation that had been established during this period of time. Secondly, it may well be the case that many of the more recently established local firms did not feel comfortable about participating in the survey given their firm's short period of activity. In regards to this last point, on several occasions local firms

Table 4.14, Year of Establishment with Foreign Capital Participation

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Year of Investment	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
1989			12	14%	2	2%					14	4%
1990	3	4%	20	23%	11	13%	2	5%	2	9%	38	12%
1991	16	20%	26	30%	20	23%	7	16%	8	35%	77	24%
1992	25	30%	18	20%	24	28%	11	25%	5	22%	83	26%
1993	22	27%	7	8%	16	18%	11	25%	8	35%	64	20%
1994			3	3%	9	10%	10	23%			22	7%
1995	10	12%	1	1%	4	5%	1	2%			16	5%
1996*	2	2%	1	1%	1	1%	1	2%			5	2%
Non-Response	4	5%					1	2%			5	2%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Note: *For *1996*, only investments made during the first quarter of the year (the full months of January, February, and March) were deemed to be applicable given the established parameters of the research study.

Figure 4.6, Year of Establishment with Foreign Capital Participation



Note: *For *1996*, only investments made during the first quarter of the year (the full months of January, February, and March) were deemed to be applicable given the established parameters of the research study.

that responded to the survey stating that they were unable or unwilling to participate in the study did mention this as a contributing factor.

The next question was directed at identifying the exact ***mode of FDI utilized by the foreign parent/partner organizations to establish the local firm*** (See **Table 4.15** & **Figure 4.7**). The choice of FDI modes falls into two main categories, either ***greenfield*** or ***acquisition***. According to Rojec, Jermakowicz, Illes, and Zemplinerova (1995), *"In principle, no modality is better or worse than other; all modalities depend on individual intentions and circumstances."*[19] Hence, the mode of FDI is dependent on both the motives of the actual investor and circumstances existing within the specific host country.

The question on the mode of FDI had two parts, first top executives were asked to classify their local firm as being established through either the greenfield or acquisition types of investment. The greenfield mode was characterized as an investment to establish a new firm with the creation of new/additional facilities, usually on a greenfield site. The acquisition mode was defined as a full or partial purchase of an existing firm through either direct or indirect means. In the second part of the question executives were requested to qualify their previous reply to the chosen type of FDI by selecting the precise mode of investment that each foreign parent/partner organization employed.

In the case of greenfield FDI, the option is between either a ***wholly-owned subsidiary (WOS)*** mode or a ***joint venture (JV)*** one. A ***wholly-owned subsidiary*** occurs when a foreign parent/partner organization establishes a local firm that is 100% owned and controlled by it. The ***joint venture*** involves the establishment of a new local firm as a result of a cooperative effort between two or more legally distinct organizations (the parents/partners), each of which actively participates, beyond a mere investment role, in the decision making activities of the jointly-owned entity.

As for the acquisition mode, there are four main alternatives in which to choose from, namely the ***joint venture acquisition (JVA)***, ***equity increase (EI)***, ***share acquisition (SA)***, or ***asset acquisition (AA)***. A ***joint venture acquisition*** is a JV (with the status of a new legal entity) formed by part of a local firm (its assets) and additional capital invested by the foreign parent/partner organization. An ***equity increase*** is where the foreign parent/partner organization makes a partnership agreement with a privatized local firm and through further investment, increases its capital and respective shareholding within the existing local firm. The ***share acquisition*** is an acquisition by the foreign parent/partner organization of a majority (control) equity share in the local *state-owned enterprise (SOE)* either through public invitation to enter negotiations or through an auction process. The ***asset acquisition*** is an acquisition by the

[19]See Rojec, M., Jermakowicz, W. W., Illes, M., and Zemplinerova, A. (1995), *Foreign Acquisition Strategies in the Central European Privatization Process*, pp. 13.

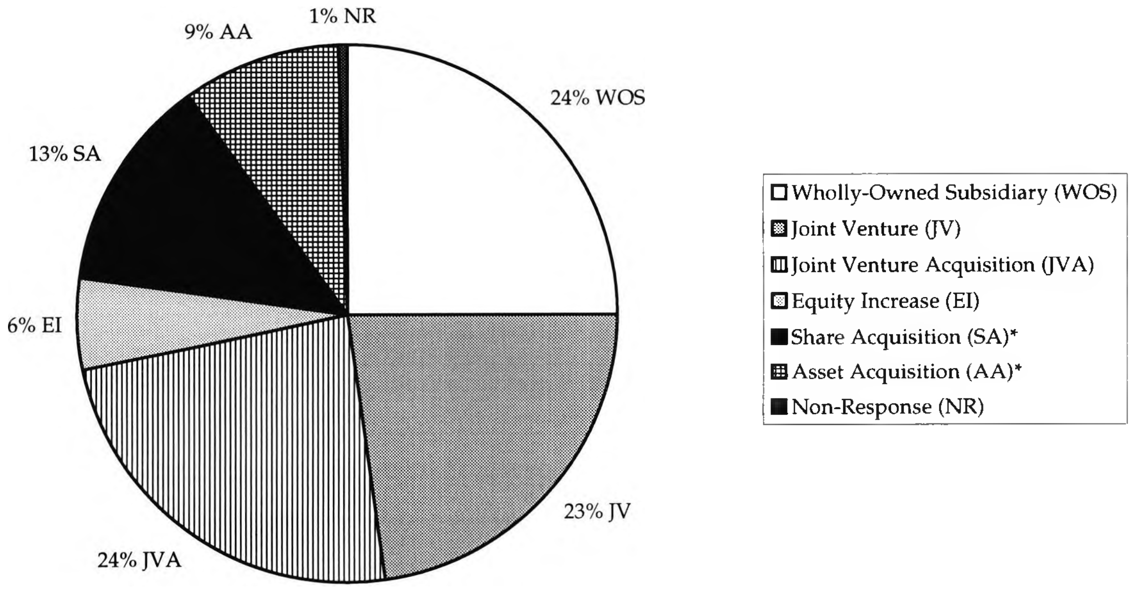
foreign parent/partner organization of the assets of a local SOE through either a direct sale (also referred to as a trade or negotiated sale) or through a liquidation sale; the assets are then used to continue the desired economic activity of the firm as either a WOS or JV. Both of the last two types of acquisition are closely associated with the process of privatization within the respective host country.

Table 4.15, Modes of Foreign Direct Investment

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Modes of FDI	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Greenfield (Totals):	33	40%	35	40%	38	44%	35	80%	14	61%	155	48%
a. Wholly-Owned Subsidiary (WOS)	23	28%	8	9%	26	30%	17	39%	7	30%	81	25%
b. Joint Venture (JV)	10	12%	27	31%	12	14%	18	41%	7	30%	74	23%
Acquisition (Totals):	47	57%	53	60%	49	56%	9	20%	9	39%	167	52%
a. Joint Venture Acquisition (JVA)	14	17%	32	36%	18	21%	6	14%	7	30%	77	24%
b. Equity Increase (EI)	7	9%	4	5%	5	6%	1	2%	1	4%	18	6%
c. Share Acquisition (SA)*	14	17%	9	10%	17	20%	1	2%	1	4%	42	13%
d. Asset Acquisition (AA)*	12	15%	8	9%	9	10%	1	2%			30	9%
Non-Response	2	2%									2	1%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Notes: *Both *Share Acquisition* and *Asset Acquisition* are usually directly associated the process of privatization within each of the respective host countries. **Due to rounding note all percentages amount to 100%.

Figure 4.7, Modes of Foreign Direct Investment: The CE Group



It should be clearly noted that this use of terminology was primarily derived from the previous work of Dunning and Rojec (1993)[20] and it has also been employed by several other researchers in their own studies on the subject.[21]

The results of these inquiries on the FDI mode of investment utilized by the foreign parent/partner organizations provided some more interesting findings. The data for the CE group demonstrated an almost equal distribution between the use of both greenfield modes with 155 firms (48%) and acquisition modes with the other 167 cases (52%). On an individual host country basis, acquisition modes were the dominant form for the samples in the Czech Republic (57%), Hungary (60%), and Poland (56%) while greenfield types of FDI were prevalent in Romania (80%) and Slovakia (61%).

In terms of the specific acquisition mode utilized, the JVA had a group total of 77 firms (24%) with above average numbers of usage in both Hungary and Slovakia with 32 (36%) and seven firms (30%) respectively. Share acquisition was also noted as important with 42 examples (13%) overall, being most concentrated in the Czech Republic with 14 firms (17%) and Poland with 17 cases (20%).

The greenfield modes of FDI were steady in both Romania and Slovakia but the situation in the other three host countries showed several differences. The WOS was the principle form of greenfield FDI in both the Czech Republic with 23 firms (28%) and Poland with 26 enterprises (30%), whereas the JV was utilized more in Hungary with 27 businesses (31%).

However, to fully comprehend the ***connection between the date of the local firms registration and the mode of investment used in its establishment*** one needs to view the two ingredients together (See **Tables 4.16a-f** & **Figure 4.8**). From the data presented it becomes clear that the use of both the JV and JVA modes of FDI are declining as time progresses while the wholly-owned subsidiary remains roughly consistent with annual increases over time. There is also a noticeable decline in the use of both share and asset acquisition modes which can be attributed to the decrease in the level of privatization activities being conducted in both the Czech Republic, Hungary, and to a lesser extent in Poland.

4.7.2 The Evolution of the Local Firm's Ownership Structure

Individual company officials were asked to specify both the ***original and present classifications of their respective firm's ownership structure*** (See **Table 4.17** & **Figure 4.9**). The term original was defined as the time of initial FDI and the present term referred to the time

[20]See Dunning, J. H. and Rojec, M. (1993), *Foreign Privatization in Central & Eastern Europe*, pp. 9-10.

[21]For example, see the papers by Bellas, C. J., Bochniarz, Z., Jermakowicz, W. W., and Meller, M. (1994), *Foreign Privatization in Poland* and Rojec, M., Jermakowicz, W. W., Illes, M., and Zemplinerova, A., *op. cit.*.

period in which the survey instrument was completed. Sample members were given a simple choice of identifying themselves with either the JV, WOS, or other classification.

Table 4.16a, Timing and Mode of Investment: Czech Republic*

Year of Investment	Modes of Foreign Direct Investment											
	Greenfield				Acquisition							
	Wholly-Owned Subsidiary		Joint Venture		Joint Venture Acquisition		Equity Increase		Share Acquisition**		Asset Acquisition**	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
1989												
1990	2	3%	1	1%								
1991	8	10%	2	3%	3	4%	1	1%	2	3%		
1992	5	6%	4	5%	5	6%	2	3%	6	8%	3	4%
1993	5	6%	1	1%	6	8%	2	3%	5	6%	2	3%
1994	1	1%	2	3%					1	1%	6	8%
1995							2	3%				
1996***												
Total (77 firms)	**21**	**27%**	**10**	**13%**	**14**	**18%**	**7**	**9%**	**14**	**18%**	**11**	**14%**

Table 4.16b, Timing and Mode of Investment: Hungary

Year of Investment	Modes of Foreign Direct Investment											
	Greenfield				Acquisition							
	Wholly-Owned Subsidiary		Joint Venture		Joint Venture Acquisition		Equity Increase		Share Acquisition**		Asset Acquisition**	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
1989	1	1%	5	6%	5	6%	1	1%				
1990	2	2%	8	9%	7	8%	1	1%	2	2%		
1991	3	3%	7	8%	13	15%			2	2%	1	1%
1992	2	2%	2	2%	6	7%	1	1%	3	3%	4	5%
1993			3	3%	1	1%	1	1%	1	1%	1	1%
1994			2	2%					1	1%		
1995											1	1%
1996***											1	1%
Total (88 firms)	**8**	**9%**	**27**	**31%**	**32**	**36%**	**4**	**5%**	**9**	**10%**	**8**	**9%**

Table 4.16c, Timing and Mode of Investment: Poland

Year of Investment	Modes of Foreign Direct Investment											
	Greenfield				Acquisition							
	Wholly-Owned Subsidiary		Joint Venture		Joint Venture Acquisition		Equity Increase		Share Acquisition**		Asset Acquisition**	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
1989					1	1%	1	1%				
1990	1	1%	5	6%	3	3%	2	2%				
1991	7	8%	2	2%	5	6%			2	2%	4	5%
1992	8	9%	4	5%	3	3%			4	5%	5	6%
1993	5	6%			4	5%	1	1%	6	7%		
1994	4	5%	1	1%	2	2%			2	2%		
1995	1	1%					1	1%	2	2%		
1996***									1	1%		
Total (87 firms)	**26**	**30%**	**12**	**14%**	**18**	**21%**	**5**	**6%**	**17**	**20%**	**9**	**10%**

Table 4.16d, Timing and Mode of Investment: Romania*

Year of Investment	Modes of Foreign Direct Investment											
	Greenfield				Acquisition							
	Wholly-Owned Subsidiary		Joint Venture		Joint Venture Acquisition		Equity Increase		Share Acquisition**		Asset Acquisition**	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
1989												
1990			2	5%	1	2%						
1991	1	2%	5	12%								
1992	5	12%	1	2%	2	5%	1	2%	1	2%	1	2%
1993	4	9%	7	16%								
1994	5	12%	3	7%	2	5%						
1995	1	2%										
1996***	1	2%										
Total (43 firms)	**17**	**40%**	**18**	**42%**	**5**	**12%**	**1**	**2%**	**1**	**2%**	**1**	**2%**

Table 4.16e, Timing and Mode of Investment: Slovakia

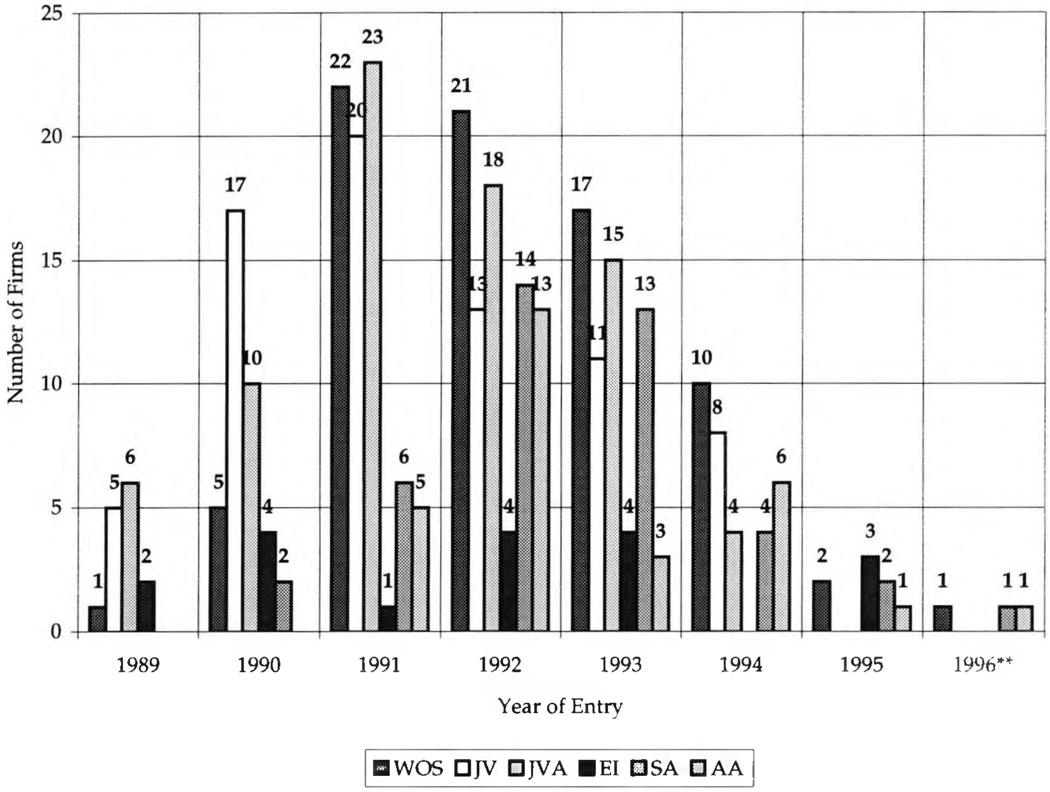
Year of Investment	Modes of Foreign Direct Investment											
	Greenfield				Acquisition							
	Wholly-Owned Subsidiary		Joint Venture		Joint Venture Acquisition		Equity Increase		Share Acquisition**		Asset Acquisition**	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
1989												
1990			1	4%			1	4%				
1991	3	13%	4	17%	1	4%						
1992	1	4%	2	9%	2	9%						
1993	3	13%			4	17%			1	4%		
1994												
1995												
1996***												
Total (23 firms)	**7**	**30%**	**7**	**30%**	**7**	**30%**	**1**	**4%**	**1**	**4%**	**0**	**0%**

Table 4.16f, Timing and Mode of Investment: The CE Group*

Year of Investment	Modes of Foreign Direct Investment											
	Greenfield				Acquisition							
	Wholly-Owned Subsidiary		Joint Venture		Joint Venture Acquisition		Equity Increase		Share Acquisition**		Asset Acquisition**	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
1989	1	0.3%	5	1.6%	6	1.9%	2	0.6%				
1990	5	1.6%	17	5.3%	10	3.1%	4	1.3%	2	0.6%		
1991	22	6.9%	20	6.3%	23	7.2%	1	0.3%	6	1.9%	5	1.6%
1992	21	6.6%	13	4.1%	18	5.7%	4	1.3%	14	4.4%	13	4.1%
1993	17	5.3%	11	3.5%	15	4.7%	4	1.3%	13	4.1%	3	0.9%
1994	10	3.1%	8	2.5%	4	1.3%			4	1.3%	6	1.9%
1995	2	0.6%					3	0.9%	2	0.6%	1	0.3%
1996***	1	0.3%							1	0.3%	1	0.3%
Total (318 firms)	**79**	**25%**	**74**	**23%**	**76**	**24%**	**18**	**6%**	**42**	**13%**	**29**	**9%**

Notes: *The data presented for the Czech Republic and Romania is based upon '77' and '43' cases respectively. The '6' missing cases, '5' for the Czech Republic and '1' for Romania, were not included in the tables due to incomplete data (either the year and/or mode of investment were missing). **Both *Share Acquisition* and *Asset Acquisition* are usually directly associated with the process of privatization within each of the respective host countries. ***For '1996', only investments made during the first quarter of the year (the full months of January, February, and March) were deemed applicable given the established parameters of the research study.

Figure 4.8, Timing and Mode of Investment: The CE Group*



Notes: *The data presented for the Czech Republic and Romania is based upon '77' and '43' cases respectively. The '6' missing cases, '5' for the Czech Republic and '1' for Romania, were not included in the tables due to incomplete data (either the year and/or mode of investment were missing). **For '1996', only investments made during the first quarter of the year (the full months of January, February, and March) were deemed applicable given the established parameters of the research study.

The responses to these questions shed some light on the evolution of local firms' ownership structure over time. For the CE group, at first the data seems to indicate a significant shift of local firms with either the JV or other status to the WOS category. However, upon a more thorough examination of the evidence it becomes apparent that this shift was localized within a few specific host countries. In fact, this shift was primarily concentrated within Hungary with a total of 26 companies reporting a transformation of legal status from the JV and other structure to that of the WOS. This is followed to a much lesser degree by a similar shift in both Poland and the Czech Republic with eight and nine firms respectively showing this same type of change.

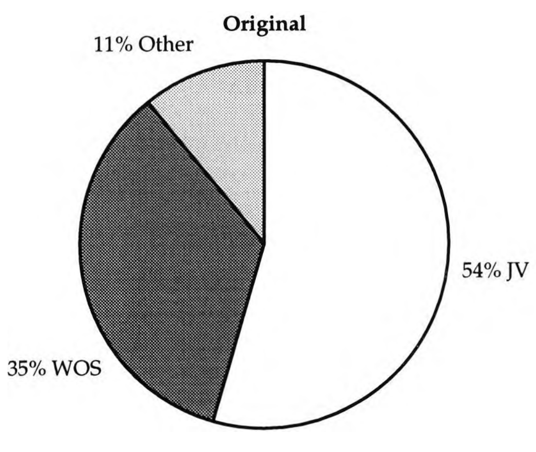
Following up with the investigation into the changes in ownership structure, executives were asked to indicate both the ***original and present shareholding positions of the foreign parent/partner organization in the local firm*** (See **Table 4.18a**). The question was posed so as to give respondents a choice of eight different shareholding categories based upon the respective level of ownership. These eight categories included minority control positions (Up to 10%, 11%-24%, and 25% to 49%), equal partnerships (50%), majority control positions (51%, 52%-74%,

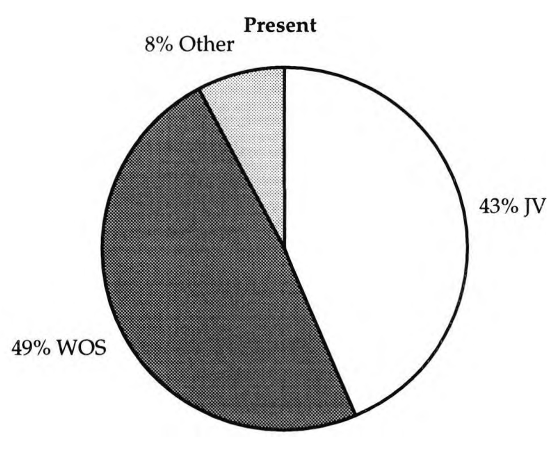
Table 4.17, Evolution of the Local Firms' Ownership Structure

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Ownership Structure*	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
Joint Venture (JV)												
Original	31	38%	66	75%	38	44%	24	55%	16	70%	175	54%
Present	28	34%	43	49%	31	36%	23	52%	15	65%	140	43%
Change	-3		-23		-7		-1		-1		-35	
Wholly-Owned Subsidiary (WOS)												
Original	34	41%	16	18%	38	44%	18	41%	6	26%	112	35%
Present	42	51%	42	48%	47	54%	19	43%	7	30%	157	48%
Change	8		26		9		1		1		45	
Other												
Original	16	20%	6	7%	10	11%	2	5%	1	4%	35	11%
Present	11	13%	3	3%	8	9%	2	5%	1	4%	25	8%
Change	-5		-3		-2		0		0		-10	
Non-Response	1	1%			1	1%					2	1%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Note: *The term *Original* refers to the date of the local firms establishment with foreign capital participation and *Present* refers to the time when the respondent was completing the questionnaire, namely during the second or third quarters of 1996.

Figure 4.9, Evolution of the Local Firms' Ownership Structure*





Note: *The term *Original* refers to the date of the local firms establishment with foreign capital participation and *Present* refers to the time when the respondent was completing the questionnaire, namely during the second or third quarters of 1996.

and 75%-99%), and absolute control (100%).

The results of this inquiry illustrate a trend of foreign parent/partner organizations increasing their shareholding positions over time from minority and equal positions towards majority and full control (See **Table 4.18b**). This movement to consolidate the control of ownership in the local firms is most pronounced in samples of firms based in the Czech Republic, Hungary, and

Poland. In fact, local firms in Hungary had the most dramatic movement in shareholding with 49 firms (56%) showing that their respective foreign parent/partner organization had increased its ownership of shares.

Table 4.18a, Evolution of the Foreign Parent/Partner Organizations' Shareholding Position

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Shareholdings	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Up to 10%												
Original	4	5%	4	5%	1	1%	2	5%			11	3%
Present			2	2%	1	1%	2	5%			5	2%
11% to 24%												
Original	1	1%	2	2%	2	2%	1	2%			6	2%
Present	1	1%	1	1%	1	1%	3	7%			6	2%
25% to 49%												
Original	15	18%	21	24%	16	18%	5	11%	4	17%	61	19%
Present	8	10%	5	6%	10	11%	3	7%	3	13%	29	9%
50%												
Original	1	1%	12	14%	6	7%	5	11%	2	9%	26	8%
Present	2	2%	8	9%	4	5%	3	7%	2	9%	19	6%
51%												
Original	5	6%	15	17%	8	9%	3	7%	4	17%	35	11%
Present	4	5%	4	5%	3	3%	3	7%	3	13%	17	5%
52%-74%												
Original	12	15%	13	15%	10	11%	5	11%	4	17%	44	14%
Present	16	20%	13	15%	11	13%	4	9%	5	22%	49	15%
75%-99%												
Original	6	7%	8	9%	13	15%	6	14%	3	13%	36	11%
Present	11	13%	18	20%	14	16%	7	16%	3	13%	53	16%
100%												
Original	33	40%	8	9%	31	36%	15	34%	6	26%	93	29%
Present	39	48%	34	39%	43	49%	17	39%	7	30%	140	43%
Non-Response	5	6%	5	6%			2	5%			12	4%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Note: *The term *Original* refers to the date of the local firms establishment with foreign capital participation and *Present* refers to the time when the respondent was completing the questionnaire, namely during the second or third quarters of 1996.

On the issue of the ***actual amounts of FDI*** (See **Table 4.19a**), survey participants were asked to provide financial data on both the original and present levels of investment in their respective firm. Given the confidential nature of such information it was not surprising to find that a number of respondents failed to answer these types of question, often specifying in writing the issues of confidentiality and/or company policy as the reasons for non-disclosure. Still, from the data made available the significance of the sample as major contributors of FDI in CE becomes very clear.

Table 4.18b, Changes in the Shareholding Position

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Change in Shareholding	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
Increased Shareholding	21	26%	49	56%	27	31%	7	16%	5	22%	109	34%
Decreased Shareholding	4	5%	4	5%	4	5%	4	9%	1	4%	17	5%
No Change in Shareholding	21	26%	25	28%	26	30%	16	36%	12	52%	100	31%
Wholly-Owned Subsidiary (No Change in Shareholding)	31	38%	5	6%	30	34%	15	34%	5	22%	86	27%
Not Enough Information Available to Ascertain any type of Change	4	5%	3	3%							7	2%
Non-Response	1	1%	2	2%			2	5%			5	2%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Table 4.19a, Changes in the Level of Foreign Direct Investment

	Host Country										Total	
Amount of FDI (in millions of US$)	**Czech Republic**		**Hungary**		**Poland**		**Romania**		**Slovakia**		**CE Group**	
Original FDI												
Sum	$2,120.39		$1,676.59		$1,748.25		$152.28		$76.82		$5,774.33	
Mean	$40.78		$25.40		$27.32		$41.16		$42.68		$177.33	
Standard Deviation	$200.00		$123.00		$116.00		$6.88		$4.13		$129.00	
# Firms/%	52	63%	66	75%	64	74%	37	84%	18	78%	237	73%
Non-Response: Firms/%	30	37%	22	25%	23	26%	7	16%	5	22%	87	27%
Present												
Sum	$2,898.57		$3,476.36		$2,801.60		$503.90		$101.45		$9,781.88	
Mean	$54.69		$48.28		$40.02		$13.26		$56.36		$212.62	
Standard Deviation	$211.00		$237.00		$121.00		$33.23		$5.07		$172.00	
# Firms/%	53	65%	72	82%	70	80%	38	86%	18	78%	251	77%
Non-Response: Firms/%	29	35%	16	18%	17	20%	6	14%	5	22%	73	23%
Total: # Firms/%	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

As a group, the sum of FDI represented by these local firms accounted for a total of $9,781.9 million dollars with a mean of $212.6 million. In comparison, given the reported $25,080.0 million dollars worth of cumulative FDI received by the countries of the CE group between 1989-1995, the sum from the sample represents 39% of the total.[22]

[22]These figures are based upon FDI statistics presented in *Table 1.2, FDI Inflows into the CEC and NIS of the FSU, 1989-1995* in *Chapter 1* of this thesis.

Table 4.19b, Original Foreign Direct Investment by its Components

Components of Original FDI	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
Number of Responses	55	67%	68	77%	59	68%	32	73%	20	87%	234	72%
	55	100%	68	100%	59	100%	32	100%	20	100%	234	100%
a. Know-How												
0%	40	73%	60	88%	47	80%	23	72%	15	75%	185	79%
1% - 25%	8	15%	6	9%	11	19%	4	13%	2	10%	31	13%
26% - 50%	3	5%					3	9%	1	5%	7	3%
51% - 75%	1	2%	2	3%	1	2%	1	3%			5	2%
76% - 99%	2	4%					1	3%	1	5%	4	2%
100%	1	2%							1	5%	2	1%
b. Cash												
0%	11	20%	2	3%	4	7%	3	9%	1	5%	21	9%
1% - 25%	7	13%	5	7%	8	14%	7	22%	3	15%	30	13%
26% - 50%	6	11%	6	9%	6	10%	4	13%	2	10%	24	10%
51% - 75%	2	4%	3	4%	2	3%	6	19%	1	5%	14	6%
76% - 99%	2	4%	5	7%	4	7%	1	3%			12	5%
100%	27	49%	47	69%	35	59%	11	34%	13	65%	133	57%
c. Equipment & Machinery												
0%	39	71%	54	79%	38	64%	13	41%	16	80%	160	68%
1% - 25%	1	2%	3	4%	4	7%	2	6%			10	4%
26% - 50%	3	5%	4	6%	3	5%	8	25%			18	8%
51% - 75%	2	4%	1	1%	10	17%	5	16%	3	15%	21	9%
76% - 99%	5	9%	4	6%	3	5%	3	9%	1	5%	16	7%
100%	5	9%	2	3%	1	2%	1	3%			9	4%
d. Other												
0%	51	93%	66	97%	58	98%	30	94%	19	95%	224	96%
1% - 25%	1	2%					2	6%	1	5%	4	2%
26% - 50%	1	2%	2	3%	1	2%					4	2%
51% - 75%												
76% - 99%												
100%	2	4%									2	1%
Non-Response	27	33%	20	23%	28	32%	12	27%	3	13%	90	28%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Note: *Almost all of the respondents whom did not complete the questions within this section of the questionnaire did so stating reasons of confidentiality and/or company policy prohibiting the disclosure of such information.

Furthermore, it should be stipulated that this calculation is only based upon a total of 251 firms (77%) reporting data.

Besides seeking to obtain financial data on the amount of FDI within the local firm, executives were also requested to provide a ***percentage breakdown of both the original and present amounts of FDI listed by their respective components*** (See **Tables 4.19b & 4.19c**). These components were labelled as know-how, cash, equipment and machinery, and other. As was the case in the previous question, data was not available for all sample members due to confidentiality and/or company policy issues. However, from the data that was available, it appears that cash contributions formed the bulk of both original and present amounts of FDI, followed by some small amounts of equipment and machinery, and lastly a even smaller contribution in the form of know-how or technical assistance.

Table 4.19c, Present Foreign Direct Investment by its Components

Components of Present FDI	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
Number of Responses	56	68%	70	80%	61	70%	34	77%	18	78%	239	74%
	56	100%	70	100%	61	100%	34	100%	18	100%	239	100%
a. Know-How												
0%	31	55%	63	90%	50	82%	25	74%	12	67%	181	76%
1% - 25%	16	29%	5	7%	10	16%	6	18%	4	22%	41	17%
26% - 50%	6	11%					2	6%			8	3%
51% - 75%	1	2%	2	3%	1	2%					4	2%
76% - 99%	2	4%					1	3%	1	6%	4	2%
100%									1	6%	1	0%
b. Cash												
0%	10	18%	3	4%	8	13%	2	6%	1	6%	24	10%
1% - 25%	9	16%	3	4%	6	10%	9	26%	3	17%	30	13%
26% - 50%	6	11%	11	16%	10	16%	4	12%	2	11%	33	14%
51% - 75%	9	16%	3	4%	9	15%	6	18%			27	11%
76% - 99%	3	5%	4	6%	9	15%	3	9%	2	11%	21	9%
100%	19	34%	46	66%	19	31%	10	29%	10	56%	104	44%
c. Equipment & Machinery												
0%	32	57%	49	70%	22	36%	12	35%	14	78%	129	54%
1% - 25%	7	13%	4	6%	10	16%	7	21%			28	12%
26% - 50%	3	5%	7	10%	13	21%	4	12%			27	11%
51% - 75%	3	5%	6	9%	5	8%	4	12%	3	17%	21	9%
76% - 99%	7	13%	2	3%	9	15%	6	18%	1	6%	25	10%
100%	4	7%	2	3%	2	3%	1	3%			9	4%
d. Other												
0%	50	89%	68	97%	58	95%	31	91%	18	100%	225	94%
1% - 25%	2	4%	1	1%	2	3%	2	6%			7	3%
26% - 50%	2	4%	1	1%	1	2%					4	2%
51% - 75%												
76% - 99%												
100%	2	4%					1	3%			3	1%
Non-Response	26	32%	18	20%	26	30%	10	23%	5	22%	85	26%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Note: *Almost all of the respondents whom did not complete the questions within this section of the questionnaire did so stating reasons of confidentiality and/or company policy prohibiting the disclosure of such information.

4.8 The Joint Venture and Joint Venture Acquisition Modes of Foreign Direct Investment

Sample members were asked ***has your firm ever been in the organizational and/or legal form of a joint venture or joint venture acquisition***. The responses to this question included 158 affirmatives (49%), 157 negatives (48%), and a total of nine omissions (3%). Prior to proceeding, it should be noted that based on the data provided through previous questions the actual number of positive responses should have been 175 firms, not a 158 firms. Nevertheless, data were only available for 158 firms that had completed this section of the questionnaire and which had at one time or another employed the JV or JVA modes of FDI.

The executives of these 158 firms were each asked to ***assess the degree of importance for a series of statements in regards to the foreign parent/partner organizations' decision to utilize the joint venture or joint venture acquisition mode of FDI in establishing/reforming the local firm in the specific host country*** (See **Table 4.20**). The question was close-ended and the degrees of importance were based upon a four point scale, using very *unimportant (1)*, *unimportant (2)*, *important (3)*, and *very important (4)*. The statements to be accessed were based on a mixture of motivational factors used previously and other factors associated with the JV literature associated with both partner need[23] and partner selection[24] variables.

Based upon the respondents' ratings of the statements several trends seem to emerge. Firstly, the executives within this CE sub-group rated as important, with a mean of 3.05, the *"advantages of having a local partner (risk sharing, lower capital exposure, benefit from the 'local' expertise, connections of local partner, and image)."* Secondly, just beneath this rating with a mean score of 3.04 was *"to accelerate the process of market entry."* The third highest mean was for the statement *"to acquire market share,"* which received a overall 2.93. Other statements with near important status included *"technically skilled workforce of the local partner"* with a mean of 2.85, *"as a means to minimize investment capital and risks"* at 2.69, and *"trademarks or reputation of the local partner"* with a 2.62 mean rating.

On the other end of the spectrum, both *"to access the local partner's sources of raw materials"* and *"patents, licenses or other proprietary knowledge possessed by the local partner firm"* were rated as clearly unimportant with mean scores of 1.99 and 1.97 respectively. These responses tend to indicate that tangible and intangible elements possessed by the local partner firm were not key to the decision to use the JV or JVA mode of FDI.

[23]The statements on *partner need* were in part derived from those employed by Lee and Beamish in their own research work. See Lee, C. and Beamish, P. W. (1995), *Characteristics and Performance of Korean Joint Ventures in LDCs*, pp. 645-646.

[24]The statements that focused on partner selection issues were those used by Geringer in an earlier one of his studies on international joint ventures. See Geringer, M. J. (1991), *Strategic Determinants of Partner Selection Criteria in International Joint Ventures*, pp. 51-52.

Table 4.20, Motivation of the Foreign Parent/Partner Organizations to utilize the Joint Venture (JV) or Joint Venture Acquisition (JVA) Mode of FDI within the specific Host Country

	Factor's level of importance: (1) very unimportant; (2) unimportant; (3) important; and (4) very important.					
	Host Country					Total
Category:	**Czech Republic Mean (25 firms)**	**Hungary Mean (63 firms)**	**Poland Mean (35 firms)**	**Romania Mean (22 firms)**	**Slovakia Mean (13 firms)**	**CE Group Mean (158 firms)**
a. only type possible/allowed at the time	2.74	2.45	2.77	2.45	2.38	2.57
b. advantages of having a local partner (risk sharing, lower capital exposure, benefit from 'local' expertise, connections of local partner, and image)	3.08	3.02	2.97	3.09	3.23	3.05
c. to acquire market share	3.00	2.90	3.06	2.82	2.85	2.93
d. to tap existing distribution channels of local partner	2.42	2.53	2.45	2.43	2.08	2.44
e. to access the local partner's sources of raw materials	2.04	1.75	2.19	2.38	1.92	1.99
f. able to use the JV/JVA as a means of acquiring only the interesting parts of the local firm	2.46	2.41	2.22	2.19	2.25	2.33
g. incentives offered by the host country to utilize the JV/JVA mode of FDI	2.13	2.57	2.69	2.62	2.00	2.48
h. avoiding the risks of hidden debt and liabilities (including environmental issues)	2.42	2.09	2.36	2.14	2.09	2.21
i. advantages associated with being a new firm	2.46	2.43	2.37	3.00	2.58	2.52
j. to utilize the JV/JVA as a learning vehicle for gaining knowledge on the host country market	2.08	2.52	2.70	2.68	2.50	2.51
k. to reduce operating/production costs	2.75	2.43	2.28	2.82	2.31	2.50
l. as a means to minimize investment capital and risks	2.83	2.76	2.67	2.55	2.38	2.69
m. to accelerate the process of market entry	3.00	2.90	3.24	3.23	2.92	3.04
n. trademarks or reputation of the local partner	2.79	2.53	2.61	2.68	2.58	2.62
o. technically skilled workforce of the local partner	3.08	2.80	2.58	2.91	3.23	2.85
p. location of the local partner firm's facilities	3.00	2.64	2.45	2.68	2.69	2.67
q. patents, licenses or other proprietary knowledge possessed by the local partner firm	2.04	1.76	2.00	2.23	2.23	1.97
r. perceived local or national identity of the venture	2.29	2.22	2.67	2.73	2.58	2.44

Overall, these findings suggest that foreign parent/partner organizations utilized the JV and/or JVA mode of FDI primarily as a vehicle to enter the market quickly, with the least amount of risk and exposure, coupled with the opportunity to gain first hand experience of the business environment in CE. However, it seems clear from the evidence presented earlier in this chapter on changes in shareholding positions that the JV mode of ownership is in a state of decline as more and more foreign parent/partner organizations exert their control over local firms via increased levels of ownership. It might be concluded that the foreign parent/partner organizations utilizes either the JV or JVA modes of investment to enter the market quickly, learn its intricacies, and maximize the advantages associated with having a local partner. Yet, from this initial situation two basic scenarios can emerge although each with the same conclusion. First, as time progresses and the foreign parent/partner organization develops the skills and connections necessary to operate in the host country independently the position of the local partner often becomes redundant. Secondly, as is sometimes the case in a number of JV situations, the relationship between the participants can become strained as a result of poor communication, different agendas of the partners, improper partner selection, etc.. The end result of these two scenarios is usually either a dissolution of the partnership, often with the dominant partner taking control of the operation through a divestiture of the other, or the outright liquidation of the firm. The evidence presented earlier on the increase in level of ownership in favor of the foreign parent/partner organization would suggest the former situation to have the strongest support.

4.9 Performance and Strategy of the Local Firm

The issues associated with performance, level of export activity, and strategy with respect to the local firm were both examined by the researcher. The inquiries into all of these topics were conducted using a series of closed-ended questions. Although, in some instances areas were set aside for respondents to list other pertinent information.

4.9.1 Performance of the Local Firm

The existing literature provides a wide array of references on the issue of company performance and the tools used by firms to evaluate it. Yet, much of the literature seems to concentrate on evaluating a firm's performance via financial based forms of assessment. Bearing this in mind the researcher sought to determine exactly what means of measurement have, and are, being utilized to evaluate the performance of local firms within the context of the CE environment. In doing so, the question was put forth to company executives ***which forms of measurement/assessment does your firm use regularly to evaluate its own financial performance in the respective host country*** (See **Table 4.21**). Executives were allowed to select multiple responses as appropriate for this question and were given a selection of nine forms of assessment to choose from as well as a other category. These nine performance measures were *return-on-investment (ROI), residual income, profit margins, asset turnover, payback period, earnings per share (EPS), turnover (profit growth or sales growth), productivity (profit per or cost per employee),* and *market share.*

In all total there were 1,330 replies to this set of measurements from the 324 local firms. As an average score, the highest number of responses came from executives of local firms based in

Poland with 4.6 replies per firm and the lowest figure in Romania with 3.3 replies per firm. In terms of the actual results of this inquiry, it reveals that local firms use turnover as a primary means of assessing their performance with 255 citations (19%). The second most used tool for measuring performance was profit margins with 226 replies (17%). The other most cited means of assessing performance were market share and return-on-investment each with 198 (15%) and 197 acknowledgments (15%). It is also interesting to note that measurements like residual income and earnings per share rated the same as the free response (fill-in) other category, each showing 3% of the group total. All of these trends were fairly consistent throughout the sample.

Table 4.21, Evaluating the Performance of the Local Firms

Forms of Assessment/ Measurement Utilized	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
Return-On-Investment (ROI)	56	15%	48	14%	60	15%	26	18%	7	9%	197	15%
Residual Income	10	3%	12	4%	9	2%	5	3%	1	1%	37	3%
Profit Margins	59	16%	56	17%	69	17%	26	18%	16	21%	226	17%
Asset Turnover	21	6%	16	5%	28	7%	6	4%	4	5%	75	6%
Payback Period	20	5%	25	7%	41	10%	8	5%	6	8%	100	8%
Earnings Per Share (EPS)	12	3%	9	3%	11	3%	2	1%	3	4%	37	3%
Turnover (profit or sales growth)	70	19%	69	20%	67	17%	31	21%	18	23%	255	19%
Productivity (profit or cost per employee)	56	15%	36	11%	45	11%	16	11%	8	10%	161	12%
Market Share	49	13%	55	16%	59	15%	23	16%	12	16%	198	15%
Others	17	5%	11	3%	11	3%	3	2%	2	3%	44	3%
Total*	**370**	**100%**	**337**	**100%**	**400**	**100%**	**146**	**100%**	**77**	**100%**	**1,330**	**100%**

Note: *The actual total number of respondents to this question was '324' for which there were 1,330 actual replies due to multiple responses.

Overall, these patterns appear to reflect the findings of the existing literature on performance that finds profitability to be the most common means of judging performance in Western firms.[25] Moreover, while both turnover and profit margins rated highly, the numbers of mention of the use of return-on-investment almost equalled those of market share. This finding contradicts the popular conception of researchers that firms rely on return-on-investment as the predominant means of assessing performance.[26]

As a follow-up question, company executives were also asked to state whether or not the forms of assessment/measurement they noted were relevant to evaluating their firm's financial performance within the respective host country. The responses indicated that 298 individuals felt that these tools were both adequate and relevant to assessing the firm's performance in the CE environment against 13 negative statements. There were a further 13 cases of non-response.

[25]For example, see Hayes, R. H. and Abernathy, W. J. (1980), *Managing our Way to Economic Decline* and Hamel, G. and Prahalad, C. K. (1989), *Strategic Intent*.

[26]Numerous researchers have identified ROI as the primary means of evaluating the firms performance. Most of these same researchers have either conceded or argued that ROI is not an accurate means of judging a firm's performance. In the case of the latter, they have suggested other alternatives for evalating performance. For example, see Doyle, P. (1994), *Setting Business Objectives and Measuring Performance*, Tse, P. (1979), *Evaluating Performance in Multinationals*, and Robbins, S. M. and Stobaugh, R. B. (1973), *The bent measuring stick for foreign subsidiaries*.

Table 4.22a, Assessing the Local Firms' Performance

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Category	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Very Poor Performance												
First Year	3	4%	3	3%	7	8%	1	2%			14	4%
Overall	1	1%			1	1%					2	1%
Poor Performance												
First Year	14	17%	22	25%	12	14%	8	18%	5	22%	61	19%
Overall	2	2%	8	9%	2	2%	1	2%	1	4%	14	4%
Average Performance												
First Year	27	33%	28	32%	24	28%	10	23%	4	17%	93	29%
Overall	10	12%	10	11%	11	13%	7	16%	1	4%	39	12%
Good Performance												
First Year	24	29%	21	24%	23	26%	10	23%	8	35%	86	27%
Overall	23	28%	39	44%	37	43%	11	25%	7	30%	117	36%
Very Good Performance												
First Year	12	15%	12	14%	12	14%	9	20%	4	17%	49	15%
Overall	42	51%	27	31%	31	36%	19	43%	14	61%	133	41%
Not Enough Information Available to Respond												
First Year	2	2%	2	2%	9	10%	6	14%	2	9%	21	6%
Overall	4	5%	4	5%	5	6%	6	14%			19	6%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Table 4.22b, Changes in the Local Firms' Performance

	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
Change in Performance	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**	**No #**	**%**
Better Performance	56	68%	55	63%	50	57%	18	41%	13	57%	192	59%
Worse Performance	4	5%	9	10%	17	20%	3	7%	3	13%	36	11%
No Change in Performance	12	15%	14	16%	14	16%	11	25%	3	13%	54	17%
No Change (Very Poor Performance)	1	1%									1	0%
No Change (Very Good Performance)	8	10%	7	8%	5	6%	9	20%	4	17%	33	10%
Not Enough Information Available to Ascertain a Change*	1	1%	3	3%	1	1%	3	7%			8	2%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

Note: *This category refers to those responses that were incomplete, the respondent having provided incomplete information by marking only one box in either the first year or overall section of the question.

The 13 firms making negative statements mentioned other more useful forms of assessment, such as internal rate of return (IRR), return-on-net assets (RONA), or net present value (NPV).

Having established the forms of assessment/measurement with regards to performance, the next logical step was to ask executives to ***denote the performance level associated with their own local firm*** (See **Table 4.22a**). A set of six statements on performance was provided and participants were asked to select the statements that best represented their local firms' performance in both the first year of operation as well as overall.[27] The six statements to this two part question were *very poor performance, poor performance, average performance, good performance, very good performance,* and *not enough information available to respond.*

In terms of the first year's performance, the feedback from respondents shows that most executives associated their firm with either poor performance with 61 instances (19%), average performance on 93 occasions (29%), or good performance in the case of 86 firms (27%). Yet, in the second part of the question on the overall performance level of the firm respondents clearly indicated that their firm's performance was improving. The data suggest a significant increase in the overall level of performance attained with a 117 firms (36%) stating that they had good performance and another 133 companies (41%) claiming very good performance. This change in performance is further highlighted by a comparison of the first year and overall categories checked by executives (See **Table 4.22b**). In examining the data presented in this table one can see that a total of 192 firms (59%) achieved better performance versus 36 firms (11%) with worse performance.

4.9.2 Export Activity of Local Firms

Company officials were requested to provide details on their firm's ***level of export activity*** (See **Table 4.23a**), if any. First, executives were asked what percentage of your firm's total production/sales is destined for exports. A total of 134 firms (41%) indicated that they were not involved in any export activity. The remaining 190 companies (59%) that were involved in export activity were relatively balanced across each of the percentage ranges with the only real concentration appearing in the 1%-10% category with 71 acknowledgments (22%).

Secondly, the 190 firms with some degree of export activity were asked to provide information on the ***regional distribution of their exports*** (See **Table 4.23b**). The data provided indicates that most export activity was directed at serving the markets of the CEC and/or FSU. There was also a modest amount of export activity aimed at the markets of Western Europe (EU and/or EFTA). However, in the other countries category there was very little export activity.

[27] The term *overall* was defined as the period of time from the first year of the local firm's operation to the completion date of the questionnaire.

Table 4.23a, Export Activity of the Local Firms

	Host Country										Total	
Percentage of Production/Sales Destined for Export	**Czech Republic**		Hungary		Poland		Romania		**Slovakia**		CE Group	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
0%	29	35%	35	40%	35	40%	27	61%	8	35%	134	41%
1%-10%	14	17%	20	23%	27	31%	7	16%	3	13%	71	22%
11%-20%	7	9%	4	5%	2	2%	1	2%			14	4%
21%-30%	12	15%	4	5%	7	8%	1	2%	1	4%	25	8%
31%-40%	5	6%	2	2%	4	5%					11	3%
41%-50%	1	1%	3	3%	5	6%	2	5%			11	3%
51%-60%	2	2%	2	2%	3	3%			1	4%	8	2%
61%-70%	3	4%	4	5%	2	2%			3	13%	12	4%
71%-80%	4	5%	3	3%	1	1%			2	9%	10	3%
81%-90%	3	4%	5	6%	1	1%			1	4%	10	3%
91%-99%			2	2%			3	7%	1	4%	6	2%
100%	2	2%	4	5%			3	7%	3	13%	12	4%
Total	82	100%	88	100%	87	100%	44	100%	23	100%	324	100%

Table 4.23b, Regional Distribution of the Local Firms' Exports

	Host Country										Total	
Regional Destination of the Exports	**Czech Republic**		Hungary		Poland		Romania		Slovakia		CE Group	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
a. Western Europe (EU and/or EFTA countries)												
0%	12	23%	13	25%	22	42%	6	35%	2	13%	55	29%
1% - 25%	7	13%	8	15%	5	10%	1	6%	3	20%	24	13%
26% - 50%	3	6%	5	9%	5	10%	1	6%	1	7%	15	8%
51% - 75%	8	15%	7	13%	6	12%	1	6%	2	13%	24	13%
76% - 99%	8	15%	11	21%	9	17%	2	12%	2	13%	32	17%
100%	9	17%	6	11%	3	6%	6	35%	3	20%	27	14%
b. CEC and/or the FSU												
0%	10	19%	13	25%	5	10%	7	41%	3	20%	38	20%
1% - 25%	14	26%	14	26%	14	27%	2	12%	3	20%	47	25%
26% - 50%	5	9%	4	8%	5	10%	2	12%	2	13%	18	9%
51% - 75%	1	2%	3	6%	2	4%			1	7%	7	4%
76% - 99%	5	9%	7	13%	5	10%			4	27%	21	11%
100%	12	23%	9	17%	19	37%	6	35%			46	24%
c. Other regions and/or countries												
0%	33	62%	29	55%	32	62%	13	76%	8	53%	115	61%
1% - 25%	12	23%	11	21%	10	19%	3	18%	5	33%	41	22%
26% - 50%			6	11%	6	12%					12	6%
51% - 75%	2	4%	2	4%	2	4%	1	6%			7	4%
76% - 99%			2	4%							2	1%
100%												
Non-Response*	6	11%	3	6%	2	4%			2	13%	13	7%
Total	53	100%	53	100%	52	100%	17	100%	15	100%	190	100%

Note: *A total of '13' firms in the sample indicated that they were involved in export activities but these same firms failed to provide a percentage breakdown of the destinations of their exports.

Tables 4.24a-f, Geographical & Functional Strategies Employed by the Local Firms:

Table 4.24a, Czech Republic

Geographical Strategies	Functional Strategies: Stand Alone	Functional Strategies: Simple/Complex Integration
Multidomestic	21 26%	12 15%
Regional	9 11%	14 17%
Global	1 1%	25 30%
Total **82 firms (100%)**	**31** **38%**	**51** **62%**

Table 4.24b, Hungary

Geographical Strategies	Functional Strategies: Stand Alone	Functional Strategies: Simple/Complex Integration
Multidomestic	29 33%	14 16%
Regional	11 13%	11 13%
Global	2 2%	21 24%
Total **88 firms (100%)**	**42** **48%**	**46** **52%**

Table 4.24c, Poland

Geographical Strategies	Functional Strategies: Stand Alone	Functional Strategies: Simple/Complex Integration
Multidomestic	28 32%	22 25%
Regional	9 10%	4 5%
Global	3 3%	21 24%
Total **87 firms (100%)**	**40** **46%**	**47** **54%**

Table 4.24d, Romania

Geographical Strategies	Functional Strategies: Stand Alone	Functional Strategies: Simple/Complex Integration
Multidomestic	9 20%	6 14%
Regional	11 25%	7 16%
Global		11 25%
Total **44 firms (100%)**	**20** **45%**	**24** **55%**

Table 4.24e, Slovakia

Geographical Strategies	Functional Strategies: Stand Alone	Functional Strategies: Simple/Complex Integration
Multidomestic	3 13%	4 17%
Regional	3 13%	5 22%
Global		8 35%
Total **23 firms (100%)**	**6** **26%**	**17** **74%**

Table 4.24f, CE Group

Geographical Strategies	Functional Strategies: Stand Alone	Functional Strategies: Simple/Complex Integration
Multidomestic	90 28%	58 18%
Regional	43 13%	41 13%
Global	6 2%	86 27%
Total **324 firms (100%)**	**139** **43%**	**185** **57%**

Note: Please note that due to rounding some percentage totals do not amount to 100%.

4.9.3 Strategy of the Local Firm

The topic of strategy was dealt with through a two-part question. First, executives were called upon to identify the geographic strategy that best reflected the overall business strategy of their own local firm. The choice of ***geographic strategies*** was multidomestic, regional, and global. ***Multidomestic*** was described as a firm whose primary focus is to serve the local host country market by adapting its products/services to meet the local needs and to compete with other local firms. ***Regional*** was characterized by a firm that focuses both on serving the local host county market and other countries within the same region by offering a fairly standardized product/service to customers. The ***global*** strategy was defined as a firm that closely coordinates and integrates its operations with that of the foreign parent/partner organization and its affiliates across geographical boundaries.

Secondly, company management was requested to select between two ***functional strategies*** in the same context as the first part of the question. These two functional strategies were classified as stand alone and simple or complex integration. ***Stand alone*** was when a firm is on its own working relatively independent of the foreign parent/partner organization. ***Simple or complex integration*** was categorized as a firm that is an integral part of the foreign/local parent/partner organization's international network of activities.

The replies to this two-part question have been combined to illustrate the corresponding mix of ***geographic & functional strategies employed by the local firms*** (See **Tables 4.24a-f**). The data for the CE group indicated that local firms usually utilize a multidomestic-stand alone strategy mix with 90 firms (28%) or global-simple/complex integration combination strategy with 86 firms (27%). Still, it should be noted that this pattern was not universal throughout each of the host countries. The trend was prevalent for sample firms located in the Czech Republic and Hungary, and to a lesser extent in both Poland and Romania. The differences in the latter two host countries were a result of high concentrations in other strategy combinations other than the group norm. In Poland, the multidomestic-simple/complex integration was associated with 22 cases (25%). For local firms based in Romania, there were 11 firms (25%) claiming the regional-stand alone strategy mix. As for Slovakia, the multidomestic-stand alone strategy mix received only three notations (13%) while various other combinations encompassing all three geographic strategies with simple/complex integration received the vast majority of mentions with 17 replies (74%) overall.

4.10 Final Points

The final group of questions in the survey was directed as ***gaining further assistance with the research*** (See **Table 4.25**). Hence, the series of questions in this section included a request for the executive's participation in a case study, a request for a company annual report, and finally the researcher's offer of a courtesy copy of a report detailing the results of the survey.

The first of the questions in this section asked if the executive would be willing to actively participate further with the research by cooperating in the creation of a case study based on their experiences in the CE environment. The group totals exhibit a split of 132 replies (41%) stating that they would be willing versus 192 cases against (59%).

Table 4.25, Final Points

Category	Host Country										Total	
	Czech Republic		Hungary		Poland		Romania		Slovakia		CE Group	
	No #	%	No #	%	No #	%	No #	%	No #	%	No #	%
Willing to Participate in a Case Study?												
Yes	40	49%	38	43%	31	36%	13	30%	10	43%	132	41%
No	42	51%	50	57%	56	64%	31	70%	13	57%	192	59%
Supply a Company Annual Report?												
Yes	45	55%	29	33%	29	33%	8	18%	9	39%	120	37%
No	43	52%	59	67%	58	67%	36	82%	14	61%	210	65%
Send a Summary Report?												
Yes	43	52%	34	39%	60	69%	33	75%	14	61%	184	57%
No	39	48%	54	61%	27	31%	11	25%	9	39%	140	43%
Total	**82**	**100%**	**88**	**100%**	**87**	**100%**	**44**	**100%**	**23**	**100%**	**324**	**100%**

The second request was for additional information on the local firm in the format of a company annual report. The data show that 210 firms (65%) did not supply such information with a very heavy concentration of negative replies appearing in Romania (82%), Hungary (67%), and Slovakia (61%). However, these statistics are rather misleading because on numerous occasions executives noted that their local firm did not produce any form of company annual report that could be made available to the public.

The last survey question gave executives the opportunity to receive a courtesy copy of the survey's findings in the format of a summary report. There were basically three main reasons behind this offer: as a small token of thanks to the respondent for their time and cooperation in actively participating in the survey by completing and returning the research questionnaire; as a means of motivating executives to participate in the study; and also as a way of increasing the level of knowledge on the subject matter with actual practitioners.

In response to this offer of a complimentary summary report, the CE group had a 184 affirmative replies (57%) versus 140 responses (43%) stating that they would not be interested in receiving a copy. In terms of the individual host countries, local firms in Romania expressed the greatest level of interest in receiving a summary report at 33 positive replies (75%), followed by Poland with 60 (69%), and then by Slovakia with 14 (61%). On the other side of the coin, the majority of executives of local firms in Hungary indicated with 54 replies (61%) that they were not interested in receiving such information.

Overall, the pattern seems to demonstrate that more economically developed host countries, primarily in the cases of the Czech Republic and Hungary, do not necessarily see the value of obtaining further information on the issues addressed by the survey. Yet, this situation is quite different with regards to the other three host countries who seem to associate a positive value with gaining further information on the subject matter.

4.11 Conclusions

Overall, the survey was considered to be an outstanding success on a variety of levels. First of all, the primary aim of this survey was to address the propositions to the population comprising major Western investors in the CE environment that have engaged in FDI between the beginning of 1989 and the end of the first quarter of 1996. This survey has succeeded in achieving this main goal and in the process has provided a significant amount of insight into the issues under investigation. In turn, the data collected via the questionnaire have been formulated into a series of responses to the stated propositions which offer some valuable insights into the nature of the population sampled.

Secondly, in regards to that last point, the importance and significance of both the population surveyed and actual participants in the study should not be overlooked. As a single group, the 1,222 local firms originally targeted by the study encompass the vast majority of major FDI into the respective host countries. In terms of the 324 participants used to define the survey results, as a group those providing data[28] reported a sum of FDI worth $9,781.9 million dollars which itself represents 39% of total amount of cumulative FDI inflows into countries of CE between 1989-1995. On a host country basis, the sample in the Czech Republic has 51% of its reported FDI accounted for, 33% in Hungary, 39% for Poland, Romania with 55%, and Slovakia with only 11% covered. All things considered, this is a very significant and important group.

Thirdly, in light of the general shortcomings of previous research in this area, this researcher has done his utmost to avoid and/or circumvent the pitfalls noted in some other studies on the subject. In doing so, this study has concentrated the investigation on a specific population of actual investors, utilized a representative sample size, obtained a very good response rate, kept a clear and concise focus throughout the study, and employed a clear methodology. The research was undertaken in such a way so as to minimize the problems and shortcomings associated with other studies while at the same time seeking to maximize the benefits to the base of knowledge in this area of international business studies.

Finally, the researcher felt this study to be a success given the nature of the questionnaire and the specific type of questions asked in it, the actual response rate achieved, the quality of responses in the completed questionnaires, and in light of the very limited research budget that was available to the researcher. However, it should be noted that this study would not have

[28]It should be remembered that only '251' local firms provided complete data on the amount of FDI at present.

been such a success if it had not been for the invaluable assistance of the senior executives of local firms based in the Czech Republic, Hungary, Poland, Romania, and Slovakia. These individuals spared the time necessary from their busy schedules to participate in this survey which in turn made this study a reality. To each of these executives the researcher expresses his esteem thanks for their time and cooperation in this endeavor.

A Prologue to the Case Studies

In Chapters 5 & 6, two *descriptive single-case studies* written in the *linear-analytic structure* format are presented. Each of these case studies illustrates the actions, activities, and evolution over time of a *major Western investor* operating within *Central Europe (CE)(the Czech Republic, Hungary, Poland, Romania, and Slovakia)* environment via *foreign direct investment (FDI)*. The firms forming the basis for this series of case studies were each selected by the researcher from a defined population of local firms with foreign capital participation located in CE which had previously participated in a research survey through the completion of a focused questionnaire.[1]

In Chapter 5, the first of these case studies focuses on ***ABB Asea Brown Boveri***, the Swiss/Swedish engineering firm with its multiple investments operating throughout CE. In Chapter 6, the second case study examines the ***Generali Group***, the Italian based insurance and financial services organization, via its two local insurance operations in Hungary, namely ***Generali Budapest Biztosító*** and ***Providencia Osztrák-Magyar Biztosító***.

The individual case studies themselves are based on various sources of data including the firms' completed research questionnaire, documentation (letters, memos, announcements, internal company reports, newspaper articles, etc.), archival records (company annual reports, company histories, etc.), and in-depth interviews with key local executives of each respective firm (in most cases with the same respondent that had completed the research questionnaire). Wherever possible, data was verified using multiple sources of evidence.

In an effort to increase the reliability of the information in each of the case studies, as well as its readability, the researcher has made every effort to maintain an element of cohesion throughout the case study, thus establishing a chain of evidence.[2] In doing so, each of the case studies follows a similar structure covering three distinct sections. These three sections include a profile of the foreign parent/partner organization(s), a detailed description of its experiences in the context of the environment of CE, and the future outlook for the foreign parent/partner organization(s) in CE as well as the region as a whole. However, it should be clearly noted that the presentation of the case studies has been subject to the level of availability of information. Hence, while each of the case studies follows basically the same structure some areas are covered in greater detail than are others.

Finally, as a point of order, in keeping with ethical considerations involving disclosure rules each of the case studies has been submitted to the appropriate executives of the firms participating in this research endeavor. These individuals were asked to review the case study

[1]For details see *Chapter 4, Foreign Direct Investment in Central Europe: Results from a Survey of Major Western Investors.*

[2]The case study methodology was primarily based on the writings of Yin. See Yin, R. (1988), *Case Study Research: Designs and Methods.*

describing their firm's activities in the CE environment noting any necessary corrections and/or areas of confidentiality. In turn, the case studies were edited according to the feedback received from these company officials as well as that of the researcher's own doctoral supervisor. Yet, it should be clearly stipulated that a company's participation in this process does not necessitate their approval and/or endorsement of this non-commissioned study and therefore the accuracy of the materials presented are entirely the responsibility of the researcher.

Chapter 5

The A-B-Bs of the East: ABB Asea Brown Boveri in Central Europe

A Case Study

5.1 A Profile of ABB Asea Brown Boveri

5.1.1 The Industry Setting

Since the late 1980s the engineering and power generation sectors have become increasingly competitive due to the worldwide conditions experienced during this period. These experiences have included the downturn in the power business following the oil shortage of the mid-1970s after which the market has grown more slowly; the globalization of the market beginning in the late 1980s driven by deregulation and a shift in market volume from the North America and Europe to the Asia region; and beginning in the early 1990s intensive price pressure experienced throughout the industry. This economic situation has led to fewer projects going on offer as well as a dramatic cutback and/or delays in implementing replacement programs, which in turn resulted in fewer orders being placed with producers, especially in the industrialized countries of Western Europe and North America. Subsequently, for companies operating within the engineering and power generation sectors the corporate buzzwords of the late 1980s like *downsizing, restructuring,* and *rationalization* took on an all too serious reality. As a result of this situation there was a dramatic shake out of the industry with some firms falling by the wayside, others seeking refuge in mergers, and almost all concerned forced to make major cutbacks within their existing operations. Two of the firms that had to face this situation were the Swedish engineering firm ASEA AB and the Swiss electrical engineering group BBC Brown Boveri Ltd..

5.1.2 The Company

In August 1987, some two years before the fall of the *Berlin Wall* and the *Iron Curtain,* ASEA and BBC Brown Boveri announced plans for a merger that would combine their assets to create a new company called ABB Asea Brown Boveri Ltd. that would have its headquarters based in Zürich, Switzerland. At the beginning of January 1988 ABB Asea Brown Boveri Limited, henceforth simply referred to as ABB, officially came to life. Under the terms of the merger the new firm was to be equally owned by its two parents. Moreover, shares in ABB were not to be publicly traded, although shares in each of the two parent firms are listed on various stock exchanges in both Europe and the United States. Furthermore, at the Annual General Meeting in 1996, in a show of company unity, the two parent firms announced that they were each being renamed, ASEA of Sweden as ABB AB and BBC Brown Boveri of Switzerland as ABB AG. This act has been cited as the final element in sealing the 1988 merger between the two parent firms.

At the close of 1988, after ABB's first full year of operation the group had generated $17,832.0 million dollars worth of revenues with a net income of $386.0 million. Then the ABB Group operated with 800 firms and 3,500 individual profit centers. These were in turn grouped into eight different business segments covering 50 business areas. These groupings were further broken down geographically, in industrialized countries by subgroups or companies and in the developing world by regions incorporating a number of countries. At the time ABB possessed some 189,493 employees, many of which were based in industrialized countries in Western Europe and North America.

In contrast, at the close of 1995 the group had almost doubled its revenues posting $33,738.0 million dollars and more than tripled its net income to $1,315.0 million. The organizational structure of the ABB Group included over 1,000 firms and more than 5,000 profit centers. While the level of employment has increased by just over 20,000 to a total of 209,637 employees during this period there has been a major shift in its national composition. This shift in the national identity of ABB employees has been a direct result of the transference of operations from North America and Western Europe to other regions, such as Asia, the CEC and the FSU. This shift is discussed in more detail later on within this section. Various key figures for the ABB Group over time are presented in **Table 5.1**.

At present, the international business activities of ABB are grouped into four main segments, namely power generation, power transmission and distribution, industrial and building systems, and financial services (See **Table 5.2** & **Figure 5.1**). These four segments represent a total of 36 different business areas which are each responsible for establishing specific global strategies, business plans, allocation of manufacturing, research, and product development. At the country level, local managers are each responsible for implementing and promoting the global strategies of their respective business areas. The group as a whole is also managed across three geographical regions, which comprise Europe (including the CEC and the FSU), the Americas (including the countries in North-, Central-, and South America), and Asia Pacific (including Australia and New Zealand) (See **Table 5.3** & **Figure 5.2**). These three regional management zones are each charged with promoting cross-border cooperation within the group as well as

Table 5.1, Key Figures for ABB

Key Figure (in millions of USD$ unless otherwise stated)	Year							
	1988	1989	1990	1991	1992	1993	1994	1995
Orders Received	17,822	21,640	29,281	29,621	31,634	29,406	31,794	36,224
Revenues	17,832	20,560	26,688	28,883	29,615	28,315	29,718	33,738
Operating Earnings after Depreciation	854	1,257	1,790	1,908	1,810	2,181	2,619	3,275
Income before Taxes	536	922	1,130	1,153	1,110	596	1,447	2,110
Net Income	386	589	590	609	505	68	760	1,315
Stockholders' Equity including Minority Interests	3,508	4,375	4,715	4,799	4,386	3,837	4,399	5,583
Total Assets	17,365	22,545	28,109	28,056	25,949	24,904	29,055	32,076
Capital Expenditure for Tangible Fixed Assets	736	783	961	1,035	957	816	935	1,171
Capital Expenditure for Acquisitions	544	3,090	677	612	253	212	196	315
Expenditure for Research & Development (R & D)	1,255	1,361	1,931	2,342	2,386	2,271	2,353	2,627
Operating Earnings/Revenues (%)	4.8%	6.1%	6.7%	6.6%	6.1%	7.7%	8.8%	9.7%
Return on Capital Employed (%)	12.1%	15.5%	17.7%	15.1%	15.4%	16.1%	17.6%	22.6%
Return on Equity (%)	12.5%	16.8%	14.5%	13.9%	11.8%	1.8%	20.2%	28.4%
Number of Employees (as shown)	169,459	189,493	215,154	214,399	213,407	206,490	207,557	209,637

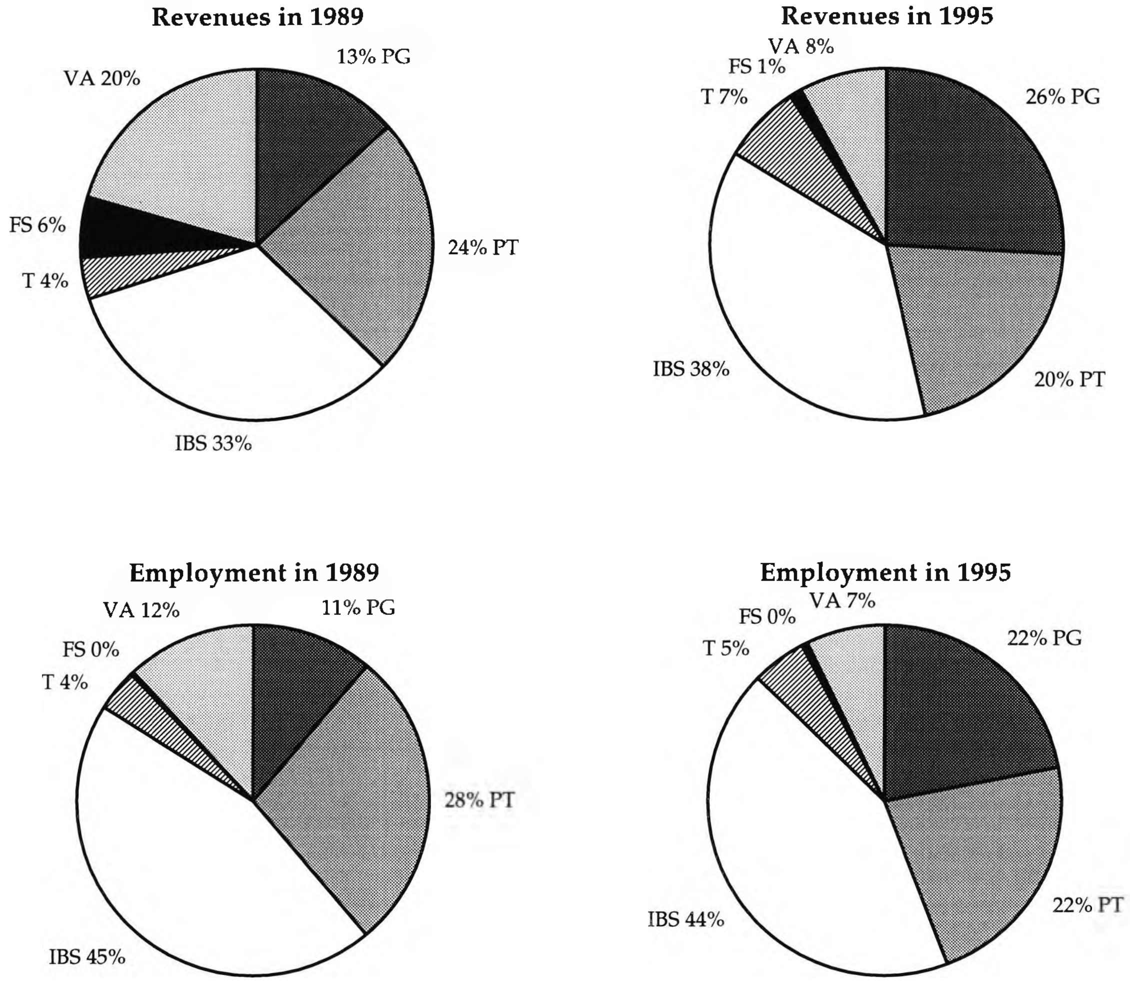
Sources: ABB Asea Brown Boveri Company Annual Reports, 1988-1995.

Table 5.2, Activity by Business Segment at ABB

Business Segment (in millions of USD$ unless otherwise stated)	Year							
	1988	1989	1990	1991	1992	1993	1994	1995
Power Generation								
Revenues	$3,138	$3,452	$5,674	$7,046	$7,155	$8,051	$8,909	$10,308
Employees	20,309	21,306	34,416	37,983	34,723	39,750	41,568	46,014
Power Transmission								
Revenues	$4,766	$6,096	$6,809	$7,121	$7,254	$6,595	$7,030	$8,144
Employees	38,762	52,632	49,994	46,882	47,071	43,484	46,457	46,827
Industrial and Building Systems								
Revenues	$7,882	$8,393	$11,457	$12,649	$12,922	$11,934	$12,820	$14,931
Employees	77,948	85,004	92,904	93,935	89,324	85,928	89,023	89,987
Transportation								
Revenues	$775	$991	$1,344	$1,946	$2,662	$2,757	$2,921	$2,882
Employees	5,196	7,371	9,583	12,527	17,500	16,119	15,760	10,717
Financial Services								
Revenues	$1,046	$1,446	$1,092	$868	$805	$362	$307	$428
Employees	515	597	715	725	687	717	777	817
Various Activities/Corporate								
Revenues	$5,037	$5,250	$3,870	$3,049	$3,844	$3,349	$2,828	$3,179
Employees	26,729	22,583	27,542	22,347	24,102	20,492	13,972	15,275
Totals								
Revenues	**$22,644**	**$25,628**	**$30,246**	**$32,679**	**$34,642**	**$33,048**	**$34,815**	**$39,872**
Employees	**169,459**	**189,493**	**215,154**	**214,399**	**213,407**	**206,490**	**207,557**	**209,637**

Sources: ABB Asea Brown Boveri Company Annual Reports, 1988-1995 and the Researcher's own calculations.

Figure 5.1, A Comparison of Activity by Business Segment at ABB



Sources: ABB Asea Brown Boveri Company Annual Reports for 1989 & 1995 and the Researcher's own calculations.

Notes: PG = Power Generation, PT = Power Transmission, IBS = Industrial and Building Systems, T = Transportation, FS = Financial Services, and VA = Various Activities/Corporate.

supporting the development of ABB's composite business operations. A detailed organizational chart of the ABB Group is presented in **Figure 5.3**.

It should also be noted that until the beginning of January 1996 ABB also possessed a fifth internal segment called transportation, which produced total rail systems. Since then this segment has been integrated into a 50:50 joint venture with Daimler-Benz of Germany, aptly entitled as the ABB Daimler-Benz Transportation Group, or Adtranz for short. The transportation group is active in the production of locomotives, high-speed trains, urban and mass transit systems, main line, fixed railway installations, and providing transportation customer support.

Table 5.3, ABB's Revenues* & Employees by Geographic Region

Geographic Region (Revenues in millions of USD$)	**Year**					
	1990	**1991**	**1992**	**1993**	**1994**	**1995**
Europe:						
a. Western Europe:						
Revenues	$15,231	$17,340	$17,665	$15,533	$16,065	$18,644
Employees	140,891	144,088	140,493	130,044	124,567	119,895
b. CEC & FSU:						
Revenues	$304	$321	$351	$465	$676	$1,087
Employees	5,186	5,208	7,259	14,766	20,033	21,658
The Americas:						
a. North America:**						
Revenues	$5,483	$5,265	$4,734	$4,696	$4,747	$4,544
Employees	33,595	30,967	27,931	24,595	23,700	23,844
b. Latin America:***						
Revenues	$994	$952	$1,093	$877	$1,103	$1,231
Employees	11,425	10,237	10,704	10,051	9,446	8,413
Asia-Pacific:****						
Revenues	$3,984	$4,350	$3,312	$4,062	$4,285	$5,654
Employees	20,179	19,809	18,878	17,902	19,379	26,394
Others Regions Not Listed:						
Revenues	$672	$655	$2,460	$2,682	$2,842	$2,578
Employees	3,878	4,090	8,142	9,132	10,432	9,433
Totals:						
Revenues	**$26,668**	**$28,883**	**$29,615**	**$28,315**	**$29,718**	**$33,738**
Employees	**215,154**	**214,399**	**213,407**	**206,490**	**207,557**	**209,637**

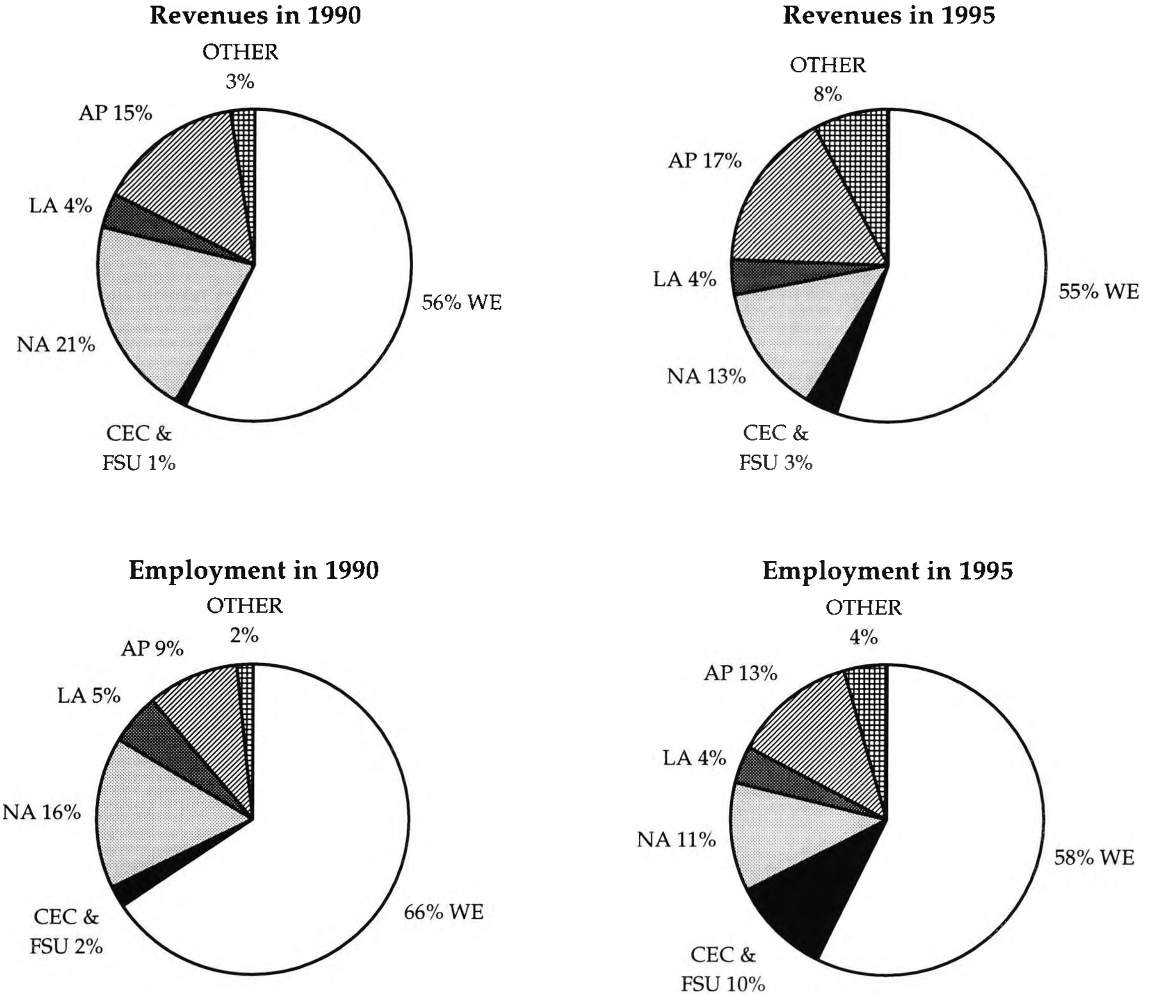
Sources: ABB Asea Brown Boveri Company Annual Reports, 1988-1995; Direct communication from ABB (1996); and the Researcher's own calculations.

Notes: *All revenues are from third party customers; **North America includes only the United States of America and Canada; ***Latin America also includes Mexico; and ****Asia Pacific also includes those countries located on the Indian subcontinent.

Heading up ABB in the capacity of president and chief executive officer since its inception has been Mr. Percy Barnevik, a Swedish national who had previously been the chief executive officer of ASEA AB and who was credited with that firm's revival during the 1980s through his program of change. Over the last nine years Barnevik has been characterized as the driving force behind the globalization of ABB. During his tenure at ABB, observers have labelled him as a missionary, corporate visionary, statesman, and world class executive. However, some individuals have not been so kind in their appraisal of Barnevik. For example, one journalist described Barnevik as *"...Europe's leading hatchet man,"* before going on to credit him as the creator of one of Europe's most successful companies.[1]

[1]Rapoport, C. (1992), *How Barnevik Makes ABB Work*, Fortune, 29 June, pp. 24.

Figure 5.2, A Comparison of ABB's Revenues & Employees by Geographic Region



Sources: ABB Asea Brown Boveri Company Annual Reports, 1988-1995; Direct communication from ABB (1996); and the Researcher's own calculations.

Notes: WE = Western Europe, **NA** = North America, **LA** = Latin America, **AP** = Asia-Pacific, and **OTHER** = Other Regions Not Listed.

These negative descriptions mainly stem from the fact that he was instrumental in transferring so many jobs from Western European countries, as well as from North America, to low cost production countries in Asia, the CEC, and the FSU. Since 1990, ABB has decreased its workforce by more than 53,000 jobs in these industrialized regions while adding some 45,000 positions in Asia and the CEC and FSU, of which almost 25,000 were established in the latter. Yet, Mr. Eberhard von Koerber, the Executive Vice President for the ABB Group and the President of their European region, reportedly defends such moves stating that "*We certainly are reducing our investment in countries that aren't reforming social and fiscal policies and shifting to countries with a more adequate business environment, be that in Eastern Europe or emerging markets.*"[2]

[2]Roth, T. (1994), *ABB's Moves to Eastern Europe Highlight Costs of the EU's Focus on Social Programs*, The Wall Street Journal Europe (WSJE), 8 December.

Figure 5.3, ABB Group Organizational Chart

ABB Group Organization

Executive Committee Member	Armin Meyer	Göran Lindahl	Sune Carlsson	**Percy Barnevik President, CEO**	Eberhard von Koerber	Robert Donovan	Alexis Fries	Kaare Vagner
Business Segments / Regions	**Power Generation**	**Power Transmission and Distribution**	**Industrial and Building Systems**	**Financial Services**	**Europe**	**The Americas**	**Asia Pacific**	**President and CEO ABB Daimler-Benz Transportation (ADtranz)**
Business Area / Country	– Gas Turbine and Combined Cycle Plants – Utility Steam Power Plants – Power Generation Industry – Hydro Power Plants – Fossil Combustion Systems & Services – Nuclear Power Plants – Power Plant Control – Environmental Systems – District Heating – Energy Ventures – Power Plant Production	– Cables – Distribution Transformers – High-Voltage Switchgear – Medium-Voltage Equipment – Network Control and Protection – Power Lines – Power Systems – Power Transformers Middle East and North Africa	– Automation and Drives – Oil, Gas and Petrochemical – Flexible Automation – Instrumentation – Motors – Contracting – Low-Voltage Systems – Low-Voltage Apparatus – Installation Material – Air Handling Equipment – Service – Superchargers	– Treasury Centers – Leasing & Financing – Insurance – Stockbrokerage & Investment Management – Project & Trade Finance	Austria Belgium Czech Republic Denmark Finland France Germany Greece Hungary Ireland Italy Netherlands Norway Poland Portugal Romania Russia Spain Sweden Switzerland Turkey United Kingdom Other European Countries and CIS South Africa and Sub-Sahara Africa	Argentina Brazil Canada Mexico USA Venezuela Other Central and South American Countries	Australia China Hong Kong Indonesia Japan Korea Malaysia New Zealand Philippines Singapore Taiwan Thailand Vietnam Other Asia Pacific Countries South Asia India Other South Asia Countries	ABB's Transportation Segment businesses were transferred to a 50-50 joint venture with Daimler-Benz AG effective January 1, 1996.
Senior Corporate Officers	Arne Bennborn Tomas Ericsson Craig Tedmon	Large Composite Plants Finance and Administration Group Research and Development						
Business Segment Manager	Jan Roxendal	Financial Services						

Source: ABB Asea Brown Boveri Company Annual Report, 1995

A case in point, one of Barnevik's first actions when he took control of ABB was to drastically reduce what he described as a bloated headquarters staff. He subsequently slashed the level of corporate headquarters employees from some 2,000 down to 176 members. On the subject, Barnevik has been quoted as saying, *"Ideally you should have a minimum of staff to disturb the operating people and prevent them from doing their more important jobs."*[3] Although some of the headquarters staff were simply let go (30%), many others were transferred to ABB subsidiaries (30%) or to new companies established by the company to take over some of the same functions previously performed internally (30%). For example, in the case of the latter, ABB Marketing Services was established by Barnevik as a separate company with its own profit and loss account. This external company handles the group's marketing services for which it charges its internal clients at competitive market prices. The remaining headquarters staff (10%) carried on the same activities as before but now in a much more streamlined fashion.

Still, regardless of one's opinion of Percy Barnevik and his methods, the fact remains that while he has been at the helm of ABB he has been credited with steering the firm on a successful course, an especially arduous task taken into consideration the very difficult economic conditions the firm faced when it was originally formed. During the end of the 1980s and into the early 90s, while key competitors within the industry were busy retrenching their operations, Barnevik was busy leading his firm on an aggressive global expansion program. The quickly arranged merger creating ABB was followed up by a wave of mergers and acquisitions as well as a concerted drive to promote internal growth within existing operations. During this period the firm spent nearly $4,241.0 million on acquisitions while also divesting itself of $1,313.0 million worth of assets and shareholdings (See **Table 5.4** & **Figure 5.4**). During the course of 1989 alone ABB expanded its operations from 800 firms to almost 1,150 companies and was still hungry for more. This first phase of ABB's corporate history was appropriately termed the merger, acquisition, and growth phase and spanned 1988-1990.

The next phase of the firm's development saw a partial reversal of the buying spree as a direct result of the deep international recession which caused the group to enter a period of consolidation and selected growth that began in 1991 and ended during the first half of 1994. However, throughout this period ABB retained some 1,300 separate firms, up by 150 from the previous phase of the company's developmental history. Between 1991-1993 acquisitions and divestments were relatively balanced with $1,077.0 and $1,043.0 million respectively (See **Table 5.4**). Yet, in terms of acquisitions this period also marked the beginning of ABB's drive east into the CEC and FSU, where ABB was quick to gain first mover advantages in the region.

During this second phase the company's development ABB also continued to decrease its workforce in Western countries, notably in the industrialized countries of Western Europe and

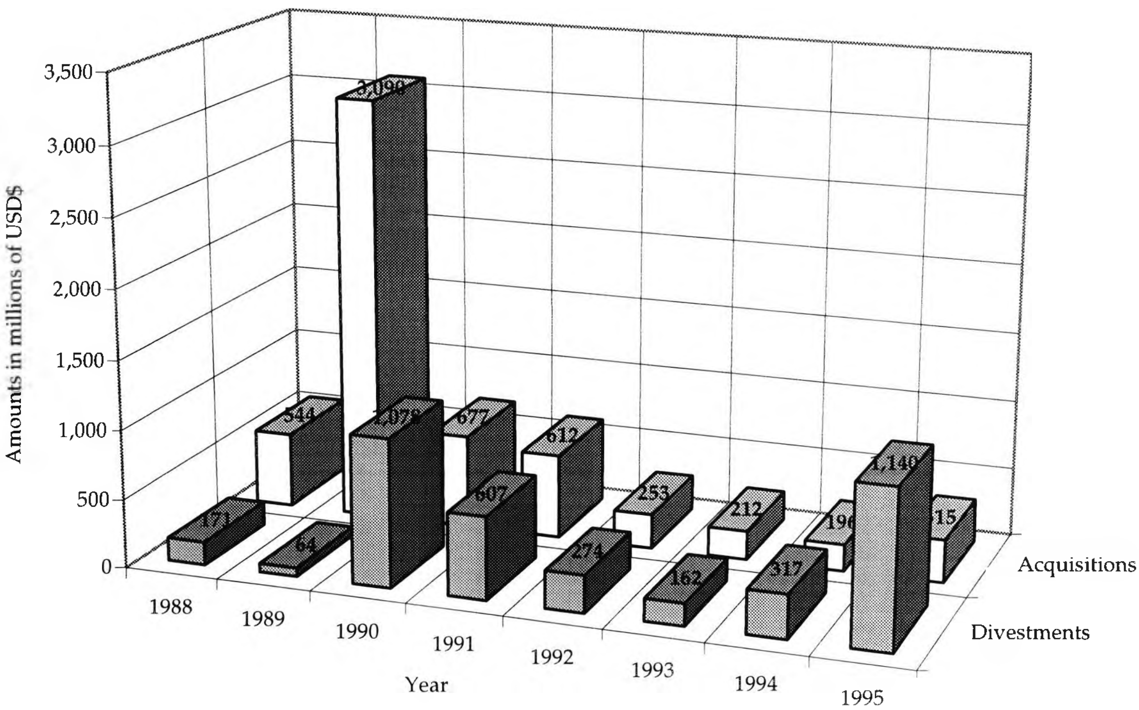
[3]Rapoport, *op. cit.*, pp. 25.

Table 5.4, Acquisitions & Divestments by ABB

Type of Activity (in millions of USD$ unless otherwise stated)	Year							
	1988	1989	1990	1991	1992	1993	1994	1995
Acquisitions	544	3,090	677	612	253	212	196	315
Change from Previous Year (%)	0.0%	468.0%	-78.1%	-9.6%	-58.7%	-16.2%	-7.5%	60.7%
Divestments	171	64	1,078	607	274	162	317	1,140
Change from Previous Year (%)	0.0%	-62.6%	1584.4%	-43.7%	-54.9%	-40.9%	95.7%	259.6%
Total (Divestments less Acquisitions)	**-373**	**-3,026**	**401**	**-5**	**21**	**-50**	**121**	**825**

Sources: ABB Asea Brown Boveri Company Annual Reports, 1988-1995.

Figure 5.4, Acquisitions & Divestments by ABB



Sources: ABB Asea Brown Boveri Company Annual Reports, 1988-1995.

North America, that were both short of orders and expensive to operate within. In an effort to gain a *low-cost producer* position many of these jobs were transferred to newly created or expanded ABB operations in Asia, the CEC, and the FSU. According to statements by Mr. David de Pury, previously Co-Chairman of the ABB Group, given in a recent interview with *The Wall Street Journal Europe*, *"The shift eastwards has been one of the major reasons why we have been able to improve our profitability in the last years despite relatively slow growth orders and revenues."*[4] Following up on this de Pury added that the decision to transfer operations from the West to the East is a simple case of economics, workers in Germany cost far more and work less hours

[4]Kempe, F. (1996), *ABB's de Pury Seeks to Shift EU Focus*, The Wall Street Journal Europe (WSJE), 2-3 January.

in a year than do their counterparts in Poland. Although de Pury states that the German worker is usually more productive this does not compensate for the huge wage differential between the highly paid German worker and the Polish alternative. Mr. von Koerber quantified this argument in an earlier interview with *The Wall Street Journal Europe* in 1994, *"For example: an ABB worker in Western Germany costs the company about $29.20 an hour and works 1,433 hours a year. By contrast, the average worker at an ABB plant in the Czech Republic costs about $1.90 an hour and works 1,910 hours a year."*[5]

The third and current phase of ABB's development which has been in effect since mid-1994 has been characterized as a period of expansion into growing markets, mostly in the same geographic locations in which ABB has been busy establishing local operations. Between 1994-1995 ABB has spent some $511.0 million on acquisitions while at the same time divesting itself of assets and shareholdings in the amount of $1,457.0 million, the bulk of which is from the transfer of the former Transportation segment to the Adtranz venture in 1995 (See **Table 5.4**). Hence, according to company statements, since ABB has already completed the phase of consolidation and restructuring, making it more lean and mean than ever, the firm is now in a position to reap the benefits of these efforts through sustainable growth.

In regards to ABB's shift into growth markets, Barnevik has stated in the company's most recent annual report that *"Gone is the era when Western Europe and North America were ABB's natural home bases and the other regions were remote export targets with minor local operations."*[6] Therefore, ABB is seeking to capture much of its growth in places like India, China, Southeast Asia, the Pacific, Latin America, the CEC, and the FSU.

5.1.3 Company Strategy

"Think global - act local" has been Percy Barnevik's battle-cry at ABB over the years, a firm which he has classified as having a *"multidomestic"* strategy. The slogan itself means that ABB companies are responsible for being both responsive and creative towards their customers and the local business environment of their respective host country of operation while at the same time closely collaborating with their appropriate business area to ensure that the global strategies of the area, region, and the group as a whole are being fulfilled. In implementing this type of multidomestic strategy ABB employs what Barnevik describes as a loose and decentralized matrix structure in the organization. In this matrix structure country and business area managers work in tandem to ensure both the successful execution of the firm's global strategies as well as the profitability of individual local host country operations. In regards to this, Barnevik has been quoted as saying that *"Our strength* (at ABB) *comes from pulling together.*

[5]See Roth, *op. cit.*.

[6]ABB Asea Brown Boveri (1995), *Annual Report 1995*, pp. 7.

We have to cooperate, we have to buy from each other, we have to help each other. If you can make this work real well, then you get a competitive edge out of the organization which is very, very difficult to copy."[7]

However, because of the nature of ABB's matrix organizational structure it occasionally results in conflicts when the goals of the local host country operation differ to those of the respective business area. In such instances, it becomes the responsibility of the host country manager and the business area manager to work things out, usually employing a give and take scenario with the bottom line being the maximization of the benefits to the group as a whole. This means not maximizing the benefit of the local host country operation while suboptimizing the results to ABB, but placing the maximization of the group above all else. Of course, according to Mr. Hans Wikse, the Vice President of Business Development for ABB in the Czech Republic, ABB's decentralized structure is a big issue for the company and to keep it functioning properly requires a lot of time devoted to communication with other ABB operations within the company's network via meetings, telephone calls, faxes, lots of travelling, etc.. But Wikse adds that one of the distinct benefits or this matrix structure is that, *"It also makes us a lot more agile than our competitors."*

The bottom line of the situation at ABB has been expressed by Barnevik during a *Forbes* magazine interview, in which he states that *"ABB will stand or fall on efficiency and the way we operate globally. And this has to improve all the time - time management, quality management, and the consolidation of the two.... Speed, quality, cost, service: You're married to it."*[8] In meeting this challenge Barnevik has been instrumental in adopting what he terms as a culture of *"continuous change"* at ABB. In this type of culture, target levels for improvement are constantly raised and the process of change is viewed by employees as the norm rather than the exception, and also as a positive development instead of a threatening or negative occurrence. Overall, it appears that Barnevik believes that the combination of the customer focus and the continuous change programs will dramatically reshape the company's culture and thus the attitude of its employees, which in turn will give ABB the ultimate edge against its competitors.

5.1.4 Key Competitors

Given the diverse nature of ABB's products and services within its economic fields of activity as well as its international spread the firm competes with a large number of firms, many of which are leading national companies within their respective home countries and some of the world's largest industrial corporations. Some of ABB's major competitors include General Electric (US)

[7]Guyon, J. (1996a), *At ABB, Globalization Isn't Just a Buzzword: It's a Corporate Culture*, The Wall Street Journal Europe (WSJE), 1 October.

[8]These comments wre extracted from an interview of Percy Barnevik by Rich Karlgaard for *Forbes* magazine. See Karlgaard, R. (1994), *ASAP Interview: Percy Barnevik*, Forbes, 5 December, pp. 66.

of the United States, the Anglo-French consortium GEC Alsthom (UK/FR)[9], Hitachi (JP) of Japan, Mitsubishi (JP) of Japan, Siemens (BD) of Germany, and Westinghouse (US) of the United States. Still, Barnevik has been quoted in an earlier interview with *Fortune* magazine as stating that the real competition is the Japanese, implying that firms like Hitachi and Mitsubishi are ABB's main competitors. According to Barnevik, *"The Japanese are the ultimate competitors....Maybe not now or tomorrow, but by 2000 they will be in all of our businesses. We go head to head with Siemens and GEC, but over my shoulder I'm looking at Japan. The Japanese are the most dangerous."*[10]

As previously stated, due to the worldwide economic downturn in the late 1980s and early 90s there was a severe shortage of orders for heavy engineering goods and services, especially in the industrialized countries of Western Europe and North America. Subsequently, the battleground for producers in the industry has shifted from these Western countries to other parts of the globe, like the countries of Asia, the CEC and the FSU, and other emerging markets. Although it now seems that the slowdown in both Western Europe and North America appears to have levelled off somewhat this will not have an effect on increased demand for ABB or its competitors for at least another year of so due to the late position of their products and services within the business cycle.[11] While there has been a shift in demand in the development of new power plants from West to East, the West still maintains its status as a major market for both service and replacement products. However, ABB claims that its aggressive investments in the eastern half of Europe are now at the stage that when demand in Western countries translates into actual orders the company will have a competitive advantage in the bidding process. This advantage will come from the company's ability to supply quality products from its low-cost producer operations in the CEC and FSU. Also, by establishing operations in Asia, the CEC, and the FSU ABB has become what the company likes to term as true *"insiders"* in the countries of these regions. This insider position will not only allow ABB to be highly competitive in supplying Western markets but also be set to grow with these emerging markets as demand for electrical engineering products and services increases over time. Furthermore, because of Barnevik's considerable efforts to reduce lead times in design and production processes throughout company, ABB will be able to supply customers with faster delivery times than many of its competitors. These products will also be of high quality as ABB factories in CE are now up to Western standards with many of their employees having gained their ISO[12] certification.

[9]GEC Alsthom is jointly owned (50:50) by General Electric Company (GEC) of the United Kingdom (UK) and Alcatel Alsthom of France (FR).

[10]Rapoport, *op. cit.*, pp. 27.

[11]This same point was also made in a recent ABB press release. See ABB Asea Brown Boveri (1996a), *ABB Group Results - First Nine Months 1996*, pp. 3.

[12]ISO stands for International Standards Organization.

5.1.5 ABB's Means of Evaluation for Foreign Direct Investment

Based on the personal experiences of Hans Wikse, ABB evaluates potential FDI on the basis of four key investment criteria. It should be stipulated that Wikse's comments are insightful not only because of his current position within ABB but also because he was previously part of company's Corporate Development team at the company headquarters in Zürich. There he was personally responsible for handling many of the firm's mergers and acquisitions that have taken place almost since the date of the firm's creation in 1988, especially investments in the CEC and the FSU. According to Wikse, the four investment criteria that ABB utilizes are the strategic fit of the target/partner in relation to the group as a whole, opportunity, selected financial factors, and new markets. In regards to the financial factors, ABB carefully examines and takes into consideration such information as the business plan, the short-term effects of the merger or acquisition on the group, and financial measures like net present value (NPV), return-on-investment (ROI), and the payback period. Of these latter measures, ABB considers the NPV calculation to be the most important financial basis for making the decision of whether or not to invest.

In regards to performance of due diligence in the process of mergers and acquisitions, Wikse states that in his own experiences there were often a lot of problems in the examination of the financial accounts of local firms. This was especially the case in many of ABB's earlier deals in the countries of CE, as well as other CEC and the FSU, when materials like annual reports were only a Western concept. Although Wikse concedes that most of the needed information on the local firm was usually within the company's accounts, it was just a matter of locating what went with what. In the overall process of exercising due diligence ABB relies almost exclusively on internal personnel in the form of the acquisition team along with appropriate legal counsel from within the company. The one exception to this rule is that ABB also employs a local lawyer who is based in the respective host country of the pending deal to assist in the process. Yet, Wikse also points out that at ABB the entire acquisition process is very decentralized in that while he and his colleagues in the corporate development department were responsible for a variety of deals other mergers and acquisitions were conducted by ABB personnel out in the field. Wikse states that, *"The biggest problem in making acquisitions is getting to the point where you have a deal that makes sense."* Still, regardless of the means employed to evaluate a proposed merger or acquisition, all of the deals arranged by company personnel have to be submitted to senior ABB management for their final approval before they are implemented.

In a conference speech, Eberhard von Koerber expanded upon ABB's plans for FDI, primarily in the context of the CEC and the FSU.[13] His address covered four specific areas including focus, differentiation, control, and education. Although he also cited that these areas would be

[13]Mr. von Koerber was speaking at the Central European Economic Review's First Annual Summit, entitled *"Prospects for growth in Central and Eastern Europe: What Lies Ahead?"*, which was held in London, United Kingdom, on 8 April 1995.

appropriate for ABB making investments almost anywhere in the world. According to von Koerber, *"Firstly, we* (at ABB) *are going out of our way to spread our risks across a broad range of different countries in Central and Eastern Europe."* In other words, ABB is not seeking to focus in just on one or two specific host countries. Hence there is no policy of centralization in ABB's establishing operations via FDI.

Secondly, ABB is seeking differentiation between sectors and industries. In doing so, von Koerber states that *"The most important criteria is knowing your customer...understanding your market means listening."* He goes on to say that it is important to act in the proper way, in his words *"Not coming in as God or as the preacher but as a hungry listener."* This focus on the customer has been instilled throughout ABB via the *"Customer Focus"* program instigated by Barnevik in 1990. In a company annual report, Barnevik stated that one of the fundamental goals of this program *"...is to increase operational excellence and to create better values for the customer by reducing cycle time and raising quality and service levels."*[14] For example, the *"T50"* program (time minus 50%) was formed to play a key role in this drive to focus more on the individual customer as well as improve ABB's speed and efficiency. The program is designed to halve lead times and improve customer service, whether it be on the manufacturing workshop floor, in engineering, in the administration office, or anywhere else within the company. By doing so, ABB can be both more productive internally and thus more responsive to meeting the needs of the customer.

Thirdly, von Koerber stresses that the issue of control is a critical element in creating successful operations at ABB. He states that, *"If you want to be successful in this environment* (in reference to the CEC and FSU) *I think it is wise to go for management control and not for a minority position. Wherever we lead with a minority position we failed and wherever we pushed for a majority position we met with a painful protest."* Furthermore, von Koerber adds that on numerous occasions ABB has decided not to move forward with a specific FDI project without first securing at least two-thirds equity and/or 75-80% of the shares in the local operation. He states that, *"The minority shareholder has sometimes become difficult, sometimes cocky, and we don't want to be held back by someone who wants a quick buck when you yourself are in there for the long haul."* Subsequently, as a result of ABB's past experiences it is willing to forgo an attractive opportunity if they can not gain the necessary level of control that the company deems as essential to making the venture a success.

Eberhard von Koerber stated that the fourth area of ABB's plans was in the area of education and know-how transfers, or what he referred to as the *"Invisible Investment."* ABB claims to inject more into its local operations in the form of technology and training than it does in actual equity payments and transfers. In doing so, ABB stresses that educating the workforce,

[14]ABB Asea Brown Boveri (1991), *Annual Report 1991*, pp. 8.

especially at the management level, to take the team approach to problem solving is the key to successful organizational learning. In explaining this concept further, von Koerber describes organizational learning under the aspect of how to handle regional challenges as the ability of personnel to learn from the general and apply these lessons to create solutions to specific problems. In turn, these solutions can be applied to similar problems being experienced elsewhere within the group's operations, regardless of their location. For example, when a problem is identified and solved in a turbine production facility in Poland the experiences learned by the Polish team can be transferred to other ABB operations suffering with such problems, be it in China, Mexico, or India. According to von Koerber, *"It's not only organizational learning, it is also organized corporate learning."* Moreover, the German executive claimed with quite a bit of exuberance that this is one of the exciting leverages of ABB.

5.2 ABB's Experiences in Central Europe

5.2.1 The Industry Setting

During the Communist era the means of production were not only nationalized under the program of *Stalinization* but also grouped together to form economic giants in an effort to achieve economies of scale. This practice was especially common in economic fields of activity like heavy engineering. However, for the most part these same efforts were the cause of the severe problems which greatly handicapped local industry in the countries of CE from the 1950s onwards.

In 1989, when the Communist authorities were removed from power in CE the newly democratic governments began the process of changing their economies from a command economy structure to that of a market oriented one. Hence, big engineering conglomerates in the region, like Skoda Koncern and CKD in the Czech Republic, which had been controlled by the State and protected from intrusions by foreign competitors were now forced to adjust to the economic realities of the international market place. Many of these *state-owned enterprises (SOEs)* found themselves in a position where they were desperately short of liquid assets, faced with sharply dropping demand and supplies of resources as traditional CMEA markets collapsed around them, and unable to effectively compete against the encroachment of foreign competitors. Therefore, almost before the dust had settled over the rubble of the Berlin Wall numerous SOEs, as well as their respective governments, began the process of locating and negotiating terms with a suitable strategic foreign investor(s). However, given the dire international economic conditions at the time not all would-be foreign investors were in a position that would allow them to establish local operations in the transitional economies of the region. One of the main exceptions to this situation was the ABB Group who was one of the first major foreign investors on the scene.

5.2.2 The Investments: A Profile of ABB's Local Firms

Since as early as the 1890s ABB, via its two predecessor firms ASEA and BBC Brown Boveri, has had a presence in many of the countries of Eastern Europe as well as in the Soviet Union, primarily via representative offices. However, in late 1989 when events in Poland created a wave of fundamental change that quickly spread throughout Eastern Europe and the then Soviet Union, ABB began to see the countries of this region in a new and positive light. On this subject Barnevik has been quoted as stating that, *"The region has 400 million people who need to invest hundreds of millions of dollars in revamping their infrastructure. If we can help them do that, and integrate them into the rest of Europe, it will make all of Europe more competitive."* In terms of the advantages of these changes to ABB, Barnevik went on to state in the same interview that *"...if we become more competitive in Europe by using the opportunities that the East offers us, we can be stronger in Asia."*[15]

In the closing months of 1989, in the wake of Poland's first democratic elections in over forty years that swept the long ruling Polish Communist Party from power, ABB began negotiations to acquire equity interests in two local SOEs, namely Zamech of Elblag and Dolmel of Wroclaw. Zamech, an ABB licensee, was engaged in the manufacture and service of turbines, heating distribution systems, and marine equipment. Dolmel, also producing under a license from ABB, manufactured generators and drives.

In January 1990, ABB announced that it had formed a joint venture with Zamech under the name of ABB Zamech Sp. z o.o., in which ABB possessed a majority ownership position in the new firm with 76% of the shares. In May of that same year the deal was made official and ABB had established its first major operation in CE. Before the end of 1990 the company had successfully completed negotiations with the Polish SOE Dolmel. With this deal ABB created two separate companies, each with the legal status of a joint venture company, one called ABB Dolmel Sp. z o.o. and the other Dolmel Drives Sp. z o.o., the former producing generators and the latter active in the manufacture of electrical motors and drives. Dolmel Drives was an interesting deal in that it represented one of the few occasions in which ABB took a minority shareholding position in the firm with only 20% of the existing shares. During 1990, ABB also entered Hungary through the acquisition mode of FDI by creating two firms each in the form of a joint venture company, namely ABB Energir Kft. and ABB Power Generation Kft..

By the end of 1991 ABB had further expanded its base of operations in both Hungary and Poland. In Hungary ABB established three local firms, ABB Szerviz Kft. to provide services to industry, a country holding company called Asea Brown Boveri Kft., and ABB Pacont Processcontrol Kft. to supply industrial controls. In Poland ABB set-up two more local

[15]These statements come from a *Fortune* magazine expose on ABB's activities in the CEC and the FSU by Paul Hofheinz. Hofheinz, P. (1994), *ABB's Big Bet in Eastern Europe*, Fortune, 2 May, pp. 26.

operations, Asea Brown Boveri Sp. z o.o. as a country holding company, and ABB Zwus Signal Sp. z o.o. to produce railway signalling equipment. During this same year ABB made its first major venture into Czechoslovakia with the establishment of two local operations, one as a local affiliate in Prague called Asea Brown Boveri, s.r.o. and the other an acquisition in the form of a joint venture company producing installation materials under the name of ABB Stotz Krompachy, s.r.o. located in Bratislava.

During 1992 ABB continued its aggressive expansion in the region resulting in the addition of five more firms in CE, of which three were in Poland, another operation in the Czech half of Czechoslovakia, and one in Romania. In Poland ABB acquired a majority shareholding in the SOE Elta, forming ABB Elta Sp. z o.o., to produce transformers and switchgear. Later in the year ABB expanded its presence in Poland through both a sales organization with the establishment of ABB Industrial Components Sp. z o.o. as well as its transportation segment with ABB Rail Engineering Sp. z o.o.. In Czechoslovakia ABB made its first acquisition in the country by obtaining the Czech firm of Chemoprojekt based in Brno, which created ABB Lummus Chemoprojekt, s.r.o. as a provider of process engineering services. During the same year ABB also made its first serious move into Romania with the formation of the joint venture company in conjunction with the Romanian firm Renel S.A.. The new joint venture company was named ABB Energoreparatii S.R.L. and its field of activity was that of a provider of services to power plant facilities.

In 1993, ABB added nine more firms to its portfolio in CE, mostly as a result of acquisitions. Four of these firms were formed in the newly independent Czech Republic, three of which came through acquisitions creating ABB EJF, a.s., ABB Elektro-Praga, s.r.o., and ABB ZPA Eneregetické Orchany, s.r.o.. The latter was subsequently merged with the Power Transmission division in Prague and renamed as ABB Energo, s.r.o.. The fourth firm set-up in the Czech Republic was in the form of a joint venture company with První Brnenská Strojírna Brno, called ABB PBS, s.r.o., and was involved in supplying power generation equipment and power stations on a turnkey basis. In Poland, where ABB already had a very strong presence, the company established three more local firms during the year including ABB Elwy Sp. z o.o. and ABB Instal Sp. z o.o., both producers of switchgear, and ABB Centrum Sp. z o.o. producing power plant control equipment. In Slovakia, ABB formed two firms, one a representative office named Asea Brown Boveri, s.r.o., and the other involved in power plants services called ABB PBS Montaze, s.r.o..

Over the course of 1994, a further five firms were added to the ABB's presence in CE, two of which were located in Poland and the other three added to the company's lone operation in Romania. In Poland, the operations formed included both ABB Elmont Sp. z o.o. and ABB Industry Sp. z o.o., Elmont producing switchgear and the other working on industrial projects as well as acting as a provider of related component parts. In Romania, ABB created three more local firms over the course of the year, which included ABB Romania S.R.L. established as a country holding company, ABB Power T & D S.R.L. as a distributor of switchgear, and ABB Rometrics S.R.L. engaged in the production of electronic meters.

In 1995, the pace of ABB's expansion program slowed down significantly in the countries of CE with only two local firms being formed, one in the Czech Republic and the other in Slovakia. In the Czech Republic, ABB created its second joint venture deal, this time with UNIS to supply systems to power stations as well as consulting services working under the title of ABB Power Plant Control, s.r.o.. The other local operation established by the company during 1995 was in Slovakia and was called ABB EZ Bratislava, s.r.o., involved in the business of electrical installations. A list of ABB's operations in the countries of CE, including company names, fields of economic activity, ABB shareholding positions, and the dates of establishment are presented in **Table 5.5**.

According to company data, ABB's operations in CE generated a total of $748 million dollars worth of revenues in 1995, which equated to 71% of all revenues generated ($1,087 million) by the company's firms in the CEC and the FSU. The bulk of this $748 million (100%) was created by ABB's local firms in both the Czech Republic and Poland with $339 million (45%) and $317 million (42%) respectively. This 1995 figure for total revenues in CE is almost seven times what these same business units posted during 1990, when combined revenues amounted to only $109 million dollars (See **Table 5.6**). Still, in terms of the countries of Western Europe the 1995 results for CE represented only 4% of the total ($18,644 million), and was only a mere fraction of ABB's overall revenues for the group with just 2% of the total ($33,738 million).

However, the revenue data for ABB's operations in CE, as well as those based in other CEC and the FSU, is rather misleading because it only takes into account sales by local companies and does not include direct sales from ABB companies abroad to local customers. Since many of the operations in the region were established by ABB to supply the company's other operations in the countries of Western Europe, as well as those located in other parts of the globe, with various products and components the revenue figures are not a true indicator of the immense importance attached to these local firms, especially with regard to manufacturing operations. According to the survey data provided by company executives of local manufacturing firms exports ranged from 20% to 50% of overall production. The vast majority of these exports were destined for Western Europe, many of which are ABB sister organizations.

For example, ABB's substantial group of operations in Mannheim, Germany have placed numerous orders with ABB firms in Poland to take advantage of their low-cost producer

Table 5.5, ABB's Operations in Central Europe, as of 31 December 1996

Host Country	Name of Company	Location	Description of Economic Activity	ABB Percentage Shareholding	Date Established	Number of Employees
Czech Republic						6,523
	Asea Brown Boveri, s.r.o.	Prague	Country Holding Company/ Industry Systems & Services	100%	October 1991	
	ABB Lummus Chemoprojekt, s.r.o.	Brno	Process Engineering	100%	December 1992	
	ABB EFJ, s.r.o.	Brno	Medium Voltage Switchgear	100%	January 1993	
	ABB PBS, s.r.o.	Brno	Boilers, Turbines, and Power Plants	67%	April 1993	
	ABB Energo, s.r.o.	Trutnov	Protection Relays	100%	September 1993	
	ABB Elektro-Praga, s.r.o.	Jabolenc nad Nisou	Installation Material	100%	November 1993	
	ABB Power Plant Control, s.r.o.	Brno	Systems to Power Stations & Consulting Services	75%	December, 1995	
Hungary						556
	ABB Energir Kft.	Budapest	Network Control, HV Substations	100%	June 1990	
	ABB Power Generation Kft.	Budapest	Turbines, Power Plant Services	100%	November 1990	
	ABB Szerviz Kft.	Fertoszemtmiklos	Service	100%	August 1991	
	Asea Brown Boveri Kft.	Budapest	Country Holding Company/ Industry & Transport	100%	September 1991	
	ABB Pacont Processcontrol Kft.	Budapest	Industrial Controls	100%	November 1991	
Poland						5,479
	ABB Zamech Sp. z o.o.	Elblag	Turbines, Distribution Heating, and Marine Equipment	76%	May 1990	
	ABB Dolmel Sp. z o.o.	Wroclaw	Generators	67%	October 1990	
	Dolmel Drives Sp. z o.o.	Wroclaw	Drives	20%	October 1990	
	Asea Brown Boveri Sp. z o.o.	Warsaw	Country Holding Company	100%	July 1991	
	ABB Zwus Signal Sp. z o.o.	Katowice	Railway Signalling	30%	December 1991	
	ABB Elta Sp. z o.o.	Lodz	Transformers, HV Switchgear	94%	April 1992	
	ABB Industrial Components Sp. z o.o.	Warsaw	Sales	100%	December 1992	
	ABB Rail Engineering Sp. z o.o.	Warsaw	Railway Engineering	41%	December 1992	
	ABB Elwy Sp. z o.o.	Lodz	Switchgear MV	100%	March 1993	
	ABB Centrum Sp. z o.o.	Wroclaw	Power Plant Control	51%	December 1993	
	ABB Instal Sp. z o.o.	Wroclaw	Switchgear LV & MV	100%	December 1993	
	ABB Elmont Sp. z o.o.	Lodz	Switchgear MV	66%	April 1994	
	ABB Industry Sp. z o.o.	Warsaw	Industrial Projects and Components	100%	April 1994	

continued...

Table 5.5 (continued), ABB's Operations in Central Europe, as of 31 December 1995

Host Country	Name of Company	Location	Description of Economic Activity	ABB Percentage Shareholding	Date Established	Number of Employees
Romania						2,000
	ABB Energoreparatii S.R.L.	Bucharest	Power Plant Service	51%	October 1992	
	ABB Romania S.R.L.	Bucharest	Country Holding Company	100%	July 1994	
	ABB Power T & D S.R.L.	Bucharest	Distribution Trafos MV/HV	100%	July 1994	
	ABB Rometrics S.R.L.	Timisoara	Electronic Meters	100%	December 1994	
Slovakia						500
	ABB Stotz Krompachy, s.r.o.	Krompachy	Installation Materials	51%	December 1991	
	Asea Brown Boveri, s.r.o.	Bratislava	Representative Office	100%	April 1993	
	ABB PBS Montaze, s.r.o.	B. Bystrica	Power Plant Service	100%	June 1993	
	ABB EZ Bratislava, s.r.o.	Bratislava	Electrical Installation	100%	August 1995	

Source: Direct communication from ABB Asea Brown Boveri (1996).

Table 5.6, Revenues* from ABB's Operations in Central Europe

Geographic Region (Revenues in millions of USD$)	Year					
	1990	1991	1992	1993	1994	1995
Czech Republic	21	38	37	120	136	339
Change from Previous Year (%)	0.0%	81.0%	-2.6%	224.3%	13.3%	149.3%
Hungary	21	41	23	22	31	54
Change from Previous Year (%)	0.0%	95.2%	-43.9%	-4.3%	40.9%	74.2%
Poland	67	124	174	200	238	317
Change from Previous Year (%)	0.0%	85.1%	40.3%	14.9%	19.0%	33.2%
Romania**	-	-	-	-	-	-
Change from Previous Year (%)	-	-	-	-	-	-
Slovakia	-	-	-	2	28	38
Change from Previous Year (%)	-	-	-	0.0%	1300.0%	35.7%
Total	**109**	**206**	**234**	**346**	**434**	**751**
Change from Previous Year (%)	**0.0%**	**88.6%**	**13.8%**	**48.1%**	**25.2%**	**73.0%**

Sources: ABB Asea Brown Boveri Company Annual Reports, 1988-1995 and Direct communication from ABB (1996).

Notes: *All revenues are from third party customers; **Data on revenues for ABB's operations in Romania were not available because the ABB group does not publish such information.

position. In return, these same local firms in Poland have also placed some orders with the company's facilities in Germany, primarily to take advantage of value-added Western technology.[16] These kind of interlinkages within the ABB Group creates a win-win strategy for the company. It also gives the company a competitive advantage over its competitors because it can demand shorter delivery times while maintaining high quality. According to comments made by Barnevik, *"Any idiot can reduce a price by 10% to become more competitive. But if you can offer an electric power transmission cable under the Baltic one year earlier than your competitor can, that is of tremendous value to the customer, and your competitor can't touch you."*[17]

Finally, it should be noted that ABB has not restricted its activities only to the countries of CE. In fact, as of 1995, ABB had established local operations in almost every one of the CEC and the NIS of the FSU, with the exceptions of Bosnia-Herzegovina, Georgia, Kyrgyzstan, the Republic of Moldova, and Tajikistan. By the end of 1995 ABB had some 79 local firms working on its behalf in the CEC and the FSU. In those countries in which ABB has set-up local firms, the majority of these have been in the areas of manufacturing and/or service operations. ABB has concentrated 71 of these types of operations within eight countries of the region, including Bulgaria (2), Croatia (2), the Czech Republic (7), Estonia (4), Hungary (5), Kazakhstan (2), Latvia (2), Lithuania (2), Poland (13), Romania (4), Russia (19), Slovakia (4), and the Ukraine (5). In the other eight counties where ABB has established a presence, these have been in the form of representative offices designed to foster local sales as well as fly the company flag. ABB has set-up representative offices in Albania, Azerbaijan, Belarus, FYROM, Slovenia, Turkmenistan, Uzbekistan, and the Federal Republic of Yugoslavia.

[16]These points were made by Terence Roth in an article on labor issues in Europe. See Roth, T. (1995), *Europe's Labors: Integrating the East, Reinventing the West Are One and the Same,* The Wall Street Journal Europe (WSJE), 30 June/1 July.

[17]Rapoport, *op. cit.*, pp. 26.

While ABB does not disclose specific financial details on its FDIs, it has been estimated that the company acquired its assets in the CEC and the FSU at a total cost of around $400 million dollars[18], of which ABB's local firms in Poland accounted for $161 million[19] and operations in the Czech Republic represented some $50 million[20]. Moreover, because ABB was one of the first major active foreign investors to enter the region during the early stages of the transition process the company was able to be both selective in its choice of investments and also benefitted greatly from very advantageous acquisition prices. Hence, the combination of ABB's ability to acquire only the interesting and viable parts of SOEs through the act of *cherry picking* in conjunction with a modest financial outlay for its acquisitions and joint ventures created a strong platform on which the company could build up its activities in the region.

However, it should be clarified that the company's reason for not divulging specific financial statistics on its FDI in the region are fairly straightforward. According to Mr. Michael Robertson, Assistant Vice President of ABB's Corporate Communications, *"...we avoid giving a figure* (on FDI) *because it is misleading - the initial purchase value of the investments is quickly exceeded by much larger investments which follow to include technology transfer, new plant and machinery, training, admin and infrastructure systems, etc.."* This is what Eberhard von Koerber had previously characterized as the *"Invisible Investment"* that ABB makes in a local firm. He went on further to state that *"This is the single most important investment."* This is an issue which is addressed in greater detail later on within this section when the case study covers ABB's program of restructuring.

5.2.3 Locational and Motivational Factors Affecting ABB's Decision to Engage in Foreign Direct Investment in Central Europe[21]

In a 1993 company annual report, ABB stated that it was *"moving quickly to tap the opportunities for growth in the economies of Eastern Europe and the former Soviet Union. Through acquisitions and joint ventures in Poland, the Czech Republic, Russia, and the Baltic States, for example, ABB's strengthening its base for future growth in this important market."*[22] Yet, to fully understand why ABB invested in CE in the first place one needs to examine the locational and motivational factors that affected the company's decision to engage in FDI within a specific host country and local firm. In analyzing the survey data provided by the executives of local ABB firms in the Czech Republic, Hungary, and Poland some specific details on these issues

[18]This is figure according to an article by Bhushan Bahree. See Bahree, B. (1995), *Power Play: Europe's engineering giants duke it out over the big deals*, Central European Economic Review (CEER), December 1995/January 1996, pp. 22.

[19]Based upon data supplied by PAIZ via direct communication.

[20]Based upon data supplied by CzechInvest via direct communication.

[21]For further details on exactly how these issues were addressed see *Chapter 4, Foreign Direct Investment in Central Europe: Results from a Survey of Major Western Investors.*

[22]ABB Asea Brown Boveri (1993), *Annual Report 1993*, pp. 14.

become apparent.

a. Locational Factors for FDI

The issue of locational factors were addressed to local ABB executives in the form of an open-ended question asking what do you consider to be the three most important location-specific advantages of the respective host country versus other countries as locations for FDI. Responses to this question indicate that local executives considered strategic position factors as the primary location-specific advantage of the host country in which they operated. However, there were some slight variations to this pattern dependent on the individual host country. In the Czech Republic statements identified with strategic position factors were the norm, characterized by the response *"being local."* In Hungary, responses were similar to those given in the Czech Republic but slightly more varied with other factors like geographic location and investment climate also being noted. In the case of Poland, where ABB made its initial FDIs, statements related to financial efficiency factors were the most predominant citation by executives, with *"to take advantage of low labor costs"* a common type of response.

In terms of the second most important location-specific advantage of the host country, the consensus amongst ABB executives in the three CE countries participating in the survey was that financial efficiency factors were rated as most important, with comments like *"low production cost"* a typical reply. The only real deviation to this pattern was found in Hungary with executives there favoring market factors more highly, with statements like *"to gain market knowledge"* and *"to be a part supplier for ABB operations in Germany and Sweden."* Although the former was also classified as being associated with the know-how factor category because it involved the transference of knowledge, in this particular situation be transferred from East to West rather than the more traditionally thought of transfer.

Respondents clearly considered employment factors to be the third most important location-specific advantage of the host country. Typical references to this included the *"workforce skill level"* and *"skilled workers/management."* However, in Poland geographic location factors were also perceived by executives as being important with responses like *"situated centrally in Europe."*

b. Motivational Factors for FDI

The motivational factors affecting ABB's decision to invest were addressed to executives via both open- and close-ended questions. The open-ended questions asked executives of local ABB firms to state their opinion as to the primary and secondary motives of ABB to invest in the local firm they represented. The responses indicated that financial efficiency factors were considered to be the predominant motive of ABB to invest in the local firm, followed closely by market related factors. Comments along the lines of to *"expand low cost capacity"* was one of the statements associated with the financial efficiency factor, especially by ABB executives in the Czech Republic. Market factor statements like the *"growth potential of the market"* were a close second place as the primary motive and were most evident in ABB's Polish operations, although company executives of both Czech and Hungarian based firms made similar comments.

In terms of the secondary motive, executives of ABB firms in the Czech Republic, Hungary, and Poland sited market factors time and time again with comments like *"to access the local market"* and *"market potential"* common. Still, it should be noted that in the case of Poland know-how factors were also mentioned by several ABB executives via statements such as *"factory in good technical and technological condition"* and *"high education of workers: engineers."* Given the nature of the latter citation, this was also attributed to employment factors.

This first open-ended question on the motives for ABB's investment in CE was followed-up by a close-ended one asking executives to assess the relative degree of importance[23] of a series of statements, each of which was directly associated with a particular motivational factor. The responses to this question provide some interesting findings. Market factor statements that focused on the local market of the specific host country were all considered to be very important motivational factors for investment while export oriented market factor statements were rated by executives as relatively unimportant.

Employment, financial efficiency, and strategic position factors were also rated as important by executives, although the latter two factors each showed variations in the degree of importance attached to specific statements. The one and only description associated with employment factors, namely *"availability of a skilled workforce,"* received the highest rating of all statements presented in this particular question. For financial efficiency factors there was a strong consensus among executives that cost related statements were very important in the decision of ABB. These financial efficiency factors included *"comparative labor cost advantages," "to reduce costs in general," "an opportunity to reduce operating costs by transferring production facilities to the host country."* Furthermore, the statement *"to increase profit levels"* associated with the financial efficiency factor was also rated by respondents as very important. However, the other statement in reference to financial efficiency factors, namely *"comparative material cost advantages"* faired poorly with a general rating of unimportant, especially in Hungary but to a lesser degree in the case of Poland. In terms of specific statements associated with strategic position factors, *"to gain first mover advantages"* and *"acquisition opportunities"* were each rated as very important while other statements in this category, such as to *"follow customers/suppliers,"* were deemed as being very unimportant motivational factors for ABB's investments.

[23]This was done on a four point scale using *very unimportant (1), unimportant (2), important (3),* and *very important (4).*

Assertions representing both resource, know-how (technology), and investment climate factors were in the main judged by executives to be unimportant. It is also interesting to note that all of the statements referring to investment climate factors were assessed as insignificant by respondents with an overall evaluation of unimportant. Furthermore, in the case of the investment climate factor statement, *"the low degree of psychic distance (language, cultural, business and customs, differences)"* was given the status of being very unimportant.

Overall, it is apparent from these findings that for ABB locational factors associated with FDI within a specific host country were primarily based on strategic position factors. As for the motivational factors affecting ABB's actual decision to invest in CE, market (those related to the local market of the specific host country), employment, financial efficiency (those related to labor and operating costs) and strategic position factors (to gain first mover advantages and acquisition opportunities) factors were all key ingredients in the FDI equation.

5.2.4 Modes of Foreign Direct Investment and their Evolution[24]

As previously noted within this section, the vast majority of ABB's operations in CE, as well as the CEC and FSU, have been formed through the acquisition mode of FDI, although initially many of these same firms were in the legal status of a joint venture company due to legal requirements of the host countries at the time. In terms of the types of acquisition modes utilized by ABB in establishing its operations in the region, most of the company's FDIs have been in the form of either joint venture acquisitions or share acquisitions. In the joint venture acquisition, ABB creates a joint venture company (which possesses the status of a new legal entity) through a combination of assets from the local firm/partner and new capital injected by ABB. In the share acquisition, ABB acquires a majority of the equity position in a local SOE, usually through direct negotiations with the SOEs existing management rather than a government agency such as a privatization or foreign investment agency. In fact, it should be pointed out that many of ABB's early investments came on the heels of the downfall of Communist regimes in each of the respective host countries of the region and therefore government agencies such as those noted previously had not yet even been created and thus they played no role in the acquisition process.

It should also be noted that ABB has employed some of its German subsidiaries to act as an intermediary firm to engage in FDI on behalf of the group. Hence, some FDI categorized as being German in origin by various organizations should be considered to be of Swiss and Swedish origin. Furthermore, ABB usually does not acquire entire local firms in CE, especially large SOEs. This point was expanded upon by Michael Robertson in a previous interview with *The Wall Street Journal Europe*, *"A lot of these companies are very large, and their product range is very*

[24]For further details on exactly how this area was addressed see *Chapter 4, Foreign Direct Investment in Central Europe: Results from a Survey of Major Western Investors.*

large (in reference to SOEs)." Robertson goes onto to state that "*We've* (at ABB) *resisted attempts to get us to take over more than we are really interested in. In that way, we don't have to trim down those companies that much afterward. The rest XYZ company carries on doing its other activities.*"[25]

In regards to ABB's preference for majority shareholding positions and/or management control, Hans Wikse provides some interesting insights in this area. According to Wikse, drawing on his previous experiences in the Corporate Development team at ABB's headquarters, as a general rule the company steered away from minority shareholding positions. Wikse clarified this further by stating that "*The problem with minority positions is that they tend to consume a lot more management time. Furthermore, given ABB's decentralized structure a minority deal just wouldn't work!*"

Over the course of time ABB has been consolidating its level of ownership in many of it local operations in CE via increased shareholding positions. For example, when ABB initially established ABB Dolmel Sp. z o.o., a Polish manufacturer of power generators, in October 1991 it possessed 55% of the local firm's shares. ABB has since increased its position in this operation to the point where it now holds 67% of the shares. In an even more pronounced case, in April 1992 ABB acquired a 51% shareholding in Elta Sp. z o.o., a Polish SOE that produced transformers and switchgear, from the Polish Ministry of Privatization. Of the other 49% of the local firm's shares, 20% were allocated to Elta's employees and the State retained 29%, 5% of which was reserved for re-privatization. According to available data, since the time of initial investment ABB has increased its shareholding position to some 94%, further evidence of ABB's efforts to consolidate its control and ownership of local firms.

Still, in some other ABB operations in CE the company has not been able or willing to increase its level of ownership, notably in the company's local firms based in Poland. For example, ABB still holds minority shareholding positions in Dolmel Drives Sp. z o.o. with 20%, ABB Zwus Signal Sp. z o.o. at 30%, and ABB Rail Engineering Sp. z o.o. with 41% of the shares. Yet, according to information provided by Hans Wikse in a personal interview, "*Overall ABB hasn't experienced many problems in their acquisitions, but problems arise more in the process of restructuring.*" However, Wikse also concedes that this is a universal problem with all FDIs in the CEC and the FSU.

5.2.5 The Restructuring Process in ABB's Local Firms

The process of restructuring an acquisition can be an extremely difficult task under normal circumstances, but even more so given the nature of the former Communist system under which enterprises functioned for more than forty years and which differed so greatly from the business

[25]These comments were made by Robertson in the capacity of a spokesman for ABB. See Guyon, J. (1994), *Drawing the Line: Slovakia Firm Accepts Benefits and Divisions Of Western Investing*, The Wall Street Journal Europe (WSJE), 5 December.

environment found in the West. In fact, the task of restructuring an enterprise in CE requires a variety of areas to be covered, such as finance, technology, production, product and services, quality, prices and packaging, marketing and sales, employment, and training. These areas will be addressed in the materials that follow, especially the latter two elements which will receive special attention.

Overall, ABB claims that it has been able to bypass, or simply avoid, many of the common problems associated with implementing the difficult process of restructuring in its local firms in the countries of the East. ABB's recipe for success in this area has been the result of several factors, including the fact that the company has usually conducted a long and detailed acquisition process, tried not to make promises it wouldn't be able to honor, and conducted its business in the region with a certain degree of humility. Statements made by von Koerber in an interview with *Business Central Europe* magazine shed light on this latter issue, *"The existing companies [in Central Europe] have managed their own businesses for over 40 years."* Mr. von Koerber goes onto to say that *"Introducing new systems and concepts must be done carefully over time. While one can introduce a new group culture, one can only slowly change the company culture, and the national culture not at all."*[26]

a. An Overview of the Restructuring Process

An example of the implementation of one of ABB's restructuring efforts was described in detail by Hans Wikse by utilizing the example of the joint venture ABB První Brnenská Strojírna Brno, s.r.o. (translated as First Brno Engineering Works) in the Czech Republic. It should be noted ABB utilized individualized restructuring plans for specific companies and situations. In late 1989, the *Velvet Revolution* removed the local ruling Communist Party from power in Czechoslovakia. At that time the Czech based SOE První Brnenská Strojírna Brno, referred to as PBS Brno, was engaged in the production of a range of engineering products as well as related services and the company employed some 10,200 staff in its operations. The company itself had long history in the field of engineering, being founded in 1814 and subsequently expanded into the First Brno Engineering Works in 1872.

In 1990, as the transition process from a command economy structure to a market oriented one got under way in Czechoslovakia PBS Brno was re-established as a shareholding company through the first wave of privatization and was renamed as PBS Brno, a.s.. At the start of 1993 the so-called *Velvet Divorce* resulted in the separation of Czechoslovakia into the Czech Republic and the Slovak Republic, the latter simply referred to as Slovakia. By this period in time PBS Brno had dramatically reduced its workforce by almost 2,900 employees bringing its

[26]These statements were made in an expose on ABB in Central Europe in a special report on FDI in the CEC and FSU. See Meth-Cohn, D., Calbreath, D., Grandsen, G., Kapoor, M., Lee, S., and Straunik, A. (1996), *A Survey of Foreign Investment*, Business Central Europe, April, pp. 44.

level of employment to 7,300.

In April of 1993, PBS Brno and ABB established a joint venture company called ABB První brnenská strojírna Brno, s.r.o., more commonly referred to as ABB PBS for short. The mode of FDI utilized by ABB in this particular case was the joint venture acquisition. Under the terms of the deal ABB gained majority control of the new venture with 67% of the shares while the other 33% were retained by PBS Holding, a Czech holding company. The new venture encompassed selected elements of PBS Brno's core businesses, namely production of boilers, turbines, and power plants and employed a workforce of some 3,800 individuals that had been screened by ABB personnel. The remainder of PBS Brno and its staff continued to function as a separate legal entity producing boiler components, shock absorbers, turbo chargers, and heat exchangers.

Almost immediately upon the formation of the new company ABB began the process of restructuring. ABB had already developed a business plan for the new firm during the negotiation phase of the acquisition and had also selected key personnel, including ABB staff and local managers formerly with PBS Brno, to implement the activities necessary for the company's actual restructuring. ABB moved quickly to install a Western accounting system, divided the local firm into specific profit centers, began providing managers with English language lessons (English is the official language within ABB), provided the new venture with more modern plant equipment, and also established new testing devices to increase the quality of the local firm's products to comparable levels found in ABB's operations in the West.

ABB also established around ten or so different restructuring tasks, each of which was administered and by a hand-picked project manager. In ABB terminology these project managers were referred to as *"Hungry Wolves"* and they were usually young host country nationals drawn from the existing pool of employees of the venture. Some of the restructuring projects focused on capital reduction, installation of information systems, reduction of delivery times, quality and process improvements, to mention a few. Besides the individual project manager, everyone of the restructuring projects was supported by a lead manager lead manager called a *"Grandfather."* The *"Grandfather"* either came from another ABB operating company or from a special internal consultancy branch set-up by ABB to oversee the restructuring process within the company's international operations established via FDI. Yet, overall responsibility for the restructuring of the ABB PBS, as it is with all local firms created in this manner, was given to one a single specified *"Grandfather,"* who was labelled the *"Anchorman."* The *"Anchorman"* worked very closely with the ABB appointed General Manager of the local firm to ensure the company was restructured effectively and efficiently.

By the end of 1993, it was reported that ABB PBS had posted revenues of $32.2 million (CZKc 967 million) with very modest profits of only a $140 thousand dollars (CZKc 4.2 million) on a capital base of $36.7 million (CZKc 1.1 billion).[27] Moreover, during 1994 ABB PBS reduced its workforce down to around 3,600 employees, mostly through voluntary redundancies while at the same time more than doubling its revenues to around $70.9 million (CZKc 2.0 billion). The following year in 1995 the level of employment was reduced further at ABB PBS so that the firm employed only some 3,240 employees while overall productivity was further increased. The issue of employment is discussed in greater detail later on within this subsection on restructuring.

Yet, given Percy Barnevik's program of *"continuous change"* within ABB means that while the major task of restructuring at ABB PBS was completed within the specified two-year period, the process of improving the local firm goes on unabated. According to data supplied by Hans Wikse's office in the Czech Republic, during 1995 the ABB PBS's divisions of boilers, turbines, power plants and services successfully earned their ISO 9001 certifications. In fact, since the formation of ABB PBS in 1993 more than 3,000 employees have taken and passed a training program on quality systems and been awarded accredited certificates for their efforts.

Furthermore, it should also be noted that the group of lead managers titled as the *"Hungry Wolves"* which ABB charged to implement the restructuring efforts at ABB PBS have also been utilized elsewhere within ABB's operations in the Czech Republic. In some instances these same individuals have also been sent out to other ABB firms in other parts of the world. Mr. Wikse illustrated this by stating that one of these Czech wolves had been assigned to an ABB operation in India to undertake a similar restructuring function. In comments given to *The Wall Street Journal Europe*, Mr. Erik Fougner, President of Asea Brown Boveri in the Czech Republic, expanded upon this point by stating that ABB's Czech managers will continue to assist in the process of restructuring in the company's operations in Russia and the Ukraine. According to Fougner, *"They are very instrumental in the acquisition process: they know the culture and the language and they have the contacts."*[28] All of this is further evidence of what Eberhard von Koerber had previously described as *"organizational learning"* within ABB that gives the company a leverage over its competitors.

b. Employment

One of the proud boasts of Communist regimes across both the former Eastern Bloc countries and the Soviet Union was the non-existence of unemployment in their respective economies. In fact, under communism it was claimed that everyone worked for the collective good of the people, or to be more accurate, the State and the Party that controlled it. However, the State's

[27] This is based on information published in the *Prague Post*, a Czech based business newspaper. See Calbreath, D. (editor)(1995), *The Prague Post 1995 Book of Lists*, pp. 53.

[28] These comments were given by Mr. Fougner in an interview with Joe Cook on the use of the Czech Republic as a vehicle into the Russian market. See Cook, J. (1995), *Europe in Transition: Some Investors Envision A Czech Bridge to Russia*, The Wall Street Journal Europe (WSJE), 29-30 December.

dedication to maintaining full employment led to gross overstaffing throughout the SOEs comprising the means of production. This situation was most pronounced in the SOEs active in the field of manufacturing, engineering be a part thereof.

However, overstaffing problems haven't been a real problem in ABB's acquisitions in CE because the company carefully works out employment issues when negotiating the acquisition. Hans Wikse noted that other foreign investors active in the region, some of which are ABB's competitors, have been known to promise a lot when negotiating a deal, especially with regard to appeasing the respective host government's wish to maintain the local firm's high level of employment. Yet, upon taking control of the local firm the foreign investor realizes that honoring the commitment to keep full employment of a usually bloated workforce isn't practical and therefore they return to the host country government to re-negotiate the specific terms on the number of employees to be retained.

Yet, this is not to say that ABB hasn't made reductions in the number of employees in each of the local firms it controls. In fact, ABB has often been associated with utilizing a 30:30:30:10 formula to reduce the workforce, especially in regards to headquarters staff of acquired firms. Under this formula 30% of the employees go to new (non-ABB) service companies, 30% are sent to operating units, 30% are reduced in one way or another, and the remaining 10% stay within the headquarters operations.[29] Still, Wikse points out that in most cases ABB doesn't fire people. A point that was illustrated earlier in the case of ABB's acquisition of the Polish SOE Zamech, via comments made by Andrzej Malinowski, previously Manager of Communications and Business Development with ABB in Poland. Malinowski was quoted as saying that *"no one was really fired"* at Zamech. Although he conceded that some members of staff took their pensions or were transferred to a separate servicing company called Elzam that was created out of the balance of Zamech's operations that were not acquired by ABB.[30]

On the subject of remuneration packages for local employees in CE, Wikse stated that pay scales under the former Communist system were very flat. One of ABB's leverages with its employees in the region was to introduce higher wages and performance based pay, although these were still at considerably lower levels than the company's operations in the countries of Western Europe as was previously illustrated. On this subject von Koerber has been quoted as stating that *"It's rubbish to say these countries lack technology or a work ethos. It's a question of pay. You put in a Western compensation system and you can't get them out of the plant at night."*[31] Still, Wikse notes that in the case of the Czech Republic pay scales are rising, especially in places like Prague and Brno which have almost no unemployment. This situation is developing into a

[29]Rapoport, *op. cit.*, pp. 25.

[30]Reed, J. (1992), *Company Case Study: Asea Brown Boveri Makes Two Polish Ventures Work,* Business Central Europe, 27 April, pp. 199-200.

[31]Rapoport, *op. cit.*, pp. 26.

problem for the company's operations in the country with a turnover rate on employees ranging between 10-15% as production personnel get better financial offers and leave ABB firms. Wikse states that, *"...there is a problem with lack of company loyalty,"* although he clarifies this by noting that this does not apply to managerial level staff.

A final point that should be addressed in terms of employees is ABB's insistence on utilizing local host country nationals as much as possible throughout its operations. ABB seems to believe that one of the aspects of being an insider is to employ locals, not just at the production level but in the local firm's management structure. In fact, since ABB's drive East began in 1989 the company has trained many thousands of respective host country nationals to run its local operations. A point that von Koerber has expanded upon by stating that out of more than 21,000 employees in the region only a handful are foreigners and most of these in the position of country directors or advisors. He goes onto say that the plan is to replace country directors with locals over the next four to five years and advisors over three years as they are needed. In doing so, von Koerber feels that with locals in charge ABB is able to establish creditability with the host country that the company is serious about this and that their investments are not simply opportunistic ventures but real and serious commitments.

c. Training

On the subject of training, ABB invests a considerable amount of resources into the training of staff in its local firms in CE. The primary focus of these efforts begin with top level management and over time work their way down to employees on the workshop floor. At the beginning of the process the chosen management team of the local firm is given intensive training so they (almost all of ABB's managers are males) could successfully fulfill the roles necessary to properly restructure their company. This intensive training comes in the form of mini-MBA course with extensive use of case studies as well as the English language lessons previously noted. This same training courses is quickly expanded to encompass other managers using a top down approach, especially given to those all important project managers fulfilling the role of *"Hungry Wolves."*

Still, it should be clearly noted that this training is not undertaken as a separate function but incorporated directly into the actual restructuring process. Moreover, the intensive training and restructuring programs are both conducted within the same time period. Hence, the company's utilization of case studies in the training scheme is felt to play an important and practical role in the actual restructuring process as this allows the overall process to be accelerated so that the actual payback period starts from day one.

Yet, ABB's training programs are not exclusive to the management level but also expands quickly once the local firm is up and running to cover ordinary employees, as was previously illustrated in the ABB PBS example on quality training for ISO 9001 certification. Still, it is apparent that ABB does rely heavily on a trickle-down method of training whereby intensive training is given to key personnel in the local firm which in turn is passed on to others within the organization.

5.2.6 Performance of ABB's Local Firms[32]

According to Hans Wikse, ABB utilizes what could be described as an even 50:50 approach to evaluating the performance of its local firm in the CE environment. In the first 50% of the equation three primary measures are employed to ascertain the appropriate level of performance achieved, namely volume, growth, and key financial measures. In terms of the latter, the key financial measures utilized include profit before tax and return-on-capital employed (ROCE). Although, the survey data from various local ABB firms in CE shows that they also rely on return-on-investment, profit margins, and turnover (profit growth or sales growth) as performance indicators. To a much lesser degree local firms also employ measures such as asset turnover, productivity (profit per or cost per employee), and market share. Other financial performance measures listed in the survey were not selected by local executives.

In terms of the other half of the equation, 50% of the local firm's performance and that of the respective general manager is based upon the effectiveness of restructuring efforts within the firm. Hence, the general manager and his management team have an enormous vested interest to ensure that the local firm is transformed in an efficient and effective manner within the prescribed two-year time period.

Finally, based upon the survey data available it is apparent from the responses via executives of local ABB firms in the Czech Republic, Hungary, and Poland that the performance levels for the group as a whole during the first year of operation were generally considered as being average. However, in the second half of the question asking executives to rate their firm's overall performance over time the consensus showed a rating of good to very good performance. However, there were a few exceptions to this trend, notably in one ABB company based in Hungary and another in Poland. The former indicating good performance during the first year of operation and only average performance overall. In the case of the latter, for the first year the executive rated the performance as poor while overall this had improved to good performance. While these types of questions are very subjective in nature they do indicate the degree of satisfaction that local executives feel with regard to their own firm. Still, on the other hand, maybe Barnevik's program of *"continuous change"* at ABB has made these executives expect too much from their firms and/or not be satisfied with anything less than perfection?

[32]For further details on exactly how this area was addressed see *Chapter 4, Foreign Direct Investment in Central Europe: Results from a Survey of Major Western Investors.*

5.2.7 Strategy of ABB's Local Firms[33]

Although the issue of strategy has already been covered within the first section of this case study some further points are worth addressing. The data collected via the researcher's own survey shows that local ABB firms adopted either a global geographical strategy in conjunction with a simple/complex integration strategy or a multidomestic geographic strategy mixed with a stand alone functional strategy. The former being the predominant overall strategy of ABB's manufacturing oriented operations and the latter utilized by local firms active as service providers. Overall, these types of findings are very consistent with ABB's stated *"think global - act local"* slogan. However, in terms of the local market, Hans Wikse states that *"Part of the reason we went in here* (in reference to the Czech Republic) *was to gain access to the market, but the Czech market isn't a huge market."* Although, Wikse goes on to say that *"The Czech market is proving much more interesting that we first thought, and not only in manufacturing but also as a low-cost source of engineering and other while collar functions."*

5.3 The Outlook for the Future

In brief, the future outlook for ABB in CE seems to be very promising. However, the company operations in Russia and the Ukraine are a somewhat different matter due to the poor economic circumstances and political situations in those countries that have raised the level of instability. Still, in regards to CE ABB was able to go into the region very early on before the dust of the Berlin Wall had a chance to settle, acquire some of the better local firms available at very low prices, and gain the coveted first mover advantages. Moreover, ABB's acquisitions at bargain basement prices of local firms did not result in a strong feeling of resentment amongst host country nationals or nationalistic backlash because the company has been able to show that it is really committed to the region for the long-term. A point that ABB's boss Percy Barnevik has time and time again stated as he has fought a personal campaign to help the countries of the CEC and FSU reintegrate with economic with their neighbors in Western Europe as well as being able to become a significant member of the global economy.

ABB's global view of the situation in the region was driven home by its number one spokesman, Percy Barnevik. In an earlier interview in 1992 Barnevik stated that, *"Those markets are dead right now* (in reference to the CEC and FSU). *They don't have any money. When we go in and buy companies, we can plug them into Western markets. We're the lubrication. We can help the world economy function better."*[34] Continuing on with the subject, in a more recent article in 1996 Barnevik was quoted as saying that, *"We* (at ABB) *are reaping the benefits of our inroads into*

[33]For further details on exactly how this area was addressed see *Chapter 4, Foreign Direct Investment in Central Europe: Results from a Survey of Major Western Investors.*

[34]Guyon, J. (1996c), *Emerging-Markets Strategy Boost ABB's Bottom Line,* The Wall Street Journal Europe (WSJE), 23 October.

Eastern Europe and Asia....The buildup of low-cost production in these countries is bearing fruit. We don't have a huge volume increase, we have a decent volume increase. The increase in profit is mainly cost driven."[35] Although rising wages and currency values are gradually diminishing ABB's low-cost producer position in CE, Hans Wikse says that the company believes that it will still be a positive factor for the next 10 to 15 years. In the meantime, ABB has already moved onto the next stage of the development process in the region by working with their local suppliers through training programs to improve both the quality level of components as well as to shorten delivery times.

Finally, as a footnote to this case study, in October of 1996 ABB announced that Percy Barnevik would be stepping down from his positions as the firm's president and CEO effective 1 January 1997. Succeeding him is Mr. Göran Lindahl, who will be moving over from his position in ABB as Executive Vice President of the Power Transmission and Distribution segment and responsible for the Middle East and North Africa regions. Barnevik will remain the group's chairman but his role will change to that of cultural ambassador for the company, promoting stronger ties with prominent politicians and business leaders.[36] Regardless of the change of leadership there is little doubt from observers that Mr. Barnevik will continue to wave the ABB flag and that the company will continue to pursue its drive for growth.

[35]Guyon, J. (1996b), *Lindahl to Succeed Barnevik As Chief Executive of ABB*, The Wall Street Journal Europe (WSJE), 11-12 October.

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Chapter 6

The Lion Roars back into Budapest: The Generali Group in Hungary

A Case Study

6.1 A Profile of the Generali Group

6.1.1 The Industry Setting

In general, the combination of the nature of the insurance business, various host country legal requirements, and the needs of customers have often mandated the existence of a national insurance industry, i.e. an Italian based insurer handling the insurance needs of customers in Italy. However, for the insurance industry the growth of international trade, the establishment of overseas operations via *foreign direct investment (FDI)*, changes in host country legislation, and the search for new markets has forced insurers to broaden both their product ranges and horizons. Probably the most profound of these factors has been the changes in host country legislation, especially for those member countries of the *European Union (EU)*. For the EU and its legislation has been moving down the road towards the near abolition of national boundaries and the development of a free and unhindered internal market, although a bumpy road it has been and will no doubt continue to be. For firms offering financial services such as insurance providers, these moves have had a dramatic effect not just on insurance companies located within EU member countries but also on the insurance industry as a whole. For the basic aim of the EUs path is in the creation of a single market is to establish an environment whereby individuals and organizations can buy and sell their products freely with universal rules of conduct applied. For example, a German business can buy insurance products not just from German based firms but also from British, French, and/or Spanish providers. These changes in the rules of the game have thus opened up a wide array of opportunities, as well as some serious threats, for European based insurance providers.

Yet, despite such ongoing changes in the industry the majority of insurers still remained very much attached to their own home country rather than evolving into a truly international entity, especially in Europe. Moreover, this situation is to expected given the rather conservative and cautious nature of the industry and its component insurers. The authors of one survey on the insurance industry summarized the position best by stating that, *"Insurers are not pioneers: when entering new markets, they follow their clients."*[1] Hence, in many cases the expansion of various insurance groups into new markets should be more categorized as a push and pull equation more than anything else. In this equation insurers are pulled by the potential threat of loosing clients to competitors if they do not follow them into other markets and pushed by those same competitors to both keep pace with them while continuing to expand their respective market shares, or at least maintain the status quo.

6.1.2 The Company

Assicurazioni Generali, the cornerstone in the Generali Group, is the largest insurance company in Italy and in terms of profit in 1995 it was the country's fifth largest company, behind giants such as IRI, FIAT, ENI, and ENEL. Besides dominating its home market of Italy the company is also a major player in the European insurance market with major operations located in France, Austria, Germany, Spain, United Kingdom, Belgium, The Netherlands, and Switzerland as well as having a presence in many other European countries. Further afield, the group also maintains a presence in a number of countries in the geographical regions of North America, Latin America, Africa, and Asia and Australia. Since 1976, the company has been more commonly referred to as simply Generali.

The company was founded on 26 December 1831 by a charter from the Austro-Hungarian Empire, of which it was then part of, under the ruling Hapsburgs as Assicurazioni Generali di Trieste e Venezia/General Insurance Company of Trieste and Venice. A few months after the company's creation it embarked on an ambitious program of expansion setting up offices throughout the territories of the Austro-Hungarian Empire, which was quickly followed up by the establishment of offices in Italy, France, Germany, and Switzerland. Generali then moved further into the Balkans and into Russia which was under the rule of the Romanov family. At the close of 1995, 164 years after it was established, the Generali Group consisted of 273 companies, 97 insurance companies and 176 non-insurance companies, operating in all four corners of the world (See **Table 6.1**). The insurance operations offer customers a full range of both life and non-life products. The non-insurance companies operate in the areas of financial services, real estate, agriculture, insurance brokerage, service companies, and travel assistance. A number of companies also function as holding companies for Generali's various operations in a multitude of host countries.

By the end of 1995 Generali's operations had generated premium income in the amount of $21,513.8 million for the year, of which there was a fairly evenly distributed between life at

[1]Petch, T., Young, V., and Clarke, C. (1993), *In Need of a Net: A Survey of Insurance*, pp. 35.

Table 6.1, Companies of the Generali Group by Type of Activity

Number of Companies for each Specific Type of Activity	Year 1989	1990	1991	1992	1993	1994	1995
Insurance Companies	58	66	74	82	86	93	97
Holding & Financial Companies	21	20	21	27	28	35	36
Real Estate Companies	28	26	21	23	21	22	22
Agricultural Companies	3	3	3	3	3	3	2
Other Companies (Non-Consolidated)*	48	55	69	86	93	109	116
Total	158	170	188	221	231	262	273

Sources: Generali Group Consolidated Company Annual Reports, 1989-1995.

Note: *Non-Consolidated companies are excluded from the Generali Group's consolidated accounts because they are either group support companies or categorized as being small scale operations.

Table 6.2, Key Figures for the Generali Group

Key Figure (in millions of USD$ unless otherwise stated)	Year 1988	1989	1990	1991	1992	1993	1994	1995
Gross Premiums Written	8,557.3	9,424.6	11,876.7	13,904.6	13,159.4	14,597.2	18,133.3	21,513.8
Life Insurance	2,860.5	3,295.8	4,318.9	5,423.4	5,378.1	5,860.4	7,946.9	10,067.6
Non-Life Insurance	6,128.7	5,696.7	7,557.8	8,481.2	7,781.2	8,736.9	10,186.4	11,446.1
Net Premiums	7,395.2	8,191.8	10,388.9	12,146.5	11,684.4	12,899.9	16,366.4	19,435.6
Change in Net Premium Income (%)	0%	11%	27%	17%	-4%	10%	27%	19%
Net Investment Income	1,707.8	1,959.0	2,599.8	3,253.9	1,171.7	1,247.3	1,307.0	1,471.2
Total Claims Incurred	4,024.3	4,425.8	5,746.7	6,803.9	7,379.9	8,451.1	10,133.0	12,565.3
Shareholders' Surplus	3,082.8	3,417.3	4,127.5	6,800.6	6,485.0	6,647.2	7,680.8	8,240.0
Commission & Acquisition Costs	1,471.9	1,607.5	2,003.9	2,208.5	1,936.3	2,177.8	2,584.7	3,000.1
Profit Before Taxes	605.1	668.5	751.3	1,043.7	626.1	874.1	898.4	935.2
Profit (Loss) for the Year	401.8	451.5	406.4	489.9	337.5	358.1	404.4	438.6
Total Assets	25,134.6	28,390.0	36,506.0	47,555.7	42,850.0	51,509.6	65,230.0	79,744.4
Number of Employees (as shown)	26,835	27,024	28,613	27,931	33,311	34,381	37,917	38,236

Sources: Generali Group Consolidated Company Annual Reports, 1989-1995 and via direct communication from Assicurazioni Generali (1996).

$10,067.6 million (47%) and non-life at $11,446.1 million (53%). This represented a change in net premium income of 19% over the previous years figure. Overall, Generali posted a net profit of $438.6 million for the year with total assets amounting to $79.744 billion and some 38,236 employees (See **Table 6.2**).

In terms of geographical distribution of Generali's gross premium income, the vast bulk of the group's business is mainly located within a few key member countries of the European Union (EU), namely Italy (28.1%), France (22.9%), Austria (11.4%), Germany (10.1%), and Spain (9.1%). In examining the comparative data for 1989-1995 (See **Table 6.3**) it becomes apparent that Generali's geographical distribution of premium income as been fairly consistent with only a

Table 6.3, Distribution of the Generali Group's Gross Premium Income by Geographical Location

Country of Origin (in millions of USD$ dollars)	Year													
	1989		1990		1991		1992		1993		1994		1995	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
European Union (EU) Countries:	**8,885.9**	**94.3%**	**11,093.9**	**91.7%**	**12,664.3**	**91.1%**	**13,906.4**	**91.2%**	**13,106.9**	**89.8%**	**15,556.0**	**88.2%**	**19,153.2**	**89.0%**
Italy	3,574.6	37.9%	4,648.4	38.4%	5,245.6	37.7%	4,599.3	30.2%	4,374.0	30.0%	5,210.3	29.6%	6,038.5	28.1%
France	1,534.4	16.3%	1,869.6	15.4%	2,104.1	15.2%	2,116.6	13.9%	2,219.4	15.2%	2,817.0	16.0%	4,928.3	22.9%
Austria	1,451.7	15.4%	1,718.7	14.2%	1,833.4	13.2%	1,905.5	12.5%	1,892.5	13.0%	2,233.9	12.6%	2,452.8	11.4%
Germany	960.8	10.2%	1,146.1	9.5%	1,461.5	10.5%	1,488.4	9.8%	1,529.0	10.5%	1,903.1	10.8%	2,177.7	10.1%
Spain	213.2	2.3%	255.7	2.1%	278.0	2.0%	1,963.3	12.9%	1,385.2	9.5%	1,676.9	9.5%	1,956.3	9.1%
United Kingdom	691.3	7.3%	908.8	7.5%	1,150.7	8.3%	1,278.3	8.4%	1,163.3	8.0%	1,084.0	6.1%	831.3	3.9%
Belgium	195.9	2.1%	244.3	2.0%	249.6	1.8%	248.0	1.6%	236.4	1.6%	275.0	1.6%	321.5	1.5%
Netherlands, The	223.7	2.4%	250.0	2.1%	279.7	2.0%	231.8	1.5%	224.7	1.5%	250.1	1.4%	287.5	1.3%
Other Countries	40.4	0.4%	52.5	0.5%	61.6	0.4%	75.2	0.5%	82.5	0.6%	105.6	0.6%	159.0	0.7%
Other European Countries:	**239.5**	**2.5%**	**295.4**	**2.4%**	**418.6**	**3.0%**	**372.5**	**2.4%**	**459.6**	**3.1%**	**895.4**	**5.1%**	**1,125.0**	**5.2%**
Switzerland	225.0	2.4%	275.4	2.2%	345.5	2.5%	258.4	1.7%	280.2	1.9%	645.1	3.7%	843.6	3.9%
Other Countries	14.5	0.1%	20.0	0.2%	73.1	0.5%	114.1	0.7%	179.5	1.2%	250.3	1.4%	281.5	1.3%
Other Countries Outside Europe	**299.2**	**3.2%**	**707.2**	**5.8%**	**821.7**	**5.9%**	**966.0**	**6.3%**	**1,030.6**	**7.1%**	**1,181.0**	**6.7%**	**1,235.6**	**5.7%**
USA & Canada	185.7	2.0%	456.8	3.8%	518.6	3.8%	617.2	4.0%	611.9	4.2%	632.8	3.6%	607.6	2.8%
Latin America			111.7	0.9%	159.7	1.1%	181.6	1.2%	239.3	1.6%	320.6	1.8%	314.8	1.5%
Africa	84.2	0.9%	103.5	0.9%	109.8	0.8%	111.6	0.7%	117.8	0.8%	136.3	0.8%	149.2	0.7%
Asia & Australia	29.3	0.3%	35.3	0.3%	33.7	0.2%	55.7	0.4%	61.6	0.4%	91.3	0.5%	163.9	0.8%
Total	**9,424.6**	**100.0%**	**12,096.5**	**100.0%**	**13,904.6**	**100.0%**	**15,245.0**	**100.0%**	**14,597.2**	**100.0%**	**17,632.4**	**100.0%**	**21,513.8**	**100.0%**

Sources: Generali Group Consolidated Company Annual Reports, 1989-1995.

Note: Individual premium income data for both USA & Canada and Latin America were not available for 1989.

couple of anomalies registering in relation to changes in its country of origin. Gross premium income from both Spain and the United Kingdom have shifted in opposite directions over the last few years. In the case of Generali's position in the Spanish market, there was a dramatic increase in the premium level from just $278 million (2%) in 1991 to $1,963 million (12.9%) in 1992. For the United Kingdom there was a small drop in premium income with $1,084 million (6.1%) in 1994 to $831 million (3.9%) in the year following.

6.1.3 Company Strategy

Generali has been described by analysts as a slow-moving giant in the decades following the close of the Second World War when the company was faced with the massive task of reconstructing its operations in Western Europe and the fact that the Communists confiscated all of its operations in *Eastern Europe* as part of their own program of *Stalinization*. All of this was especially difficult given the new political situation brought on by the arrival of the *Cold War*. In the late 1950s and throughout the 1960s Generali embarked on a program of worldwide expansion, mostly via cooperation agreements with other insurance groups such as the American insurer Aetna Life and Casualty (US) and Japan's Mitsui Mutual Life (JP). During the 1970s Generali changed it strategy somewhat and began the process of rationalizing its foreign activities. The goal of this process was to create a local host country identity for Generali's operations through greater local integration. In the late 1980s and early 1990s with the prospect of a unified Europe and open market via directives from the EU, Generali, as did many of competitors, sought to fortify its position in various EU member countries through a variety of mergers and acquisitions. At the same time, Generali also looked east to some of the *Central European countries (CEC)* as the political situation changed dramatically with the fall of the *Berlin Wall* and the infamous *Iron Curtain* in late 1989. Generali, who had already been conducting negotiations with Hungary's State insurer to form a joint venture, moved fairly quickly to re-establish itself in the region.

6.1.4 Key Competitors

In terms of insurance stock based on 1994 revenues, the Generali Group ranked seventh internationally within the insurance industry according to a *Fortune* magazine profile.[2] Ahead of Generali from the top were Allianz Holding (BD), Union des Assurances de Paris (FR), Group des Assurances Nationales (GAN)(FR), AXA (FR), American International Group (AIG)(US), and Zürich Insurance (SW). Rounding out the top ten are Münchener Rück (BD), Fortis (BG/NL), and the Travelers Group (US). All of these insurance companies compete with Generali, notably in Europe where almost all of these insurers claim as home.

[2]Fortune (1995), *Fortune's Global 500.*

6.2 Generali's Experiences in Hungary

6.2.1 The Industry Setting

In order fully to understand the nature of the insurance industry in Hungary today one must examine how the system functioned previously under communism. During the period between the First and Second World Wars there were some seventy insurance providers operating within Hungary. However, in Hungary, as was also the case in other CEC, the rise to power of communism in the mid-1940s and subsequent adoption of the *Stalinist* economic model resulted in the virtual wholesale nationalization of the economy as well as the abolition of almost every vestige of private ownership. As part of this overall process all providers of insurance services, some of which were foreign owned and operated entities, had their assets seized and collectively transferred to the direct control of the State's finance ministry. The State in turn became the sole insurance provider and thus exerted complete monopolistic control over the market.

In most cases the State usually operated a two-tier insurance system, one through a *state-owned enterprise (SOE)* that was responsible for handling all domestic insurances within the host country and another SOE which was charged with dealing with all forms of insurances that required an element of foreign (hard) currency due to the international nature of the coverage. This two-tier system was the situation that existed in what at the time was the USSR as well as Bulgaria. In Czechoslovakia, Hungary, and Romania there was only one main State insurer which handled both domestic and international coverages, although a division of business activities did eventually take place later on in these countries.

In regards to international coverages, the State provider offered insurances such as marine and aviation covers, foreign based construction projects, export credits, and the State's property located on foreign territory. Furthermore, given the nature of these types of insurances and the associated risks involved they were placed on the international reinsurance markets, often via internationally known insurance brokers such as Lloyd's of London.

As for domestic insurances, the State offered its citizens both life and non-life products. Life insurance policies were widely available usually through arrangements made between the State provider and SOEs whereby premium payments were deducted from the wages of those employees participating in the scheme. However, such policies were often very simple and of limited value and utility. Non-life policies focused on motor, household, as well as numerous compulsory type coverages. Yet, these types of policies were also quite basic and of limited and restricted scope, especially given the reality of a continuous shortage economy. In general, the public were discouraged by the State's provider from taking out policies on personal property.

For example, an insurance policy on a family television was undesirable because a claim for loss or damage would not suitably compensate the policy holder with a replacement for a product that could take years to acquire via a waiting list with one of the few State suppliers. Motor insurance tended to concentrate on liability for many of the same reasons and accident coverage was also arranged through the individual's respective SOE employer in the same manner as life policies. Other non-life coverages were seen as non-essential under the Communist system since the State guaranteed the basic needs of the citizenry in terms of health care, education, employment, and pensions. Compulsory insurances, such as third party motor and agriculture related policies, were widely viewed by the general public as other forms of taxation and subsequently resented. This was despite the fact that such policies, especially agricultural ones, generated heavy losses for the State provider. Finally, because of the ownership structure of the SOE there was little need for commercial insurance coverages since the State replaced any losses incurred directly. The exception to this being commercial activities related to international operations which were covered by the respective State provider for such services.

It should be noted that compulsory insurances functioned in a way that was very different than what would be expected by Western insurers. From the Western perspective, compulsory insurance imposes an obligation on the individual to purchase a policy and make his/her premium payments. Yet, this and other insurance concepts were understood quite differently in the CEC. In the CEC, the obligation to sell the policy and obtain the respective premium was on that agent of the State insurer and his/her failure to collect it did not relieve the State of its responsibility to cover any losses. In the case of such a claim, the State would merely deduct the appropriate premium payment from the amount of the claim settlement. According to statements by Simon Aubrey-Jones, an insurance analyst focusing on the CEC and the FSU, *"This inverse method of handling the business* (types of insurances formerly covered under compulsory policies) *has left its influence on the way in which much insurance is bought and sold today. Many assureds, corporate as well as private, simply have not learnt their responsibility to go out and seek insurance protection."*[3]

Overall, the domestic insurance system was operated by the sole State provider, which established premiums at almost arbitrarily levels for each of the few products it offered and for which the State was the sole underwriter. Revenues which were collected via premium payments that were used to offset both losses incurred during the year as well as the operating expenses of the provider. Surpluses from operations were absorbed by the State and deficits were guaranteed by it. In the case of non-life products there was little or no attempt to estimate or provide for future liabilities that had not materialized during the course of the year. The rate of premiums themselves for specific insurance products were not rated according to proven actuarial tables but were instead based upon artificially low rates set by the State which bore a

[3]Aubrey-Jones, S. (1996), *Developments in Eastern Europe - Part I*, pp. 398.

very low degree of correlation, if any at all, to the actual risks involved with the nature of the coverage. Hence, the Western concept of insurance as a means of acquiring coverage for various activities, items, and/or individuals based upon premiums calculated according to the perceived levels of risks was greatly distorted.

The overall circumstances under which the insurance industry in the CEC operated under Communism has been described by Mr. Camillo Guissani, General Manager for the Generali Group. According to Giussani, in a conference speech on financial relations between North-Eastern Italy and the CEC, which was later reported in a company newsletter *"...insurance had been run for several decades by large State bodies which could only with some approximation be called insurance companies; they were as a matter of fact highly bureaucratized agencies for which the idea of risk as such had been replaced by the concept of management of risks in a centralized manner and without the support of most of the necessary technical and intellectual bases."*[4]

In Hungary, the State insurer was Állami Biztosító/State Insurance, commonly referred to as ÁB, which acted as the sole provider of both domestic and international insurances in the country. In 1986 the Hungarian government under the leadership of János Kadar enacted legislation that partially liberalized the country's insurance industry by removing ÁB's monopoly on the local market with the formation of a second state-owned insurer that was named Hungária Biztosító/Hungarian Insurance. Under the terms of the government legislation ÁB retained the bulk of the life insurance policies while Hungária took over the portfolios of foreign trade insurance, motor liability, and reinsurance accounts. Hence, up until 1989 these two State providers exercised duopoly control over the Hungarian insurance market.

However, when the Communists fell from power in late 1989 the liberal economic policy that Hungary had pursued since the late 1960s and which was carried on through to the 1980s, although with very mixed results, became even more pronounced in the period of economic transition. For the insurance industry this meant the beginning of real competition in the Hungarian market for the first time in over forty years. At first, the competition came through joint ventures with minority foreign shareholdings. Later, majority joint ventures and eventually full foreign ownership in local insurance operators was allowed, even with the two state-owned insurers. In regards to the latter, the new and democratically elected government of Hungary also moved relatively quickly to privatize both ÁB and Hungária, which were both sold off to foreign concerns by 1992. Hence, unlike many of its neighbors, Hungary made no attempt to maintain a so-called *national* insurance industry, with the small exception of the State in 1994 creating and operating an export credit insurer.

[4]Generali Group (1996), *Insurance Looks East*, pp. 6.

6.2.2 The Investments: A Profile of the Generali Group's Local Firms

The Generali Group had first established a local presence in Hungary back in 1832, only months after Assicurazioni Generali Austro-Italiche had been founded, when the country was part of the Austro-Hungarian empire under the Hapsburgs. Generali's operations in Hungary, as well as those in other countries of the region, grew and prospered over time despite some difficult circumstances. They survived the immense turmoil caused by the First World War; the dissolution of the Hapsburg empire, the considerable territorial downsizing of Hungary's borders, and the political upheaval that followed the war's end; the severe economic depression of the 1920s that was experienced worldwide; and the chaos and destruction brought on by the Second World War. However, despite the resilience of Generali's operations during these difficult periods, the company did not survive the establishment of Communist based regimes following the end of the Second World War. In Hungary when the State, under full and complete control of the local ruling Communist Party, enacted its program of Stalinization, Generali's assets in the country, along with all foreign interests, were nationalized along with other facets of the economy.

The same situation occurred to Generali's business throughout the region and the group lost a total of 14 subsidiaries which were active insurance operators as well as considerable real estate holdings. Generali's operations in Czechoslovakia, Hungary, Poland, and Romania bore the brunt of the company's losses under Communist based regimes. In Albania, Bulgaria, and Soviet occupied eastern Germany, and Yugoslavia the company's assets faired slightly better but considerable losses were still incurred. Almost immediately as Generali's assets were seized the company began seeking compensation for its lost businesses and holdings from respective host country governments in the region and eventually some IT Lira 13 billion was recovered, but this was only a mere fraction of the value of what was taken as a result of the rise to power of the Communist Party in the region.[5]

a. ÁB-Generali Budapest Biztosító Rt.: A Joint Venture Acquisition

In 1988 Generali entered into negotiations with the Hungarian State insurer Állami Biztosító (ÁB) in an effort to form some sort of cooperative business relationship in the field of insurance that would operate in the Hungarian market. The negotiations were carried out on behalf of the Generali Group via its Austrian subsidiary EA-Generali based in Vienna. It should be noted that EA-Generali's territorial area of operations includes not only its home market of Austria, but also Germany, Slovenia, Hungary, Czech Republic, and Slovakia. In regards to Poland and Romania as well as potential holdings in the FSU and other CEC (which are not territories

[5]This information is based on both reports directly from Generali as well as an independent profile of their company history by Hast. See Generali Group (1995a), *Generali Group, The Insurer Without Frontiers.* Also see Hast, A. (editor)(1991), *International Directory of Company Histories, Volume 3*, pp. 208.

covered by EA-Generali), Generali offices in Trieste, Italy exercises direct control over operations in these countries.

In October of 1988 executives from both Generali and ÁB signed a memorandum of association creating the joint venture company ÁB-Generali Budapest Biztosító Rt./ÁB-Generali Budapest Insurance Company. This was followed up on 25 May 1989 when a delegation of top executives from Generali, led by Mr. Enrico Randone, then Chairman of the group, travelled to Budapest where they met with representatives of ÁB and together signed a syndicate contract. These were both historic events since it not only established the first foreign entry into the Hungarian insurance market in over forty years but because it also marked Generali's return to Hungary. The Generali Lion had indeed returned to Budapest.

Under the terms of the joint venture agreement ÁB transferred some 50,000 of its contracts over to the new firm, Generali was to provide for technical and management expertise that would facilitate the modernization of ÁB's operations, and both joint venture partners contributed capital to the firm reported as totalling some $20 million dollars[6]. At the time of this ground breaking deal Hungarian laws on FDI did not permit majority foreign ownership. Moreover, ÁB wanted to retain majority control over the venture as well as ownership over the contracts assigned to the venture. Hence, the shareholdings in ÁB-Generali Budapest were distributed with 60% going to ÁB and 40% owned by the Generali Group, of which 20% was with Assicurazioni Generali of Trieste, Italy and the remaining 20% with EA-Generali of Vienna, Austria. In September 1989 ÁB-Generali Budapest officially became active at a time when monumental events in the CEC were unfolding at a rapid pace which was to spell an end to the power base of Communist based regimes in the region. At the time of Generali's entry into the Hungarian market there were a total of four other insurers, the two State insurers ÁB and Hungária, as well as two other operators, namely Atlasz and Garancia.

The creation of the joint venture company was intended to benefit both Generali and ÁB. The Generali Group had secured a cooperative business venture with Hungary's primary insurer at the inception of the process of economic, political, and social transformation in the country and the region. In doing so, Generali not only gained first mover advantages in the market but also re-established a presence in a country where prior to the onset of communism it had enjoyed a fairly strong market position. Hungary was also a virtually untapped new market of just over 10 million potential customers that was sure to develop as time progressed given the proper encouragement.

From the perspective of ÁB's management, there were a multitude of perceived benefits associated with the creation of the joint venture company with Generali. The insurance

[6]This figure of $20 million dollars was reported by Douglas in his own study of the insurance industry in the CEC. See Douglas, R. M. (1992), *Foreign Direct Investment in Central Europe: The Case of Insurance*, pp. 122.

legislation enacted in 1986 not only resulted in the loss of ÁB's monopoly on the local market but also saw much of the company's most profitable lines of insurance business transferred to its new competitor Hungária. ÁB was left holding the existing life and compulsory insurances, like agricultural and property policies, which were the least lucrative product lines. Through the ÁB-Generali Budapest vehicle ÁB felt it would be able to reclaim some of its more profitable business in the commercial lines of insurance as well as international coverages. It was also envisioned that ÁB could access Generali's vast network and resources to operate effectively in the reinsurance business. Furthermore, the technical and administrative skills necessary to operate an insurance business that had been so seriously lacking in the industry under communist era could readily be supplied by the company's new partner Generali. All of these issues became increasingly important as other competitors entered the Hungarian insurance market. This was especially the case given the fact that ÁB's main competitor Hungária had also formed a joint venture in 1989 with the German insurance giant Allianz (BD).

However, despite the stated mutual needs of the respective parent organizations in forming ÁB-Generali Budapest the relationship between the two organizations in the joint venture proved to be unworkable as time progressed. This was especially the case as Generali's management team and technical staff became more involved in the day-to-day operation of the venture via running various training programs as well as in the installation of accounting and computer systems. The root cause of the difficulties seems to have stemmed from Generali's lack of adequate management control in the venture which was compounded by the bureaucratic nature and structure of ÁB as well as a high degree of resistance from its staff and management to change, especially when they were in the form of directives from foreign managers. The bottom line of the situation was that Generali, via its minority shareholding in the joint venture, was unable to implement the measures necessary to create an effective and efficient modern insurance operation. Hence, given these circumstances it became evident to Generali's managers on the scene that the situation had to change, and the sooner the better.

In 1991, with the pending planned privatization of ÁB-Generali Budapest's local Hungarian parent ÁB, Generali was given a window of opportunity to rectify this situation of control which it duly exercised. Towards the close of 1991, just over two years after opening its doors for business in Hungary, Generali solved the problem of control in ÁB-Generali Budapest by acquiring ÁB's 60% shareholding in the venture for a reported $8 million dollars.[7] According to Dr. Zsolt Vágó, Chief Executive Officer of Generali Budapest, *"As part of the separation arrangements, Generali inherited both some staff from Állami Biztosító that had been with the joint venture and some of the insurance policies that had been written."* These comments by Vágó are based on personal experiences as he has been an integral part of Generali's management team since the beginning of the company's re-entry into the Hungarian market in the late 1980s. Dr.

[7]This figure is also based upon information drawn from Douglas's work. *Ibid.*, pp. 123-124.

Vágó, a Austrian citizen with Hungarian roots, joined EA-Generali back in 1975 and in 1988 he was given the task of starting the deal between his company and ÁB and has been at the helm of Generali in Budapest ever since.

b. Generali Budapest Biztosító Rt.: A Wholly-Owned Subsidiary

After Generali's successful acquisition of ÁB's shareholding position in the joint venture ÁB-Generali Budapest, the firm was appropriately renamed as simply Generali Budapest Biztosító Rt./Generali Budapest Insurance Company. The ownership structure of the operation was now that of a wholly-owned subsidiary of the Generali Group with a share capital of HUF 1 billion ($13.2 million)[8], of which 80% of the shares were held by EA-Generali with Assicurazioni Generali retaining its original 20% shareholding. The focus of Generali Budapest's activities has remained on the commercial insurance business and agriculture, although the firm offers a full range of insurance products and services.

Over the course of 1992, in Generali Budapest's first full year of independent operation, the company generated premium income revenues worth HUF 2,293 ($27.3 million) via 39 branch offices and with a 875 company staff. Yet, this amount of premium income only equated to 2.5% of the overall Hungarian market, which at the time was still heavily dominated by the newly privatized ÁB, now ÁB-Aegon Általános in association with the Dutch insurer Aegon (NL), and Hungária, which had Allianz (BD) as a partner. Hungária's position in the market being important because it was Generali Budapest's key competitor in the commercial insurance business. Furthermore, while the amount generated in 1992 represented a 56% increase in premium income, or only 22% if adjusted for Hungary's 22% inflation for the year, over the previous year's figure it did little to stem the firm's losses incurred during the year which resulted in an overall loss of HUF 233 million ($2.8 million) being posted for 1992 (See **Table 6.4**).[9]

Still, it should be noted that Generali Budapest's financial performance was a result of not only some poor policies written in its former days with ÁB but also as a result of the very poor economic situation in Hungary. Inflation rates were rampant in 1991 at 32%, which in 1992 came down by 10% to 22% for the year. Furthermore, the value of the Hungarian forint was continuing to erode against other currencies such as the US dollar. For example, in 1990 the exchange rate was HUF 61.5 = $1 USD and in 1992 it was HUF 84 = $1 USD, representing a 27% decline in its value. The unemployment rate in Hungary was running at around 8% in 1991 and as high as 12.7% in 1992, up from just only 0.3% in 1989 during the days of full guaranteed employment under communism. These harsh economic conditions made operating any business

[8]Based upon a year-end exchange rate for 1991 of HUF 75.6 = $1 USD.

[9]The exchange rate for figures presented in 1992 are based upon HUF 84 = $1 USD.

Table 6.4, Key Figures for Generali Budapest

Key Figure (in thousands of HUF unless otherwise stated)	Year				
	1991	1992	1993	1994	1995
Premium Income	1,469	2,293	3,367	5,106	6,573
Change from previous year (%)*	0%	56%	47%	52%	29%
Adjusted for annual rate of inflation**	1,469	1,789	2,660	4,034	4,733
Adjusted change from previous year (%)*	0%	22%	49%	52%	17%
Reinsurance Results	1,017	789	1,327	2,270	3,302
Capital Investment	541	1,018	1,052	1,328	2,250
Net Technical Reserves	565	540	720	1,099	2,615
Share Capital	1,000	1,000	1,000	1,000	1,000
Profit (Loss) for the Year	-294	-233	-250	-232	-80
Total Assets	1,746	2,060	2,491	3,641	5,212
Number of Employees (as shown)	na	875	1,433	952	1,021

Sources: Generali Budapest Biztosito Company Annual Reports, 1992-1995 and via direct communication from the company (1996). Inflation rates in Hungary for each year shown are based upon statistics reported by the EBRD (1996).

Notes: *For the sake of comparison, 1991 has been used as a based year; **Inflation rates in Hungary for each year were as follows: 22% in 1992, 21% in 1993, 21% in 1994, and 28% in 1995.

difficult. For Generali Budapest, as was the case for other insurers, there was a severe shortcoming in selling specific insurance products at a set price at the beginning of the year only to have the value of the premium payment be greatly diminished by high inflation during the course of the year, especially in the case of a claim. The problem was most acute in the area of car insurance products where the Hungarian government set artificially low prices for compulsory third party liability which at the time was a money pit for every insurer on the Hungarian market. In fact most of Generali Budapest's losses were derived from unfavorable ratios of payments in damages in car insurance products.

By the close of 1995, Generali Budapest had improved its position in the Hungarian insurance market as well as its financial performance. Premium income for 1995 totalled HUF 6,573 million ($52.2 million) for the year which represented a 5.5% market share in a very competitive market that now had some 14 different insurance providers competing for business. On the surface this value of premium income represented a 29% increase from the figure for the previous year, which was HUF 5,106 million ($40.5 million). Yet, when Hungary's annual inflation rate of 28% for 1995 is taken into consideration this equated to an real increase in premium income against the 1994 figure of just 17%. Also, during the year Generali Budapest was able to continue to expand its network of branches to 65 offices with total employment of 1,021. While the company still posted a year-end loss of HUF 80 million ($635,000), this was down considerably on previous years and in-line with the management's expectations given difficult but easing economic conditions under which the firm had to operate (See **Table 6.4**).[10]

For example, the inflation rate had risen to 28% in 1995, up from 21% the previous year. Also,

[10]The exchange rate for 1995 is based upon HUF 126 = $1 USD.

the Hungarian forint had continued to decline further in value from HUF 110 = $1 USD in 1994 to HUF 126 = $1 USD at the end of 1995, a drop in value of 12% over the period. The rate of unemployment in the country remained at around 10% but the population grew more pessimistic about the overall economic situation as a result of a decrease in real wages of some 11% and also because many of their social benefits were reduced or eliminated under the governments austerity package of reforms. In fact, Generali Budapest's annual report for 1995 characterized the year as the beginning of reconstruction in the Hungarian economy.[11]

Finally, returning to the issue of Generali Budapest's financial performance, according to comments by Vágó, *"By the end of 1996 Generali Budapest should be posting a modest profit or at least reaching the break even point."* Vágó went on further to explain the poor financial situation that has been experienced by his firm by stating that, *"The main problem is that Generali Budapest inherited a lot of bad policies from its relationship with Állami Biztosító that have hampered the firm's financial performance."* In fact, preliminary financial data for 1996 indicates that Generali Budapest has indeed finally turned that all important financial corner and come out of the red and into the black, although with only a negligible amount of profits shown for the year. Still, a profit is a profit and in 1997 the company hopes to continue to improve both its market share and profitability.

c. Providencia Osztrák-Magyar Biztosító Rt.: A Greenfield Joint Venture

In August 1989, a month before ÁB-Generali Budapest officially opened its doors for business, a company named Providencia Osztrák-Magyar Biztosító Rt./Providencia Austrian-Hungarian Insurance Company began its operation offering insurance services and products to customers in the Hungarian insurance market. Providencia, as it is more commonly referred to, was established as a greenfield joint venture involving a multiple partnership scheme comprising both Austrian and Hungarian partners. The Austrian partners of Providencia included the Austrian insurer Wiener Allianz (OE), which held a 51% shareholding in the venture, and several private Austrian based shareholders with 8%. The Hungarian partner firms were in the form of Postabank és Takarékpénztár Rt./Post Bank & Savings Bank Corporation and the Magyar Posta Vállalat/Hungarian Post Company with 26% and 15% of the shares respectively.

However, prior to proceeding some further clarifications regarding the partner firms are necessary. Firstly, it should be noted that Magyar Posta has a vested controlling interest in Postabank, and hence together their shareholdings originally represented some 39% of Providencia's shares. Secondly, and with critical importance to this case study is that fact that Wiener Allianz was at the time a majority controlled interest of the Generali Group with 55.54% of the shares in the Austrian insurer. This 55.54% shareholding was distributed within the group

[11]Generali Budapest Biztosító Rt. (1995), *Company Annual Report 1995*, pp. 9 (pp. 4 of English translation).

with EA-Generali of Austria possessing 25.16% of the shares, another 25.08% being held via various group holding companies, and 5.3% held directly by Assicurazioni Generali of Italy. The outstanding shares in Wiener Allianz were controlled by the German based insurer Allianz (BD) via its Italian subsidiary RAS (IT).

Consequently, Generali, via Providencia, had somewhat indirectly been the third entry into the Hungarian insurance market joining the two State insurers Állami Biztosító and Hungária Biztosító. The move also pre-empted the entry of Generali's other operation ÁB-Generali Budapest into the market. Overall, it was a move that Dr. Károly Gergely, Deputy General Director and Chief Financial Officer (CFO) of Providencia, described as *"very lucky."* Gergely himself is a natural born Hungarian with German citizenship who returned to Hungary on behalf of his employer Wiener Allianz specifically to assist in the establishment of Providencia in January 1990. Gergely stated that to begin with there were no employees at Providencia, only himself and other members of the management team appointed by Wiener Allianz.

Providencia was set-up to concentrate on offering private insurance in the motor, life, and household branches. The company began operation with a share capital of HUF 1,000 ($16 million)[12], which was the minimum capital requirement prescribed by Hungarian law. Because Providencia was established through the greenfield form of FDI almost all of the infrastructure of the company had to be built and developed from the ground up. However, via Providencia's two local Hungarian partners, Postabank and Magyar Posta, the new insurer was able to access their distribution network including numerous bank branches along with some 3,200 post offices spread throughout the country. In doing so, Providencia was not only able to utilize this expansive network of its Hungarian partner firms as a place of product promotion via marketing efforts, but more importantly as a direct point of sale for various insurance products the company had to offer.

At the end of 1990, well over a full year after Providencia opened its doors for business, the company recorded premium income revenues that totalled HUF 140 million ($2.2 million) with 14,669 policies written during the course of the year and with an internal staff of only 267 employees. In 1990 competition in the Hungarian insurance industry consisted of a total of six insurers, of which on the basis of premium income Providencia had a market share of only 0.4%. Overall, the company posted a loss of HUF 245 million ($4 million) Yet, this was to be expected given the initial start-up costs involved with the venture and the very difficult economic conditions in Hungary during this time in which the company was forced to operate within (See **Table 6.5**).[13]

[12]The exchange rate for 1989 is based upon HUF 62.5 = $1 USD.

[13]The exchange rate for figures presented in 1990 are based upon HUF 61.5 = $1 USD.

Table 6.5, Key Figures for Providencia

Key Figure (in millions of HUF unless otherwise stated)	Year					
	1990*	1991*	1992	1993	1994	1995
Premium Income	140	2,450	5,673	8,269	10,839	13,579
Claims Incurred	6	1,257	2,076	2,330	3,094	5,066
Profit on Reinsurance	13	5	210	15	-266	-152
Operating Expenses	174	1,436	2,967	3,364	3,546	5,380
Financial Income	121	310	308	667	1,621	3,070
Capital Investment	975	1,323	2,483	4,987	9,111	14,148
Net Technical / Actuarial Reserve	48	853	1,441	2,612	5,446	8,331
Capital Net Worth	1,005	1,043	546	877	1,191	1,420
Share Capital	1,000	1,000	1,000	1,500	1,500	1,500
Profit (Loss) for the Year*	-245	-254	-495	-151	217	258
Number of Policies (as shown)	14,669	376,902	561,977	671,530	729,816	782,673
Number of Claims (as shown)	109	12,670	40,048	53,112	78,948	93,587
Number of Employees (as shown)	267	791	1,195	1,371	1,657	2,112

Sources: Providencia Osztrak-Magyar Biztosito Company Annual Reports, 1993-1995; Direct communication from the company (1996); and the Researcher's own calculations.

Notes: *Due to changes in reporting methods by the company some data in both 1990 and 1991 are subject to potential error. The questionable data for these two years includes statistics on Premium Income, Claims Incurred, and Capital Investments.

In 1991 the ownership structure of Providencia underwent a dramatic change. As a result of strategic reorganization within the Allianz Group of Germany, one of Wiener Allianz's main parents and namesakes, and subsequently one of Providencia's owners, a share swap agreement was arranged between Allianz and the Generali Group. Under the terms of the agreement between the two big insurers, EA-Generali on behalf of the Generali Group ceded some of its assets in Austria and Germany, including its shareholdings in Wiener Allianz. In return, Allianz gave EA-Generali some of its assets in the same two countries as well as its holdings in Providencia of Hungary.

Dr. Geregely expanded upon this situation stating that Allianz wanted to concentrate on its activities in the company's more traditional home markets (German speaking ones). Therefore, the basic logic of Allianz's move was to consolidate its Austrian operations by gaining complete control of the Wiener Allianz joint venture. As for Providencia, Allianz's decision to give Generali complete control of the Hungarian insurer was based on the fact that Allianz had already gained a majority position in the second biggest insurer in the country via Hungária Biztosító, which also possessed a dominate market position as a provider of commercial insurances. Hence, given this situation Allianz apparently wanted to concentrate all its efforts on further developing Hungária's position on the Hungarian market and subsequently operating two insurance firms in Hungary was deemed to be a counter-productive activity.

Of course the share swap deal also proved to very advantageous to the Generali Group, especially with regards to its position in the Hungarian insurance market. In the deal EA-

Generali acquired management control of Providencia along with 51% of the companies shares. Hence, the Generali Group had now acquired two local insurers in Hungary, Providencia which focused on the market for private insurance products such as life, motor, and property, and Generali Budapest which offered insurance products to the commercial, industrial, agricultural, and service sectors.

By the close of 1992, a full year after Generali had gained control of its second major Hungarian venture, Providencia had once again increased its level of premium income from the previous year to a total of HUF 5,763 million ($67.5 million) with an even more dramatic increase in policies written equalling 561,977. Even more importantly, during the year Providencia was able to increase substantially its respective market share in terms of premium income to 9.6% in a very competitive local market with some 12 other competitors. This feat was accomplished via Providencia's implementation of an aggressive marketing strategy as well as the continued expansion of the company's network of regional offices, agencies, and branch offices which were operated by some 1,195 employees. However, despite this dramatic increase in Providencia's level of business activity the company still recorded a year-end loss of HUF 495 million ($5.9 million), mainly as a result of the very tough and persistent economic conditions that were experienced in Hungary during this period (See **Table 6.5**).[14]

By the end of 1995, the economic situation in Hungary had improved somewhat as described in Providencia's annual report for the year. According to Providencia's general assessments of the economic situation in Hungary in 1995, *"The economic growth that began in 1994 continued in 1995 as well. The year brought significant macroeconomic improvements."*[15] In terms of the insurance market Providencia stated in the same annual report that *"The insurance market increased from 94 billion forints to 118 forints in 1995 and achieved a nominal growth of 25.9% compared to that of 26.3% the previous year - a real decrease of 2.9% (1994: -7.5%). This decrease is primarily due to the excessively low (9.8%) increase of premiums on state-controlled motor third party liability insurance since this segment alone amounts to 31.5% of the whole market."*[16] The report also added that, *"Due to the inflation rate* (28% for 1995) *and the real decrease of the market* (which was -2.9%), *the costs of insurance companies went up more sharply than premiums. Investments necessary for the modernisation and the reasonable operation of big companies are a further reason for the increase in costs."*[17]

At the end of 1995 Providencia had generated total premium incomes amounting to HUF 13,579 million ($107.8 million) with the total number of policies written equalling 782,673. This

[14]The exchange rate for figures presented in 1992 are based upon HUF 84 = $1 USD.

[15]Providencia Osztrák-Magyar Biztosító Rt. (1995), *Company Annual Report 1995*, pp. 8.

[16]*Ibid.*, pp. 9.

[17]*Ibid.*, pp. 9.

level of premium income represented both a 25% increase over the previous year and a 11.4% share of the Hungarian market. For the year, Providencia posted another year of profit with HUF 258 million ($2.05 million), having turned that all important financial marker back at the end of 1994. These results were achieved by Providencia's 2,112 internal employees working in 53 agencies and 27 branch offices (See **Figure 6.1**). This level of performance is viewed as considerably positive especially in light of the aforementioned state of both the Hungarian economy and the country's insurance industry over this period of time (See **Table 6.5**).[18]

It is also interesting to note that EA-Generali now possessed a total of 78% of the available share capital in Providencia. This change in ownership that first began in 1993 when EA-Generali expanded its shareholding position in Providencia from 56% to 75.13% and was accompanied by an increase in the company's total share capital which rose from HUF 1 billion ($9.9 million) to HUF 1.5 billion ($14.9 million)[19]. In 1994, EA-Generali extended its level of ownership further by gaining control of another 2.87% of the shares. This brought the Generali Group's level of control in Providencia to 78% with the remaining 22% being held by other concerns, 15% from Magyar Posta, 5% by Postabank, and 2% held by private individuals registered as being in Austria. At present, this is the existing ownership structure found in Providencia.

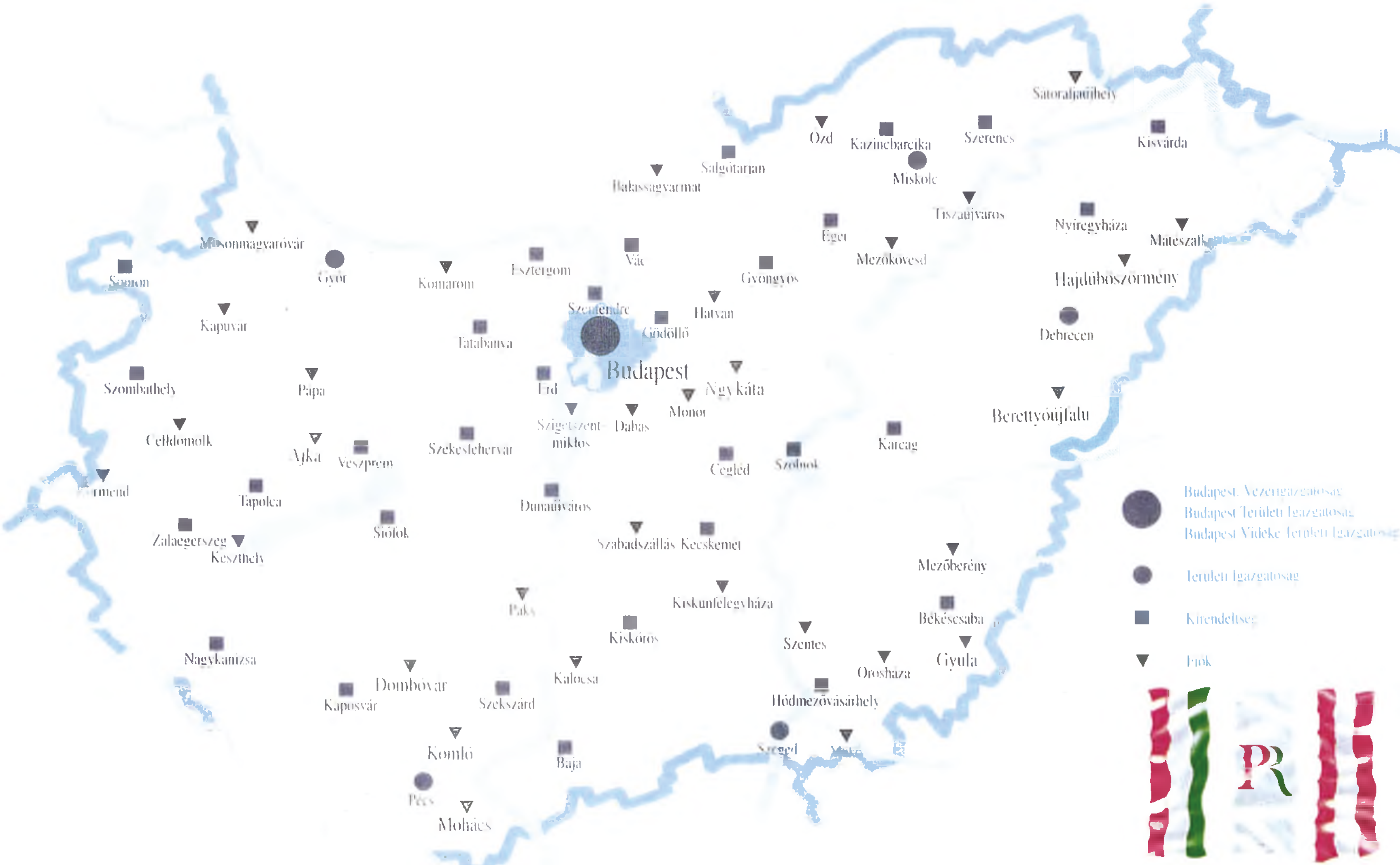
Finally, it is very interesting to provide an analysis of the composition of Providencia's premium income for which data is available for the period of 1991-1995 (See **Table 6.6** & **Figure 6.2**). In 1991 premium income amounted to HUF 2,450 million ($32.4 million), which by insurance type included 39% from motor insurance, 17% from property, and 44% came through the sale of life products. At the end of 1995 this situation had changed somewhat. The total of premium income for 1995 was HUF 13,579 ($107.8 million), of which 36% was from motor policies, 25% from property insurance products, and 39% from life insurance. Cumulatively speaking, between 1991-1995 Providencia has generated premium income in the amount of HUF 40,810 million ($387.7 million). In terms of cumulative averages this total amount of premium income was distributed by insurance type: 37% motor products, 22% property, and 41% life insurance. This represents a cumulative growth rate of 57% for motor, 67% on property, and 48% for life. Taking into account Hungary's high annual rates of inflation for these years the growth rates for motor, property, and life insurances in real terms equate to 42%, 53%, and 48% respectively. Overall, this represents a total growth rate for Providencia of 52% for 1991-1995, which adjusted for inflation equals 40%.[20]

[18]The exchange rate for figures presented in 1995 are based upon HUF 126 = $1 USD.

[19]These exchange rates are based on 1993 data, where HUF 100.8 = $1 USD.

[20]All exchange rates for HUF = USD are based upon year-end quotes.

Figure 6.1, Providencia's Network of Offices in Hungary



PROVIDENCIA
OSZTRÁK-MAGYAR BIZTOSÍTÓ RT.

Sources: Providencia Osztrak-Magyar Biztosito Company Annual Report, 1994-1995.

Notes: Budapest, Vezerigazgatosag = Budapest, Headquarters; Budapest Teruleti Igazgatosag = Budapest Regional Directorate; Budapest Videke Igazgatosag = Outer Budapest Regional Directorate; Teruleti Igazgatosag = Regional Directorate; Kirendeltseg = Branch Office; and Fiok = Agency.

Table 6.6, Providencia's Premium Income by Insurance Type

Type of Insurance (Premium Income in thousands of HUF)	1991*	1992	1993	1994	1995
Motor Insurance	956,151	2,306,624	2,720,500	3,954,331	4,941,138
percentage of total	39%	41%	33%	36%	36%
change from previous year (%)	0%	141%	18%	45%	25%
adjusted for annual rate of inflation**	956,151	1,799,167	2,121,990	3,123,921	3,557,619
adjusted change from previous year (%)	0%	88%	18%	47%	14%
Property Insurance	424,312	1,102,667	1,878,169	2,607,582	3,384,267
percentage of total	17%	19%	23%	24%	25%
change from previous year (%)	0%	160%	70%	39%	30%
adjusted for annual rate of inflation**	424,312	860,080	1,464,972	2,059,990	2,436,672
adjusted change from previous year (%)	0%	103%	70%	41%	18%
Life Insurance	1,069,669	2,264,131	3,670,046	4,276,701	5,253,790
percentage of total	44%	40%	44%	39%	39%
change from previous year (%)	0%	112%	62%	17%	23%
adjusted for annual rate of inflation**	1,069,669	1,766,022	2,862,636	3,378,594	3,782,729
adjusted change from previous year (%)	0%	65%	62%	18%	12%
Total	**2,450,132**	**5,673,422**	**8,268,715**	**10,838,614**	**13,579,195**
percentage of total	**100%**	**100%**	**100%**	**100%**	**100%**
change from previous year (%)	**0%**	**132%**	**46%**	**31%**	**25%**
adjusted for annual rate of inflation**	**2,450,132**	**4,425,269**	**6,449,598**	**8,562,505**	**9,777,020**
adjusted change from previous year (%)	**0%**	**81%**	**46%**	**33%**	**14%**

Sources: Providencia Osztrak-Magyar Biztosito Company Annual Reports, 1993-1995. Inflation rates in Hungary for each year shown are based upon statistics reported by the EBRD (1996).

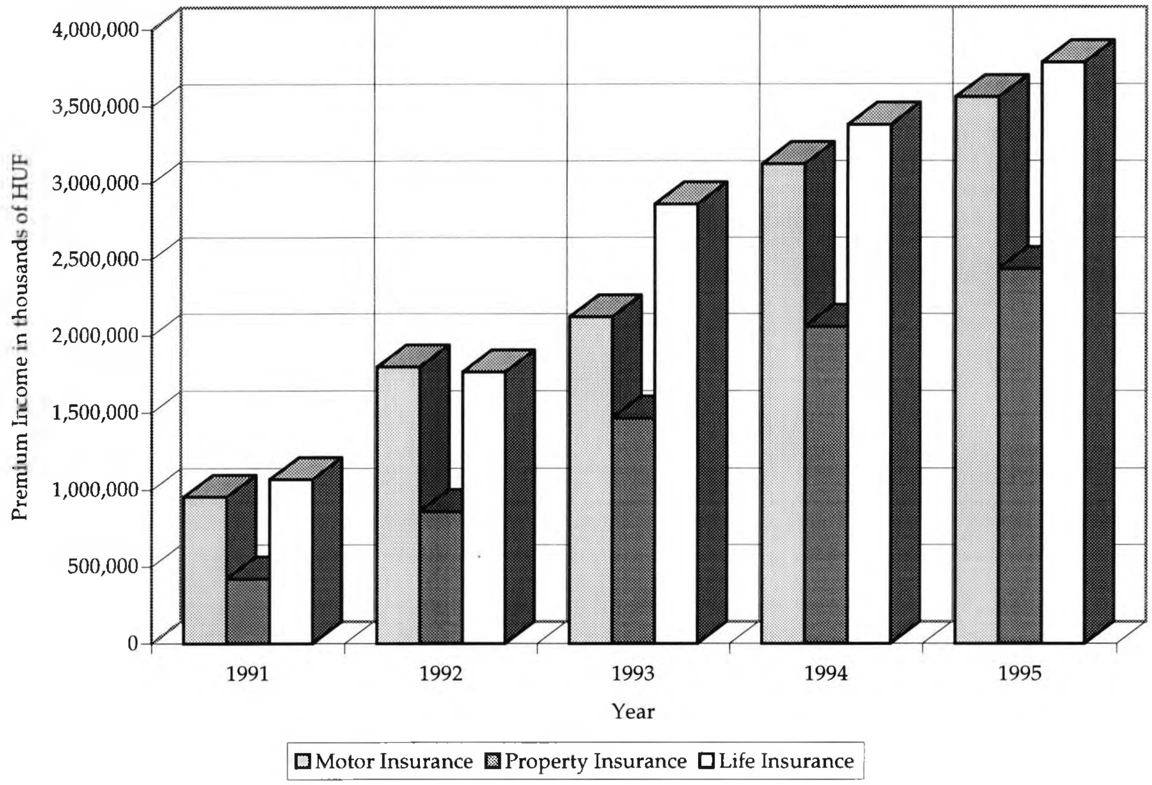
Notes: *For the sake of comparison, 1991 has been used as a based year; **Inflation rates in Hungary for each year were as follows: 32% in 1991, 22% in 1992, 21% in 1993, 21% in 1994, and 28% in 1995.

d. Generali's Other Investments in the East

The Generali Group has also established several other operations in Hungary, mainly through their two local subsidiaries Generali Budapest and Providencia. Including the latter two companies named, Generali has a total of ten individual firms operating within Hungary. These companies are active in the areas of financial services, real estate, and specialized insurance. The establishment of these other operations began in 1991. After consolidating its holdings in both Generali Budapest and Providencia, the Generali Group formed GEN-EA Befektetési és Tanácsadó Kft. for investment and economic consulting as well as management of property. The operation was established with a share capital of HUF 10 million ($132,000) and was 100% owned by Erste Allgemeine Versicherungs of Austria, which was itself a subsidiary of EA-Generali.

In 1992, two more firms were set-up in Hungary, both of which were real estate companies operating out of Budapest. One named EA-Generali Epitö és Tervezö Kft., 100% of which was

Figure 6.2, Providencia's Premium Income by Insurance Type Adjusted for Annual Inflation



Sources: Providencia Osztrak-Magyar Biztosito Company Annual Reports, 1993-1995. Inflation rates in Hungary for each year shown are based upon statistics reported by the EBRD (1996).

Notes: For the sake of comparison, 1991 has been used as a based year. Inflation rates in Hungary for each year were as follows: 32% in 1991, 22% in 1992, 21% in 1993, 21% in 1994, and 28% in 1995.

owned indirectly by EA-Generali via its subsidiary Erste Allgemeine Versicherungs. The other real estate company was called Pro-Immo Vagyonkezelő és Szolgaltato Kft, which Providencia owned all 100% of the shares. The initial share capital in each of these two real estate companies was HUF 10 million ($119,000) and HUF 1 million ($12,000) respectively.

In 1993 DOTTO MAG Mezögazdasági és Kereskedelmi Kft. was created through the group's Italian subsidiary Sementi Dotto which owned 100% of the venture. The new company operated in the field of agriculture, was based in Mezökovácsháza, and had a share capital of just HUF 1 million ($10,000).

During 1994 the group continued to expand its operations in Hungary with the creation of Európai Utazásbiztosítás-közvetítöi Kft. based in Budapest. Providencia directly held 98.33% of the shares and the remaining 1.67% were controlled by Providencia's own real estate company Pro-Immo. This venture was established with a share capital of HUF 6 million

($54,000) and is an active insurance broker for Providencia operating in the same Budapest facilities that house Pro-Immo.

The following year, in 1995, EA-Generali Management-Consult Kft. was formed with a share capital of HUF 1 million ($9,000). The firm was established to act as a holding company for EA-Generali's interests in Hungary, namely Generali Budapest and Providencia.

In 1996, the Lakaskassza First General Home Savings Fund Rt. was set-up to operate as a German style mortgage bank for when the home saving fund law comes into effect. The ownership structure of the venture involves multiple partners including EA-Generali (25%), Providencia (22%), Generali Budapest (5%), Creditanstalt (OE) of Austria (21%), the Hungarian based Postabank (21%), and the remaining 6% by the Hungarian Volksbank (HU). The new mortgage bank share capital was set at between HUF 800 million and HUF 1 billion ($5.3 million and $6.7 million).[21] Given these shareholdings this operation should be considered to be a Generali majority controlled operation as the group holds a total of 52% of the available shares.

Finally, it was announced in late 1996 that the Generali Group was to establish a new insurance company to be called European Travel Biztosító Rt. with a share capital of HUF 400 million ($3.2 million). The operation is owned by both Generali Budapest, with 74% of the shares, and Providencia holding the remaining 26%. The new venture will take over the two parent companies' travel insurance portfolios and will begin operating at the start of 1997.[22]

It should also be noted that Generali has not confined its activities solely to Hungary, instead choosing to set-up a number of other local operations in the Czech Republic and Romania, and more recently in both Slovakia and Slovenia. Each of which will be discussed according to the respective host country of operation.

In 1993, Generali made a return to the Czech lands via Generali Allegmeine Leben (OE) and established a real estate company called Anglická Business Center spol. s.r.o. with a share capital of CZKcs 71 million ($2.4 million) with Generali maintaining complete control of all of its shares. In 1994 Generali set-up two further Czech operations in the form of EA-Generali Spiraea Nemovitosi spol. s.r.o. and Harris & Dixon Praha a.s., an insurance company and a insurance broker respectively. The former being established via another one of Generali's Austrian firms called Allgemeine Immobilien and the latter by the British brokerage company of the same name. Also during 1994 Generali finalized the necessary preparations for the establishment of a full service insurer in the Czech Republic. At the start of 1995 this new

21East European Insurance Report (1996c), *Hungary*, pp. 18.

22Econews (1996d), *Generali to set up new insurance firm*, pp. 22.

operation came on-line and was called Generali Pojistovna a.s.. Generali Pojistovna took over all of Generali's insurance activities in the country and subsequently replaced EA-Generali's other local insurance providers and inherited their business. Shareholdings in the new Czech insurer were distributed with 80% for EA-Generali and 20% for Assicurazioni Generali and the company was started with a share capital amounting to CZKcs 410 million ($15.5 million).

During the course of 1995 Generali also entered the Czech pension fund market with the creation of a joint venture company named Generali-Creditanstalt Penzijní Fond based in Prague with all of the group's Czech operations. The pension fund company was given a share capital of CZKcs 20 million ($750,000) and EA-Generali held 80.2% of the shares and Creditanstalt (OE) the remaining 19.8%.[23]

All of this activity in the Czech Republic was described in a Generali Group company newsletter. According to a Generali , *"In the Czech Republic the reconstruction work around the Group's presence is progressing more leisurely. Unlike the strategy adopted in Hungary it was considered preferable to enter the market unaided by local partners."*[24]

During 1992, the first steps were taken to enter the Romanian insurance market under the guidance of Assicurazioni Generali which was responsible for this territory. In mid-1993, Generala Asigurari S.A. officially began its operation as an insurance provider offering all major types of coverages to customers within the country. Generala Asigurari was set-up as a joint venture company with a share capital of Leu 300 million ($650,000) in which Assicurazioni Generali initially possessed 51% of the shares with the rest of the share capital coming from local Romania partners. In 1995 Assicurazioni Generali had extended its shareholding position in Generala Asigurari to 56.67% and its share capital was now at Leu 2,155.5 million ($1,060,000), partly as a result of economic circumstances in Romania.

Overall, Romania has been an extremely difficult place to do business, the country suffering from the same type of economic problems that were described in the case of Hungary but to a much greater extreme. For example, in 1993 Romania's annual inflation reached 296% and subsequently the exchange rate of the currency plummeted losing some 37% of its value.[25] Generali described this situation in a report in their company newsletter, *"...Rumania* [*sic*] *stagnates in a plight of considerable insurance backwardness, as testified by a 0.4% premium-to-GDP ratio and by a yearly per capita outlay of just 3 dollars. The 1993 premium collected in the entire market amounted to 50,000 billion lei (50 million dollars)."*[26] Still, despite this very difficult

[23]The exchange rates for both 1993 and 1995 are CZKcs 30 = $1 USD and CZKcs 26.5 = $1 USD respectively.

[24]Generali Group (1995b), *The Lion in the "New Markets" of Eastern Europe*, pp. 5.

[25]In 1993 the Romania leu was valued at Leu 1,276 = $1 USD and by 1995 the exchange rate was at Leu 2,033 = $1 USD.

[26]Generali Group (1995b), *op. cit.*, pp. 6.

environment by 1994 Generala Asigurari had reported a very modest profit of Leu 82 million ($46,000). By 1995 the insurer's level of profit had grown slightly to Leu 765 million ($376,000).[27]

During 1996, Generali announced that it would be entering both the Slovak and Slovene insurance markets with local firms commencing operation sometime in 1997. As for the latter, it was announced by EA-Generali that it would be establishing a presence in Slovenia under the name of Ljubljanska Zavarovalnica which would be based in the country's capital Ljubljana. The presence would be in the form of a joint venture company which would initially concentrate on offering both life and accident insurances through the local partner's existing distribution network. The partners of the joint venture would be both EA-Generali and its subsidiary Interunfall Versicherungs (OE) taking 50% and the other 50% stake going to SKB Banka (SL), Slovenia's second largest bank.[28]

In regards to the former, as early as February 1996 it was reported that Generali would be setting up shop in Slovakia, once again utilizing EA-Generali.[29] By November of the same year this was confirmed by an official company announcement that Generali would indeed be establishing a insurance company based in Bratislava under the name of Generali Polstovna with a total share capital of SKKcs 184 million ($6.0 million)[30]. At the time Mr. Dietrich Karner, CEO of EA-Generali of Austria was quoted by the press as saying that *"The move will round off our presence in central Europe."*[31]

6.2.3 Locational and Motivational Factors Affecting Generali's Decision to Engage in Foreign Direct Investment in Hungary[32]

In a conference speech, Camillo Giussani, one of the Generali's top executives, stated that, *"The essential guideline we* (at Generali) *always have in mind when entering a new market is a long-term perspective..."* Giussani went on to conclude that,

> *"Considering the potential offered by Central-Eastern European countries in all sectors of insurance and realizing how quickly the juridical and legislative structures are adjusting to a system totally different from the past one and, last but not least, the ever increasing propension [sic] of foreign investors to take an interest in these countries and thus create new needs for insurance, I am convinced that we can be reasonably optimistic on the future progress and*

[27]The exchange rates for both 1993 and 1994 are Leu 460 = $1 USD and Leu 1,767 = $1 USD respectively.

[28]European Insurance M arket (1996b), *Company News*, pp. 365.

[29]European Insurance Market (1996f), *Company News*, pp. 40.

[30]The exchange rate for 1996 is based upon SKKcs 30.8 = $1 USD.

[31]European Insurance Market (1996a), *Company News*, pp. 380.

[32]For further details on exactly how these issues were addressed see *Chapter 4, Foreign Direct Investment in Central Europe: Results from a Survey of Major Western Investors.*

development of the insurance markets in the Central-Eastern European countries."[33]

Bearing these comments in mind it is important to examine the key factors affecting Generali's choice of Hungary as a location for FDI as well as the company's motivation in engaging in FDI with the creation of Generali Budapest and Providencia. In doing so, the questionnaires received from these two companies, which were completed by their respective top executives, sheds some light on these issues.

However, prior to proceeding it should be noted that Generali's interest in Providencia at the time of its creation was through its shareholdings in the Austrian joint venture company Wiener Allianz, in which Allianz of Germany was also a major partner. Given this situation, the responses from Providencia's respective executive to specific questions in the research questionnaire on the locational and motivational factors affecting the foreign parent/partner to invest might be subject to a certain degree of bias because of the composition of the actual investor, namely the joint venture company Wiener Allianz.

On the other side of the coin, given the prominent role of the Generali Group in the creation of both Generali Budapest and Providencia, one would expect to find a fairly strong correlation in the executives' responses to the questions in the research questionnaire. However, as the evidence will show, while there are a number of instances where a strong positive correlation exists between responses of the executives of the two firms, there are also a number of differences in their replies. One interpretation is that these differences appear to be a direct result of changes in the environment of the investment, though it could be just the different perspectives of the executives of the local firm to this same environment.

a. Locational Factors for FDI

The issue of locational factors were addressed to executives of both Generali Budapest and Providencia in the form of an open-ended question asking what do you consider to be the three most important location-specific advantages of Hungary versus other countries as locations for FDI. The responses by both executives to these questions were quite similar, although put in different orders according to the degree of importance. For the executive of Generali Budapest, the first most important location-specific advantage of Hungary was listed as *"geographic center of the region,"* in reference to the geographic location category. In the case of Providencia, the answer to the same question was *"the general attitude of Hungary to foreign investment,"* which is strongly associated with investment climate factors.

In terms of the second most important location-specific advantage of Hungary, Generali

[33]Generali Group (1996) *op. cit.*, pp. 8.

Budapest noted the *"political stability"* of the host country. This reply was categorized as being part of the investment climate factors. Providencia's reply to this question was *"the possibility of acquiring market share (because of the liberalization of the market),"* thus considered to be part of market factors.

In response to the third most important location-specific advantage of Hungary, Generali Budapest listed *"growth potential"* and Providencia stated *"historical links to Hungary,"* being categorized with market and investment climate factors respectively. Providencia's reply is interesting in that it classically illustrates the historic relationship that has existed between Generali and Hungary for well over a hundred years and which was only suspended as a result of the rise of Communist regimes in the country in the mid-1940s.

b. Motivational Factors for FDI

The motivational factors affecting Generali's decision to invest were addressed to executives via both open- and close-ended questions. The open-ended questions asked executives to state their opinion as to the primary and secondary motives of the Generali Group to invest in the local firm they represented. For Generali Budapest, the predominant motive for FDI was stated as being *"to be the first foreign insurance company on the Hungarian market."* This response was indicative of strategic position factors. Providencia's executive commented that, *"it was a greenfield investment and our foreign parent did not want the trouble with restructuring a former State-owned company,"* a reply which was also classified with strategic position factors. As a secondary motive for investment in Hungary, Generali Budapest stated it was because of the *"underdeveloped insurance market leading to unexploited opportunities,"* which was associated with market factors given its focus on the local market.

This first open-ended question on the motives for Generali's investment in Hungary was followed-up by a close-ended one asking executives to assess the relative degree of importance[34] of a series of statements, each of which was directly associated with a particular motivational factor. The replies from each of the executives of both Generali Budapest and Providencia clearly show a strong positive correlation between them.

All of the statements associated with either exporting or manufacturing related activities were rated by executives of the two Hungarian based insurance companies as being a very unimportant, or at least unimportant, motivational factor in the foreign parent/partner organization's decision to engage in FDI. This finding is to be expected given the nature of both Generali Budapest's and Providencia's business activities in the field of financial intermediation, namely insurance. In regards to export oriented statements, these included all three forms of *"to*

[34]This was done on a four point scale using *very unimportant (1)*, *unimportant (2)*, *important (3)*, and *very important (4)*.

create an export base for countries within CEC and/or FSU; EU and/or EFTA; outside Europe" as well as *"avoidance of tariff and non-tariff barriers."* Those statements associated with the manufacturing field receiving very unimportant ratings included *"to gain access to supplies of raw materials," "to secure needed inputs," "comparative labor cost advantages,"* and *"an opportunity to reduce operating costs by transferring production facilities to Hungary."*

At the other end of the spectrum several specific motivational factors were noted by executives of the two local firms as being important or very important in Generali's decision to invest in Hungary. Both Generali Budapest and Providencia rated the market factor *"to access/supply the local Hungarian market"* as being very important. The only other market factor to receive a positive rating was the *"growth potential of the local Hungarian market,"* although for Generali Budapest this was considered as very important while for Providencia it was only rated as important.

In the remaining statements in the question positive responses were fairly spread throughout the other factors listed. The only exceptions to this being the single statement associated with know-how (technology) factors which was considered as very unimportant in the case of Providencia and unimportant for Generali Budapest. It should also be noted that there was no statement given in the question in relation to geographical location factors. In terms of the positive replies, the only employment factor statement listed, namely the *"availability of skilled workforce,"* received a rating of important by both companies. For financial efficiency factors, the executive completing the questionnaire on behalf of Providencia listed *"to increase profit levels"* as very important and marked both *"comparative labor cost advantages"* and *"to reduce costs in general"* statements as important. In the case of Generali Budapest, the only financial efficiency factor to receive a positive rating was *"to increase profit levels,"* that was listed as important.

In regards to statements based on investment climate factors, almost all of them were given an important rating by the two executives participating in the survey, although there were some slight deviations. For Providencia, the *"overall stability of Hungary for investment"* was considered as being a very important motivational factor for investment whereas Generali Budapest considered *"historical trading links with Hungary"* as very important. Both executives rated *"the general attitude of Hungary to foreign direct investment"* as important.

Finally, the strategic position factor statement *"to gain first mover advantages"* was very important by Generali Budapest and just important by Providencia. These types of responses are supported by the fact that both Generali Budapest and Providencia were established at the start of the transition process in the Hungarian insurance market. The only other statement in this category to receive a positive rating was *"to follow customer firms (firms we supply),"* which the executive for Generali Budapest noted as being an important factor.

Based on all of these data, some general comments can be made as to both the locational and motivational factors that have affected Generali's decision to establish its two local operations, Generali Budapest and Providencia, in Hungary via FDI. First, in terms of locational factors, Hungary's investment climate seems to have been a major reason for investing in this country as opposed to other host countries. Market factors, those focusing solely on the local Hungarian market, also had a considerable impact on Generali's choice of Hungary for investment.

The data for motivational factors also shows the strong influence of host country specific market factors in Generali's decision to invest in Hungary. Other motivational factors included the availability of a skilled workforce, the chance to increase profit levels, Hungary's positive investment climate, and the chance to gain first mover advantages in the local market.

From the evidence available it appears that the Generali Group considers a number of local markets for insurance services[35], including those in the CEC, and possibly even some of the countries in the FSU, as areas for potential investment. In the investment equation it seems that the key criteria of the decision to invest or not invest within a specific host country is that the country in question must both possess a certain degree of stability, especially political stability, and be somewhat friendly to the concept of direct investment by a foreign based entity. Proof of these points can be seen in Generali's decision to establish local operations not only in Hungary, but also in the Czech Republic and Romania, and more recently in both Slovakia and Slovenia. While one could question the merits of this conclusion in light of Generali's investment in Romania, it should be remembered that despite extremely harsh economic conditions in Romania over the last seven years the country has up until recently had one of the most stable and longest serving governments in the region. Furthermore, Romania's attitude towards FDI has been quite positive, even if only on the surface. Hence, Generali's decision to establish a local presence in Romania fits into the scenario postulated.

In conclusion of this area of discussion, since 1989 the Generali Group has re-entered, or is currently in the process of re-entering, each of the countries in which prior to the onset of communism it had local operations functioning on its behalf. However, despite the historic links that exist between Generali and these particular host countries, it has been stated that this is not a form of re-establishing a former lost empire. According to comments made by Gergely of Providencia, *"Generali was not seeking to re-establish its former empire of insurance in the East that disappeared after the close of the Second World War. It is merely coincidence that Generali has been investing in these countries due to market opportunities."* Gergely elaborated on this further by stating that Generali's decision to invest in specific host countries was based upon those same host countries possessing a certain degree of stability, especially political stability. Furthermore, bearing this point in mind, Gergely pointed out that in the short-term in was very unlikely that

[35]It should be noted that Generali's focus on the local market of a host country is a result of the nature of the insurance industry and fairly standard host country legal requirements on such business activities.

Generali would be expanding into the FSU anytime soon due to the very high level of associated risks in these countries. However, Gergely pointed out that this did not rule out Generali engaging in FDI in other countries of the region.

This was a point which one of Gergely's colleagues at Generali has alluded too in his own personal statement. Prior to the official company announcement regarding Generali's move into Slovakia, Mr. Camillo Giussani, General Manager for the Generali Group, was quoted as saying that, *"Should we come across a favourable opportunity, we might also consider Poland with interest."*[36] Given this statement it is likely that Generali will eventually enter other host countries within the CEC, provided that these investments both further the group's strategic objectives in the region and fulfil their basic investment criteria. This information confirms the findings from the survey data.

6.2.4 Modes of Foreign Direct Investment and their Evolution[37]

As previously detailed, Generali has employed several modes of FDI with mix results in Hungary. To begin with Generali entered the Hungarian insurance market via the creation of ÁB-Generali Budapest which was in the organizational form of a joint venture company and employed a joint venture acquisition mode of FDI. It should be noted that Generali's use of the joint venture mode was necessitated by Hungarian legal requirements at the time which restricted other forms of foreign ownership. In the joint venture Generali effectively controlled 40% of the company's shares but gave management authority to its partner ÁB. However, as time progressed executives on the scene working for Generali realized that the venture was not achieving the desired results it wanted out of the Hungarian market and that the venture's operational structure was problematic due to both Generali's lack of management control via its minority shareholding position and the very bureaucratic nature of ÁB. In late 1991 following long and complex negotiations Generali rectified this situation by acquiring ÁB's 60% shareholding in the joint venture. At the beginning of 1992, the newly acquired company was renamed Generali Budapest and it began the process of re-establishing itself in the Hungarian insurance market focusing on commercial and agricultural coverages. At the time the company had only a small staff and some previous insurance accounts gained from the acquisition of ÁB's shareholding. However, for the Generali Group the silver lining in this situation was that it now had full control of the company with a 100% shareholding position (80% EA-Generali [OE] and 20% Assicurazioni Generali [IT]) and was given the chance to enhance further its position within the Hungarian market.

Generali's second venture into the Hungarian insurance market was via the Austrian joint

[36]European Insurance Market (1996c), *Company News*, pp. 281.

[37]For further details on exactly how this area was addressed see *Chapter 4, Foreign Direct Investment in Central Europe: Results from a Survey of Major Western Investors.*

venture Wiener Allianz, in which both Generali and the German insurer Allianz were partners. In 1989, Wiener Allianz set-up Providencia in Hungary via the greenfield joint venture mode of FDI. Providencia's joint venture structure gave Wiener Allianz a majority stake with 59% of the shares and the balance held by other partners including two local Hungarian firms.

In 1991 Providencia's ownership structure changed significantly as a result of strategic re-organization at Allianz. In a share swap agreement Generali, via its Austrian subsidiary EA-Generali, gained control of Providencia with 51% of the shares. Over time Generali has consolidated its shareholding position in Providencia and it currently controls 78% of the shares, with the remaining 22% being distributed between two local Hungarian partners (15% Magyar Posta [HU] and 5% Postabank [HU]) and some private individuals (2%) based in Austria. At present, it seems unlikely that the Generali Group will seek to extend its shareholding position in Providencia any further. This is mainly because to do so would dilute the interests of its two Hungarian partners whom the company uses as a point of sale for its products, which was a very important factor in forming the joint venture. However, there is a strong possibility of this shareholding situation changing if there is a full merger between itself and its sister company Generali Budapest at some point of time in the future. Still, on this last point Vágó for Generali Budapest commented that a merger between Providencia and Generali depends on the conditions of the local market. He went on to state that Providencia is doing well on its own at present.

6.2.5 The Development of Two Hungarian Insurance Operations: An Examination of Generali Budapest and Providencia

In the beginning some of the most difficult tasks facing both Generali Budapest and Providencia were to find the right personnel, train them to be effective and efficient in the field of insurance, and expand their respective networks throughout Hungary; the latter being a ground up process for both companies. Although Providencia has been able to utilize the existing network of its two local Hungarian partners as a point of sale for its products. Still, despite having a common parent in Generali, both Generali Budapest and Providencia have each used their own techniques and methods to complete these all important tasks. As a result of this, each of the two companies now possesses their own unique company culture. Yet, in order to understand the difference between these two company cultures one must examine how the topics of employment, training, modernization of operations, and personnel issues have each been handled by these two firms. In doing so, the reader will be able to see the similarities as well as the differences that exist between these two firms and which have subsequently shaped each of the company's respective cultures.

a. Employment

As previously stated, the Western concept of insurance functioned very differently in Hungary under the former Communist system, as was also the case in other countries of the region. Camillo Giussani of the Generali Group, from the retrospective viewpoint, aptly described the legacy of communism on the skill levels and attitudes of employees within the insurance industry in the CEC in one of his speeches. According to Giussani,

> *"Another problem to be tackled was, as can be imagined, the lack of people with proper skill and experience in the insurance field; over 40 years of 'non-insurance minded' attitude had made it impossible to set up a structure not only of technicians but, in general, of persons capable to 'manage' in the real sense of the word, that is to say ready to assume those entrepreneurial responsibilities which are, somehow or other, the prime mover of our economic system."*[38]

Given this situation, the issue of finding suitable individuals capable of becoming skilled in the field of insurance has been paramount to any insurance operation in the region.

To begin with, the original core workforce of Generali Budapest was composed of staff inherited from the joint venture with ÁB. From this small group of staff Generali Budapest hired others and has been able to develop its organization. At the close of 1995 the company was operating through a total of 65 branch offices spread throughout Hungary. In terms of the sales force, besides employing its own full- and part-time agents the company has also utilized a country-wide network of agents who exclusively handle Generali Budapest's line of insurance products. In the middle of 1995, in an effort to expand further its network, the company began the process of franchising some of its operations out to suitable individuals, with a primary focus on increasing sales of life products.

In contrast, Gergely stated during a personal interview that contrary to the actions and policies of other insurers serving the Hungarian market, Providencia has followed another way of recruiting employees. Providencia recruited employees on the basis of four main considerations: 1) candidates had to be young and motivated; 2) have a university degree; 3) possess a knowledge of at least one foreign language, preferably German; and 4) they had to have no previous experience working with either of the two former state-owned insurance organizations, Állami Biztosító or Hungária Biztosító. According to Gergely, *"This recruiting policy has been the key to Providencia's success in the market."* He goes on to mention this is also why the company's employees are so sought after by its competitors.

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[38]Generali Group (1996) *op. cit.*, pp. 7.

b. Training

In terms of training, almost all of the key staff in executive positions at Generali Budapest have been sent to EA-Generali in Vienna for various intensive training courses. The sole exception to this being some high echelon executives that had originated from the Austrian subsidiary and were assigned to start the operation with ÁB in the first place. In the beginning, most of the non-executive members of staff were primarily trained on-site in Hungary through a training scheme run by a high level human resources executive sent over from EA-Generali for this specific purpose. Besides this element of basic training, Generali Budapest has over the years continued to run numerous internal educational training courses, especially with their sales staff. For example, according to Generali Budapest's 1995 company annual report, *"In 1995, almost one half of our staff took part in at least one educational training course. In addition to our full-time staff members, our part-time agents also participated in numerous 1-3 day training sessions."*[39]

The training program at Providencia has been very similar, and in some cases identical, to the one at its sister company Generali Budapest. According to Gergely, since nearly everyone at Providencia spoke German they were sent off to EA-Generali in Austria for training at the mother company, a process which is still done today. Providencia has also worked out its own in-house training system for both executive and non-executive members of staff. The management participates in both medium and high level training programs. Gergely believes that quality of the training regime at Providencia is comparable to those found in such major international consulting firms such as McKinsey, Andersens, etc.. Furthermore, Gergely added that Providencia is the only insurer in Hungary that has implemented a *"Total Quality Management (TQM)"* training program. After five years of doing business in Hungary, Providencia created a TQM certification program to increase the quality of the administration processes and operations of the firm. Gergely stated that, *"The TQM certificate doesn't mean that the products are good but it means that the processes are good and function in the right way."* The bottom line of this certification program is the ability of Providencia's staff to provide better service to its customers.

c. Modernization: The Development of the Electronic Data Processing (EDP) System

In 1993, Providencia commissioned the establishment of an *Electronic Data Processing (EDP)* system that was specifically designed to link-up the company's network of offices and agencies throughout Hungary. Providencia's data processing center in Budapest formed the hub of this link-up through its own in-house central computer. Although, given limited computer storage facilities on this particular system a direct computer link was also established between Providencia and EA-Generali's data processing center in Vienna, thus greatly increasing the

[39]Generali Budapest Biztosító Rt. (1995), *op. cit.*, pp. 12 (pp. 8 of English translation).

system's capacity and reducing response times. According to statements in a Providencia annual report for 1993, *"One of the main objectives of our efforts to develop the use of automation in 1993 was the decentralisation of the work process and the computer-controlled integration of consecutive business transactions."* The report went on to state that, *"Of particular importance here are the automatic registering of payments received, and sending out of reminders, the new life insurance administration, and the claims paid statistics."*[40]

By 1995, Providencia reported that all of its agencies had been connected to on-line processing services via the EDP system. Furthermore, since the inception of the EDP system both Providencia and Generali Budapest have been able to utilize the system for their own respective clients. Overall, the net benefit to both companies in the implementation of the EDP system has been not only speedier service to their respective customers, but also a vast improvement in the ability of staff to track essential company information as well as increased efficiency in the collection of payments. The latter being an extremely important function in obtaining the desired level of the liquidity in each of the two companies.

d. Personnel Issues

In 1995, the *Comité Européen des Assurances (CEA)*, representing insurance companies operating within 24 member countries (including countries in the EU, EFTA, and some CECs), identified Hungary as the country with highest number of employees per insurance company with an average of 1,254. In comparison, in the EU, Austria and Germany were rated by the CEA as possessing the first and second highest number of employees per insurance company with 438 and 351 respectively.[41] Given these facts, what is the employment situation at Generali Budapest and Providencia?

In terms of employee turnover, Vágó for Generali Budapest stated that his company has experienced a high turnover rate of agents but that the turnover rate of internal staff has remained fairly low. Vágó added that in general, Generali Budapest has not sought to put its workers out on the street despite making some necessary cutbacks.

In the case of Providencia, Gergely commented that while his company intends to continue to increase its network of agents the workforce in general will remain fairly constant. Although he also noted that Providencia is seeking a reduction in its workforce. But the focus of this reduction will not be aimed at terminations of employees but instead utilizing the same employees in other parts of both Providencia and Generali Budapest's operations in Hungary as their business continues to expand. For example, transferring existing staff to run the new travel

[40]Providencia Osztrák-Magyar Biztosító Rt. (1993), *Company Annual Report 1993*, pp. 12.

[41]These findings came from the CEA's publication entitled *"European Insurance in Figures 1995,"* which was reported by DYP in one of their newsletters. See European Insurance Market (1996e), *Weak Economy Does Not Halt Insurance Sector*, pp. 53-55.

insurance firm European Travel Biztosító Rt., or the savings bank operation Lakaskassza First General Home Savings Fund Rt., etc.. The same sentiment was expressed by Vágó of Generali Budapest in regards to utilizing current employees in other parts of the company's present and future operations.

Yet, it should be noted that a number of employees have been let go over the years. Since 1995, there has been a reduction of internal office staff as a direct result of the merging of the administrative operations and offices of both Generali Budapest and Providencia into one central headquarters unit located in Budapest. On the impact of the merger and subsequent staff redundancies it has caused, Gergely stated that, *"The relationship between Generali Budapest and Providencia is generally very good. Yet, you have to understand that in the process of merging operations there is a lot of emotional issues involved. In the enumerative areas there are no problems. The only main problem is in the rationalization of personnel in merging some of the two firms operations."* Gergely then concluded that, *"However, over time the synergies created via the merging of certain operations will benefit the two firms because their competitors are faced with a higher level of administrative expenditures."* Hence, the merger of specific internal operations of the two companies should be viewed as creating a competitive advantage for both Generali Budapest and Providencia.

6.2.6 An Overview of the Hungarian Insurance Market

Since 1989 the Hungarian insurance market has changed dramatically, moving from a State duopoly to one of a highly competitive nature. At the close of 1995 there were a total of 14 different insurance companies operating within Hungary. The vast majority of these operations were established between 1990 and 1991. Of these 14 insurers, one focuses exclusively on life insurance products (Nationale-Nederlanden), another deals exclusively with property coverages (Argosz), one offers only export credit insurance on behalf of its owner the Hungarian State (MEHIB), and the remaining 11 are composite insurance companies (licensed to offer both life and non-life products)(ÁB-Aegon Általános, Atlasz Utazási, Colonia, AHICO, Európa-Gan, Generali Budapest, Glória-Swiss Life, Hungária, OTP-Garancia, Providencia, and Signal). The 14 companies are also differentiated by their respective forms of ownership structure as well as the origins of their owners. Six of the companies are 100% wholly-owned subsidiaries, of which one is state-owned (MEHIB) and the remaining five are owned by foreign interests (ÁB-Aegon Általános, Colonia, Generali Budapest, Nationale-Nederlanden, and OTP-Garancia). The other eight companies possess a mixed ownership structure, seven being dominated by foreign entities each through a majority shareholding position and the other one contains a mixture of Hungarian owners as well as one foreign shareholder (Atlasz Utazási, Argosz, AHICO, Európa-Gan, Glória-Swiss Life, Hungária, Providencia, and Signal). Each of the original 14 companies were formed under the original Hungarian legislation which stipulated a minimum share capital of HUF 1 billion ($8 million)[42] and allowed for composite insurance operations to be established.

During 1995 the Hungarian government finally passed the long awaited and debated legislation on the insurance industry. The new *"Insurance Act"* went into effect in January of 1996. The new law is intended to provide proper conditions and the necessary legal background to allow insurance companies efficiently and effectively to operate in Hungary. One of the most important aspects of the new law was the significant lowering of minimum capital requirements for the establishment of an insurer, from HUF 1 billion to HUF 250 million for life insurers and between HUF 150-350 million for non-life insurers. This element was designed by the government in an effort further to open the local market to new entries, especially domestic ones. It seems to be the government's intention that this will not only expand the range of insurance choices available to customers but also increase the level of competition in the market.

When asked for his opinion on the new law, Vágó of Generali Budapest provided some insightful comments. According to Vágó, a good thing about the new law was that it clarified several important areas of concern. He stated that the bad thing about the law was that it decreased the amount of capital foundation required to start an insurance firm, adding that this has been compounded by Hungary's high rate of inflation and devaluation of the forint. Vágó also stated that while there has been some deregulation of the industry by the new law there has also been stricter control by the government in overseeing the operation of insurance firms. Gergely at Providencia expressed some similar thoughts when asked the same question.

With the adoption of the new *Insurance Act of 1996*, another three insurance companies have been established in Hungary (Hermes, Winterthur, and Zürich) one of which was actually established four days before the close of 1995 under the old Hungarian law allowing it to operate as a composite insurance business (Winterthur).[43] In terms of types of insurance offered, one has initially offered life and pension coverages (Winterthur), one concentrates on export credit insurance and intends to eventually add credit for domestic transactions (Hermes), and the last has been licensed for both property and liability coverages (Zürich). On the issue of ownership and origins, two of these new insurers are wholly-owned subsidiaries (Winterthur and Zürich) and the other a joint venture (Hermes), and all three companies are completely owned by foreign interests. Hence, with these latest three entries, there are now a total of 17 insurance companies operating within the Hungarian market place, thus increasing the level of competition even further. A profile of Hungarian insurance companies is given in **Table 6.7**.

In terms of the nature of the Hungarian insurance market by specific type of coverages, non-life

[42]The exchange rate for 1995 is based upon HUF 126 = $1 USD.

[43]This was reported by the EEIR. See East European Insurance Report (1996f), *Hungary*, pp. 15.

Table 6.7, A Profile of Hungarian Insurance Companies, as of 31 December 1996

Name of Insurance Company	Capital Stock (in million HUF)	Principal Owner(s)	Home Country	Shareholding Percentage (%)	Type of Insurance				
					Life	Other Personal	Property	Liability	Third Party Motor
AB-Aegon Altalanos Biztosito Rt.	9,370	AEGON International BV	NL	100.0%	Y	Y	Y	Y	Y
Argosz Biztosito Rt.	1,800	Assurantie Van De Belgische Boerenbond (ABB-Verzekeringen)	BG	60.6%	Y	Y	Y	Y	Y
		Groupama International SA	FR	15.0%					
		Fonds Nieuw Europa	BG	8.0%					
		NFU Mutual Insurance Society	UK	5.0%					
		Interpolis	NL	5.0%					
		FBD Insurance	IR	3.0%					
		R & V Versicherungs Holding	BD	2.8%					
		Farmers Unions (MOSZ)	HU	0.5%					
		Rakosmezeje Rt.	HU	0.1%					
Atlasz Utazasi Biztosito Rt.	1,000	IBUSZ Co.	HU	36.7%	Y	Y	Y	Y	
		OKHB Bank Rt.	HU	23.2%					
		IBUSZ Invest	HU	18.1%					
		Colonia Versicherung AG	BD	12.0%					
		Hungarian State Railways (MAV)	HU	10.0%					
Colonia Biztosito Rt.	1,171	Colonia Versicherung AG	BD	100.0%	Y	Y	Y	Y	Y
Elso Amerikai-Magyar Biztosito Rt. (AHICO)	1,000	American International Group (AIG)	US	88.0%	Y	Y	Y	Y	
		Metallurgical & Electric Union (VASAS)	HU	11.0%					
		Civil Service Union	HU	1.0%					
Europa-Gan Biztosito Rt.	1,000	Group des Assurances Nationales (GAN)	FR	89.4%	Y	Y	Y	Y	
		SAI	IT	10.0%					
		Private Investors	HU	0.6%					
Generali Budapest Biztosito Rt.	**1,000**	**EA-Generali AG**	**OE**	**80.0%**	**Y**	**Y**	**Y**	**Y**	**Y**
		Assicurazioni Generali SpA	**IT**	**20.0%**					
Gloria-Swiss Life Biztosito Rt.	1,000	Swiss Life	SW	51.0%	Y	Y	Y	Y	
		Il Mare Assicurazioni	IT	19.0%					
		Mezobank Rt.	HU	14.0%					
		Cia de Seguros Imperio	PT	11.0%					
		Iparbankhaz Rt.	HU	5.0%					

continued...

Table 6.7 (continued), A Profile of Hungarian Insurance Companies, as of 31 December 1996

Name of Insurance Company	Capital Stock (in million HUF)	Principal Owner(s)	Home Country	Shareholding Percentage (%)	Type of Insurance				
					Life	Other Personal	Property	Liability	Third Party Motor
Hermes Hitelbiztosito Magyarorszag Rt.	400	Hermes Kreditversicherungs AG	BD	54.8%			Y		
		Prisma Kreditversicherungs AG	OE	25.1%					
		Soc Francaise d'Assurance Credit (SFAC)	FR	20.1%					
Hungaria Biztosito Rt.	4,266	Allianz Holding AG	BD	90.0%	Y	Y	Y	Y	Y
		APV Rt. (Hungarian State)	HU	9.2%					
		Hungaria Biztosito Rt.	HU	0.8%					
Magyar Export Hitel Biztosito Rt. (MEHIB)	1,000	Hungarian National Bank (Hungarian State)	HU	100.0%			Y		
Nationale-Nederlanden Hungary Biztosito Rt.	1,250	ING Group	NL	100.0%	Y	Y			
OTP-Garancia Biztosito Rt.	4,050	OTP Bank Group	HU	100.0%	Y	Y	Y	Y	Y
Providencia Osztrak-Magyar Biztosito Rt.	**1,500**	**EA-Generali AG**	**OE**	**78.0%**	**Y**	**Y**	**Y**	**Y**	**Y**
		Magyar Posta Vallalat (Hungarian Post Company)	**HU**	**15.0%**					
		Postabank es Takarekpenztar Rt. (Post Bank & Savings Bank Corporation)	**HU**	**5.0%**					
		Private Individuals	**OE**	**2.0%**					
Signal Biztosito Rt.	1,000	Signal Unfallversicherung AG	BD	59.0%	Y	Y	Y	Y	
		Austria Collegralitat Osterreichische	OE	20.0%					
		Societa Reale Mutua de Assicurazioni	IT	20.0%					
		National Association of Crafts Union	HU	1.0%					
Winterthur Biztosito Rt.	1,000	Winterthur Schweizerische Versicherungs	SW	100.0%	Y	Y			
Zurich Biztosito Rt.	na	Zurich Insurance Group	SW	100.0%	Y	Y	Y	Y	

Sources: Magyar Biztositok Szovetsege/Association of Hungarian Insurance Companies (MABISZ)(1991,1995,1996); Budapest Business Journal (1995, 1996); Assecuranz Compass 1996 (1996); Central European, November (1994); and the East European Insurance Report (EEIR), various issues (1996).

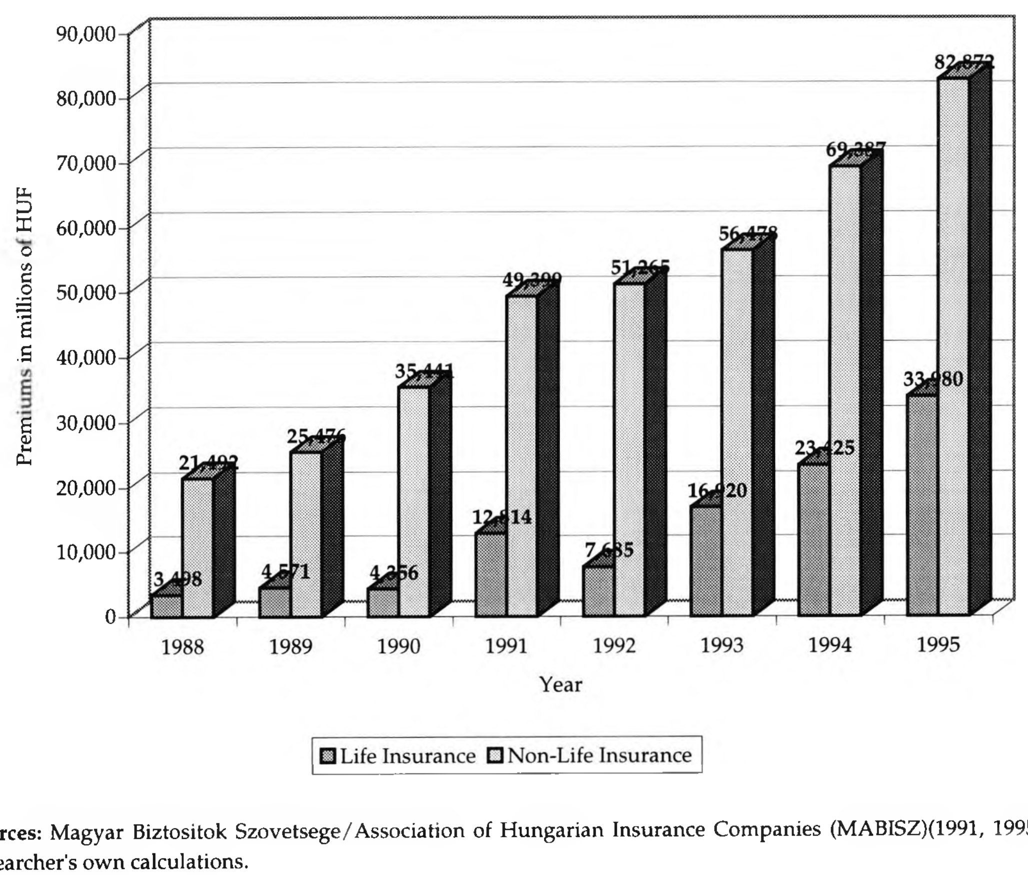
Table 6.8, The Hungarian Insurance Market by Insurance Type

Gross Premium Income by Insurance Type	Year							
	1988	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**
Life								
in millions of HUF	3,498	4,571	4,356	12,814	7,685	16,920	23,425	33,980
in million of USD$	67	73	71	169	91	168	212	270
percentage of total	14%	15%	11%	21%	13%	23%	25%	29%
change from previous year (%)	0%	31%	-5%	194%	-40%	120%	38%	45%
Non-Life								
in millions of HUF	21,492	25,476	35,441	49,399	51,265	56,478	69,387	82,872
in million of USD$	409	408	576	653	610	560	627	659
percentage of total	86%	85%	89%	79%	87%	77%	75%	71%
change from previous year (%)	0%	19%	39%	39%	4%	10%	23%	19%
Total								
in millions of HUF	**24,990**	**30,047**	**39,797**	**62,213**	**58,950**	**73,398**	**92,812**	**116,852**
in million of USD$	**476**	**481**	**647**	**823**	**702**	**728**	**838**	**930**
percentage of total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
change from previous year (%)	**0%**	**20%**	**32%**	**56%**	**-5%**	**25%**	**26%**	**26%**

Sources: Magyar Biztositok Szovetsege/Association of Hungarian Insurance Companies (MABISZ)(1991, 1995, 1996) and the Researcher's own calculations.

Note: Gross Premium Income figures reported are based upon Hungarian Forints while figures given in USD$ Dollars are based upon the appropriate year-end exchange rates.

Figure 6.3, The Hungarian Insurance Market by Insurance Type



Sources: Magyar Biztositok Szovetsege/Association of Hungarian Insurance Companies (MABISZ)(1991, 1995, 1996) and the Researcher's own calculations.

insurance policies have tended to be the predominate force in the market (See **Table 6.8** & **Figure 6.3**). Cumulatively speaking, between 1988-1995 non-life premiums have averaged 80.9% while premium income from life policies averaged 19.1% over the same period. Still, in comparative terms, in 1988 non-life insurance products accounted for 86% of gross premium income with only 14% coming from life products. Yet, by 1995 this situation had changed somewhat with non-life representing only 70% of premium income and life the other 30% of the gross premiums for that year. Hence, life coverages have been gaining ground but non-life policies still constitute the dominant form of insurance in the Hungarian market.

Gergely stated that *"Everyone in the Hungarian insurance industry would like to focus more on the life insurance sector."* He added that *"Providencia would like to offer complete packages* (which would provide both life and non-life coverages) *to customers/clients and is planning to offer such a service."* According to Gergely, Providencia has already conducted a detailed market survey in this area with some of its existing customers to assess the degree of demand for such comprehensive packages covering all of the customers' insurance needs. In response to this market survey, a number of customers have stated that they are indeed interested in this one-stop shopping for insurance coverage.

If the Hungarian life insurance sector is one that most local insurers would like to focus more on the motor branch is one that some have expressed a desire to leave. Motor insurance, in the form of both *motor third party liability (MTPL)* and *motor own damage insurance (casco)*, has been fairly unprofitable for most insurers that still offer such coverages, especially in the case of casco (See **Table 6.9**).

As for *casco*, which covers theft and damage on vehicles, only seven insurers currently offer such policies and only on a very selective basis with high premium levels due to ever increasing problems of both rising theft and repair costs. For example, between 1991-1995 gross claims expenses have often exceeded premium income for *casco* coverage. This has been the situation three out of the five years in the period for ÁB-Aegon Általános, Hungária, and Providencia; two out of five years for Argosz and Generali Budapest; and for both Argosz and OTP-Garancia, whom have only offered *casco* since 1994, one out of two years. Only Colonia has been able to favorably offset claims expenses against its level of premium income generated, and even they have experienced a high percentage of claims versus premiums at 79%. Furthermore, to put this into perspective, Colonia's cumulative level of premium income on *casco* only amounts to just 11% to that of Hungária, which still dominates the motor insurance business.

Overall, insurers losses on *casco* can be partially blamed on the growing problem of car theft in Hungary, which has been a growing problem in the country in recent years as the Eastern mafia

Table 6.9, Motor Insurance Premium Income & Claims Expenses

Name of Insurer (in millions of HUF)	Motor Third Party Liability MTPL						Motor Own Damage Insurance CASCO					
	1991	1992	1993	1994	1995	Cumulative Total	1991	1992	1993	1994	1995	Cumulative Total
AB-Aegon Altalanos Biztosito Rt.												
Premium Income	2,527	5,287	6,094	6,211	6,073	26,192	1,501	2,016	897	595	712	5,721
Claims Expenses (Gross)	1,150	4,344	2,962	2,681	3,208	14,345	3,049	3,748	960	390	577	8,724
Claims as a Percentage (%) of Premiums	46%	82%	49%	43%	53%	54%	203%	186%	107%	66%	81%	129%
Argosz Biztosito Rt.												
Premium Income				39	153	192				22	86	108
Claims Expenses (Gross)				17	86	103				29	49	78
Claims as a Percentage (%) of Premiums				44%	56%	50%				132%	57%	94%
Colonia Biztosito Rt.												
Premium Income	121	370	532	887	1,196	3,106	58	320	599	911	1,711	3,599
Claims Expenses (Gross)	112	344	228	442	1,638	2,764	58	308	333	525	1,451	2,675
Claims as a Percentage (%) of Premiums	93%	93%	43%	50%	137%	83%	100%	96%	56%	58%	85%	79%
Generali Budapest Biztosito Rt.												
Premium Income	**2**	**28**	**169**	**509**	**1,142**	**1,850**	**8**	**70**	**202**	**292**	**482**	**1,054**
Claims Expenses (Gross)	**1**	**20**	**101**	**424**	**1,095**	**1,641**	**7**	**112**	**160**	**249**	**784**	**1,312**
Claims as a Percentage (%) of Premiums	**50%**	**71%**	**60%**	**83%**	**96%**	**72%**	**88%**	**160%**	**79%**	**85%**	**163%**	**115%**
Hungaria Biztosito Rt.												
Premium Income	5,480	11,297	14,665	18,289	20,059	69,790	5,062	4,182	5,919	8,871	10,005	34,039
Claims Expenses (Gross)	4,622	9,412	10,543	13,882	17,090	55,549	16,206	6,777	5,335	7,496	10,216	46,030
Claims as a Percentage (%) of Premiums	84%	83%	72%	76%	85%	80%	320%	162%	90%	85%	102%	152%
OTP-Garancia Biztosito Rt.												
Premium Income	115	309	633	1,123	2,249	4,429				201	592	793
Claims Expenses (Gross)	43	221	101	424	1,095	1,884				178	597	775
Claims as a Percentage (%) of Premiums	37%	72%	16%	38%	49%	42%				89%	101%	95%
Providencia Osztrak-Magyar Biztosito Rt.												
Premium Income	**683**	**1,686**	**2,290**	**3,352**	**3,980**	**11,991**	**228**	**524**	**444**	**571**	**929**	**2,696**
Claims Expenses (Gross)	**581**	**1,536**	**2,034**	**2,459**	**3,428**	**10,038**	**436**	**773**	**425**	**432**	**967**	**3,033**
Claims as a Percentage (%) of Premiums	85%	91%	89%	73%	86%	85%	191%	148%	96%	76%	104%	123%
Total												
Premium Income	**8,928**	**18,977**	**24,383**	**30,410**	**34,852**	**117,550**	**6,857**	**7,112**	**8,061**	**11,463**	**14,517**	**48,010**
Claims Expenses (Gross)	**6,509**	**15,877**	**15,969**	**20,329**	**27,640**	**86,324**	**19,756**	**11,718**	**7,213**	**9,299**	**14,641**	**62,627**
Claims as a Percentage (%) of Premiums	73%	84%	65%	67%	79%	74%	288%	165%	89%	81%	101%	145%

Sources: Magyar Biztositok Szovetsege / Association of Hungarian Insurance Companies (MABISZ)(1991,1995,1996) and the Researcher's own calculations.

from the FSU and CEC has moved westwards. According to Gergely, *"Thieves have no real preference in what they steal...its just stealing! All of which is destined for the Eastern markets like Romania, Bulgaria, Ukraine, Russia, etc.."* He also added that theft of car is very common in every class of automobile. According to Gergely thieves are not just taking expensive foreign cars like BMWs, Porsches, Rovers, but also lower cost models like Opels, Ladas, and Skodas. This situation has forced Providencia to only offer coverage on expensive cars if the client has other business with the company besides the client taking measures on his/her own, such as installing a car alarm, a club for steering wheel, etc.. Still, Generali Budapest has had to continue offering coverage to some of its corporate clients despite incurring such losses. Vágó illustrated the problem facing his company in this situation, *"The Generali Group as a whole insures the Porsche Group* (Porsche Hungária in Hungary) *and you can't say to a firm that you will insure their business but not their vehicles."* Given this situation, Generali Budapest simply has to continue to absorb such losses and push the authorities to take measures to correct the problem.

Even for *MTPL*, claims expenses as a percentage of premium income have been high, with Colonia, Hungária, and Providencia each having experienced a cumulative average of 80% or more between 1991-1995. Both ÁB-Aegon Általános and Argosz have been in the 50% area. Only OTP-Garancia has been able to hold its cumulative claims versus premiums at below the 50% mark, and this only based on a low volume of business which equates to just 6% of market leader Hungária's own level of premium income for the same period.

The problem with *MTPL* is that the premium rates are set by the government and in the opinion of insurers at a very low level. On the subject one Hungarian insurance executive stated, *"...that the system had to change because there was 'no question' that the obligatory price acceptance-uniform tariff system breached the fundamental underwriting principle of understanding a risk and offering a price for it."*[44] There is also a big problem with fraudulent claims from some individuals. This situation has forced both Generali Budapest and Providencia to establish a special anti-fraud department composed of former young policemen. Dr. Vágó estimated that as much as 33% of total claims were fraudulent. Still, Gergely noted that fraud is a cultural problem in Hungary and an insurance firm can not do very much to combat this attitude. He added, that if people feel it is okay to steal then they will.

Overall, since 1989 the Hungarian insurance market has been growing ever more competitive with local insurers fiercely competing with each other for market share. This despite the existence of only the limited number of insurers operating within Hungary, which now stands at 17 firms to serve some 10 million customers. Still, in terms of market share the Hungarian insurance market still remains dominated by the two former state-owned insurance companies, ÁB and Hungária (See **Table 6.10**). The former now operates under the name of ÁB-Aegon

[44]This statement was from Mr. Gábor Kepecs, General Manager of ÁB-Aegon Általános Biztosító in an interview with the EEIR. See East European Insurance Report (1995b), *Hungary*, pp. 15.

Table 6.10, Premium Income & Market Share of Hungarian Insurers

	Year						
Name of Hungarian Insurer*	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**
AB-Aegon Altalanos Biztosito Rt.							
Premium Income (in million HUF)	14,680	22,662	21,355	22,008	23,405	28,451	35,218
Market Share (%)	40.4%	37.3%	37.1%	29.8%	25.2%	24.3%	23.1%
Argosz Biztosito Rt.							
Premium Income (in million HUF)			2	221	381	706	1,547
Market Share (%)			0.0%	0.3%	0.4%	0.6%	1.0%
Atlasz Utazasi Biztosito Rt.							
Premium Income (in million HUF)	393	590	896	976	1,157	1,407	1,739
Market Share (%)	1.1%	1.0%	1.6%	1.3%	1.2%	1.2%	1.1%
Colonia Biztosito Rt.							
Premium Income (in million HUF)		2,497	1,860	2,684	3,557	5,061	6,428
Market Share (%)		4.1%	3.2%	3.6%	3.8%	4.3%	4.2%
Elso Amerikai-Magyar Biztosito Rt. (AHICO)							
Premium Income (in million HUF)		26	113	398	852	1,473	2,307
Market Share (%)		0.0%	0.2%	0.5%	0.9%	1.3%	1.5%
Europa-Gan Biztosito Rt.							
Premium Income (in million HUF)		85	180	589	807	951	1,205
Market Share (%)		0.1%	0.3%	0.8%	0.9%	0.8%	0.8%
Generali Budapest Biztosito Rt.							
Premium Income (in million HUF)	**1,208**	**1,443**	**2,293**	**3,686**	**5,021**	**6,342**	**8,897**
Market Share (%)	**3.3%**	**2.4%**	**4.0%**	**5.0%**	**5.4%**	**5.4%**	**5.8%**
Gloria-Swiss Life Biztosito Rt.							
Premium Income (in million HUF)			6	101	393	507	785
Market Share (%)			0.0%	0.1%	0.4%	0.4%	0.5%
Hungaria Biztosito Rt.							
Premium Income (in million HUF)	19,609	30,380	22,840	28,741	36,217	41,191	49,944
Market Share (%)	53.9%	50.0%	39.6%	39.0%	39.0%	35.3%	32.7%
Magyar Export Hitel Biztosito Rt. (MEHIB)							
Premium Income (in million HUF)			195	348	40	7	25
Market Share (%)			0.3%	0.5%	0.0%	0.0%	0.0%
Nationale-Nederlanden Hungary Biztosito Rt.							
Premium Income (in million HUF)		195	1,573	4,105	7,111	11,289	17,359
Market Share (%)		0.3%	2.7%	5.6%	7.7%	9.7%	11.4%
OTP-Garancia Biztosito Rt.							
Premium Income (in million HUF)	350	863	1,315	2,192	3,127	5,500	8,243
Market Share (%)	1.0%	1.4%	2.3%	3.0%	3.4%	4.7%	5.4%
Providencia Osztrak-Magyar Biztosito Rt.							
Premium Income (in million HUF)	**140**	**2,057**	**4,997**	**7,610**	**10,435**	**13,179**	**17,750**
Market Share (%)	**0.4%**	**3.4%**	**8.7%**	**10.3%**	**11.2%**	**11.3%**	**11.6%**
Signal Biztosito Rt.							
Premium Income (in million HUF)				86	307	803	1,265
Market Share (%)				0.1%	0.3%	0.7%	0.8%
Total							
Premium Income (in million HUF)	**36,380**	**60,798**	**57,625**	**73,745**	**92,810**	**116,852**	**152,712**
Market Share (%)	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Sources: Magyar Biztositok Szovetsege/Association of Hungarian Insurance Companies (MABISZ)(1991, 1995, 1996); Generali Budapest Biztosito Rt. (1996); Providencia Osztrak-Magyar Biztosito Rt. (1996); Econews (1997); and the Researcher's own calculations.

Note: *Some insurers have not been included in this table because they have only recently entered the Hungarian market (1996-1997) and subsequently data on their activites are not yet available.

Általános, which is 100% owned by the Dutch insurer Aegon (NL). As for the latter, the name Hungária has been retained but its ownership structure changed with Germany's Allianz now possessing 90% of the company's shares.

In terms of market shares based on premium income received, in 1990 ÁB-Aegon Általános and Hungária had market shares of 40.3% and 53.8% respectively. The third biggest market share was possessed by Generali Budapest with just 3.3%. Over time the market shares of both ÁB-Aegon Általános and Hungária have suffered from erosion due to the increased level of competition. At the end of 1996, the market share of ÁB-Aegon Általános was 23.1% and Hungária's was at 32.7%. In relation to 1990 data this represented a decline in each company's market share of 57% and 61% respectively. Still, despite such heavy losses in terms of market share both companies have still managed to retain their positions as the number one and two in the Hungarian insurance market in terms of market share based on the level of premium income received. Although the gap between them and others has been dramatically decreased with the third largest market share at the end of 1996 being controlled by Providencia with 11.6%, followed very closely by Nationale-Nederlanden with 11.4% in fourth, and Generali Budapest coming in fifth with a market share of 5.8%.

6.2.7 Performance of Generali Budapest and Providencia[45]

According to the survey data from the respective senior executives of both Generali Budapest and Providencia, the two companies employ the same means of evaluating their financial performance in Hungary, although with very different results for each company. The two forms of measurement/assessment cited were turnover (profit growth or sales growth) and market share. This evidence should come as no surprise given previous comments made about the fierce level of competition in the Hungarian insurance market.

Finally, continuing on with the survey data, during the first year of operation both Generali Budapest and Providencia rated their company's performance as being average. However, when the same executives were asked to rate their companies overall performance (from the first year of operation to the present) the answers were quite different. In fact, the responses are quite reflective of the level of financial performance and market shares that each of the companies has achieved. For Generali Budapest the executive felt that his company's performance had remained average overall, the company only entering the profitable zone at the end of 1996. In contrast, the executive for Providencia responded that his company's performance was very good overall. This is supported by the fact that Providencia has been able to secure a prominent share of the market with 11.4% at the end of 1995 and had already turned the corner to profitability back in 1994, well before many of its competitors, some of which are still

[45]For further details on exactly how this area was addressed see *Chapter 4, Foreign Direct Investment in Central Europe: Results from a Survey of Major Western Investors.*

continuing to post losses.

6.2.8 Strategy of Generali Budapest and Providencia[46]

As would be expected, the survey data shows that both Generali Budapest and Providencia have adopted the same overall business strategy. In terms of geographical strategies the two insurers employ a multidomestic strategy which means that each of the companies focuses on the local Hungarian market by both adapting their products and services to meet the local needs of its customers as well as competing with other local firms, which as previously noted are also some of Generali's key competitors in other parts of World, notably in Europe. As for functional strategies, both Generali Budapest and Providencia have utilized a stand alone variety whereby their respective firms work relatively independently of the foreign/local parent organization.

Overall, Dr. Gergely of Providencia believes that Generali's strategy in Hungary has so far been fairly effective because Providencia and Generali Budapest combine to control 17% of the Hungarian insurance market. He goes on to add that Providencia is ranked third on the overall market. Gergely also stated that *"Generali saw Hungary as a very important place to establish financial services not only in Hungary but for the entire region."*

6.3 The Outlook for the Future

In brief, the future outlook for Generali in Hungary, as well as in the rest of Central Europe looks to be promising provided that the group can keep its long-term perspective of the situation at the expense of short-term profitability. Generali has been able to re-establish its operations not only in Hungary, but also in the Czech Republic, Romania, and more recently in both Slovakia and Slovenia. However, Generali's success in these markets will not only depend on improvements in economic conditions in the countries of the region but more so in educating the populations of these countries as to the merits of Western style insurance while at the same time curtailing abuses of it.

As for the future of both Generali Budapest and Providencia, executives of the two firms were each asked their opinions on the state of the Hungarian insurance sector in the future, for example in the year 2000. Generali Budapest's CEO Vágó foresees that the level of competition in the market will increase which in turn will force the level of premiums for products down thus instigating a price war where firms take on increased risks. By the year 2000 Vágó thinks that there will be around 15-16 firms operating within the local market and that an increased in both the quality and speed of service will be a key to better relations with clients and to beating out the competition. Which in regards to the last point, Vágó stated that Hungária will still be

[46]For further details on exactly how this area was addressed see *Chapter 4, Foreign Direct Investment in Central Europe: Results from a Survey of Major Western Investors.*

Generali Budapest's main competitor.

On the future of Hungarian insurance sector, Gergely of Providencia stated that, *"Eleven years ago there was only one insurance company in Hungary and Hungary had, and still has, 10 million inhabitants. By the year 2000 there will be at least 20 or so insurance firms operating within the Hungarian market. In contrast, in Austria, with a population of 7.5 million, there are some 72 insurance firms. Experts have claimed that the smaller insurance firms* (in Austria) *will merge, but in Hungary there will still be about 20 firms operating in the country."* Gergely went on to say that the life insurance business is going to play a crucial role in the Hungarian insurance market because the State's pension and healthcare systems are at the moment collapsing. By the year 2000 insurance firms, including Providencia, will be offering customers various healthcare services. In Gergely's opinion, overall by the year 2000 *"quality"* will be the real key to success in the Hungarian market for insurance.

Finally, by the year 2000 the goal of Generali Group in Hungary is to gain at least a combined 20% market share of the local market, via its two operators Generali Budapest and Providencia. Their combined market share at present now stands at around 17%. This is a common strategy for both companies and a goal in which they are likely to reach given their past histories.

As for the potential full merger of both Generali Budapest and Providencia into one firm, in Gergely's opinion this may eventually happen but not for some time to come given the fact that while Providencia's brand name isn't known outside of Hungary it is an important brand inside the country. He goes on to note that when and if the full merger does come the new firm will be called Generali because of the brand recognition of the name around the world. In the meantime, both insurers will each continue to try and gain control of a bigger share of the market, hopefully at the expense of their main competitors ÁB-Aegon Általános and Hungária.

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