

International Business

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**New Patterns of Foreign Direct Investments**

**Indirect Internationalisations of MNCs Using Platform Countries**

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## **Abstract**

Since the fall of the Soviet Union in 1989, the former communist countries have been in a period of transition towards a market economy. The Central and East European countries have, however, developed to different extents. Several of the most transitionally advanced countries are situated in Central Europe whereas a number of the less successful countries are situated in Eastern Europe. As a result of this they attract different degrees of foreign investments. Several foreign companies choose to establish in countries that are considered as top performers when it comes to development. These companies then serve neighbouring countries that possess a more risky environment, from this base. Consequently, the country in which the company chooses to establish is used as a platform for further expansion.

The purpose of this study is to describe and explain the way Swedish owned MNCs expand into Eastern Europe via a subsidiary in Central Europe and to explain the reasons for, as well as well as difficulties with, this decision. Moreover, the benefits of this kind of strategy are also described. The main focus is on Hungary and Romania. In order to be able to fulfil this purpose, a number of Swedish owned subsidiaries in Hungary and their activities in the Romanian market have been investigated.

In this thesis, it is demonstrated that several Swedish owned MNCs establish in Hungary and then grow gradually but considerably in this market. Consequently, knowledge and experience about the Hungarian market as well as the neighbouring markets is then accumulated. As a result of this, the risk of, as in this case, the Romanian market entry is greatly diminished.

**Key words:** *Indirect FDI, Platform Countries, Central and Eastern Europe, Internationalisation, Networks, Subsidiary, Hungary, Romania.*

## **List of Abbreviations**

|               |   |
|---------------|---|
| <b>CEB</b>    | Central and Eastern Europe and the Baltic States  |
| <b>CEE</b>    | Central and Eastern Europe; in most cases include the countries; Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. |
| <b>CIS</b>    | Commonwealth of Independent States; Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kirgistan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.    |
| <b>EBRD</b>   | European Bank of Research and Development   |
| <b>EU</b>     | European Union  |
| <b>FDI</b>    | Foreign Direct Investment   |
| <b>GDP</b>    | Gross National Product  |
| <b>NATO</b>   | North Atlantic Treaty Organisation  |
| <b>MNC</b>    | Multinational Corporation   |
| <b>OECD</b>   | Organisation for Economic Co-operation and Development  |
| <b>UNCTAD</b> | United Nations Conference on Trade and Development  |
| <b>SEE</b>    | South Eastern Europe; Croatia, Bosnia-Herzegovina, Serbia & Montenegro, FYR Macedonia, Albania, Bulgarian, Romania and Moldova  |
| <b>SME</b>    | Small and Medium Sized Enterprise   |

## Table of Contents:

|   |           |
|---|-----------|
| <b>CHAPTER I: INTRODUCTION.....</b>   | <b>9</b>  |
| 1.1 Background.....   | 9         |
| 1.2 Problem Formulation.....  | 10        |
| 1.3 Purpose .....   | 11        |
| 1.4 Research Model .....  | 12        |
| 1.5 Delimitations .....   | 12        |
| 1.6 Disposition.....  | 13        |
| <b>CHAPTER II: METHODOLOGY .....</b>  | <b>15</b> |
| 2.1 Research Design .....   | 15        |
| 2.2 Research Method .....   | 16        |
| 2.3 Data Collection.....  | 17        |
| 2.3.1 <i>Primary Data</i> .....   | 18        |
| 2.3.2 <i>Secondary Data</i> .....   | 19        |
| 2.4 Quality of the Research .....   | 20        |
| 2.4.1 <i>Construct Validity</i> .....   | 20        |
| 2.4.2 <i>Internal Validity</i> .....  | 21        |
| 2.4.3 <i>External Validity</i> .....  | 23        |
| 2.4.4 <i>Reliability</i> .....  | 23        |
| <b>CHAPTER III: THEORETICAL FRAMEWORK.....</b>                                | <b>25</b> |
| 3.1 A Macro Perspective of Foreign Direct Investments .....                   | 25        |
| 3.1.1 <i>New Patterns - Indirect FDI</i> .....                                | 26        |
| 3.1.2 <i>Analysis of Indirect FDI and Implications</i> .....                  | 30        |
| 3.2 Internationalisation .....  | 31        |
| 3.3 Uppsala Internationalisation Model .....                                  | 34        |
| 3.3.1 <i>The Establishment Chain</i> .....                                    | 34        |
| 3.3.2 <i>Development Across markets - The Psychic Distance</i> .....          | 35        |
| 3.3.3 <i>A Model of Firm Internationalisation</i> .....                       | 37        |
| 3.4 Foreign Market Entry Modes .....  | 40        |
| 3.4.1 <i>Export Entry Modes</i> .....   | 40        |
| 3.4.2 <i>Contractual Entry Modes</i> .....                                    | 42        |
| 3.4.3 <i>Investment Entry Modes</i> .....                                     | 42        |
| 3.4.4 <i>Types of International Production</i> .....                          | 44        |
| 3.5 Network Approaches to Internationalisation.....                           | 44        |
| 3.5.1 <i>Industrial Networks</i> .....  | 45        |
| 3.5.2 <i>The Network Model of the Firm Internationalisation Process</i> ..... | 48        |
| 3.6 Theory – Concluding Remarks.....  | 51        |
| <b>CHAPTER IV: REGIONAL OVERVIEW IN TRANSITION.....</b>                       | <b>53</b> |
| 4.1 Transition and the Business Environment.....                              | 53        |
| 4.1.1 <i>Dimensions of Transition</i> .....                                   | 53        |
| 4.1.2 <i>The Role of Networks in Transition</i> .....                         | 56        |
| 4.2 The Pattern of FDI in Central and Eastern Europe.....                     | 60        |

|   |            |
|---|------------|
| 4.3 The Hungarian Environment .....                   | 61         |
| 4.4 The Romanian Environment.....                     | 63         |
| <b>CHAPTER V: EMPIRICAL FINDINGS .....</b>            | <b>67</b>  |
| 5.1 Case Companies Following the Indirect Path.....   | 67         |
| 5.1.1 Sandvik.....                                    | 67         |
| 5.1.2 SCA Hygiene Products.....                       | 70         |
| 5.1.3 PlymoVent.....                                  | 73         |
| 5.1.4 Tetra Pak.....                                  | 76         |
| 5.1.5 Intrum Justitia.....                            | 79         |
| 5.1.6 HL Display.....                                 | 82         |
| 5.1.7 FoodTankers.....                                | 86         |
| 5.2 Case Companies Following the Direct Path.....     | 89         |
| 5.2.1 Skanska .....                                   | 89         |
| 5.2.2 ASSA ABLOY .....                                | 93         |
| 5.3 Concluding Remarks - Activity in the Region ..... | 95         |
| <b>CHAPTER VI: ANALYSIS AND DISCUSSION .....</b>      | <b>99</b>  |
| 6.1 Macro Perspective of Investments.....             | 99         |
| 6.1.1 Direct Path of FDI.....                         | 100        |
| 6.1.2 Indirect Path of FDI.....                       | 101        |
| 6.1.3 The Use of Platforms – Concluding remarks.....  | 103        |
| 6.2 Internationalisation Process .....                | 104        |
| 6.2.1 The Market Entry and Establishment Chain.....   | 105        |
| 6.2.2 The Market Commitment.....                      | 108        |
| 6.2.3 Market Knowledge .....                          | 111        |
| 6.2.4 Internationalisation - Concluding Remarks.....  | 112        |
| 6.3 The Use of Networks .....                         | 112        |
| 6.3.1 Networks - Concluding Remarks .....             | 119        |
| <b>CHAPTER VII: CONCLUSIONS.....</b>                  | <b>121</b> |
| 7.1 Facing the Purpose of the Study .....             | 121        |
| 7.2 Recommendations for Companies.....                | 126        |
| 7.3 Recommendations and Further Research .....        | 127        |
| <b>REFERENCE LIST .....</b>                           | <b>129</b> |
| <b>APPENDIX: QUESTIONS FOR INTERVIEWS .....</b>       | <b>139</b> |





## **CHAPTER I: INTRODUCTION**

This chapter provides an introduction into the research. It covers the background, problem formulation and the eventual purpose of the study. Furthermore, a research overview followed by delimitations, are presented.

### **1.1 Background**

At the end of 1989, a series of historic events paved the way for political and economic transformation in Central and Eastern Europe (CEE). The political, social and economic reforms that later took place in the 1990's have had a striking impact on the way these countries are currently governed as well as their paths to economic development and the way they have integrated into the wider global framework. The countries within this region are often perceived as a single "eastern bloc", however, it has become more evident how much difference there is between them since they have conducted reforms against different historical, political and institutional backgrounds (Bachtler, 2000).

One of the top performers among these Central and Eastern European transition economies is Hungary. Unlike its neighbouring countries, its economic liberalisation paved the way for full political liberalisation. The enterprise and financial sectors are today mainly private with great foreign involvement. Moreover, it is an attractive target for multinational companies, situated ideally when in search of expanding to the eastern and southern regions of the continent, since the country is located in the middle of Europe. The significance of the country is also enhanced by its closeness to the candidate countries of the European Union. One of the latecomers in the region is Romania, since it has fallen behind most other countries in the area in terms of economic restructuring, and since the privatisation of previously state owned companies has progressed carefully. The country is, however, expected to build up a better business environment, and it is also the second largest emerging market in central and Eastern Europe (Swedish Trade Council, 2003).

Even though the favourable economic and political environment and its strategic geographical position has attracted companies to invest in Hungary during the last couple of years, more and more companies have moved even further eastwards. This fact may be explained by cheap raw materials, low

wages, and qualified labour as well as improving investment climate in those countries. Moreover, in the future, tasks such as assembling may shift to Eastern Europe due to knowledge transfer activities, therefore allowing Central European countries to stress their higher standards of production, design and R&D activities. Subcontracting also allows these countries to benefit from the incentives present in the Eastern European countries. Therefore Central European countries, such as Hungary, in several cases, serve as platforms or incubators where companies arrive, grow and start to expand into neighbouring countries. These platforms also serve as a position to learn about neighbouring countries and their possibilities. Romania, Hungary's neighbour and a candidate to the EU, represents an interesting case where it is possible to find Swedish companies, which have entered from Hungary, and not directly from Sweden.

## **1.2 Problem Formulation**

The internationalisation of multinational companies into emerging markets is a development that involves a great deal of risk due to volatile markets in the sense of both political and economical instability. When looking at it from a macroeconomic perspective, there are an increasing number of company investments that follow an indirect path towards Eastern European countries, via platform countries. In such a way, it becomes rather complicated to evaluate the flow of FDI in one country or another. Companies choose different paths when entering these markets for different reasons. Some companies prefer the gradual path considering market after market, taking into consideration time and knowledge; whereas others avoid a step-by-step entry. This thesis will specifically handle Swedish multinational companies that have chosen Hungary as a platform for their internationalisation into the Eastern European countries.

Taking into consideration the information above, the main question of this study is:

***How and why does a Swedish owned subsidiary in Hungary launch and extend its business activities eastwards?***

The main question chosen will be further divided into four sub-questions in order to facilitate the study and understanding of the research problem. Firstly,

the chosen companies' entry into the Hungarian market will be explored with the intention of explaining why Hungary was chosen as a platform:

***1) Why was Hungary selected as a market to enter and how was it entered?***

Secondly, when analysing the eastward expansion, Romania was chosen as a focus country:

***2) How did the Swedish subsidiary in Hungary enter the Romanian market and what was the intention of this additional market entry?***

Thirdly, the prediction of future activities in Romania and potential activities in other Eastern European countries will be explored:

***3) What are the barriers encountered in the market entries, how are these handled and what implications will they have on future activities?***

Finally, assuming that a platform country facilitates the internationalisation of a firm;

***4) What are the benefits of expanding gradually by using a platform country?***

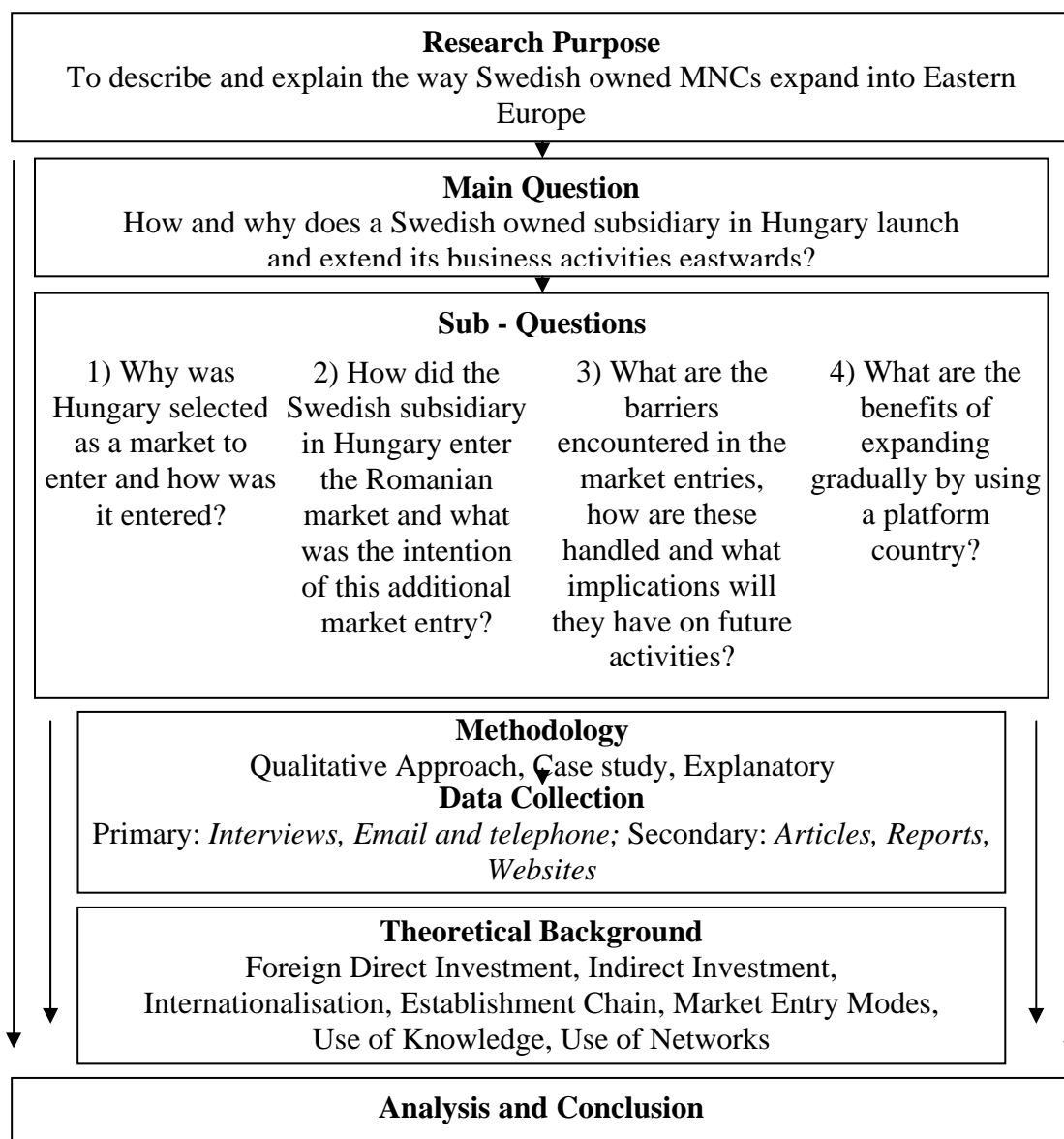
### **1.3 Purpose**

The overall purpose of this study is to describe and explain the way Swedish owned MNCs expand into Eastern Europe via a subsidiary in Central Europe. The study also focuses on presenting the use and importance of so called platforms where companies first establish, before considering their expansion. In such a way, the pattern of indirect FDI is to be shown.

The purpose is based on the assumption that companies base their internationalisation decisions on the knowledge gained from previous investments. Based on the Uppsala Model, which is used as a cornerstone in this thesis, we further hypothesise that after entering a country, which is known to a great extent, companies gain knowledge about the neighbouring markets. This fact influences the investment decisions and transforms the first entered market into a platform for further expansion. Moreover, taking into consideration the time dimension, companies transfer their knowledge to the

second market, thereby allowing platform countries to deal with more complex activities such as design and development.

## 1.4 Research Model



## 1.5 Delimitations

The criterions chosen for this study are firstly that the multinational companies are required to have started their initial internationalisation into Central and Eastern Europe, in Hungary. It was chosen as the base for Swedish subsidiaries, due to its exceptional position as well as its favourable economic and political environment. The second criterion is that the destination country is Romania.

The companies are to be present in Romania through investments or at an exporting level. The explanation for only choosing Romania as destination country is mainly to be able to increase the comparison ability of the companies' growth strategies and experiences. The centre of attention will be the individual companies and their chosen expansion approaches. Nevertheless, the Hungarian market environment will also be investigated, as well as the Romanian one.

Seven Swedish companies, which fulfil the original criteria, were chosen to be studied with main focus. Moreover, two other Swedish owned companies, which have a subsidiary in Hungary, but do not fulfil the second criterion of using it as a kind of platform for their activities in Romania, are also investigated. These companies have entered the Romanian market in a different way. However, these companies are merely included as a comparison of an alternative strategy.

## **1.6 Disposition**

The study is divided into seven chapters. First, an introductory chapter lays the groundwork for the research by presenting the problem and the purpose of the study. Secondly, in the methodological chapter, a "plan of action" provides the reader with design and method, data collection procedure and quality of the study. Thirdly, a theoretical background follows, which is used for analysis. Fourthly, a bridge between the theory and empirical data is made, by describing the region under focus and the specifics of the transitional period. The fifth chapter is comprised of an overview of the empirical data, which is then analysed in the sixth chapter, by the use of theory. Finally, conclusions are presented in the last chapter, where the main research question is answered.



## CHAPTER II: METHODOLOGY

This chapter offers the plan of collecting, organising and integrating the data in order for the objective to be reached. It aims to give insight into how the research was done, and in what order different tasks were conducted. The chapter starts by describing the research design and the method. Furthermore, a description of the data collection and analysis is presented. Finally, the quality of the research is discussed.

### 2.1 Research Design

The research design represents a logical sequence that connects all the results to a study's initial research questions and, ultimately, to its conclusions. In plain language, it is an action plan for getting from "here" to "there", where *here* is defined as the initial set of questions to be answered, and *there* is some set of conclusions to these questions (Yin, 1994).

This paper takes the shape of a case study with a number of companies under focus. A case study, one out of five types of research strategies, is defined as: "(...) an empirical inquiry that investigates a contemporary phenomenon within its real-life context (...)" and "(...) relies on multiple sources of evidence, with data needing to converge in a triangulation fashion, and (...) [which] benefits from the prior development of theoretical propositions to guide data collection and analysis" (Yin, 1994). Merriam (1998) suggests that the case study is designed to gain an in-depth understanding of the situation and meaning of those involved; and the interest is in the process rather than the outcome, in the context rather than specific variables and in discovery rather than confirmation.

The above-mentioned method was chosen since it gives a deeper understanding and a more holistic view of the studied research problem. The contemporary phenomena under focus represents the patterns of FDI and internationalisation strategy. The empirical enquiry investigating this, represents the case companies under focus explaining how and why their decisions were taken.

Furthermore, case studies may be characterised as having single-case or multiple-case characteristics. This research uses multiple cases as a method to ensure validity. Although this mode does not allow an extensive analysis of a

single case, it does increase the empirical background information. Additionally, a multiple-case study follows replication logic, where each case predicts similar results; or produces contrasting results but for predictable reasons - i.e. either the single cases support the theory that is challenged or they do not but for expected reasons.

Additionally, a case study can be divided into being descriptive, exploratory and explanatory (Merriam, 1998). Descriptive research presents detailed information about a phenomenon under study and exploratory research aims to find or develop a research problem and clarifies it. Explanatory research attempts to establish explanations for the same phenomenon and tries to assess when it will be possible to apply the explanations to another situation. Thus, explanatory research aims at explaining why one event leads to the other and, therefore, it deals with cause and effect relationships (Yin, 1994). Keeping in mind the purpose of this study, this research is of an explanatory nature. The main research question, which is further subdivided, is intended to find an explanation for why the companies under focus, behave in a certain way.

## **2.2 Research Method**

A study can be qualitative, quantitative or a mix of both. The quantitative approach requires standardised measures, so that the varying perspectives and experiences of people can be fitted into a limited number of predetermined categories. The necessary data applicable in such a case is of a statistical nature and findings can be presented succinctly and parsimoniously (Patton, 1990).

A qualitative approach consists of an understanding and explains the meaning of a social phenomenon with as little disruption of the natural setting as possible. It permits an evaluator to study selected issues in depth and detail (Patton, 1990). Thus, qualitative research reveals and explains people's behaviours; based on the assumption that they create reality as they interact with their social environments. In order to analyse these creations, human beings are the key data sources in qualitative studies and, therefore, fieldwork is a very common means of collecting data (Merriam, 1998).

The phenomenon of internationalisation as a part of a company's strategy is certainly manipulated by individuals making various decisions. Explaining this



behaviour requires an in-depth analysis of major decisions. The qualitative approach is most suitable for this purpose, since it allows one to go deeper into each company's strategy by collecting primary data. The comparatively small number of respondents also gave us the possibility to study each response intensely.

Merriam (1998) also makes a distinction between an inductive, deductive and abductive study. The inductive approach is characterised by empirical data collected and subsequent theory formulation, based on these findings. The researcher is generating new theories aiming to explain the phenomena, due to a lack of existing theories. In a study with a deductive approach, the point of departure is to test an existing theory using a particular hypothesis. By conducting a logical deduction of the findings, the theory is either confirmed or modified in line with the new conclusions. The abductive approach is a combination of the inductive and deductive approaches. The starting point is the empirical findings, which together with existing theories form the basis for discovering certain hypothetical patterns. The abductive approach is suitable when the researcher is trying to gain a deeper understanding of a particular phenomenon.

The abductive approach represents the most suitable method for this study. This is decided by the fact that empirical data is combined with the existing theories in order to discover possible hypothetical patterns regarding the internationalisation strategy of Swedish owned subsidiaries in Eastern Europe. Moreover, this study does not seek to elaborate on a theory or to testing one. The main focus is to explore and explain companies' behaviour.

### **2.3 Data Collection**

There are mainly two kinds of data: primary and secondary. Primary data is collected especially to address a specific research objective. Secondary data is known to already exist and includes information such as reports, articles and case studies in the field of interest (Yin, 1994). This study uses both types of data; however an emphasis is put on primary data.

### 2.3.1 Primary Data

One of the most important sources of case study information is the interview, which may take several forms. Most commonly, and appropriate for this research, is an *open-ended nature*, in which it is possible to ask the respondents' opinion about events. In some situations, it even gives the opportunity to ask about the respondent's own insight into certain incidences. One of the reasons why interviews were chosen is because primary data is supported by its strengths. These are (1) *targeted* – focused directly in real time, and (2) *contextual* – covering the context of events (Yin, 1994).

#### 2.3.1.1 Case Companies

The companies examined in this study were difficult to find. First of all, there was no accessible data concerning Swedish owned companies with a subsidiary in Hungary, which also used it as a platform for business activities in Romania. However, after being in contact with the Swedish Trade Council, lists of Swedish companies with activities in Hungary could be collected. This sort of list was also collected for Swedish owned companies with activities in the Romanian market. Unfortunately, information regarding the type of activities these companies' had in the two countries, was not found via this source. Therefore, these lists of companies were investigated in search of the activities in the two countries. Thereafter, the companies were contacted. Some companies were helpful and fully explained their activities, whereas, a few companies did not want to participate.

The criterions from the start were that the Swedish owned company's subsidiary in Hungary, in some way should be responsible for the Romanian business activities. At the beginning, this seemed to be a difficult task, however, it turned out easier than expected and seven companies were found that fulfilled the necessary criterions. In several cases, the business activities in Romania were small or at a starting point and, therefore, the information regarding these activities was not revealed until contact with the responsible person at the subsidiary in Hungary. We were in contact with many companies. Some companies, which did not fulfil the criterion, offered their help and therefore, two Swedish owned companies, which have subsidiaries in Hungary, but have not used it as a platform in any way for their expansion in Romania,

were also included. This was mainly done to show the different establishing procedures; however, the main emphasis is on the other seven companies.

### *2.3.1.2 Questionnaire*

To ensure the validity of the findings from the interviews in relation to the research proposition, the design of the questionnaire followed principles of instrument design accepted within the academic community. This included a rigorous process of generating appropriate questions and assessing their links to the objectives of the research. The questionnaire instrument was developed from the current literature on internationalisation and from consultations with experts in this field. However, due to the qualitative approach of this study, the interview had an open form based on a discussion. The respondents were asked to present the company and its history, how the markets were entered, what were the main impediments and incentives, etc. A preliminary sketch of the discussion was decided in advance, and the respondents were aware of the purpose of this study. When designing the actual questionnaire, an emphasis was put on three major aspects: general information about the company and subsidiary, the establishment in the Hungarian market and the entrance into the Romanian market (See the Appendix, for questionnaire).

### *2.3.1.3 Respondents*

In some cases, the person responsible for the region of interest was found directly and contacted. However, in several cases, the appropriate person was identified from references within the company. Before starting with the fieldwork, respondents responsible for the Hungarian and Romanian activities were found. Since the investigated companies differ in size and amount of business activity, the respondents' positions differ. However, the most common position was managing director for the Hungarian subsidiary. When referring to the Romanian market, in some cases the Hungarian managing director controlled both markets. One must also note that when actual subsidiaries were present in Romania, these were also contacted.

## **2.3.2 Secondary Data**

Initially, the researcher uses secondary data to develop the awareness regarding the proposed objective. The companies presented in this study were investigated via their official WebPages; however, since the information

needed for this study mainly concerns a subsidiary, data from this source was limited. When analysing the markets under focus, secondary data was also appropriate, such as articles, reports and governmental statistics.

Considering the use of theory, the third chapter comprises the necessary theoretical framework that is relevant for this research. Yet, one must note that there is almost no research done in the field of indirect investments and the use of platform countries. For this purpose the authors tried to design a model, which is further combined with most theories within the internationalisation discipline.

Firstly, a model of indirect FDI helps to investigate new patterns of internationalisation. It distinguishes a few stages, where companies are involved in different actions depending on the market knowledge and commitment. Secondly, when explaining how and why certain decisions were made during the process of market entry, the internationalisation theory shows its appropriateness. It emphasises the importance of knowledge when committing to new markets, therefore explaining how companies increase their presence in a country. Thirdly, market entry modes are described, with the intention to show the steps that usually are taken by companies that establish in a new market. Finally, due to the fact that some companies no longer expand gradually, the network theory is presented.

## **2.4 Quality of the Research**

For any research project it is essential to evaluate the “accuracy” of the study with regard to the applied methods of data gathering and, moreover, the analysis of the material. The research design has been carefully planned and followed during the study, in order to make sure that the quality of the research is high. It is of great importance for the researcher to critically evaluate the quality of the research as well. Means for conducting this kind of evaluation include construct validity, internal validity, external validity and reliability (Lincoln and Guba, 1985; Yin, 1994).

### **2.4.1 Construct Validity**

Construct validity concerns the establishment of correct operational measures for the concepts being studied. In other words, construct validity focuses on

how well a study has measured the changing factors of analysis. Using multiple sources of evidence and establishing chains of evidence while collecting the data can tackle this. Furthermore, researchers could improve construct validity by using multiple sources or data triangulation (Yin, 1994).

Considering that this research is focused on analysing the way Swedish owned companies internationalise in foreign markets, the internationalisation theory, which includes gradual expansion and the importance of networks, is used as a tool for analysis. The authors of this study acknowledge the existence of other theories. However, the ones being used are the most accepted in the academia. Moreover, the utilised theories cover and explain the in-depth process of gradual internationalisation applicable for the case companies. Furthermore, taking into account the triangulation of existing literature, the methods of previous research were analysed. This fact also influenced the decision of considering the theory in use.

#### **2.4.2 Internal Validity**

Yin (1994) argues that internal validity is more essential when aiming at establishing explanations and causal relations, and not that important in the case of more descriptive and exploratory research. Consequently, internal validation is less applicable for this study due to the nature of its purpose. However, an attempt to increase the internal validity follows.

Merriam (1998) explains the internal validity as a match between a study's findings and reality. The concept of reality, however, is a subject of interpretation due to one's perception of reality. Consequently, measuring validity is related to the individuals understanding of the world. Some methods are proposed that aim to increase the internal validity. By using the triangulation method, the findings may be matched to other researchers' views, comparing multiple instruments of investigation or multiplying the sources of data. Furthermore, the findings may be evaluated and confirmed by the respondents. During the data collection process, primary and secondary data may be compared in order to assure the understanding and correct interpretation.

Throughout the research the authors continuously considered existing theory. Even though the theoretical background was established, there was, on several

occasions, a need to reconsider some aspects, for example, when collecting the primary data. Hence, the correlation between theory and empirical findings is emphasised. Furthermore, during the study, opinions from tutors and colleagues regarding the method and theory were greatly considered.

The data gathered was presented to the respondents and a discussion was initiated where a few misunderstandings were clarified. Considering the language barriers, it must be said that all the interviews were conducted in English, in which all participants had a sufficient comprehensive understanding. Moreover, on several occasions, the interviews were compared to the information provided in a secondary source – e.g. WebPages, annual reports and publications. Apart from these, email correspondence was conducted with the Swedish, Hungarian and Romanian entities; therefore a communication with several employees was possible.

One may certainly consider alternative methods of conducting this research. However, the choice of an explanatory case study method was chosen by the authors due to the lack of similar studies: there was a need, therefore, to explain the phenomena in question. Nevertheless, descriptive or exploratory methods may also be applicable. However, at this point the authors believed that the descriptive mode would give only an overview of the phenomena under focus thus not being enough, while an exploratory method just seeks to clarify the research problem. A qualitative approach may also be substituted for a quantitative one. However the latter approach would necessitate a number of companies, which follow an indirect or direct path of FDI. Thus, only a pattern of establishment preferences could then be observed. While using the qualitative approach, it is less problematic to understand how and why certain actions are taken.

When considering the use of statistical data, regarding the flow of FDI from Sweden to Hungary and from Hungary to Romania, the authors did not find it suitable, since the general statistics do not allow tracking of Swedish investments, which aim indirectly at Romania through Hungary.

A final remark refers to the choice of companies investigated in this study. One may clearly note that the number of companies which have chosen one or another path of investments does not correspond. There are only two

companies presented for the direct path, and the reason for this is just to give an overview of another possible strategy.

### **2.4.3 External Validity**

The notion of external validity concerns an establishment of the domain to which a study's findings can be generalised (Yin, 1994). Thus, external validity deals with the possibility of generalising the findings from a certain study, to other cases. When making generalisations regarding existing theory, one case study may not ensure validity. Researchers usually have to replicate the same findings a second or even a third time in order to create a solid base for a generalisation to other cases. Thus, using multiple case studies is a way of obtaining improved external validity (Yin, 1994).

External validity is influenced by the degree of internal validity (Merriam, 1998). A high degree of internal validity influences the external validity. Therefore, the authors believe that this is the case in this research. The choice of using seven case companies and theoretical replication also permits a higher level of external validity.

### **2.4.4 Reliability**

Reliability refers to the findings and results achieved but also reproduced by another researcher, at a different time. This, in turn presents two aspects: firstly, the use of the same methods; and secondly a time dimension. Assuming different views upon the conduct of research in academia, a difference in the use of method is acceptable; imposing only desirability of the consistence in the empirical data. However, when considering the time dimension, several conclusions may be affected due to the development of countries.





## **CHAPTER III: THEORETICAL FRAMEWORK**

The purpose of this chapter is to give an overview of internationalisation. In doing so, the appropriate theories and models are used. Firstly, a macro overview of the Foreign Direct Investments (FDI) is presented, followed by a conceptualisation of indirect FDI. The idea behind it is to broaden the appeal of the topic for a wider audience with the presumption that not all readers have specialised knowledge in this area. It also embraces a discussion on the internationalisation process based on the concepts of knowledge when entering new markets. Next, market entry modes are presented, as well as the use of networks. The theoretical background also serves as a basis for further empirical analysis.

### **3.1 A Macro Perspective of Foreign Direct Investments**

FDI represents the purchase of physical assets or a significant amount of the ownership (stock) of a company in another country, to gain a measure of management control. Thus, the core of FDI is international flow of capital (Wild et al, 2003).

According to Dunning's (1988) eclectic paradigm, FDI occurs when three conditions are met. These conditions are ownership specific advantage, location advantage and internationalisation opportunities. Ownership specific advantage means that the company involved in FDI has an advantage in, for example, technology, which is an internal advantage for the company. Location advantage argues that there must be benefits in producing the product locally. Such benefits can include cheap labour, low transportation costs or tariffs. This advantage is external to the company. Finally, internationalisation advantage refers to when a company uses its advantage rather than selling or leasing it to a new market. There are two types of investment structures, such as direct ownership and partial ownership. FDI does not only cover financial matters whereby companies transfer capital between each other, but also the establishment of foreign subsidiaries. FDI is, to a large extent, about transferring technological and organisational knowledge and can be seen as a complement to trade (Robson, 1998).

When considering investing and establishing abroad, companies have to consider the climate for entrepreneurship, if the country is economically stable and if a legal system, which is favourable for foreign investments, exists (Cameron, 1998). International companies are becoming more and more important in the global economy. They offer knowledge, technology, capital and job opportunities. Companies are decentralising their control systems in the sense that international companies manage capital and knowledge, while subcontractors take care of other stages in the production. Often subcontractors compete with low prices rather than with quality (Axelsson Nycander, 1999).

Nowadays, FDI is frequently larger than aid in developing countries (Axelsson Nycander, 1999). Multinational Corporations (MNCs) often have much better production techniques and knowledge than domestic producers (Lundberg, 1995). They can, through FDI, exploit the localisation advantage and technological knowledge can be introduced to the world more cheaply. There is a correlation between growth and FDI in developing countries, but FDI can crowd-out domestic investment, because of the impact of capital formation and capital flows. Capital flows might sometimes indicate a higher rate of capital formation excess in the country. It is difficult to comment on the total investment effect. FDI influences a country's balance of payments on three levels, namely; the capital balance, the trade balance and the balance on current account. The transaction of capital affects the capital balance. This might lead to possible gains on the balance of current accounts and eventually the trade balance show the influence of the product delivery (Palm, 1995).

### **3.1.2 New Patterns - Indirect FDI**

A considerable number of studies address FDI in the Central and Eastern European (CEE) countries and some examine the impact of FDI in these economies (Moulins, 1997; Van Geenhuizen and Nijkamp, 1998); whereas others assess the investment opportunities in the region (OECD, 1994; Palivoda, 1994). There are also studies that emphasise the investors' decision-making procedure and experience in the CEE countries (Djarova, 1996; Hanon, 1996; Kvint, 1994; EBRD, 1996).

Several reasons can be found for companies to engage in FDI in a CEE country, such as the search for low-cost production and development of new

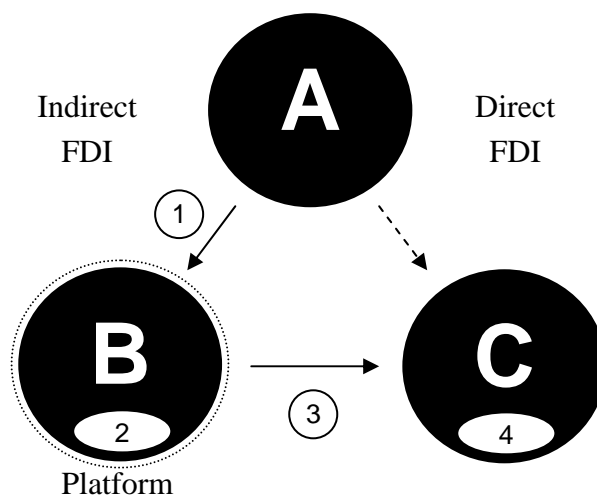
markets. The cross-border investment starts with the match between the company's global strategy and the advantages or disadvantages of the market considered. On the basis of these considerations, companies decide on the form of investment, taking full advantage of investment opportunities offered in the area. When companies cross the borders the main aim is to become a global market player. The crossing of borders is a result of a company's dilemma; to diversify at home or to expand abroad. Domestic companies gain from a better match between production and local consumer needs, whereas global companies gain from the comparative advantages of nations and experience of a sustained economy of scale, economies of scope and learning effects (Djarova, 1999).

Some MNCs that are investing in CEE countries channel their FDI through a subsidiary, such as a regional headquarter, which is set up in a second country. Such FDI are termed indirect FDI, in order to distinguish them from the FDI that is set up by the parent company (headquarter) directly. FDI by a foreign affiliate is indirect, signifying that the resulting asset-stock is owned by the parent company via the foreign affiliate, and that it represents, therefore, an indirect flow of FDI from the parent's home country (and a direct flow of FDI from the country in which the affiliate is located) (UN, 1998). It is of great importance to mention that for the purpose of this thesis, an indirect path of FDI also refers to sales activities in a third country. This is assuming that these sales may eventually lead to further investments.

Moreover, the flow of the indirect FDI is highly dependent on factors related to home and host country policies and incentives, as well as on factors related to companies' strategies and behaviours (UN, 1998).

Taxation and embargoes as well as sustainable environments are among the country-specific factors that might induce indirect FDI. An example of this would be if Hungary had concluded a double-taxation treaty with Romania. This incentive would attract foreign companies to establish holding companies in Hungary in order to invest in Romania. Serving as a stream for this indirect FDI, Hungary may become one of the largest FDI sources for Romania. Similarly, an investment embargo by one country on another may induce MNCs to invest in the latter economy via a third economy that is not affected by the embargo.

Company-related factors conducive to indirect FDI include the type of division of labour that exists within corporate networks, which, among other things, can give a certain degree of autonomy to foreign affiliates vis-à-vis their parent companies. Regional headquarters, for example, may be able to make their own decisions regarding undertaking FDI.



*Figure 3.1: Definition of Direct versus Indirect FDI, Researchers' Own Model.*

Figure 3.1 illustrates the patterns of “Indirect FDI”. One must note that the model was developed by the authors of this thesis, based on findings from the discipline of internationalisation and investments. Firstly, for the purpose of this study, a definition of the “Platform” concept would be appropriate for later operationalization. A platform represents a country, which serves a company as an incubator for establishment in a region, where it can learn about the local and neighbouring environment; and further facilitates the company to expand.

Consequently, three different geographical entities are distinguished between, represented in the model as countries A, B and C. Assuming the purpose of this particular study, authors would like to imply that countries are: A – Sweden, B – Hungary and C – Romania.

A direct FDI involves countries A and C, represented by the dashed arrow in the model. In such a case companies from country A invest directly in country C, and as a result a higher risk and market uncertainty is encountered. The most appropriate examples of companies for this type of internationalisation would be MNCs, which have a strong financial background and knowledge about the market entered or any network ties related to country C.

The opposite of the above described, an indirect FDI would include countries A, B and C. It is difficult to say whether the target of the investment would be country C, since initially it was country B. It is safe to assume that this process is ongoing and requires time, knowledge and a financial base.

The first step is the actual first entry into country B; this is usually done by analysing the best options of establishment in this country. A suitable discussion on entry modes would include the establishment chain developed in the 1970's by Johanson and Wiedersheim-Paul (1975). However, the most common forms of entry are representative offices or joint ventures, which as time passes, transform into subsidiaries. By this transformation, the company passes to the second stage of the model. It is assumed that once a subsidiary is created, the headquarters strongly believe in the market of the country, which is the reason for the increased commitment. By this time, the subsidiary is continuously accumulating knowledge regarding market preference, customer habits, and business specifics. A transfer of knowledge and technology from country A to B is also initiated. Additionally, the political and legal environment becomes more familiar.

By step 3, the company simultaneously considers exports to the neighbouring countries. A process of familiarisation with the whole region begins. This includes an analysis of the countries, which aims to find similarities and all types of impediments. One may also note that bilateral agreements between countries B and C certainly facilitate and support the decision to start exports to country C.

Consequently, a market entry is done in step 4. Alternative establishment types are considered. The main characteristics of this stage arise from the fact that almost all decisions are made by the subsidiary in country B. The parent company is also involved; however, at this stage they have confidence in the decision makers from country B. In cases when there is a desire to be present in country C, but due to numerous reasons it is not possible, the subsidiary from country B becomes responsible for this and all activities are conducted from there. Assuming a neighbouring position between countries B and C, an entry may be possible through regions, which have ethnical similarities. However, one must also note that usually the most attractive place for establishment is where other MNCs are present. Assuming an establishment in country C, a

process of knowledge and technology transfer is initiated as time passes. This process combines a mixture of inputs from both countries A and B.

This type of gradual internationalisation may be continuous if a company is successful. An interesting point is also that during this time, with the transfer of knowledge and technology, country B puts emphasis on more sophisticated processes such as R&D or marketing, while transferring simple manufacturing to country C. This fact allows the parent company to concentrate on major decisions and strategic development of the whole group.

### **3.1.3 Analysis of Indirect FDI and Implications**

Reported inward or outward FDI, is supposed to comprise indirect investments by definition. In fact, the Balance of Payments Manual of the IMF and the OECD's benchmark definition of FDI include investment by foreign affiliates in the definition and they advise governments to include it in their FDI data. When it comes to a country that hosts a foreign affiliate engaged in FDI, the investment (an indirect investment by the affiliate's parent company) is recorded as outward FDI from that economy, because the definition of FDI for balance-of-payments purposes is based on the location rather than on the ownership of the investing enterprise. However, such an investment is typically not recorded in the statistics of the home country of the ultimate parent company. Tracing the ultimate beneficial owner, and hence the magnitude of the share of the ultimate home country as compared with the immediate home country from which the investment is made, is difficult and possible only for selected countries (UN, 1998).

The fact that indirect FDI is included in the outward FDI of countries hosting foreign affiliates, obscures the actual volume of FDI made by nationally owned firms of those countries. Moreover, the same is applicable to strategic alliances, many of which are made by affiliates and not recorded for the parent company. Information distinguishing FDI made by nationally owned companies from that made by foreign affiliates located in a given country, is also limited (UN, 1998).

The policy implications of indirect FDI are rather complex. MNCs that undertake FDI from one of their host countries may do so because they regard that country as a strategic location for their regional or global operations. As far

as the host countries are concerned, it may be important for them to monitor the volume and direction of indirect FDI because it may provide them with a better understanding of their own advantages for outward FDI. To the extent that outward FDI is determined by ownership advantages, the advantages underlying indirect FDI may be erroneously attributed to the immediate home country's companies. The non-recognition of indirect FDI could lead to an overestimation of the competitiveness of a country's companies in international markets and this may detract from the need to consider policy measures to enhance competitiveness. In any event, as MNCs operate more and more globally, and their corporate networks become more and more complex, investments by foreign affiliates will become increasingly important (UN, 1998).

### **3.2 Internationalisation**

Internationalisation is a process of increasing involvement in international operations across borders (Welch and Luostarinen, 1988a) and it binds both changed perspectives and changed positions. Therefore, internationalisation is a major dimension of the ongoing strategic process of most business companies. The strategic process determines the ongoing development and change in the international company in terms of scope, business ideas, action orientation, organising principles, nature of managerial work, dominating values and converging norms.

The internationalisation dimension is related to all these aspects of the strategy process (Vernon-Wortzel, Wortzel, 1997). Lyles (1990) even argues that the internationalisation theme regarding global competition was viewed as the coming decade's most important area of strategic management research. Since Welch and Luostarinen's (1998a) comprehensive analysis of internationalisation, a number of practical reviews have assessed and synthesised the general internationalisation process literature - e.g. Johanson and Vahlne, 1990, 1992; Melin 1992; Andersen, 1993. Each of these reviews seems to conclude that efforts to summarise the internationalisation concept in a definitive manner have been inadequate.

Assuming that internationalisation is a dynamic concept (Johanson and Vahlne, 1992; Melin 1992), the definition of internationalisation offered by Beamish

(1990), would be appropriate: ... the process by which firms both increase their awareness of the direct and indirect influences of international transactions on their future, and establish and conduct transactions with other countries. Furthermore, Welch and Luostarinen (1988b) raise the interest in the internationalisation processes driving force, leading companies to extensive multinational investments. Companies are believed to undertake internationalisation for various reasons (Lam and White, 1999). Some companies internationalise due to the fact that their competitors or customers have been globalised (Ohmae, 1990), while others internationalise their business because multinationalism is a symbol of success and progress (Lam and White, 1999). It has also been proven that increased internationalisation results in improved profitability (Gerlinger et al, 1989).

According to Daniels and Radebaugh (1998), one of the reasons why companies engage in international business is to gain a competitive advantage. This advantage is achieved by the use of low-cost production facilities in locations close to raw materials and low cost labour, expanding their channels of distribution and gaining access to new technologies. Furthermore, the objectives for international business may be divided as follows:

*To expand sales* - sales depend on a consumers' interest, readiness and ability to purchase a company's products. Nevertheless, the magnitude of purchasing power in one country is limited; therefore cross border sales expansion increase revenues and consequently profits. Numerous large multinationals sell over half of their products outside their home country.

*To acquire resources* - companies can engage in the worldwide exploration, processing, transportation and marketing of raw materials. The benefits of this practice are obvious: either the profit margin may be increased or the cost savings may be passed on to consumers, who will in turn buy more products, thus producing increased profits through greater sales volume. Sometimes a company buys abroad in order to acquire a service or raw material not available in its home country. Other resources that a company may try to gain can be intangible such as technology, knowledge, expertise, etc.

*To diversify sources of sales and supplies* - to help avoid swings in sales and profits companies look for alternative sources of supply. Furthermore, many



companies take advantage of the different timing of business cycles in various countries. Recessions and expansions differ among regions and countries and skilful management helps to avoid sales decreases. Additionally, obtaining supplies of the same product or component from different countries diminishes the impact of price swings or shortages in any given country or region.

*To minimize competitive risks* - many companies expand internationally for defensive reasons. They seek to counter advantages that competitors might gain from foreign operations because such advantages could be used against them domestically. Additionally, by spreading sales over more than one foreign market, a producer might be able to minimize the fluctuations in demand. Another factor in spreading risks is that through dealing with many foreign markets a company develops more customers, thereby reduces its vulnerability to the loss of a single customer.

Bartlett and Ghoshal (1989) support this way of thinking and state that the search for resources, markets and cheap labour have motivated the overseas expansion of most worldwide companies and shaped the attitudes of their managers.

When considering how firms internationalise, there are two approaches, which enables examination (Andersen, 1993; Barkema et al, 1996). Firstly, a group of Innovation-Related Internationalisation Models; and secondly, the Uppsala Internationalisation Model. All these models consist of a number of distinct stages with higher-level stages indicating greater involvement in a foreign market.

The first group of models are based on Rogers's (1962) stages of the adaptation process. The common idea for these models is that the internationalisation process is a series of innovations for the companies. Their focus is exclusively on the export development process, in particular of small and medium sized firms (see Leonidou and Katsikeas, 1996). This is conceived as a number of fixed and sequential stages, although the number of stages identified varies considerably between models, ranging from as few as three to as many as six (Bilkey and Tesar, 1977; Cavusgil, 1980; Czinkota, 1982; Reid, 1981). Leonidou and Katsikeas (1996) identify three generic stages on the basis of a

comprehensive review of these models: the pre-export stage; the initial export stage and the advanced export stage.

The distinctive mark of the Uppsala Internationalisation Model is the focus on the different institutional forms that are associated with the growing dependence on foreign markets. As Reid (1983) notes, this model examines internationalisation in terms of structural adjustments to foreign market servicing arrangements resulting from the level of export sales dependence. Foreign market servicing modes change once a certain threshold of dependency in the host country is reached. The specifics of this Model will be further examined later on.

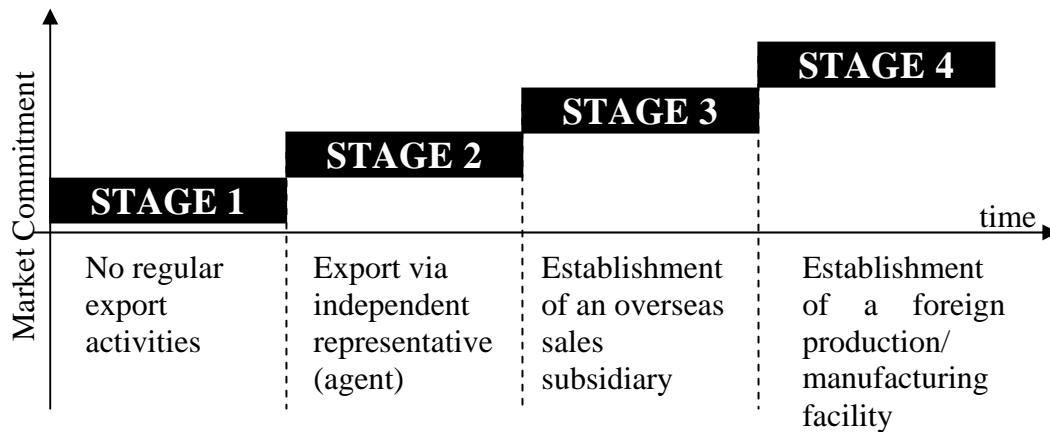
### **3.3 Uppsala Internationalisation Model**

The Uppsala Model seeks to explain and predict two aspects of the internationalisation of the company: (1) the step-by-step pattern of institutional development within individual national markets; and, (2) the expansion of companies across national markets as they move from nations which are proximal to those which are increasingly psychically distant.

Johanson and Vahlne developed the Model in 1977, on a basis of empirical findings made by Hörnell et al (1973) and Johanson and Wiedersheim-Paul (1975). These empirical findings from 1975 and 1973 respectively describe two patterns (in the Uppsala-model called operationalization); 1) a company's development within a specific country, and 2) its development across countries.

#### **3.3.1 The Establishment Chain**

One of the Model's aspects stipulate that due to considerable uncertainties associated with operating internationally (e.g. consumer habits, rules and regulations, cultural and political differences, etc.), companies increase their commitments to individual markets in small incremental steps. A company's involvement in a specific national market develops according to the following four stages, termed - the establishment chain (Johanson and Wiedersheim-Paul, 1975):



*Figure 3.2: The Establishment Chain; Source: Johanson and Wiedersheim-Paul, 1975.*

Johanson and Wiedersheim-Paul's study from 1975 involved four Swedish manufacturing firms, Sandvik, Atlas Copco, Facit, and Volvo. The study showed that Swedish firms entered and developed their businesses within a new market gradually. These stages are important due to fact that they are different with regard to the degree of involvement of the company in the market and they are also often referred to by persons in the business world (Johanson and Wiedersheim-Paul, 1975).

Consequently, these steps suggest that internationalisation is a process of organizational learning characterized by the increasing degree of involvement of companies in specific foreign markets. Companies increase their presence in a foreign market by moving from Stage 1 through Stages 2 and 3 to Stage 4, by accumulating market-specific knowledge. This type of knowledge is experiential and refers to knowledge of culture, customers, business and market structure and so forth in individual markets. The establishment of a production facility is, therefore, dependent upon the knowledge that has been accumulated previously. Hence, prior experience of operating in a particular foreign market, in some way, is essential to the process of acquiring relevant market-specific knowledge.

### **3.3.2 Development Across markets - The Psychic Distance**

In early years of internationalisation research, it was hypothesised that companies would enter new markets with successively greater psychic distance (Hörnell et al, 1973). Companies were supposed to start their

internationalisation by going to markets they could easily understand and where perceived market uncertainty was low (Johanson and Vahlne, 1990).

Johanson and Wiedersheim-Paul (1975) defined the psychic distance as a set of factors preventing or disturbing the information flows between companies and foreign markets. Examples of such factors include differences in languages, culture, political system, level of education and level of industrial development. Furthermore, the psychic distance is also correlated with geographical distance. One must note, however, that exceptions are easy to find, even when countries are neighbours. Great Britain and Australia are far way from each other, but being in the British Commonwealth with common characteristics, the physic distance is diminished. The US and Cuba, on the other hand, are neighbours geographically, but for political reasons, they are far apart with regard to psychic distance. As these examples show, the psychic distance is not a constant variable and may change due to development of the communication system, trade and other kinds of social exchanges.

Johanson and Wiedersheim-Paul (1975) concluded that the international expansion of four large Swedish multinationals followed a series of small, cumulative steps over time. These companies expanded their overseas business by successive stages to markets that were characterized by greater psychic distance. The entry mode also followed an incremental pattern, with an agency operation preceding a sales subsidiary in 75% of the cases.

In the early 1990's, Nordström and Vahlne (1992) defined psychic distance as factors preventing or disturbing companies from learning about and understanding foreign environments. They viewed psychic distance as the sum of the distance creating factors (cultural, structural and language differences) minus the sum of distance-bridging factors (such as knowledge dissemination or trial-and-error learning processes). Their empirical enquiry of the internationalisation did not support the proposition that the world was getting smaller due to diminishing psychic distance.

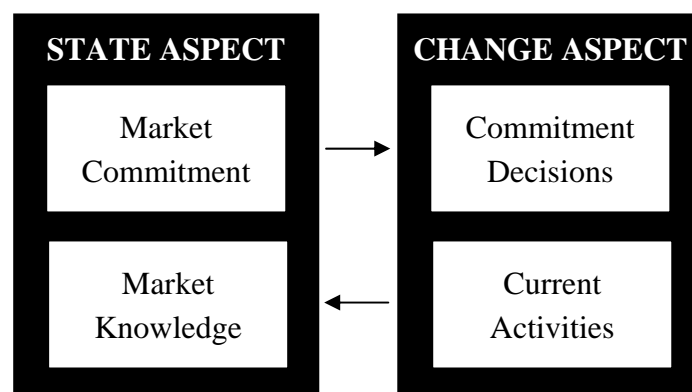
Even though the definition of psychic distance has varied within the literature, depending on how it is conceptualised and measured, most scholars since the 1970's have viewed the concept as representing the psychological distance between the home country and the respective trading or investing countries.

### 3.3.3 A Model of Firm Internationalisation

The main emphasis of the Uppsala Model is made on knowledge acquisition, therefore on learning. The main issues of the model concern the way organisations learn and how their learning affects their investment behaviour (Johanson & Vahlne, 1977, 1990). During the last two decades several empirical studies have aimed to test the model, but as pointed out by Hadjikhani (1997), surprisingly little work has been carried out so far to check the validity of the theoretical core of the model.

Initially, it was hypothesised by Johanson & Vahlne (1977, 1990) that firms would enter new markets associated with successively greater psychic distance. Moreover, the model assumes the following: firstly, companies are expected to strive to increase long-term profit, which in the model is equal to growth; secondly, companies are seen as risk averse and, therefore, pursue low risk-taking. When explaining the incremental nature of the process, Johanson & Vahlne (1977) further formulated a dynamic model, in which the outcome of one cycle of events is seen as providing the input for the following cycle.

Consequently, the main characteristic of the model rises from the distinction between state and change aspects of internationalisation (see Figure 3.3). On one hand, the State aspect, include foreign market commitment (i.e., resource commitment) and knowledge about foreign markets and activities. On the other hand, the change aspects include the decisions to commit resources and engage in foreign activities, as described below. The basic assumption is that market knowledge and market commitment affect both commitment decisions and the way current activities are performed, which, in turn, affect market knowledge and commitment (Andersen, 1993).



*Figure 3.3: The Basic Mechanism of Internationalisation - State and Change Aspects; Source: Johanson and Vahlne, 1977.*

The market commitment is composed of the amount of resources allocated and the degree of commitment. The magnitude of resources placed in a particular market is correlated to the actual commitment to the market. Therefore, the commitment is higher when more resources are integrated with other units of the international company and their value is derived from these integrated activities. The size of the committed resources is nearly the size of investment in the market, including investments in marketing, organisation, personnel and other areas.

Since learning is the main concept of the model, knowledge forms the decision background when committing to a certain market. Therefore, knowledge of opportunities and problems directly influence decisions. Evaluation of alternatives rise from the facts about the environment a company operates in and performance of various activities. Moreover, when considering knowledge from a resource point of view, it represents a valuable asset, which also influences the market commitment and competitiveness.

Additionally, knowledge may be categorised based on the way it was acquired. The objective knowledge is usually taught or transmitted from someone, therefore less trustworthy. Experimental knowledge in contrast, can only be learned through personal experience. The latter type represents a considerable value, since it is acquired gradually by each firm individually and may represent a competitive advantage in a market.

One may also differentiate between general and market-specific types of knowledge. General knowledge concerns marketing methods and customer knowledge, irrespective of their geographical location. The market-specific knowledge represents the specifics about a certain market's business climate, cultural patterns, structure of the market system, and, most importantly, characteristics of the individual customer firms and their personnel. A company needs both types of knowledge when operating in a foreign market. Market-specific knowledge is usually acquired through experience and local interaction. Whereas, general knowledge can be transferred from other markets and applied in any other market. In such a way, companies take advantage of previously gathered knowledge and may utilise it in new situations.

The change aspects of the Model include the current business activities and decisions to commit resources to foreign operations. Current activities are the main source of experience and knowledge in a market. An alternative would be to hire personnel that have experience in the local market. This allows for further differentiation between company and market experiences. Successful expertise requires both types, since there is a borderline between the company and the market. Therefore, interaction between outsiders and insiders is also required to sometimes interpret the information from both sides of the border.

The change aspect also includes decisions to commit resources to foreign operations. These decisions depend on which alternatives are raised and how they are chosen. Decisions are made in response to perceived problems and/or opportunities on the market. Furthermore, an assumption is made that companies choose their decision alternatives from the existing problems and opportunities in a market. These problems and opportunities are dependent on experience. Hence, the ones responsible for activities and who deal with the activities are the ones who encounter the decision situations.

When additional market commitment is made, two effects can be distinguished between; economic effect and market uncertainty. The economic effects are associated with the size of the operations and the uncertainty effect concerns the market uncertainty, meaning the inability of decision makers to estimate the future outcomes generated by the market. However, the increasing interaction with customers, establishing new services or acquiring new customers may reduce the latter effect.

Decisions leading to commitment are usually expected to follow a small step-wise increase in market commitment. However, exceptions to this normally appear when companies possess large resources, the market has a stable environment, or when the company is able to use the knowledge from similar or neighbouring markets. Market knowledge and market commitment at a certain point of time are assumed to affect the commitment decisions and how the activities are carried out in the subsequent period, which in turn will influence market knowledge and market commitment at later stages.

On the basis of these four concepts, and by making the assumption of incrementalism, the model predicts that the basic pattern of companies' internationalisation is: (1) to start and continue to invest in just one or in a few neighbouring countries, rather than to invest in several countries simultaneously; and (2) that the investments in a specific country are carried out cautiously, sequentially and concurrently with the learning of the company's people operating in that market (Forsgren, 2000).

### **3.4 Foreign Market Entry Modes**

A company's choice to enter a new market is influenced by several factors, such as the local business environment. Each market under consideration might necessitate different entry modes and these may also bring about different risks and rewards for the company. Moreover, there are several entry modes to choose from. The Uppsala Model presents some examples of how a company will possibly enter a foreign market. However, there are further choices for a company to make in order to enter a new market. The most common ones will be briefly presented below.

#### **3.4.1 Export Entry Modes**

Multinational corporations, medium and small-sized firms as well as entrepreneurs all export, however, with a different degree of involvement. Some companies use intermediaries in order to get their products into foreign markets, whereas others handle all of their export activities by themselves. There are mainly two central forms of export involvement; indirect exporting and direct exporting. These two entry modes are the least demanding forms of



international expansion and in these situations the company's products are produced outside the target country (Wild et al, 2003).

Indirect exporting is used by companies, which may not have a lot of resources available for exports, have little experience of exporting, have little knowledge of the target market or consider it a risk activity. These companies then sell their products to home-based middlemen or market intermediaries, which then resell them to buyers in the chosen market. There are three main types of intermediaries to choose from. Firstly, *Agents*, which are individuals or organisations that represent one or more companies and often do this simultaneously. It is a rather common choice since starting a relationship with an agent is fairly unproblematic and inexpensive. Secondly, *Export Management Companies* that work contractually either as an agent or as a distributor. They also typically provide other services on a retainer basis such as, for example, gathering market data and formulating promotional strategies. Lastly, *Export Trading Companies*, which provide services to indirect exporters as well as activities directly related to the clients exporting activities. They are not restricted to export-related activities but may also provide, for example, import and counter trade services as well as expanding distribution channels (Wild et al, 2003).

When a company sells its products directly to buyers in a target market, direct exporting takes place. These direct exporters, need not, however, sell directly to end-users. Rather, they are completely responsible for getting their goods into the market by selling directly to local buyers and not going via intermediary companies. Characteristically, local sales representatives or distributors are relied upon. A *sales representative*, which is either an individual or an organisation, represent only its own company's products and is hired by a company. They promote these products in several ways; however, they do not take the title for them. *Distributors*, however, take ownership of the goods when it comes into their country. By doing this, they acknowledge all the risks related with generating local sales. They then sell via their own distribution channels to retailers, wholesalers and end users. Even though this alternative greatly minimizes the risks of the exporter, it may weaken the exporter's control over the actual prices that are charged (Wild et al, 2003).

Furthermore, if a company decides that they want to have greater control of their exporting activities, they may decide to establish a domestic company owned *sales organisation*, which deals with the sales in the target market. They can consist of three different types; an in-house export department, a separate export department or an export sales subsidiary. They can either be concerned directly with exporting or serve as a home-based export-marketing department. Moreover, if the company wants to be present in the target market and handle its distribution and sales locally, they may decide to establish a foreign based sales organisation, which handles all the sales, communication, distribution and promotional work in the target market and sells to wholesalers, retailers, industrial users, etc. This type of organisation can consist of three types; an overseas sales branch, an overseas sales subsidiary or travelling overseas sales staff (Molnár and Nilsson Molnár, 1999).

### **3.4.2 Contractual Entry Modes**

There are various companies, which offer products that may not be traded in open markets since they are intangible. In this case a variety of contracts may be used, such as licensing or franchising. *Licensing* occurs when a company that owns intangible property, the licensor, permits another firm, the licensee, to use that property for a certain period of time in exchange for an amount of royalty. The licensed property might entail patents, copyrights, trademarks, technology, different types of know-how, etc. Two major advantages of this entry mode are that it does not involve large capital investments or detailed knowledge of foreign markets. However, disadvantages may be that the licensor can create its own competition in both the entered target market and other foreign markets. As well as that the licensor might have difficulties in controlling the quality of the licensed product and the sales volume in the market (Molnár and Nilsson Molnár, 1999). *Franchising* is a type of licensing common in retail and services sector. Instead of a company merely granting the rights to its commercial-industrial-intellectual property to another business, franchising engages in selling a whole business concept or format (Mercado et al, 2001).

### **3.4.3 Investment Entry Modes**

The activities within this category involve ownership of production units or other facilities in the overseas market, based on some sort of equity investment.

Several companies want to have ownership in some or all of their international ventures. This can be achieved by joint ventures (equity based), acquisitions, green-field investments or wholly owned overseas subsidiaries (Mercado et al, 2001).

*Joint Ventures* include some kind of equity investment leading to the sharing of ownership and control of overseas facilities together with one or more local partners. In several cases, the investing and local firm or firms, join to form a new business entity and sustain their legal independence. Each party contributes something valuable for its partners, such as managerial talent and financial capital. The major advantage of this alternative is that it greatly reduces risks, since a lesser part of the companies' assets are exposed. Furthermore, joint ventures can help a company to enter untapped markets quickly and generally at a lower cost than either an acquisition or a green-field investment. Moreover, companies may also use it to enter a market that would otherwise be impossible to enter. For example, various local governments demand non-domestic companies to share ownership with local companies or they give incentives in order for them to do so. These requirements are very common in developing economies (Wild et al, 2003).

An *acquisition* is a process where a company, which controls one business or businesses, acquires control of another by obtaining a majority of its voting shares. Mergers usually also fall under this category, however, they involve the mutual agreement of two companies to join. These entry modes are often seen as a way of accomplishing a rapid market entrance. However, there are also several disadvantages, such as the problem of integrating the foreign operation into the company. Moreover, if a company wants to engage in an independent venture, they may choose a *green-field investment*, where the company builds its own facilities, which offer a freer selection of location, investment in the most recent technologies and management practices (Mercado et al, 2001). A *wholly owned subsidiary* is also an independent venture, where a facility is owned and controlled entirely by a sole parent company. The major advantage of the last two investment entries is that managers have complete control over the activities in the target market. The major disadvantages are that they involve a great deal of capital as well as risks (Wild et al, 2003).

### **3.4.4 Types of International Production**

Overseas investments by companies may be classified into two broad categories namely: market-oriented and supply or cost-oriented production. The boundary between them is, however, not very clear. They are nevertheless important to mention since they may explain some companies intentions for establishing in a foreign market.

Firstly, market-oriented production is established in a country in order to serve the local geographical market. Most foreign direct investment in service industries as well as in manufacturing is planned to serve a certain geographical market by locating inside that market. The good or service, which is produced, may be identical with the one that is produced in the home market. There may, however, also be some modifications in order to serve the specific tastes or requirements of the local market.

Secondly, supply or cost-oriented production, where supply considerations are the main determinant. This generally is the case for companies in the natural resource industries. In this situation the company establishes itself in the market due to the availability of attractive supplies for their manufacturing, which are greatly localised geographically. When considering this investment mode, the company's cost structure is important as well as the evaluation of the importance of a certain production factor. If the cost of a certain production is not lower in another market, there is no great need for the company to move its production. For instance, technological changes in production processes and in transport have evened out the importance of location for some traditionally important factors of production. Currently, the main location-specific factor is considered by many to be labour, in particular semi-skilled and unskilled labour. Factors such as wage costs and labour productivity are main determinants in this case. Labour cost is an especially important determinant in international investment-location decisions.

### **3.5 Network Approaches to Internationalisation**

As a result of the increasing changes in the world throughout the last few decades, previous reasons for companies internationalising may not always be accurate. Several firms no longer internationalise according to the step-to-step

process due to a more rapid changing environment. As a result of this, the concept of network is becoming more and more important and several theories take this into account. Johanson and Mattsson (1988) emphasise in their theory of industrial networks, the importance of a network perspective in internationalisation. Furthermore, as a result of criticism of not considering networks, the Uppsala Internationalisation Model has been updated with a network perspective.

Internationalisation is defined as developing networks of business relationships in additional countries via extension, penetration and integration. The investments that are new to the company are the extensions, while penetration refers to the development of positions and the increase of resource commitments within the network where the company already has a position. Moreover, integration is the co-ordination of diverse national networks. Since the relationships between companies are seen as a network, companies may internationalise as a result of other companies within their national or international networks internationalisation (Andersen, 1993; Johanson and Mattsson, 1988). Important findings, which are a result of network-based research, are that internationalisation is related to the adjacent network and the process of internationalisation is greatly driven by existing network relationships (Coviello and Munro, 1997).

### **3.5.1 Industrial Networks**

In an industrial system companies deal with production, distribution and the use of goods in addition to services. Network is used to describe the relationship between these companies and the division of work between them, which results in a dependency on each other. In order to make the network function, coordination is required. It takes place via interaction of the companies in the network and they are free to select their counterparts. The company's possibility of selection is, however, constrained since exchange relationships have to be established with firms, which takes time and effort. Every company in the network has a relationship with, for example, customers, suppliers, distributors and occasionally even with competitors. Indirect relations with customers' customers and supplier' suppliers may also be important. The networks may be both stable and changing since new relationships can be established and old one's can be broken. However,

individual business transactions between companies generally occur within the framework of established relationships (Johanson and Mattsson, 1987)

As a part of the relationships, different sorts of bonds are developed between companies according to Johanson and Mattsson (1987). However, a distinction may be made between technical, knowledge, planning, legal and socio-economic bonds. Of course other companies also want to obtain access to the exchange relations, either as sellers or as buyers. The reasons for companies maintaining their contacts are that there are certain inter-firm dependency relations. A company has direct and certain dependence relations with companies that it has exchange relations with. It also has indirect and certain dependence relations with actors with which its counterparts have exchange relationships. When a company wants to establish itself in a new market, it has to build relationships, which are new to it and to its counterparts. This may sometimes result in old relationships ending or in new relationships being added to already existing ones.

Internationalisation is taking place when relationships with actors in foreign networks are established and developed. It is seen as a cumulative process where relationships are constantly established, developed, maintained and dissolved in order to achieve the objective of the firm. Emphasis is made on gradual learning and development of market knowledge via interaction in the networks. Since there is a cumulative nature of the market activities, the company's position in the network is vital. One basic assumption in the network model is that the single company is dependent on resources, which are controlled by other companies. The company obtains access to these external resources via its network positions. The position of the company in the network is both from a micro perspective; company-to-company, and from a macro perspective; company-to-network. According to the micro perspective, companies are interdependent both via cooperation and competition. The macro perspective includes both direct and indirect relations within the network. Johanson and Mattsson have combined the micro and macro perspective and identified four stages of internationalisation; the early starter, the late starter, the lonely international and the international among others.



*Figure 3.4: Internationalisation and the Network Model; Source: Johanson & Mattsson 1988.*

The network model of internationalisation clarifies the process rather than the existence of international companies. From this perspective, the company's internationalisation strategy is characterised by minimizing both the need for knowledge development and the need for adjustment as well as being able to exploit established network positions. For a company that is just starting its internationalisation, these demands cause great pressure because it is in the midst of the first to developing the network and the costs of developing the needed knowledge and overcoming the problems can be high. Both quantitative and qualitative resource adjustments are needed. Quantitative since the company's production capacity has to be increased in order to meet the demand of the new market. Furthermore, qualitative adjustments might be a consequence of the difference between the markets and, therefore, there is a need for an increase in knowledge development. The lonely international encounters lower external pressures than the early starter, however, the coordination of international activities plays a greater role for the lonely international. Moreover, the late starter encounters different problems than the early starter or the lonely international. Companies that are already a part of an established network structure can resist the latecomer's attempt to enter the internationalised market. However, customers and/or, suppliers inside the network can "pull" the company into the international network. The

international among others operates in a developed and competitive network where national differences have slowly disappeared as a result of globalisation (Johanson and Mattsson, 1988).

### **3.5.2 The Network Model of the Firm Internationalisation Process**

A business network is as a set of interrelated business relationships where every exchange relation occurs between business companies conceptualised as collective actors (Anderson et al, 1997). The companies consider close and lasting relationships between companies, doing business with each other, as critically important since it takes time and resources to build them. Consequently, all companies are engaged in a restricted set of business relationships with essential customers and supplier companies, and they have in turn, relationships with other companies. As a result of this, every company is a part of endless business network (Johanson and Vahlne, 2003).

Foreign country markets are separate entities in which operations are performed or not. As a result of them being different, they need particular modes of operation or forms of organization. The Uppsala Internationalisation model argues that there is a process driven by the interplay between learning about international operations as well as commitments to international business. The major obstacle for internationalisation is the lack of knowledge about foreign markets and operations in these. In order to overcome these obstacles, knowledge needs to be developed via experience from operations in the chosen markets. Each country market has economic, institutional and cultural barriers. Psychic and cultural distances determine the size of these obstacles. Entering a market is a question of climbing over these barriers and this is done by a proper operational mode. However, from a business network perspective, the difficulties of entering a market are not associated with country markets but with certain customer or supplier companies. Instead of focusing on entries and expansions of foreign markets, the focus is on managerial problems related to the establishment and development of relationships with customers and suppliers. Internationalisation is seen here as a general expansion of the company, which is not affected by country borders. The barriers that are present concern the establishment and development of relationships (Johanson and Vahlne, 2003).



Even though, country borders are no longer significant, an internationalisation process that is a result of interplay between experiential knowledge development and commitment can still be anticipated. However, the experiential knowledge and commitment involve potential and existing relationship partners, not countries. The relationships are gradually developed as a result of the companies learning from interaction with each other and becoming increasingly committed to the relationship (Andersson and Weitz, 1992; Blankenburg Holm et al., 1999). As a result of this process, the actors learn about each other's needs, resources, business conducts and strategies. Both partners need to be committed to the relationship since it is a process, which involves a great deal of time and resources.

There are three types of business network learning. Firstly, partner specific ones, which occur when companies conduct business in a customer-supplier relationship, where they learn, for example, the different roles of the individuals in the partner company. Hence, they learn about each other in a way that enables them to develop the relationship even more and, therefore, there is also an additional commitment to the relationship. Secondly, relationship development experiences are where two companies, which are interacting in a relationship, learn some skills that may be transferred and used in other relationships. Thirdly, relationships are connected with each other. This is a result of the partner companies learning when they are interacting in a relationship, how they shall coordinate activities with those in another relationship. As a result of the mentioned business network learning, the company understands how to build new business networks and connect them together (Håkansson and Johanson, 2001).

Johanson and Vahlne (2003) argue that the international expansion is a result of the company's development of its existing relationships. Moreover, it will be the outcome of the company's establishment of relationships with customer or supplier companies, which in some way are similar to the customers or suppliers with which they already have successful relationships. Furthermore, the internationalisation of the company will be an outcome of the relationship developments with the customer companies that are connected to those, which they already are working with. The internationalisation process will follow almost the same pattern as described in the general internationalisation process

literature, however, nothing is said about which countries to enter and expand in, since country markets are not significant entities. Moreover, it is not anticipated that the companies would follow the establishment chain inside the target market. Companies most likely organize their business mainly so as to develop, support and coordinate relationships. The organisation will probably expand as a result of the development of the crucial relationships, for example, to improve relationship learning and indicating commitment to relationships.

According to studies in internationalisation, two different kinds of market specific experience may be distinguished between; business experience and institutional experience. The first deals with experiences, which are associated with the business environment of the company that, in relation to the business network view, involve the companies with which it is conducting business or is trying to do so. The latter concerns issues such as regulations, laws, language and public and semi-public authorities applying laws and regulations (Eriksson et al, 1997). Therefore, institutional experience concerns several of the factors, which make up the psychic distance between countries. Consequently, the internationalisation process model and the network view should be combined since there is one set of direct business-related managerial problems that are relationship-specific and an additional set of problems, which are related with country-specific institutional and cultural barriers. Therefore, there is a distinction made between relationship-specific psychic distance and country-specific psychic distance (Johanson and Vahlne, 2003).

As a result of the above reasoning, there are several ways of entering a foreign market. Patterns of interrelated network relationships exist both between countries and within country borders. However, these can never be seen. The actor as well as the observer may know that they exist but not how they are structured, since each relationship is unique and composed of several different interdependencies and links. The only way of learning how the network is structured is to start interacting with one or several of the actors within the network. Therefore, it is impossible for outsiders to understand foreign market networks even if they know they exist. Relationships may be used as a way of climbing over the country market barriers and entering the target market. However, unlike to the internationalisation model, there is more than one way to do this. For example, a company might try to set up a relationship with a

customer company in a foreign market. This may be done by approaching several different companies and because every possible counterpart is unique and might call for a certain relationship development process and also have certain consequences, the choice of approaching one of these companies is an important and difficult one. Foreign market entries can also be a result of a company that follows its partner abroad, as they are required to do so or they follow in order to extend their relationship to cover business also in foreign markets (Johanson and Vahlne, 2003).

Moreover, Johanson and Vahlne argue that while there is a qualitative distinction between foreign market entry and foreign market expansion in the former internationalisation models, they involve related problems. Foreign market expansion is an issue of first developing the company's relationships in the chosen market, then establishing and developing supporting relationships, and lastly developing relationships which are similar or connected to the focal one. Even though these processes may be restricted to one country market they can also cross country borders and result in entry into another foreign market. In order to be able to support a strategic relationship, a company can be forced to develop a relationship in another country and, therefore, enter another country.

### **3.6 Theory – Concluding Remarks**

Throughout this chapter, relevant theoretical issues were explained, which examine the different aspects of the internationalisation procedure and the impact of the general flow of FDI. The theoretical sequence will facilitate the analysis and conclusion. Firstly, the model of the direct and indirect path of internationalisation, attempts to demonstrate the use of so called platforms for a company's growth. Secondly, the internationalisation theories, which have an emphasis on learning, gradual expansion and the use of networks, aim to explain how companies entered the markets and why certain decisions were made. However, before empirical data is presented, an overview of the region under focus is given. This presents the reader with a macro perspective of the countries in question, as well as the specifics of the transitional period.



## **CHAPTER IV: REGIONAL OVERVIEW IN TRANSITION**

The purpose of this chapter is to present the characteristics of the region under focus. It covers an explanation of what transition is and its effects. Furthermore, the pattern of FDI in the CEE countries is presented; followed by a description of the countries examined in this study. One must note that this section also serves as an introduction to the empirical findings presented later on.

### **4.1 Transition and the Business Environment**

The concept of transition needs to be explained in order to comprehend the environment in which the foreign companies are conducting business. Therefore, the main changes of the regional environment and within business relationships will be discussed below. Firstly, four different processes of the transition will be presented, thereafter; main alterations within network relationships between West and Central/East European companies will be discussed.

#### **4.1.1 Dimensions of Transition**

Transition in the case of the CEE countries, concerns the change from a Soviet-type socialist planned economic system towards a market-based economic system. The term transition does, however, also involve simultaneous changes in political, social and cultural spheres. The post-socialist transformation in the CEE countries started more than a decade ago. However, the different countries within the region have implemented their transitions either gradually, such as Hungary, or via so called “shock therapy”, such as Poland, with a deep structural reform at an early stage. Moreover, they all also have different backgrounds and were to different extents tied to the Soviet socialist economic system, which also affects the speed of implementation. The differences in the pace of the reforms and changes are apparent when observing them more closely. Countries such as Poland, Hungary and the Czech Republic, have come far in their development. Whereas, countries such as Romania, Bulgaria and several of the non-Baltic Soviet states, have been continually delayed in their reform process. The difference in development is also currently more apparent, as new candidate countries are to be accepted into the EU. Poland,

Hungary, the Czech Republic, Slovenia and Estonia have long been seen as the five CEE “front-runners”. As well as these five countries; Latvia, Lithuania and Slovakia also belong to the countries in the region that will enter the EU in May 2004. However, countries such as Romania and Bulgaria will need to prepare more for their memberships (Bachtler et al, 2000).

Even though there is a difference in the reform processes, there are some commonalities between them. Nieminen (1999) has distinguished between four main change processes, of which all the countries discussed go through.

Firstly, *Political changes*, which are the most important features of the transition process since the socialist ideology was abandoned. A multiparty system has been put into practice and democracy has been implemented. There are, however, still barriers to overcome. One major concern is that in many countries, the market reforms have not had any state control, which has resulted in an uncontrolled economic development. The consequence of this has been shadow economies and criminal activities. Moreover, the inhabitants’ attitudes and loyalty to the pre-regime countries differ to a great extent. In countries where the Communist party dominated the governments, the political changes have been harder to implement. However, in the Baltic countries and several of the CEE countries, the Soviet presence was greatly resented and the quest for democracy and free markets has always been strong. Moreover, there is also a strong tendency for these countries to align themselves with the West. The great desire of joining the EU and NATO are examples of this.

Several groups of people have become less fortunate in the rising economies; socially, economically and demographically. Fundamental social changes have taken place as a result of the political and economic changes and there has been a growth in inequalities, corruption and increasing nationalistic activities. There is a crucial role for the state, which often has been ignored in the rush to a market economy, and as a result of this, these situations have occurred. Due to this, several foreign companies are reluctant to invest in these countries, since they perceive them as politically risky. This is highly unfortunate since the acceleration of the reform processes depends, to a great extent, on the ability of the countries to attract foreign investments.

Secondly, *Macroeconomic changes* play a crucial role in the region's transition process. They are generally associated with different ways of liberalising the economy; stabilising the macro economy, privatising the formerly state owned enterprises and restructuring companies and industries in order to meet the requirements of the open market. During the planned economy period, the CEE countries were not suited for an open market economy. During that time, there was a state monopoly of all means of production, which resulted in a lack of competition and a lack of consumer orientation. Price controls and subsidies were used, distribution was conducted by state enterprises and there was a latent more than real unemployment. Production at that time was mainly focused on basic and heavy industries, which usually were highly inefficient. In order to come to terms with this material and energy concentration, restructuring and modernisation of the economy is needed. Moreover, production has to be restructured to meet the needs of local consumers and companies. Privatisation of these state-owned enterprises is an important part of this restructuring process. A move towards smaller companies instead of these large ones and a move from heavy industry to services is also important.

Thirdly, *Institutional changes* are needed to be able to build the required infrastructure for the market economy to function properly. The development of institutional reforms are closely related to the extent and duration of liberalisation, since there is a need for institutional changes when there occurs macroeconomic and ownership reforms. The changes of legal institutions, banking services, tax administrations and enforcement mechanisms are in several countries still in the early stages. The unrestrained developments in the economy were a consequence of the liquidation of government institutions, which were active in the planned economy. The result was that several companies lost their greatest customer, the State. It will take a long time to build up the needed infrastructure. Currently, the legal and regulatory environment might be incoherent and contradictory, which creates a confusing environment for domestic as well as foreign companies. The poor development of an infrastructure that supports a market economy and the lack of government control in the economic activities are the main features, which deter the countries from having functioning market economies.

Lastly, *Behavioural changes* that take place in the social and cultural settings are a great part of the transition process. Individual decisions are the start of all the change processes in the transition. These can be made by individual persons or by policymakers and company managers. However, the ability of these people to learn a new behavioural pattern is crucial for the entire transition process. A great deal of the population in the transition countries has been faced with increased poverty, inequality and insecurity. This has resulted in scepticism about the changes. In addition to education at the managerial level and for employees, which are often handled by Western companies, behavioural changes are also needed among individual inhabitants. Individualism instead of collectivism needs to be realised, as well as an acceptance of income inequalities and lower government support for social healthcare. These habitual and attitudinal changes, will take a long time to accomplish and it is the younger generation, which will adapt the fastest.

Despite the fact that there was a difficult external environment after 2002, the transition economies of Central and Eastern Europe and the Commonwealth of Independent States (CIS) turned out to be very resilient. Growth for the whole region was 4.3% in 2001 on a weighted average basis, the second best performance since transition began. Consumers and investors had a major role in this. In Central/Eastern Europe and the Baltic States (CEB), in southern-eastern Europe (SEE) and in several countries in the CIS, including Russia, private domestic demand was the major engine for growth. Although the transition economies outperformed most other emerging markets in 2001, the outlook for 2002 was not as optimistic. The EBRD growth forecast for the region is 3.3% on a weighted average basis, a decline on last year's performance. However, there are large differences among the countries. The CEB countries are forecasted to maintain the solid pace of growth that it experienced in 2001. However, in the SEE countries, the impact of fiscal tightening may result in a slower pace of growth (EBRD, 2002).

#### **4.1.2 The Role of Networks in Transition**

In order to examine the development of the business relationships between West and Central/European companies, Nieminen (1999) uses a network approach. The most noteworthy change in the CEE countries is the increased independence of the local companies. During the planned economy period they



could not make independent decisions when it came to what products to produce, which suppliers to use, to whom to sell to and at what prices. Foreign trade transactions were also included in the state monopoly. As a result of the fall of communism, the companies were exposed to direct contact with their business partners. The Western companies welcomed this since it meant increased flexibility and control over their businesses in the region. The companies in the CEE countries also welcomed the development, however, they were fairly inexperienced within this area and the increased independence has in some cases led to negative consequences. The lack of control and authority has in those cases resulted in tax evasions and other illegal operations.

The companies in the CEE countries are still slowed down by numerous internal and external factors. The internal factors mainly consist of lack of knowledge and experience concerning business behaviour in a competitive environment but also the lack of competitive products and financial resources. Moreover, companies also face several managerial problems, such as the lack of ability to take initiative and responsibility. The external factors are comprised of a lack of adequate infrastructure, high taxation rates and political as well as economical instability. When considering the network perspective, the increased independence of the companies results in new challenges for them to establish business relationships. Due to their need for obtaining financial resources and technological or managerial knowledge, the companies are very eager to get in contact with Western companies. However, some Western companies have negative experiences from such business relationships such as low commitment, conflicting objectives for co-operation and a quest for short term profits, to name a few (Nieminen, 1999).

When conducting business in the CEE region, networks are very important. Currently, these networks are established between different actors than they were previously. Governments, monopolies and authorities no longer interfere in the business transactions. However, the developments of networks in the CEE countries are somewhat different to the ones established in Western countries. This is a result of some of the still prevailing market inefficiencies. It is not just the buyer-seller relationship that is important and instead of just focusing on the focal actor's network, weaker links with other actors in the environment are also important. The most crucial networks outside the focal

net consist of, for example, managers of other foreign companies in the market, suppliers, distributors, local employees, politicians, bankers, government and municipal organizations, etc. Furthermore, as a result of the continuous changes in the region, the networks are exceptionally dynamic and various actors may become stronger, whereas others may weaken. Therefore, the network management is in a need of a holistic approach. Foreign companies must focus on concurrent management of different relationships, instead of concentrating on single cases separately. The composition of the network does, however, depend on the nature of the business as well as the market experience of the company (Nieminen, 1999).

Additionally, Nieminen (1999) argues that the role of the individual in the CEE countries is heavily emphasised, whereas in the Western economies, establishments are usually between individual companies. The result of this is that good personal relationships greatly diminish the uncertainties in the markets, such as, institutional inefficiencies. Networks are also established to acquire crucial market information. Since the institutional framework is unable to give security and trust, this is looked for in personal relationships. Any business relationship regardless of country origin needs this. However, in transition economies, networks that are derived from good personal relationships with various actors in the market are a requirement for the formulation of business relationships. In more advanced market economies, good personal relationships often occur as a consequence of the business relationship.

As shown in the figure above, the liberalisation of foreign trade legislation and control has brought about a decentralisation of potential business partners in the region. Today, Western companies have stronger bonds directly with clients and the politically governed networks are of less importance. This is a new situation for the Western companies and it makes potential partners much more difficult to find than it used to be. Moreover, this situation increases the marketing expenses of exporting companies and therefore it is more beneficial to set up a local presence. If companies choose to operate from outside the market, they lose the possibility to establish efficient relationships with suppliers, customers, etc. Moreover, the necessary personal contacts are easier established if they are present in the market.

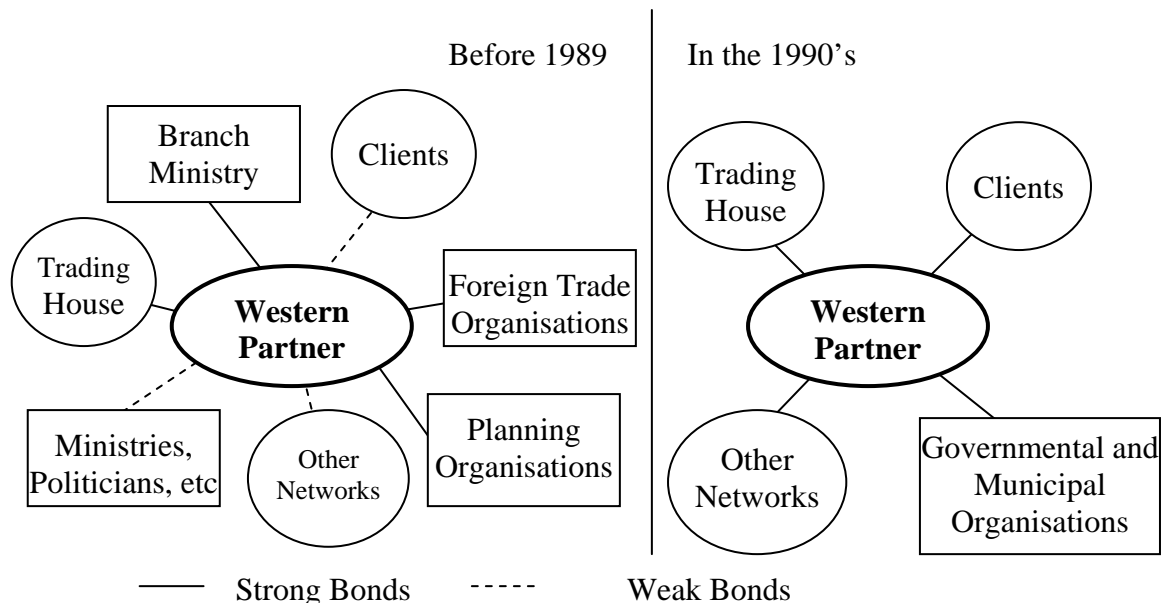


Figure 4.2: The Evolution of Business Networks in Eastern Europe from the Command Economy Era up to present; Source: Nieminen 1999.

As a consequence of the change from a planned economy to a market economy, inter-firm cooperation has been strengthened as a result of the founding of equity joint ventures, acquisitions and subcontracting deals. Before 1990, foreign companies were not allowed to establish wholly owned subsidiaries in these countries. The foreign direct investments are somewhat small considering the size of the countries and the local economy. However, there are some exceptions. The reason for the small investments is the uncertainty of the region. Companies chose different entry modes in the individual countries, depending on the perceived risk level. Operations modes that require high degrees of risk, such as wholly owned subsidiaries and acquisitions are most often chosen in countries that have had an above average accomplishment in the transformation process and are more or less politically and economically stable. These are Poland, Hungary, the Czech Republic and Estonia. Countries with high-perceived environmental uncertainty are usually entered with low commitment operational modes, such as traditional export-import operations or local sales subsidiaries. Joint ventures may also be chosen in order to reduce the risks. Foreign companies are progressively establishing more sales units in their main markets in the CEE region. The purchasing power of the population is increasing and therefore there is a need for being established there. There is

also a need to be closer to the market in order to control and observe the local operations more efficiently (Nieminen, 1999).

## **4.2 The Pattern of FDI in Central and Eastern Europe**

One of the main limitations on FDI is the rather unfavourable investment climate in the region, especially in the SEE and CIS countries, which worsens the balance between the risk and return to investment. When it comes to foreign investment in CEE, in 2001 it held up well, as investors reassessed the risk-return profile of the region compared to other emerging and mature markets. The accessions to the EU for a number of countries were the key driver behind this reassessment (EBRD, 2002). In 2002, the Central and Eastern European countries' FDI inflows rose by 15%, amounting to \$29 billion, compared to \$25 billion in 2001. This resulted in the region going against the global downturn trend. However, FDI rose in 9 countries and fell in the other 10. There was a trend for companies, local as well as foreign affiliates, to discard unskilled labour activities and to develop into higher value-added activities, benefiting of the educational level of the local labour force. The region's FDI inflows are most likely going to increase additionally in 2003, partly due to the EU enlargement. The EU accession countries in the region need to harmonise their FDI regulations with the EU ones. Whereas, the non-accession countries need to adjust and modernise their FDI regimes in order to reap some benefits from their neighbouring countries becoming members. As a consequence of the shifting dynamics of FDI and that some of the late comer countries have caught up, the long-established domination of the Czech Republic, Hungary, Poland and the Russian Federation has altered, with only the Czech Republic still growing, while the other three countries have declined (UNCTAD, 2003).

Moreover, all bilateral and regional agreements concluded by the CEE countries with the EU, enclose investment clauses, reflecting the priorities of international economic relations of both parties. Of the 19 countries in the region, only four have not signed such agreements. However, both Hungary and Romania have. These investment-related clauses include an extensive array of issues, reflecting the depth of economic integration between the two parties. All present guarantees for transfer, protection of intellectual property rights and State-State dispute settlement mechanisms. At the regional level, the EU

enlargement is the most crucial policy development, which influences FDI inflows to the CEE. FDI in non-accession countries is also affected, however in a different manner. The accession countries are upper middle income or high-income countries, except for Bulgaria and Romania. All non-accession countries, except for Croatia, are lower middle-income countries. This results in an increase in FDI in services and higher corporate functions in accession countries, from existing EU members and third countries. EU enlargement furthermore presents opportunities for non-accession countries, since assembly-type manufacturing will possibly transfer from higher cost accession countries to them. The new EU member states might turn out to be key sources of skill-intensive assets, combining their advanced education and competitive production costs. EU's legal regime offers the needed framework for the free movement of persons, goods and capital within the region. However, labour-intensive activities may be relocated from accession countries to developing Asia, instead of to lower income CEE countries. As a result, the low FDI outflows from accession countries limit the extent for restructuring to non-accession countries (UNCTAD, 2003).

### **4.3 The Hungarian Environment**

At the start of 1991, Hungary had already managed to come quite far on their way to a market-oriented economy, due to prior experience of market-type economic reforms. The country's tax system had already undergone major reforms in order to be in line with Western practices. Prices, imports and exports had also come far in terms of liberalisation. These changes prepared the country for the more fundamental changes that would come after 1989. However, it was not until then that the communist party's power was removed from the companies, political control over the economy was restrained and privatisation of large companies started to be important (Hare, 1991). Today, Hungary is an attractive target for multinational companies, situated ideally when in search of expanding to the eastern and southern regions of the continent, since it is located in the middle of Europe. The country has traditionally linked North and South, East and West. Furthermore, the significance of the country is enhanced by its closeness of the candidate countries of the EU. The country also attracts foreign investments since it offers liberalised regulations for business enterprises, favourable tax and

business laws, in addition to a well-educated labour force. When it comes to the privatisation process in the country, it was largely completed in 1997, even though the banking, transport and steel sectors are still under preparation (Swedish Trade Council, 2003).

Unlike its neighbouring countries, Hungary's economic liberalisation paved the way for full political liberalisation. Despite the fact that the first free elections were not held until 1990, the basic institutions of a market economy were already being established prior to the complete liberalisation, which took place in 1989. As a result of the Parliamentary elections in April 2002, a Socialist-Liberal Coalition replaced the former Centre- Right Government. Even though there has been a downturn in the global economy, Hungarian economic growth was the highest in the region in 2001, and more than double the rate of the main EU member states. However, during the last couple of years the growth has decreased and in 2002, it was 3.3%. The budget situation worsened greatly in 2002, and the deficit increased to 9.4 % of GDP. Inflation was 5.2% in 2002 but continues to decrease. Unemployment is among the lowest in the candidate countries, at 5.9 % during the fourth quarter of 2002. However, Hungary enjoys high country ratings, low risk premiums and easy access to international finance. As a result of this, the financing of the deficit does not appear to pose a sustainability problem. Currently, one of the country's major economic policies is to assist a rapid integration into the EU (Swedish Trade Council, 2003).

The country's stable economic growth has mainly been a result of the great inflow of FDI, which amounted to €1,281 million in 2002. However, Hungary was one of the countries in the CEE region, in which FDI declined in 2002, it was only the eighth largest recipient. One reason for the lower than anticipated level of FDI, may be a wait-and-see attitude from the investor's side, since the accession countries are in progress of adjusting their FDI regimes to EU requirements. An example of a nonconforming FDI instrument is Hungary's 10-year tax holidays, granted only to large investors. This investment incentive was changed in 2002 in order to conform to EU rules. However, the country sought to provide a framework, which was no less favourable for investors (UNCTAD, 2003). Sweden was the fourth biggest investor in Hungary in 2002, with investments adding up to €102,5 million, which is 8% of the total. Sweden exports mainly engineering products to Hungary. Furthermore, the trend from

low value-added to high-tech investments continues. Currently, some established investors are leaving Hungary for countries with cheaper labour, which is a result of increasingly higher wages. It is also due to the natural modernisation of the Hungarian economy (Swedish Trade Council, 2003).

According to the EBRD, Hungary faces several key reform challenges. Firstly, recent progress in structural reforms has been slow and there have been setbacks in a number of areas, such as re-nationalisation and privatisation. Therefore, a revitalisation of reform is necessary to sustain the attractiveness of the country to investors. Secondly, in order for the government to be able to reduce the inflation, a return to fiscal transparency and an overall tightening of fiscal policy are needed. Finally, social reforms have to be accelerated, above all in the health sector, in order to improve services as well as to diminish underlying fiscal imbalance (EBRD, 2002).

#### **4.4 The Romanian Environment**

The country is, with its approximately 22.5 million consumers, the second largest emerging market in Central and Eastern Europe. As a result of the fact that a great portion of the territory of Romania once belonged to Hungary when it was a part of the Austro-Hungarian Empire, there is a significant minority of Hungarians in Romania today, officially around 6.6% of the population in 2003 and they are mainly situated in the Transylvanian region of Romania (CIA, 2003). When it comes to the country's economic development, it has throughout the 1990's and till today struggled hard with the transition towards a market-based economy. Romania started its conversion from Communism in 1989 with a mostly outdated industrial base and output which did not suit the country's needs (Swedish Trade Council, 2003). In 1989, there were merely six joint foreign ventures in Romania, and they had, by law, minority foreign ownership. Even though the country was independent, in 1990, further foreign investment was discouraged due to goal of being a "self-reliant" country. Nevertheless, a new law was made in 1991, which permitted foreign participation through either joint ventures or wholly owned foreign companies. The changes that needed to be made in Romania, such as open trade, liberalisation of prices, closing down unprofitable companies, the creation of temporary unemployment, all demanded a government that had considerable

legitimacy. However, the Romanian population has been very distrustful of government policy in general and this confidence will take time to build up. However, it is crucial in order to restart economic development (Ben-Ner, 1991).

Currently, the main government goals are NATO and EU membership, enrichment of the country's living conditions, enhanced trade balance and economic growth, as well as harmonisation of legislation with that of the EU states. Romania intends to gain EU membership in 2007. However, there are several changes that need to be made before that. One great problem, which also deters foreign companies from investing in the country, is corruption. According to a study of PricewaterhouseCoopers, Romania loses two thirds of its potential investments due to this and the lack of transparent legal and political systems (Swedish Trade Council, 2003). The political situation in Romania is at present relatively stable. In September 2003, the small Humanist Party ended its coalition with the ruling Social Democratic Party (PSD). The cooperation between PSD and the Democratic Union of Hungarians in Romania is, however, maintained. As a result of this arrangement, there is a secure majority in both houses of Parliament. Moreover, a major constitutional revision was adopted following a referendum in October 2003. This revision initiated changes, which are required for the country's EU accession and it also entailed reforms of the parliamentary and judicial system (European Commission Candidate Country Reports, 2003).

Despite a less favourable environment for international investment, Romania's economic growth has continued to be strong. The Romanian GDP grew by 4.9% in 2002 and in 2003 it is expanding for the fourth year in a row, since GDP rose by 4.3% year-on-year under the first semester. As a result of this encouraging background, additional gains towards domestic stabilisation were accomplished since inflation fell more than it was expected to. The unemployment rate increased slightly, and in 2002 it amounted to 8.4%. Even though there has been a solid economic growth, Romania has made modest progress in real convergence towards EU per capita income levels. A major challenge for the country is to catch up to levels in other European countries, in terms of income and productivity. In 2002, GDP per capita in purchasing power standards improved vaguely to 25% of the EU level. However, the



regional disparities seem to increase. This is mainly a result of the above-average growth of the Bucharest region, where the 2000 per capita income was more than double the national average and approximately three times more than the one in the poorest region (European Commission Candidate Country Reports, 2003).

The legal framework for a market economy has continued to strengthen but the enforcement of property rights is difficult to enhance without major improvements in the efficiency of the judicial system and public administration. The country has made considerable efforts to enhance the investment climate, for example by decreasing red tape, ensuring greater stability of the tax code and an establishment of a Romanian Agency for Foreign Investment (European Commission candidate country reports, 2003). Between the years 1990 and 2000, total foreign direct investment in Romania amounted to \$6.05 billion. The Romanian Trade Registry states that 85, 142 companies with foreign capital were registered in Romania between 1991 and 2002. The EBRD is the greatest international investor with commitments for over €2 billion. Moreover, Romania is the third chief recipient of EBRD funding. Romania is thus expected to build up an improving business environment as a result of increased presence of international consulting companies and international banks. The legal system is starting to become harmonised with that of the EU. The Romanian legislation offers national treatment of foreign investors and there is no limit on the foreign participation in companies; a foreign investor can set up a 100% owned enterprise (Swedish Trade Council, 2003).

According to the EBRD, there are a number of key reform challenges that have to be dealt with in Romania. Firstly, there has to come about an effective implementation of structural reforms, together with an ambitious privatisation agenda as well as measures to improve the investment climate, in order to secure a stable inflow of foreign direct investment. Secondly, the state-owned enterprises need to improve the financial discipline, to be able to reduce inflation and quasi-fiscal deficits. Finally, the authorities have to strengthen financial sector supervision as well as regulation and complete the privatisation of the largest state-owned bank (EBRD, 2002).



## CHAPTER V: EMPIRICAL FINDINGS

This chapter aims to present the empirical data of a primary nature. One must note that the amount of data differs from case to case. This is mainly due to the size of the company, availability of published information and more importantly, the information gathered from the interviews. The chapter presents all the companies included in the project, even though two of them do not follow the indirect path of FDI. Furthermore, a presentation of the region and its potential is made in accordance with the view of the interviewed persons.

Each company presentation is divided into three parts. Firstly, a presentation of the company is made, which has been collected both from primary and secondary data. Thereafter, an overview with both the Hungarian and Romanian subsidiaries are presented, based on the interviews conducted.

### 5.1 Case Companies Following the Indirect Path

A presentation of the companies, which have been established in the CEE countries by using a platform country, follows. These companies have firstly established in Hungary and then expanded to Romania.

#### 5.1.1 Sandvik

The interview with Sandvik was conducted with Mr. László Józsay, Sales Manager for Coromant Products and Mrs. Zsuzsanna Döme, Administrative Manager, at the Hungarian subsidiary.

##### 5.1.1.1 Company Overview

Sandvik has developed into a global company and it is a high-technology engineering group with advanced products and a world-leading location in three core areas. These areas of concentration are; firstly, the *Tooling business area*, which concentrates on tools and tooling systems for metalworking applications. The customers within this area are mainly automotive and aerospace industries. The second area is *Mining and Construction* that focuses in rock-working equipment and tools utilised in mining and civil engineering globally. The third area of concentration is *Materials Technology*, which develops primarily products in stainless steel, particular alloys and resistance heating materials plus process systems. Within this area, the main customers

are in the industrial segments. The Group is represented in 130 countries and annual sales amount to about SEK 50 billion. The head office is located in Sandviken, Sweden and the main business concept is to develop, manufacture and market highly processed products that add to enhance the productivity and profitability of their customers. Growth is the main focus and sales have almost doubled during the past five years (Sandvik AB, General presentation, 2003).

#### *5.1.1.2 Hungarian Market*

At present, the Coromant and Rock Processing division are present in Hungary. Sandvik first entered the country in 1984, by establishing a representative office with three Swedish representatives. The main task at that time was to be present in the country and investigate further business possibilities. In 1991, the representative office was turned into a subsidiary and developed in all directions. Later on in 1997, the subsidiary established well and moved to its own office building. The capacity of the Coromant division has become stronger and stronger every year, starting from HUF 900 million up till HUF 2 billion today. Currently, the subsidiary involves 6 sales engineers and 13 technicians; altogether the subsidiary has 34 employees. The main customers usually are global companies; therefore there is a strong technical partnership with multinationals such as Audi, Siemens, Opel and General Electric Power Systems. The main Hungarian customers are from the diamond moulding industry and automotive industry. New solutions for the customers are usually provided every six months, therefore, strong communication with customers is normally maintained. When dealing with clients a major emphasis is put on branding and the well-known name of Sandvik is usually respected and trusted.

As a result of the fact that the subsidiary is oriented towards delivering solutions, great emphasis is put on pricing and technical issues. Furthermore, the main strategy of the company is to show to its customers the potential savings when dealing with Sandvik. Therefore, each time a business plan is made that clearly shows in which way the customers can save by choosing Sandvik instead of other companies. Even though, the prices are not the lowest in the market, customers gain a lot since Sandvik present additional opportunities tied to their equipment. This process however, requires a huge effort due to the rapid development of technology and competition. One must also note that the general strategy of the company is to provide ongoing

solutions by maintaining the value level and not by offering discounts. Generally speaking, this represents a competitive issue since other companies offer very generous discount programs.

Currently, the subsidiary has full decision-making power, when considering the Central and East European market. However, they still report to the headquarters of Sandvik AB in Sweden. The subsidiary believes in its Swedish identity, however, in the Hungarian market, local administrative knowledge is very much appropriate. It should be emphasised that there is a difference between the Hungarian and Swedish business mentality, therefore, though a Swedish company, the affairs are conducted in a Hungarian way. This fact allows for a better understanding of the customer and the general local environment. Moreover, training is organised by the Swedish parent company about four times a year, as well as general conferences for the industrial segment.

The production of Sandvik is situated in Sweden and the US. Special tools are produced in these two countries as well as in Germany. When analysing the stocks logistics this is a special chapter of the strategy. There is no stock in Hungary. Therefore, when there is a request from a customer, the warehouse in Rotterdam, Holland, is approached. This warehouse holds approximately 25,000 items and covers Central and Eastern Europe. The other warehouse is situated in Asia. Usually 98% of deliveries are conducted within 48 hours and there is a big emphasis on time value. Since the “just-in-time” concept is gradually disappearing, this is more convenient from the financial point of view as capital is involved in other activities such as research and development or value added. At present the company has 24% of the Hungarian market share and increases it every year by one percent.

#### *5.1.1.3 Romanian Market*

A small part of Sandvik’s business in Romania is handled from Hungary. This is the part of equipment for mining, where the Hungarian subsidiary is responsible for the marketing and sales also in the Romanian market. In order to facilitate this, a distributor has been used since 1998, which reports to the Hungarian organisation. However, currently, Sandvik Coromant is also present in Romania with a distributor status. One must also note that the company

emphasises that a distributor status is not very much appreciated, since the goals of the distributor are more important than the goals of Sandvik. In such a way, Sandvik's brand name can be affected since these distributors do not have any appropriate training by the parent company. The selling activity, however, is better developed in Romania than in Hungary. The Coromant brand is well known in Romania, since even during the Communist era it was highly used in industry, due to the high industrial capacity of Romania.

When analysing the Romanian market, the company believes that by 2006 they will establish a subsidiary there. The appropriate way of entering the market would be via the Transylvanian region, utilising the Hungarian speaking population.

### **5.1.2 SCA Hygiene Products**

Information regarding SCA Hygiene Products activities in Hungary and Romania was collected during an interview with Mr. Geza Nagy, who is the Commercial Director of the Hungarian subsidiary as well as responsible for this subsidiary's business in Romania. Email correspondence was also conducted with Mr. Alexandru Vasiliu, at the Romanian office.

#### *5.1.2.1 Company Information*

SCA Hygiene Products is the largest business area within the Swedish SCA Group. The SCA Group is an integrated group of companies, which produce absorbent hygiene products, corrugated packaging and graphic papers. In 2002, net sales amounted to €9.6 billion and SCA has approximately 43,000 employees in 42 countries (SCA Hygiene Products, Facts and figures, 2003).

SCA Hygiene Products is a global company, which is involved in the development, manufacturing and marketing of hygiene products. The company's products include – e.g. toilet paper, kitchen towels, handkerchiefs, napkins, baby diapers and incontinence care products. The most well known brands comprise Edet, Libresse, Tork and Libero. Customers range from large international retailers to industries, restaurants and hotels. The company employs 18,800 people in 42 countries and had a turnover of €4.9 billion in 2002 (SCA Hygiene Products, Facts and figures, 2003). In Central and Eastern Europe, SCA Hygiene Products has developed market positions for its

Consumer Products division. Products are available in thirteen countries. The company is organised in geographical regions. One of these regions is the “new” east market, covering Hungary, Poland, Czech Republic and Slovakia. However, former Yugoslavia, Romania and Bulgaria also are included in this region. The consumer division is governed from Vienna, Austria whereas the hygiene division is governed from Hungary.

#### *5.1.2.2 Hungarian Market*

In 1985, SCA Hygiene Products first established a presence in Central Europe, more precisely in Hungary. At that time, the Hungarian legislation allowed foreign companies only to enter the market via joint ventures with the state, and they then had to have the majority of the shares. As a consequence, this was also the case for SCA Hygiene Products. When the company entered the market, they were the first to offer high quality products.

The Hungarian market is the only one where SCA Hygiene Products are in a leading position in all their brand names. Currently, the Hungarian subsidiary is fully owned by the SCA Group and it includes approximately 200 employees. The activities present are sales and packaging. Previously there was also a production facility; however, it was recently removed to Slovakia and Australia. The reason for this may be that the EU entrance and harmonisation of the market create difficulties in production – e.g. an increase in labour wages.

When it comes to decision-making, there is a regional manager in Warsaw, Poland, who reports to the regional office in Munich, Germany. Moreover, the board at the Swedish headquarters makes the strategic decisions such as expansion. Within this business segment, there is an overcapacity in Europe, and the only way to grow is via acquisitions. However, the Eastern European market is considered to be different, since it is growing itself. With the EU entrance, new possibilities are expected to appear in terms of pricing and the tax system, which will lead to a more business friendly environment.

Furthermore, when considering competitors, a few local producers are present. However these are no major threat. A big competitor in other markets, Kimberly-Clark, has no subsidiary in Hungary, only a representative office. This partly explains why SCA Hygiene Products is number one in the market.

Considering the stock logistics, the Hungarian Kft. function as an International Distribution Centre serving the new east area, i.e. the company has a large warehouse for stock of certain products. However, a few products are sent directly from production in Sweden and Germany.

The subsidiary strongly believes in its Swedish identity, which is empowered by trainings and Swedish representatives present at the Hungarian subsidiary. Moreover, there is a belief in a close relationship between the Hungarian and Swedish business styles. One of the key success factors of the Hungarian subsidiary is the fact that it was established so early and then managed to establish itself in day-to-day life. The subsidiary is also working very hard on maintaining the brand of the company by developing trust, credibility and in time payments.

#### *5.1.2.3 Romanian Market*

SCA Hygiene Products consumer division has a representative office, a consumer products office, in Bucharest, Romania, which was established in 1996. The division at the subsidiary in Hungary, AFH Tissue, is selling products in Romania via a dealer in Bucharest. This dealer does not have exclusivity contracts since SCA Hygiene Products believes they are counterproductive and the exclusivity directly influences the brand name of SCA. Usually, the request for products comes from Romania, and there is a great interest in obtaining their products. The main responsibility of the Romanian representative office is distribution co-ordination, pricing and profitability, brand and trade marketing as well as the logistics and supply chain. When it comes to decision-making, the Romanian entity reports to a regional office in Vienna. Furthermore, the decision to expand into the Romanian market was a joint one, by both the Swedish headquarters as well as the Hungarian subsidiary. The Swedish headquarters were interested in a geographical expansion, and had a mid-to long-term perspective. The Hungarian subsidiary had more of a short-term perspective since their aim was immediate revenue gains. Before to the establishment of a representative office in Romania, the market was handled via imports from the Hungarian subsidiary. There were, however, several distributors in the market that bought from either the Hungarian International Distribution Centre or directly from



factories. Nevertheless, it was the SCA Export Manager in Budapest, which coordinated the business.

When serving the Romanian market most of the products are imported directly from factories in Europe, such as in Slovakia, Austria and Germany or taken from the Hungarian stock. Furthermore, the Romanian market is much bigger than the Hungarian one, and it is considered to have great potential. Currently, SCA Hygiene Products have approximately 10-15% of the market as a sum of all the categories in which they compete. The Hungarian subsidiary has at present no direct influence over the activities in the Romanian market. However, they may have an indirect effect due to some spill over effects from the Hungarian TV advertising within the Transylvanian Hungarian minority. For example, if prices are low in Hungary as a result of a “war” between two manufacturers or two retail chains, there may be some parallel imports in Romanian regions close to the border.

Previously, SCA Hygiene Products in Romania experienced some problems with payments for the products. However, this is not a problem today since there is no longer a lack of capital to finance the business and cash flow, or problems across distribution channels. However, many other companies are known to have great problems in this area.

### **5.1.3 PlymoVent**

The interview with PlymoVent was conducted with Mr. Bagi Gábor, Managing Director of the Hungarian entity, AC PlymoVent Kft. as well as for the Romanian one, AC PlymoVent Romania s.r.l.

#### *5.1.3.1 Company Information*

PlymoVent is a leading manufacturer and provider of service in source capture ventilation from start to finish. They identify applications, provide projecting and install the solution. The mission is: “to diligently work for continuously more effective, more economical solutions for Clean Fresh Air and a productive harmony between environment, man and machines in the industrial society”. Furthermore, PlymoVent plans their strategies in relation to market sizes. They have five big markets with wholly owned entities in France, Great Britain, Germany, the US and Canada. The rest are small markets. Hungary is

one of these, however, it is the biggest one of these small. The head office is located in Malmö, Sweden and it manages exports worldwide with a well-established distribution network, which covers over 30 countries. Development, construction and manufacturing are situated in Lycksele, Sweden (PlymoVent, About Us, 2002). The company is considered “Micro” in terms of its size, labour and turnover. Moreover, the business area in which it is active is considered a special one, due to its orientation on special segment dealing, not general ventilation matters but more sophisticated ones. It is based on an at-source construction base, oriented to plants, metal industry, car repair shops and fire departments.

PlymoVent offer solutions for Clean Fresh Air in various areas. The *Industry product* assortment solves air pollution problems in all kinds of manufacturing together with demanding *Top Grade* solutions. The Top Grade products are designed to meet the challenging needs of the pharmaceutical, chemical and food processing industries. The *Vehicle Exhaust* assortment abolish exhaust emissions wherever vehicles are run indoors. Moreover, the *Fire House* systems assure Clean Fresh Air in fire- and emergency vehicle stations. Within this last segment, PlymoVent is considered to be number one, however, it is a small market and, therefore, it generates more honour than revenue. In all of the mentioned areas, the company presents projecting, sales, installation, service and maintenance and guarantee from one single source (PlymoVent, About Us, 2002).

#### 5.1.3.2 *The Hungarian Market*

The Hungarian market was entered by a joint venture, with a majority of more than 50% by the Hungarian company with which PlymoVent joined. Initially the Hungarian company was known as HBC, which had specific suppliers from Sweden. They were supplying the Hungarian market with ventilation and heating systems from Sweden and Germany. In 1989, the company started their cooperation with PlymoVent, whose owner at that time followed a basic concept of being an industrial “supermarket” supplier. They made general supplies to industries that were a big mixture of goods in different product ranges and branches. The process ventilation started in Hungary with a limited amount of suppliers in the market, and there was a minimal local production at that time. In 2000, PlymoVent took the decision to take a considerable part of

the shares in the company. As a result of this, PlymoVent got the opportunity to start operations in Central Europe and the Hungarian company got a supplier directly behind them. However, there was limited decision-making from the Hungarian company's point of view.

Currently, there are 7 employees in Hungary and there is a small stock of goods. The stocks are planned by considering new customers future demands. However, this is hard to predict due to the specific nature of the business and it is always hard to have the right quantity. The business is also highly project oriented. There is a great pressure to start production in Hungary due to high costs and logistic problems when having to transport everything from Sweden. The problem of transportation concerns the size of the products offered, since it involves parts that need to hold large amounts of air. When this will start is unknown. The company has a full level of control. However, the managing director reports to the board and shareholders in Sweden. At meetings the annual reports are presented as well as the ongoing activities. The managing director is highly affected by the decision making in Sweden but the majority of the decisions are made in Hungary and the managing director has full responsibility for finding and making contacts with new companies. The cooperation with the Swedish headquarters is going well and PlymoVent believes that working with Swedes has been a great success, due to mutual respect.

Furthermore, PlymoVent also has a big joint venture in Russia, with a production facility and about 200 employees. Due to this fact the Hungarian company will not consider expanding to this area, since countries such as Ukraine will be handled from Russia, due to cultural similarities. Moreover, Ukraine is also considered as a very unpredictable market due to criminal development. Considering this region, Moldova is also a potential target, due to its similarities to the Romanian culture. However, when considering this expansion the most important factor is capital.

#### *5.1.3.3 Romanian Market*

It was due to the initiative of the Hungarian entity that they expanded into the former communist countries. However, the parent company in Sweden had had this idea for some time. The first steps taken were exhibitions. However, the

Hungarian entity acquired one of the most important companies in this branch, and then PlymoVent was seeking a deeper cooperation. Currently, there is one employee in Romania and this employee has a representative status. Initially this person was found via personal investigation and personal contacts in the Hungarian community in Romania, in the Transylvanian region. However, the Hungarian company was not fully satisfied with this person and he was replaced with another one. The Romanian representative office was first situated in Tirgumures, which is situated in the Transylvanian region. However, the company did not feel they were successful from there and moved their operations to Bucharest at the start of 2003, forming a legal entity, an SRL (company with limited responsibility) in June 2003. The Romanian entity is supplied via the Hungarian stock. There is however a stable plan in that the market is big enough to have a stock of its own.

The Romanian market potential is considered to be small as a result of the small segment in need of PlymoVents products and due to the fact that it is dependent on manufacturers. The market was chosen to be entered since it has great potential and the rapid modernisation of infrastructure and industry. Moreover, the main clients in Romania are the ones that PlymoVent conduct business with in Hungary. One major problem with the Romanian market is that it is still corrupted. However, the corruption is seen to be more manageable than in other former Soviet republics, such as Ukraine. PlymoVent suspects some corruption in their own operations, but it is not considered to exceed the current “standards” of corruption in this region.

#### **5.1.4 Tetra Pak**

The interview with this case company was made with Mr. László Honéczy, who is the Planning and Export Manager of the Hungarian subsidiary. Moreover, the information regarding the Romanian activities was collected via email with Mrs. Catalina Siriteanu, Marketing, Communications and Environment Manager at Tetra Pak Romania, Bulgaria and Moldova.

##### *5.1.4.1 Company Overview*

Tetra Pak started in the early 1950’s as one of the initial companies, which packaged liquid milk. Today it is one of the largest suppliers of packaging systems for milk, drinks, fruit juices and several other products. In 1991, the

company also extended into liquid food processing equipment, plant engineering and cheese manufacturing equipment. Currently, it is the only international company, which is able to offer integrated processing, packaging and distribution line and plant solutions for food manufacturing (Tetra Pak, The Company, 2003).

In 1991, Tetra Pak acquired Alfa Laval, which is one of the world's largest suppliers of equipment and plants for the food industry, processing industries and agriculture. The acquisition resulted in the Tetra Pak Alfa Laval Group. However, Tetra Pak and Alfa Laval's activities continue to be carried out separately by the two companies. In 1992, the organisation increasingly restructured and in 1993, the company obtained the name Tetra Laval. The new Tetra Laval Group consists of four industrial groups; Tetra Pak, Tetra Laval Food, Alfa Laval and Alfa Laval Agri. Tetra Laval Holding Finance is responsible for overall financial control over the Group and Headquarters is in Lund, Sweden. At present, Tetra Pak is regionalized into four regions; Tetra Pak Europe, Tetra Pak Central Asia/Middle East & Africa, Tetra Pak Asia/Pacific and Tetra Pak Americas, which all have regional headquarters in order to serve local needs. Tetra Pak has 77 marketing companies around the world, 59 packaging material plants including licenses and 12 packaging machine assembly factories. The company's products are sold in more than 165 markets and it has 20,150 employees. In 2001, the net sales were €7.65 billion (Tetra Pak, The Company History, 2003).

Tetra Pak is built on a so-called "Market Company Structure", which means that every country, or sometimes groups of countries if they are small, has its own structure, administration. For example, Tetra Pak has a Market Company in Hungary, Tetra Pak Hungary Ltd. and there is also one in Romania; Tetra Pak Romania Srl.

#### *5.1.4.2 Hungarian Market*

The factory in Hungary was officially finished in 1992 and production started in 1993. The entrance was via a green-field investment and since 1996, it is the leading company in Hungary. It is growing on a yearly basis and at present stage 1.5 billion packs are produced. The factory is oriented around Tetra Brick packages with two types of imprints. The subsidiary consists of 135 employees

and is divided into two parts. The first is a factory, which deals with production related operations such as design, production related tasks and sales administration for exports. The other is the marketing division, which is responsible for sales, finance and human resources. The products are exported to the Czech Republic, Poland, Romania, Bulgaria, Croatia, Slovenia and Germany.

The staff includes Swedish representatives in positions such as financial director, technical director, etc. The equipment in the factory has been sent from Sweden. When looking at the market share in the juice segment Tetra Pak is the leader, competing with Combi Block. In the milk carton segment, it is alone. When analysing the decision-making procedure, the world market is divided into clusters. Therefore, Hungary is in the Central and Eastern European cluster. The head of this cluster is situated in Switzerland and the managing director of the Hungarian subsidiary is reporting to this office. However, the managing director of Hungary has a high level of decision-making power due to market knowledge and experience.

#### *5.1.4.3 Romanian Market*

The Romanian market was entered in 1993 by an establishment of a subsidiary as a part of the company's regional development strategy. The presence in Romania consist of a Local market company; Tetra Pak Romania Srl. This company is responsible for the marketing and technical service of Tetra Pak in Romania as well as for the search of new customers and for making contracts between the Hungarian packaging factory and the Romanian final producers. The Romanian market is provided only with Tetra Brick. Therefore, they are forced to import other types of packs from countries, such as Russia. The Tetra Pak factory in Hungary supplies the Romanian market, among others, with packaging material.

The company perceives the Romanian market as a market with great potential, since there are approximately 22.5 million inhabitants. Even though, the purchasing power is low currently, this is gradually increasing and the population is open to a new and modern way of life. As a result of this, Tetra Pak Romania is very optimistic about the future. Furthermore, the Hungarian company has no direct investments in Romania; it is the Headquarter in

Lausanne, Switzerland, which is responsible for the European region, which plans the investments. However, the Romanian Market Company is responsible for its own business growth.

At present, there is a plan to expand production to Romania and move some of the production facilities from Western Europe to Hungary, which then will extend the Hungarian production activities. In such a way, factories in Western Europe will focus on newer and more sophisticated types of packaging. As time passes, with the market and technology development, it may be that the simple production of Tetra Brick will be moved to Eastern countries, thereby allowing Hungary to also focus on more sophisticated types of production.

### **5.1.5 Intrum Justitia**

The main information on this case company is based on an interview with Mr. Miklos Volner, Sales Manager at Intrum Justitia in Hungary.

#### *5.1.5.1 Company Overview*

The company is the leader in Europe, within the area of Credit Management Services (CMS). CMS handles the process, which begins when an invoice is issued and ends when the receivable is paid. Intrum Justitia offers wide-ranging services, which enables them to support their clients all through the process, by considerably improving the client's cash flow. These services are primarily grouped in three service lines: Sales Ledger Services, Consumer Collection & Debt Surveillance and Commercial & International Collection. Furthermore, the company purchases receivables, which have been written off; Purchased Debt services, as a channel for creating cases for its consumer debt collection operations. In addition to this, as a result of local client demands, a range of CMS-related services are offered. The overall objective of the company is to continue to be the leading provider of receivables management services in Europe and to make every effort to considerably improve its customer's cash flow and long-term profitability by providing high-quality services to both clients and debtors in all local markets. Intrum Justitia employs approximately 2,900 people and revenues amount to about SEK 2.8 billion (Corporate Governance Report, 2003).

The parent company moved its base and head office from the Netherlands back to Sweden in 2002. Currently, Intrum Justitia's operations are separated into seven regions and business is conducted in 21 countries with over 80,000 clients. The organization intends to focus locally on clients and debtors, build up regional synergies and to make use of European best practices. The credit management business is local and, to some level, regional. Therefore, the company considers it to be imperative to be situated geographically close to clients and debtors, in order to provide services in accordance with local customs, laws and regulations (Organization Report, 2003).

Intrum Justitia is divided into two main operational areas. Firstly, the international, which is involved in the communication between agents and offices in Europe, as well as collection reports. Their task is not, however, primarily to be debt collectors. Secondly, there is the domestic area, which further involves two groups; consumer and commercial. Consumer is oriented towards individuals and commercial dealings with business-to-business cases.

The company offers what may be described as a package of services, which enables clients to decide the amount of involvement of Intrum Justitia in their activities. At the first stage, Intrum sends an invoice of the payment day, using the clients' company name, not its own. Secondly, they may interfere in the debt collection process but in this case, they use the Intrum Justitia brand name. This service is also related to field inspections, the purpose of which is to pursue the debt collection and obtain information about the debtor. Finally, additional services are available, such as legal consulting and processes, in cases where the debtors do not pay.

#### *5.1.5.2 Hungarian Market*

Intrum Justitia entered Hungary in 1993 and currently the subsidiary is fully owned by Intrum Justitia AB. Two Swedish entrepreneurs, which then had 49% of the shares, founded the company. At that time the company was the leader within this special segment of services. However, nowadays a few domestic and international competitors are present, such as Kasolvenzia Sigma and Creditexpressz. Nevertheless, these competitors focus on single company cases, whereas Intrum Justitia focus on providing solutions. Therefore if there is a need, they develop a new service and offer the customer everything they want.



This means that the company has the highest prices in the market, which are based on the high qualifications and competence of its employees. Clients also prefer Intrum Justitia due to its well-established name and reputation within this business field. Currently, it is hard for the company to differentiate their strategy since several other competitors have a tendency of imitating their services, therefore, there is a continuous struggle to increase market share. Moreover, Consumer collection and Debt Surveillance account for most of the revenue increase and earnings contributions.

The Hungarian subsidiary has 65 employees and approximately 40 field inspectors. There are about 3,000 clients in Hungary and many of these clients come from a customer base of multinationals, which are represented by Intrum Justitia's subsidiaries in different countries. In addition to this, the Hungarian subsidiary considers themselves a Swedish company and it has full decision-making power. They do, however, report to the regional manager in Sweden. This regional manager is responsible for the Central and Eastern European region that includes; Poland, Hungary and the Czech Republic. Moreover, the company is in continuous collaboration with the Swedish Chamber of Commerce that is present in Hungary.

#### *5.1.5.3 Romanian Market*

Currently, Intrum Justitia has an agent working for them in Romania and this has been the practice since 1999. As a result of this, the Hungarian subsidiary approaches him when they need contacts in the Romanian market. Nowadays the subsidiary in Hungary quite often receives cases involving Romanian debtors and the main Romanian activities originate from the Hungarian investors in Romania. Therefore the request usually comes from the Hungarian customer's side that wants to insure payments. In such a case, the Romanian representative is contacted due to the fact that he is familiar with the market and legislation. One must note that the same policy is used for all countries. Generally speaking, when considering cases involving companies from two different countries, usually the agents and representatives are found in a special book, which includes agents from all over the world. Today, there are about 2-3 main competitors in the Romanian market.

Currently, one of the founders of the Hungarian subsidiary is considering establishing a subsidiary in Romania, due to the fact that more international investors currently are present there. This fact however, does not necessarily mean that there is a lack of business ethics; since wherever there is business there are debtors. A couple of years ago, this was not the case since then the efficiency and the payment morale was not as high as it is today.

### **5.1.6 HL Display**

The interview at HL Display was made with Mrs. Timea Pesti, who is the Managing Director at the Hungarian subsidiary.

#### *5.1.6.1 Company Information*

HL Display is the world-leading supplier for the retail industry, present in 38 countries. They provide store solutions for areas such as the display of price, product and campaign information as well as on- and off-shelf merchandising. As a result of being present all over Europe, the company is capable of tailoring solutions to the needs of every individual market. Customers consist of all leading retailers and brand manufacturers. The company was founded in 1954; employs more than 900 people and in 2002; group sales were SEK 1,154 million. Global headquarters are situated in Skarpnäck, Sweden. Furthermore, innovation is the main driving force and a major success for the company is, for example, the Datastrip for shelf edge labelling that was patented in 1975 and currently is an industry standard. The vision is to be the principal supplier of merchandising systems in addition to the most cost effective supplier of in-store communication systems (HL Display, About HL, 2003).

#### *5.1.6.2 Hungarian Market*

HL Display Hungary Ltd. is an affiliate of the Swedish HL Display. The company presently handles two major areas; in-store communication and merchandising. In-store communication concerns how to maintain shelf organisation at major trading hours, at the same time as guaranteeing a full-face display yet at low stock levels. Merchandising deals with how the store presents clear and precise price and product information and an offer, which is understandable and structured for the customer (H Lundvall Display Hungary Ltd, 2003).

Previously, the company had a distributor governed from Sweden, which handled the Hungarian market. However, this distributor did not generate enough sales so a subsidiary was established legally in 1997, and operations started in 1998. Currently there are 9 people employed. When the company started their operations there were 2 employees. Today the company is one of the 500 fastest growing companies in Europe and the subsidiary is the leader in the Hungarian market within its segment. The present market share is 42% with a turnover of approximately SEK 26 million a year. Their main customers are usually multinational retail chains such as Tesco and brand manufacturers such Unilever and Nestle. When analysing the competition there are a few local competitors in the segment of metal work and printed material, these competitors are usually less expensive. However, the quality is also lower. When it comes to multinational competitors, the majority of them only have small offices in Hungary since HL is the leader and they entered the Hungarian market early with an aggressive strategy. The reason behind this was the rapid development of the Hungarian market and the big growth of the retailing industry. The subsidiary is responsible for neighbouring countries such as Romania and former Yugoslavian countries. The Hungarian subsidiary is also responsible for the Bulgarian market since they have no people or organisation there. There is a distributor in Greece, which has a distributor contract for Bulgaria. However, this person does not have distributor contracts with HL Display. There are plans for establishing a subsidiary in the country, which are continuously postponed since it is a big investment and the progress in the country is very slow. When it comes to decision-making, the Hungarian division has full power. However, they must follow a well-established yearly budget. Since the company is listed in the stock exchange it also reports its financial status to the headquarters. The communication between the parent company and the subsidiary is well developed with Swedish representatives visiting Hungary on a continual basis.

80-85% of the merchandise comes from Sweden, which is equipped with five factories. However, if there is a need of special design, it is locally produced. The subsidiary also keeps stock, which serves the neighbouring countries as well. Even though it affects the financial operations it, allows them to provide the necessary products in time. When looking for customers it is a shared responsibility. However, the emphasis is put upon multinational retail chains

since it allows large sales. These multinational companies, such as Unilever, Johnson & Johnson, Nestle, Tesco and Spar, are targeted since HL already has a great reputation with these companies as a result of previous business with them in other markets. Therefore, they receive high-quality value from the start as well as a price wise one. One must also note that small local chains are also served.

The famous Swedish identity is present. However, the subsidiary is highly adapted to the Hungarian market. The Swedish HL Display brand is highly trusted and related to high quality in Hungary. Generally speaking, one must also note that HL Display considers itself a multinational company with international experience. When considering the EU enlargement there is a belief that it will not impact the ongoing activities of the subsidiary. The only difference, which may arise, is from a customer point of view, since their buying may be more centralised.

#### *5.1.6.3 Romanian Market*

HL Display Romania started its operations in the Romanian market at the second half of 2002. Even though the company realises it is an unstable market, it is also evident that it is constantly growing. Due to its wide range of products, the company is able to satisfy the customer's needs in the market (HL Display Romania, 2003).

The managing director of the Hungarian organisation of HL Display is also the legal administrator of the Romanian company. She is responsible for both the Hungarian and Romanian market. Before there was a local presence in Romania, the Hungarian team of HL Display supplied the Romanian market with goods, which were produced in Sweden, and exported to Romania. However, in 2001 the Management group decided that it was time to have a local presence in the country. In 2001, a subsidiary was established in Romania with four employees via a green-field investment. The reason for this comes from difficulties in communication and their need to be present when deals are made with the customers. The Romanian entity is an independent subsidiary of HL Display, which is called HL Display Romania and a Romanian managing director manages it. It is fully owned by the Swedish parent company like the company's other subsidiaries. However, it is operatively reporting to Hungary

since the legal and administration tasks are governed from there. A special reporting chain is therefore created with Romania, with the Romanian representatives reporting to Hungary and the Hungarian subsidiary reporting to Sweden. The main responsibilities for the Romanian subsidiary are the same as for other subsidiaries; to grow and educate their market, establish the HL name and reputation in Romania and gain market share and profit. When entering Romania, the company focus was on the same clients as in Hungary. The general strategy of the company is to grow by offering new products and by expanding geographically.

When generally considering the Romanian market, an optimistic view was taken on the growth potential of the market. However, the speed of this growth in the retailing market was slow and disappointing. Even the multinationals from the retailing industry, which had said that they were going to enter Romania, postponed their plans. Even though the market is huge, only three hypermarkets are present. However, when conducting business in Romania no major problems are encountered except for a few cultural differences and bribing issues.

Moreover, the Romanian managing director and the team in general is highly important since they help with the local market issues and custom matters. Without this team, business would be even more difficult and slower. There is no stock at the Romanian subsidiary. However, there is a plan to establish one due to the small sized customers present in Romania, such as corner stores that require small quantities of products. Once a month the managing director of the Hungarian subsidiary visits the Romanian subsidiary and discusses strategy matters such as marketing, which are then decided upon together. When it comes to designs, all decisions are made in Hungary as well.

Despite the fact that several other Hungarian companies enter Romania via Transylvania, HL Display did not consider the Transylvanian region as an entry point since their major focus, as mentioned, is on big international companies. These company headquarters are situated in Bucharest since Romania is a very centralised country. One of the most developed retail chains in Romania is METRO, which comprises 15 stores and has its headquarters in Bucharest. Another reason for establishing in Bucharest is that the infrastructure in the rest of the country is inferior.

### **5.1.7 FoodTankers**

The information regarding FoodTankers activities in Hungary is based on an interview with Mr. Tamás Benke, Managing Director of the Hungarian subsidiary. He is also a member of the Board of FoodTankers AB and responsible for strategy development.

#### *5.1.7.1 Company Overview*

FoodTankers offers services in the form of tanker transport, logistical systems, know-how and training. Transport services are offered to the European food industry. Since the company covers a logistic system, it can offer local, regional, national and international traffic to customers more or less despite destination. The concept consists of full control over the logistic chain via their own drivers, trucks and tankers. FoodTankers vision is to be the leading food tanker transport company in Europe. Focus lies on customer benefit and they make possible contacts, trade and transport for people, companies and regions. The company has progressively developed a national and international presence via its subsidiaries in order to respond to the necessities of a local presence and increased efficiency (FoodTankers, Company presentation, 2002).

In 1955, FoodTankers, at that time known as RoadTankers, started as a transportation company, which worked for a Swedish factory in Karlshamn - Karlshamn AB. This factory specialised in alcohol production, but is currently producing raw material for industries. It also specialises in processing of raw fats and oils. Due to the nature of these products, the transportation required a specific type of technology providing sterile surfaces inside the tankers. In 1998, FoodTankers separated from the company and started to provide their services to other clients as well. At present the main transportation includes liquid foods. FoodTankers has its headquarters in Sweden, with subsidiaries in Hungary, Poland and Estonia. It is one of the biggest companies in their field in Europe and by far the biggest in Scandinavia. However in quality they are the leader. They have around 100 vehicles meant for this special segment and in this segment this amount of vehicles is large. There are 9 units in Hungary, 7-8 in Poland, 5 in Estonia and 75 in Sweden.

The reason for the company being famous for their quality is twofold; firstly they are high in quality since they do what they promise and deliver in time.

Secondly, the equipment is unique, with tankers made from steel with a special surface and thereby providing product safety. A major emphasis is also put on human factors, meaning the special education of drivers on how to transport the products and emphasising how important it is to know what has been in the tank and to clean it properly.

#### *5.1.7.2 Hungarian Market*

In 1999, the decision was made to enter Hungary and a wholly owned subsidiary was established by an acquisition of ProRemy Kft. Hungary was chosen due to fact that the company wanted to grow and since the Western European market was saturated, they looked at the Eastern European market, since it is growing. Hungary was the second country to enter in the CEE region after Estonia, and the reason for this was the country's rapid development, which was also easy to predict.

The former local employees were kept in the company and trusted for continuing the activities since the parent company thought these people knew the Hungarian market. Moreover, no one from the parent company was placed in the Hungarian subsidiary. One must note that when buying the company, the main reason was for obtaining market knowledge, not the equipment since it was of low quality. Therefore, equipment was sent from Sweden. The main strategy at this time was to build a company with a slow but stable growth, until Hungary joined the EU. In such a way they could face the competition of the Western market. The Hungarian subsidiary had full decision-making power, a fact that later proved to be a big mistake. Several questionable affairs were made and not reported to the head office. This could also be related to a lack of written reports on ongoing activities. On the other hand, the mistakes were also made by the Swedish side, due to the nature of their business culture and high trust of the Hungarian subsidiary. The difference also rose from the desire for income, since the Swedish company was thinking in long terms, whereas the Hungarian was thinking in short terms. Consequently, tax evasion and unpaid bills appeared at the Hungarian subsidiary. This may also be explained by the fact that the transportation business is burdened with heavy regulations, which are very time consuming and costly to fulfil.

In 2001, the Swedish parent company decided to appoint a new managing director, due to a lack of communication with previous employees. The new strategy focus was on quality and not on cost savings as in previous management. The new managing director previously worked for Swedish Match. Therefore, the hope was to bring in the Swedish business culture into the Hungarian subsidiary.

At the start, FoodTankers AB faced some financial problems due to the fact that their policy is to buy new trucks, not lease them, therefore reducing the possibility to decrease prices. This is understandable since they want to offer the highest standard possible. Competitors, on the other hand, focus on low prices. However, it is known that in this special segment of liquid food, the main interest is quality and time. Consequently, an emphasis was also put on empowering the brand of FoodTankers.

The Hungarian office currently has 9 trucks and 15 employees. However, in May 2003, a decision was made to send 15 trucks from the Swedish parent company to Hungary and register them there. This will mean that FoodTankers Hungary will be the biggest within their field in the country, since the main competitor has 6 trucks.

The Hungarian subsidiary has full decision-making power and legal independence and is only reporting the ongoing activities to Sweden. Moreover, the managing director is also involved in the strategic development of the whole Group.

#### *5.1.7.3 Romanian Market*

The company did have previous business activities in Romania in 2002, involving transportation of wine from Romania to Germany and occasionally Hungary. This activity ended due to unpaid invoices. It was, however, fully handled by the Hungarian subsidiary. Nevertheless, there are plans to expand to Romania via the Hungarian subsidiary but not during 2004. The plans for expansion will be carried out during the following months. When considering this expansion, contacts will be made with companies that need this special type of services. The only products in Romania today that requires this specific transportation technique are oils and wine. It is also important to note that there are no products of this kind, which are being imported to Romania. This is due



to the fact that vegetable oil and fruits are exported from Romania but never come back again. They only have ready packed goods. Since there is no production in Romania today in need of this kind of service, companies need to set up production in the country before FoodTankers can go there.

## **5.2 Case Companies Following the Direct Path**

A presentation of companies, which have established in the CEE countries directly, without the use of a platform country, will follow. These companies have established in Romania directly from Sweden, without any cooperation with the Hungarian entities.

### **5.2.1 Skanska**

The interview was conducted with a former Skanska employee; Anders Jönsson, who was the Managing Director of the project development unit of Skanska and who is still involved in winding up these activities in Hungary and Romania.

#### *5.2.1.1 Company Overview*

Skanska was founded in 1887 and started by manufacturing cement products. It quickly diversified into a construction company and within 10 years the company received its first international order. The company has played a key-role in building up Sweden's infrastructure including roads, power stations and housing. Growth in Sweden has been followed by international expansion. In the mid 1950's the company made a major move into international markets. Skanska's success can be attributed to technical competence and the ability to adapt to local cultures. This approach was used to enter markets in the Middle East and Africa in the late 1960's and Poland and the former Soviet Union in the 1970s. Currently the company is regarded as a local player in many countries (Skanska, About Skanska, 2003).

Skanska is divided into two different business units: Service and Project development and Construction services. The Project Development unit assumes, manage and develop a wide range of services, including IT infrastructure, within office buildings, production plants and real estate in general. Moreover, the company assumes responsibility for creating complete

service solutions, tailored to the core business of each client. The Construction unit is focused on housing and building construction and services related to road construction and civil engineering. The operations are intended to satisfy people's need for housing, work environments and communications opportunities. To facilitate the best possible solutions, Skanska offers its skills at all stages, from ideas and development to construction, in addition to operation and maintenance. In 2002, the company's turnover was around SEK 146 billion, and in 2003, they had approximately 6,000 employees. Primary markets are Sweden, the US, UK, Denmark, Finland, Norway, Poland, the Czech Republic, Argentina, Hong Kong and India (Skanska, About Skanska, 2003).

The main problem for Skanska today is that the company has a strategy of being present in markets in which the market share is great. The company decides if they want to enter the market or not and then buy the biggest companies in the market chosen. The traditional way is to send out someone to investigate the markets and then the expansion starts by acquisition. Skanska wants to obtain total control. At the start only a part of a company may be bought. However, the main aim is always and has already from the start of the deal been, to acquire the whole company. Skanska may cooperate in specific projects but not for a long time.

#### *5.2.1.2 The Hungarian Market*

Skanska first entered the Hungarian market in 1989 with the construction commission of the East-West Business Centre. The company used local contractors, which further used subcontractors. The whole project however was a joint venture between Skanska with 51% of the shares and a local bank, insurance company, the state trade organisation and the district in which the Business Centre was built. This kind of local partnership was very valuable and helped smooth the operations in Hungary a great deal.

At that time, the decision-making procedures were organised from Sweden and the Swedish headquarters were responsible for both the Hungarian and Romanian market. One must note however, that there were no ties between the two markets. Romania was always seen as being a kind of side activity; the main focus was on the Hungarian market.

Since 1990, Hungary has become highly receptive to investments, therefore attracting a lot of foreign companies. Moreover, when comparing Hungary with Romania, the political environment was more stable. When considering the establishment into Hungary a decision was made to screen the market for local competitors for the purpose of acquiring these. This process, however, took longer than planned due to the transition phase. The local competitors were considered as poor and not advantageous; therefore it was hard to rely on them. As time passed, the most suitable way to establish in Hungary turned out to be via acquisitions of a local firms, even though sometimes these acquisition did not provide too many fixed assets, it was the local knowledge of the market that had the highest value. A green-field investment was however also suitable in some cases, though in such a case the company needed to obtain competent employees, structure and contacts, which was often difficult.

Since 2002, it is only the Project development unit, which operates in Hungary. Due to a new strategy and vision of the newly appointed CEO, the construction activities were closed down. The two different business units had been working very closely together, and the project unit had used the construction unit for several projects. Therefore the result of the close down of the construction part resulted in the fact that the project unit no longer had any in house competence. Another reason for winding up construction operations was the size of the market, which was considered too small, and was not generating profits. Currently, the Hungarian market falls under Skanska Project Development Europe, and this part of the company's responsibility is to initiate, develop and run commercial real estate project, for instance office buildings and shopping centres/commercial buildings.

#### *5.2.1.3 Romanian Market*

When planning to invest in Romania, a decision was made to establish there through a green field investment. This in turn resulted in several problems due to the lack of knowledge about the market, lack of local networks, as well as qualified employees. However, the market was considered big enough and with enough potential, due to the changes in the country.

The actual entry in 1998 was made as a contractor for the EBRD, when developing a logistics park near Bucharest. A small office was established with

about 10 employees. The specifics of this entry constituted the fact that everything was planned from Sweden. There was no communication with the representative from Hungary, who were closer to Romania and had more knowledge about the region. The rationale behind this was the partnership with EBRD, which in this case were a strong party and a guarantor. The project was finished successfully, however, some problems were inevitable. Main difficulties were experienced due to an underdeveloped legal structure and a different business mentality. There were a few more projects planned; however these were delayed.

At the same time, the Hungarian subsidiary was considering entering Romania through the Transylvanian region. This was mainly due to the increasing number of multinational companies that were establishing in Romania. The main emphasis was put on these companies, which have had previous contracts with Skanska in other markets, since Romanian contractors were choosing local competitors. Nevertheless, in 2003, the decision was made to close down the office in Romania due to the new strategy of the company of only being present in big markets.

Currently, there are no plans to re-enter the Romanian market. There are several problems posed in this special market, which do not make it a high priority. For example, an area to start a project may look good on the map, however, it may not be that good in reality since it may be situated in a bad neighbourhood or it may be difficult to accept due to historical reasons.

These problems may be faced in other markets too, however, they are easier to detect and solve due to better knowledge of these areas. Moreover, the bureaucracy in Romania is considered to be very hard; the rules are changing continuously, which also results in difficulties. When it comes to corruption, it is still a big problem. The old structures in Romania have not changed to a great extent, and the only change is that they now have become private, since the former communist leaders today are the owners of big private companies. In order to overcome all these obstacles in the Romanian market, the only solution is to find good local partners, which Skanska did not do.

### 5.2.2 ASSA ABLOY

The information regarding this case company was mainly obtained from a telephone interview as well as emails with Mr. Lars Lilja at ASSA ABLOY in Sweden and emails with Mr. Geza Poka, Managing Director of ASSA ABLOY Hungary Kft.

#### 5.2.2.1 *Company Overview*

The ASSA ABLOY Group started in the Nordic region in 1994, as a spin off of Assa AB from the Swedish security company Securitas and an acquisition of the Finnish lock company Abloy, shortly after that. Thereafter, the Group has expanded via organic growth and additional acquisitions. Today, the ASSA ABLOY Group is the world leading manufacturer of locks and associated products. The company develops, produce and market mechanical, industrial, electromechanical and electronic locks in addition to hotel locks, fittings, exit devices and accessories. Crucial to the success is the experience of local requirements, business arrangements and distribution patterns. The ambition is to ensure security, safety and convenience for lock users all over the world. The whole ASSA ABLOY Group has 30,000 employees and annual sales of approximately €3 billion. There are more than 100 companies that operate in 40 countries, which means that ASSA ABLOY has a very strong global presence and holds more than 10% of the world market (ASSA ABLOY 1994-2002, 2002).

The organisation reflects three major regions; Europe, Americas and Asia Pacific. ASSA ABLOY Hospitality, the Identification Technology Group and Besam are organised in a separate business segment for Global Technologies, in order s to be able to respond more effectively to the opportunities of these specialised international markets. The Group is currently seeing the fastest growth in Asia, South Africa, South America and Eastern Europe. These markets have previously been small markets for locks and previously mainly local manufacturers that supplied traditional designs served them. The first former Soviet country that they entered was Estonia in 1994.

#### 5.2.2.2 *Hungarian Market*

ASSA ABLOY Hungary Kft is an ASSA ABLOY Group company and it markets and sells ASSA ABLOY products in Hungary. The Hungarian market

was first entered in June 2000 and the main reason for this was the Group's intention of developing a position in Hungary and to increase the high security products share. Moreover, the company wanted to supply the market with a comprehensive range of locks and locking systems for security, safety and control. The product segment in which ASSA ABLOY Hungary is active includes; mechanical locks, lock systems and accessories; electromechanical and electronic locks; industrial locks as well as door closers and door automatics. The entry mode chosen was a green-field start-up of a sales company and the future plans of operations are to keep this sales company. Currently, the Hungarian subsidiary has 5 employees and a turnover of HUF 166 million in 2003. The market is considered to be growing due to a growth in the construction area, which in turn is in need of high quality and security, a very slow development has however been faced. Geographically, the Hungarian market segments by channels, such as the retail market, the construction project market, the professional end users and system integrators, as well as OEM's. The Hungarian subsidiary does not in any way, function as a base for any other Central or East European country.

When it comes to competition in the market, it is very hard and price driven. The main competitors are locally based producers that are owned by lock groups, as well as professional lock distributor companies.

#### *5.2.2.3 Romanian Market*

ASSA ABLOY first established in Romania in 1997. The Group initially bought a distributor in Romania, which sold ASSA and some other ASSA ABLOY products in Romania. That company is today ASSA ABLOY Romania s.r.l. and it sells imported high-security products in the local market with ASSA and VingCard (hotel locks) as the most important brand names. After that, the Group bought the lock part of the state owned Urbis, which today is Urbis Security s.r.l. This company manufactures and markets locks and fittings. Finally, Urbis International s.r.l. is also present in the Romanian markets and manufactures hardware for windows and doors and sells it to other Group companies.

Business activities in Romania were present before ASSA ABLOY established in the market. However, the market was then handled from either Sweden or

from other markets in Western Europe. The reason why the company decided to establish in the market was because a business opportunity occurred when a former state owned company went up for sale. ASSA ABLOY grasped this opportunity and acquired it. This was considered as a great chance since in order for the company to develop, more direct control of the market was needed. Furthermore, as the company established themselves in the market, it showed confidence in the market as well as when a company is established in a market, it is able to provide greater service. By relocating lock manufacturing to lower-cost countries costs are reduced. Currently, the company considers Romania as a low-cost production base in Europe and ASSA ABLOY invests a great deal in the production and consider it a great opportunity for the company. The East European market is highly fragmented, with many small and medium-sized family-owned lock companies operating in the region, which in turn generate several possibilities for future restructuring and harmonisation.

### **5.3 Concluding Remarks - Activity in the Region**

During the interviews, special attention was paid to the reasons for choosing one country or another, as well as to the region as a whole. All interviewees had almost the same opinions on this matter. Furthermore, particular emphasis was put on the expectations of the EU accession and the fact that it will facilitate the business environment in a positive way. An interview with the Swedish Trade Council also gave a general investment overview of both Hungary and Romania, since its responsibilities include both countries.

Initially, the region became attractive for investments during the transition period. The majority of multinational companies have chosen the region for the purpose of an establishment and acquirement of a leading position in the region during the next few years. The internationalisation towards the CEE region was also motivated by the fact that Western European markets are already saturated whilst there is a potential for growth in the CEE region. Moreover, even though the region experiences low purchasing power compared to other markets, there is a strong belief that the market will grow considerably during the next ten years. The number of multinational companies increases on a yearly basis, which results in a chain reaction that attracts even more companies. In such a

way, these multinational companies that have business relationships in other markets may continue through cooperation into additional markets.

Hungary offers a favourable investment climate to motivate foreign companies to establish there. Moreover, the political, legal and economic environment is characterised as one of the most stable in the CEE region. In addition, the establishment procedure does not require a great deal of time or financial resources and the establishments are facilitated by special agencies such as Trade Councils or Chambers of Commerce. The Swedish Trade Council in Hungary assist with information regarding the market that the Swedish companies intend to invest in, whether it is Hungary or Romania.

The Romanian investment climate was described by the majority of the investigated companies as a very promising one. However, the major shortcoming concerns the slow transition pace. Several companies plan to establish in the market, but hesitate due to economic and political instabilities. In addition, there is a high concentration of foreign companies in the Bucharest region. This fact is understandable since the foreign companies that are there attract other companies. Furthermore, the transition process also results in changes in the legal and political environment. The legislation process in the country is experiencing ongoing change, a fact that impedes several multinational companies' decisions, when planning to invest. Furthermore, a strong establishment by a company in these countries allow it to expand its activities more easily into additional Eastern countries.

Hungary is considered as a special market, since it combines knowledge and habits of both Western and Eastern business cultures. This fact is mainly influenced by several foreign investors, which bring with them a business culture into the country that is implemented in the company. Hungary is furthermore considered as having a highly skilled labour force and previously also very inexpensive, however the wages are increasing. Moreover, Romania has an even less expensive labour force, which is highly suitable for less demanding production.

The main entry mode of small and medium sized companies in Hungary is via a joint venture, whereas big companies consider green-field investments. The joint venture preference is characterised by the desire to acquire knowledge



about the market. The green-field investment, however, is acceptable for companies that can afford the risk of such a great degree of involvement. There are also a high number of green-field investments in Romania, due to the poor production facilities currently present in the country, which give no great incentive for acquiring an old factory.

When observing the companies that use Hungary as a sort of platform country for their further expansions Eastwards, various companies mentioned the Transylvanian Region in Romania as an area to go through. The region has a large minority of Hungarians, which speak both Hungarian and Romanian. Hungarian companies trust the people in this region due to ethnic ties. Therefore the first step to entering the Romanian market is often made via this region. Another issue often referred to, for both countries are the under-the-table payments, which often speed up the decision making process, as well as the selection process in tender procedures. Related to this is also the high degree of bureaucracy, which requires a great deal of paper work and time. However, the above-mentioned situations are more often encountered in Romania than in Hungary.

Furthermore, the EU enlargement was also mentioned during the interviews. Generally, companies believe that the enlargement will bring about positive changes. Among the advantages pointed out were the free movement of goods, harmonized customs and tax barriers for trade as well as structural funds for infrastructure development.

As one may note from the presentation made, the case companies follow different ways of establishment in the region. By using the existing theory and the regional overview, an analysis is made that explains why certain decisions were made and how these decisions facilitate the business activities in the region.



## **CHAPTER VI: ANALYSIS AND DISCUSSION**

This chapter presents the reader with an analysis and discussion, which is based on the empirical findings and the relevant theory. It explains and analyses the decisions and actions that were taken by the case companies when they entered the CEE region. Firstly, an overview is given from a macro perspective, which provides the indirect and direct path of internationalisation. Secondly, an explanation follows of how the markets were entered and why certain entry modes were chosen. Finally, a network perspective and its impact on the foreign market entries are presented.

### **6.1 Macro Perspective of Investments**

According to the empirical data, companies focus on the internationalisation opportunities, ownership advantages and location for their investments. Because internationalisation and expansion are methods for organic growth, all the companies investigated have emphasised an establishment in the new markets during the last ten years. The reasons for this were mainly a higher degree of competitiveness as well as the goal of acquiring a leading position. The actual establishment and presence in a new market provided the companies with an advantage over their competitors, which in several cases were only represented in the market via selling activities. In such a way, the presence in Hungary gave the investing companies the possibility to focus not only on the local market, but also on the region as a whole. This fact, in turn, transformed Hungary into a platform for further growth, since as the empirical evidence have shown, after a while decisions were made to enter additional markets.

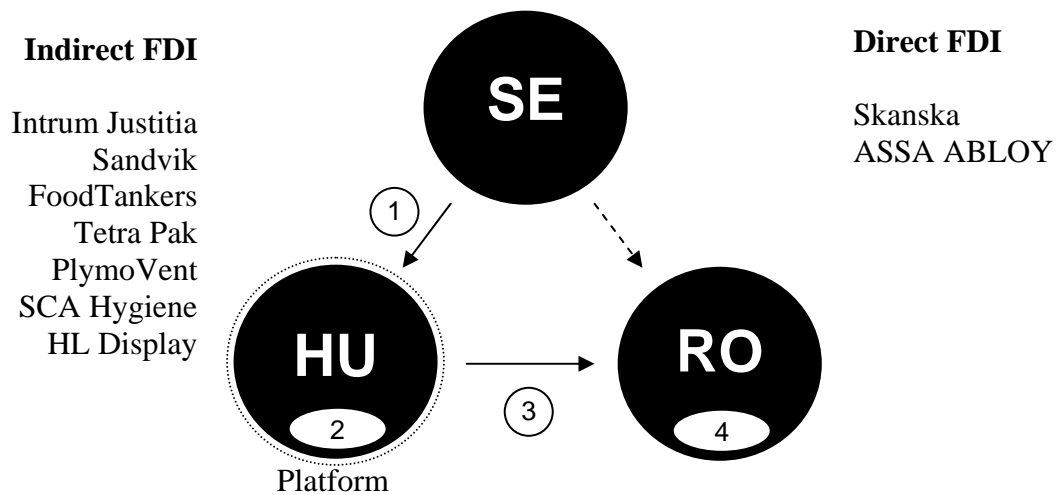
Nevertheless, after the establishment in the Hungarian market, one may note the ownership advantage, which is characterised by the dominance of resources and capabilities. This fact placed the companies in a better position when compared to the local ones and in some cases even foreign competitors. The empirical data also shows how each company brought specific foreign knowledge and technology into Hungary, in such a way differentiating its activities. Some of the input into the country may also be characterised by regular transfer of knowledge by organisational trainings for the employees as well as invitations to conferences outside Hungary. Apart from knowledge,

considerable technology as well as innovations was also brought into Hungary. With the future expansion, all these facts in combination with the Hungarian knowledge and technology will be further transferred to other markets and in such a way influence the development of those countries.

The choice of Hungary, as a market to enter, also gave the companies a competitive advantage. One of the main reasons why this country was chosen was the rapid development during the last ten years, as well as the great potential for further growth. Moreover, the geopolitical situation of the country gave the possibility to build a “bridge” between the Western and Eastern European markets. Hungary also has an advantageous position from a production point of view. Since an inexpensive and well-educated labour force is present; moreover, incentives in order to attract investment are also present. Consequently, a favourable investment climate exists. Additionally, one must also note the possibility to export products and services at a lower price from Hungary compared to exports from Western Europe.

### **6.1.1 Direct Path of FDI**

When deciding on establishment in the CEE region, companies consider different ways of entry, which influence the pattern of FDI. Some companies choose to enter a market without any previous knowledge, directly. That was the case for Skanska and ASSA ABLOY, which chose to enter the Romanian market directly from Sweden (see Figure 6.1). This type of entry is characterised by a higher degree of risk and market uncertainty. Skanska first entered Hungary. However, this entity was not considered when the Romanian market was entered. The decision was made at the Swedish headquarters without any communication with the Hungarian entity, regardless of this entity’s knowledge of the region. Moreover, the entry of Romania was in the form of a project with the EBRD as actual commissioner. This shows that even though there is a great risk and market uncertainty, a strong associate may influence the decision of establishment. Furthermore, the risks were also reduced due to the cooperation with the EBRD, which represent a credible partner.



*Figure 6.1: Companies following the Direct and Indirect patterns of FDI*

One must note, however, that as time passed several mistakes were made due to lack of knowledge regarding the local business culture. ASSA ABLOY followed the same pattern and entered both markets separately. However, in their case they were presented with a chance to obtain a formerly state owned company, which highly suited their criteria. The major decision to enter the market was made in Sweden. Considering the involvement of high technology in the security services provided by ASSA ABLOY, one might agree with this decision, since local competitors lack similar technology. However, unlike Skanska, ASSA ABLOY obtained local networks and local knowledge by acquiring an already existing company; therefore avoiding mistakes.

### 6.1.2 Indirect Path of FDI

The majority of the empirical findings are, however, focused on the companies that have entered the new regions gradually. As Figure 6.1 shows, seven companies entered via smaller steps and chose to enter Hungary first and then, after a while, Romania. The first actual step, entering Hungary, was motivated by the desire to establish in the region and have close access to the neighbouring countries. The time of entry differs from company to company. The first company to enter were Sandvik in 1984, followed by SCA Hygiene Products in 1985, both companies with an, at that time, obligatory joint venture with the state. Even though this was inconvenient for the companies' strategies, both companies wanted to establish themselves in the region with the hope of new developments. One must also note the specifics of the products provided

by these companies. Sandvik was dealing with high quality industrial supply, while SCA Hygiene Products provided the market with high quality hygiene products. At that time both types of products had little competition in the Hungarian market, therefore, the companies were able to establish and grow well in the market, before they started to export from Hungary. The company PlymoVent entered the Hungarian market later in 1989. The investment climate at that time was more favourable and several visible changes were noticed. The industrial orientation of this company also let it compete with local suppliers and supply high quality products that were designed outside Hungary. The strategic belief was also oriented towards a strong establishment in the country, which allowed for further expansion in the region. Tetra Pak entered Hungary in 1992, with a green-field investment and established a factory outside Budapest. Due to the specifics of Tetra Pak's products, the company did not experience any major competition from local producers, however Elopak is their main international rival. Tetra Pak has its own segment, which is liquid food, and at the entry time the company was certain that the food industry would develop fast. After a while, the company started to export packaging products to neighbouring markets.

Intrum Justitia entered Hungary in 1993 with its debt-collecting services. The company's strategy necessitates a local establishment in order to grow and offer services to the greatest extent. The company firmly believes that the need for their services will increase during the next couple of years due to the changing business mentality in the region. HL Display entered Hungary in 1997 and provided supplies for the retailing sector. Since this specific sector develops fast, the company had a strategy of substantial growth during the following years and then to expand its activities to the neighbouring markets. FoodTankers then came to Hungary in 1999 and provided services for the food sector. This company also had the ambition to grow fast, since the competition in the local market is low. The company plans to expand to Romania, via the Hungarian subsidiary, during the next couple of years.

Currently, all the companies have entered and are active in the Romanian market, except for FoodTankers, which is in the phase of entry preparation. This company previously had business activities in the country, which have ended. Moreover, all the seven companies that entered Romania via Hungary

have described Hungary as a place to grow – an incubator – in order to expand to additional markets and their increased knowledge about the region was used for this purpose. Furthermore, all these companies first created a joint venture, which was later, transformed into a subsidiary; except for Intrum Justitia, Tetra Pak and FoodTankers. Some of the Hungarian subsidiaries still have the decision-making power for the Romanian market, a fact, which also places Hungary as a platform for business. Almost all companies also have the status of being the region’s headquarters, and are, as a result, responsible for scanning the neighbouring markets as well as providing consultancy to the headquarters when regional issues appear.

### **6.1.3 The Use of Platforms – Concluding remarks**

The establishment in Hungary and the utilisation of the country as a platform resulted in the fact that the investigated case companies gained certain advantages. Firstly, the degree of market uncertainty of the whole region was diminished. Since the CEE region was an unknown market to enter, the companies chose Hungary as the country with the most potential since it had the fastest transitional development and most suitable geopolitical position. In such a way, they were able to enjoy the favourable investment climate, which was targeted to foreign investors. Moreover, the risks were also reduced, due to the fact that with establishment in Hungary, the companies had the possibility to learn about the region in general. This was done as time passed and by the employment of a workforce with local knowledge. This fact allowed for the understanding of the local customers behaviour as well as business conduct. Furthermore, by being present in Hungary, this also made the companies familiar with their competitors in both the local and regional markets. Consequently, when plans were made to enter neighbouring markets, existing competitors were also known. In other words, the companies were able to do their “homework” very thoroughly, when they were considering and planning for the new investment possibilities.

By using the Hungarian subsidiary for the entry of the Romanian market, the companies were given the chance to utilise the bilateral relationships between the two countries. Moreover, due to fact that both countries are to enter the EU, there is a harmonisation of rules and regulations in both environments. In such a way, the difference between the two markets is also decreasing. Furthermore,

this type of indirect investments into Romania, make it difficult to track the general FDI pattern. This is because even though the Swedish owned subsidiary in Hungary invests in Romania, the FDI is considered Hungarian.

## **6.2 Internationalisation Process**

One can see the decision by companies to engage in international expansion, as the desire to expand sales, acquire new resources, diversify sources of sales and supplies as well as minimize competitive risks. The expansion of sales was the main driving force of all the investigated companies when they entered the CEE region. By analysing each case, one can certainly note, that every company, regardless of the year of entry, wanted to establish well in Hungary and the whole region in order to increase their sales. This is, after all, a natural path of a company's growth.

Furthermore, internationalisation may be motivated by the acquisition of new resources. In the case of the Hungarian market, it is difficult to say that resources were acquired in terms of fixed assets. Some of the companies created joint ventures and later subsidiaries, since they were focused on acquisition of a certain local infrastructure or network as well as local knowledge. This fact is also crucial, since the entry into the new unknown market is difficult without a network of potential customers as well as suppliers.

However, when considering the diversification of sales and supplier sources, it is possible to note that these factors were very much considered when the region was entered. Due to the fact that the Hungarian market was a few steps behind in the development compared to other Western markets, companies were able to provide products and services more easily, due to low competition. Moreover, some of the sales were comprised of goods, which there was no demand for in other markets. This is also attributed to the services – e.g. Intrum Iustitia's services are to some degree, different in Sweden, mainly due to the conduct of business and the existing business ethics. When considering diversification of supplies from Hungary and the whole region, it is possible to argue that they were low, since all the companies, except for Tetra Pak, were oriented to sales not to production.



Considering the minimization of competition, it is also possible to argue that the case companies entered the new region in order to maintain their place in the competitive environment in the global market. They may also have followed some of the global competitors that have entered the CEE region. It is also possible to argue that the establishment in the region increases the companies' global sales share.

### **6.2.1 The Market Entry and Establishment Chain**

As the presented theory explains, all the investment decisions are highly influenced by the difference between the countries and consequently by the lack of knowledge about the new markets. When observing the countries involved in this research, it is possible to divide them into two sections, Sweden on one hand; and on the other, Hungary and Romania as part of a region. There is a considerable difference between these two, even though they are all present in Europe. Each country has had its own development and political characteristics, Sweden as a part of Western Europe, whereas Hungary and Romania belonged to the former Eastern European bloc. The two latter countries are, compared to Sweden, less developed since they are still under development in the transition towards well functioning market economies. Moreover, the difference also rises from culture, language, education, market preferences and conduct of business. Consequently, though all three belong to the same geographical region – Europe, the actual psychic distance between Sweden and Hungary/Romania is high.

However, even though Hungary and Romania are considered to be similar and are situated in the same region, there is also a great difference between them. Both countries have had different patterns of development both during the Soviet era and afterwards. As a result the countries vary in their current status of development. Even though they are neighbouring countries, there is also a difference in culture, conduct of business and market preferences. Nevertheless, it is possible to conclude that Hungary and Romania may be grouped together, and represent a high psychic distance for Swedish companies when entering these countries. In such a way, companies face considerable uncertainty and risk.

Several of the companies differ somewhat in their choice of entry strategy in the region. Firstly, Skanska and ASSA ABLOY chose to enter Romania directly, by an establishment of a representative office and of a subsidiary, respectively. These companies did not consider a gradual expansion into the region via other more favourable countries; therefore they did not use Hungary as a platform to grow from before the Romanian market was entered. On the other hand, the other seven investigated companies considered a gradual establishment in the region. Figure 6.2 shows the establishment chain followed by the companies when they entered the Hungarian and later the Romanian market. All of them took smaller steps and in the meanwhile learned about the Hungarian market and its neighbouring markets. The reasons for the companies' different choices of entry mode were diverse. Some companies entered first by exports to Hungary and later, as time passed, made an actual investment in the country by creating a joint venture or subsidiary.

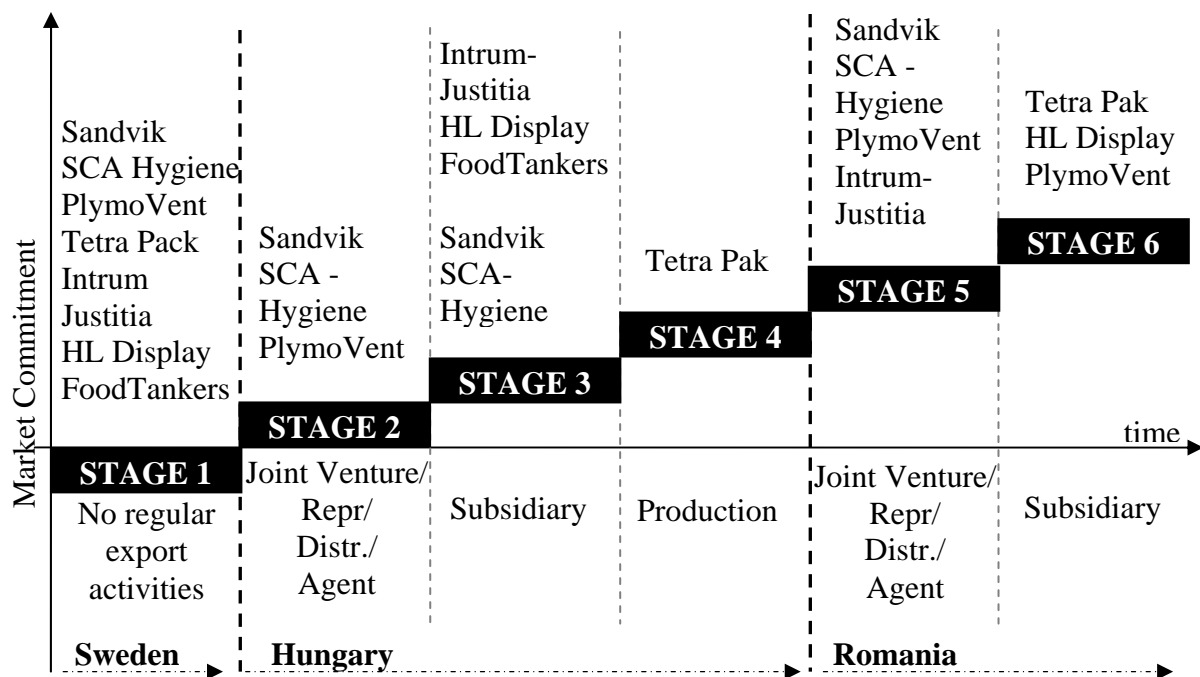


Figure 6.2: The Establishment Chain in the Hungarian and Romanian Market

Sandvik and SCA Hygiene Products were the first two companies to enter Hungary before its market liberalisation. Sandvik established a representative office, which was later turned into a subsidiary. However, SCA Hygiene Products entered via the obligatory joint venture with the state. Nevertheless,

with the market liberalisation, the companies were able to extend their investments and to create fully owned subsidiaries.

PlymoVent also followed the same path of an establishment of a joint venture in 1989. A joint venture was seen as facilitating an easy entry into Hungary, which at the time was a different and unknown market. In such a way, companies ensured that their brand was respected and the local part of the venture provided networks in the market. Later, when positive results were obtained, the Swedish side bought the rest of the venture and the Hungarian entity became a wholly owned subsidiary.

Intrum Justitia, HL Display and FoodTankers entered Hungary by an establishment directly with a subsidiary. Local employees were however enrolled, to ensure that knowledge about the market existed. The companies were motivated by ownership desire and an intention to grow fast in the market.

Tetra Pak was a company, which decided to enter via a green-field investment. Since the specifics of their production required all the equipment to be imported into Hungary, there was no need for acquisition of any old factories. A new factory was built, which produced packages for the CEE region and a marketing division was also established.

All the companies investigated thereafter went even further in their expansion since they started to export to the Romanian market and some of them made even further investments by the creation of subsidiaries in Romania. This additional entry took some time after the first entry to Hungary. However during this time the companies had the opportunity to learn about the Romanian market and its needs and preferences. In Romania, Sandvik, SCA Hygiene Products and PlymoVent, found their partners by representative or distributor contracts; and later on created joint ventures. Intrum Justitia, on the other hand, has a representative office, which is contacted when cases that involve both countries appear. Tetra Pak, HL Display and PlymoVent have shown even more commitment and have established fully owned subsidiaries.

As shown in figure 6.2, the pattern of these seven companies has gradual characteristics and represents an example of the classical internationalisation

theory, where companies, due to the low degree of knowledge and commitment to the market, decide to take smaller steps when they establish in a region.

When it comes to types international production, only two of the investigated companies are conducting this, namely Tetra Pak in Hungary and ASSA ABLOY in Romania. A market-oriented approach is the case in Tetra Pak's situation, since the main aim of establishing a production facility in the country was to serve the local geographical market as well as the closest neighbouring countries. However, when it comes to ASSA ABLOY, the aim of the establishment was to take advantage of the low-cost labour force, present in Romania. The cost factor is highly emphasised in this case and the facility is seen as a centre for low-cost production. Moreover, further investment in this market is also considered due to this factor. Furthermore, a development of increasing establishments of production facilities in Romania is to be expected. This is mainly due to the low-cost labour factor. Most likely, semi-skilled and unskilled manufacturing will be moved to the country, whereas countries such as Hungary will probably see an increase in more highly skilled production due to their relative inexpensive labour force within this area, compared to other European markets. As a result of this, the current low-skilled production facilities currently in Hungary might in several cases be moved to Romania.

### **6.2.2 The Market Commitment**

Companies' market commitments are characterised by the amount of resources allocated and the actual degree of commitment. In other words, the size of investments and the persistence the company manifests, symbolise the market commitment.

Table 6.1 presents the time dimension of the establishment in both Hungary and Romania. It shows when the companies first entered Hungary and which market entry mode was used; and more importantly, how long it took for the companies to make further commitments.

| Company         | Hungarian Market |             |      |      | Romanian market |               |
|-----------------|------------------|-------------|------|------|-----------------|---------------|
|                 | Year             | Mode        | Year | Mode | Year            | Mode          |
| Sandvik         | 1984             | REP         | 1991 | SUB  | 1998            | DISTR         |
| SCA Hygiene     | 1985             | JV          | 1991 | SUB  | 1996            | REP           |
| PlymoVent       | 1989             | JV          | 2000 | SUB  | 2003            | REP, then SUB |
| Tetra Pak       | 1992             | Green Field |      |      | 1993            | SUB           |
| Intrum Justitia | 1993             | SUB         |      |      | 1999            | AGENT         |
| HL Display      | 1997             | SUB         |      |      | 2002            | SUB           |
| FoodTankers     | 1999             | SUB         |      |      |                 |               |

*Table 6.1: The establishment chain in time*

Sandvik first established a representative office followed by a subsidiary in Hungary. SCA Hygiene Products went a step further, by creating a joint venture also followed by subsidiary. The rationale behind this was to first gain a greater understanding of the market by selling products. When some positive results were achieved, a joint venture was created, in order to obtain more control over the business and decrease the risks. Later on a subsidiary was created and in such a way, the companies showed an increasing commitment to the market. Moreover, the transfer of knowledge as well as financial and technical resources also increased. The companies also acquired new assets such as office buildings. When analysing the market commitment towards Romania, almost the same pattern is visible. SCA Hygiene Products established a representative office in the market and in such a way was present in the market, with a low degree of investment, which allows the Romanian entity to take care of their merchandise. However, Sandvik serves the Romanian market with distributors, which proves an even lesser commitment mode.

PlymoVent went a step further by the creation of a joint venture directly in Hungary. Event though the market commitment was still low, there is a difference when compared to previous companies and the joint venture decreased the risk. A small amount of resources were invested in the new venture. However, after a while the rest of the shares were acquired and a fully owned subsidiary was created. Considerable investments were made and new assets were acquired. The commitment towards the Hungarian market may be

characterised as medium but increasing. When entering the Romanian market, the same path of commitment may be observed. PlymoVent first had a representative contract followed by a fully owned subsidiary. The company has a low commitment to the Romanian market and prefers gradual growth.

Intrum Justitia, HL Display and FoodTankers went even further by the direct establishment of fully owned subsidiaries in Hungary. Significant investments were made in order to acquire new assets and a high commitment towards the Hungarian market is noticeable. The companies had high expectations when they entered the market, and the fully owned status gave them the possibility for independent decision-making. By observing the entry modes in Romania, Intrum Justitia has an agent and therefore avoids investments; while HL Display established a fully owned subsidiary and as a result, invested more. Still the market commitment may be characterised as medium. FoodTankers is still analysing its market entry strategy in Romania, however a subsidiary is considered.

Tetra Pak had the highest degree of commitment in the Hungarian market. The company entered via a green-field investment, which resulted in investments in new assets and a transfer of technology into Hungary. The entry decision may be motivated by the specifics of the company's production. When extending further into the Romanian market, they established a fully owned subsidiary, thus also presenting a medium commitment.

Skanska and ASSA ABLOY may also be characterised as having a medium degree of commitment towards both markets due to the establishment procedures; Skanska created a representative office and ASSA ABLOY a subsidiary. However, in Romania, ASSA ABLOY has a high commitment mode since they have a great deal of production there. However, it is possible to argue that the commitment towards the region is high, since both companies entered these countries independently, without considering a gradual expansion from Hungary to Romania.

Generally, it is possible to say that the companies investigated have a medium commitment towards the markets under focus. However, when looking at it more precisely, it is medium towards Hungary and low but increasing to Romania. This is explained by the high risks, which are usually mentioned in

the literature on internationalisation towards the CEE region. The risks are mainly related to the transition period process and the development of the market; but also to the changing legal environment as well as the political and economic instability. The low commitment in the CEE region also rises from the lack of knowledge about the market as well as the local conduct of business.

### **6.2.3 Market Knowledge**

Commitment decisions are based on the degree of knowledge a company has and the ability to evaluate opportunities in the market. Furthermore, when considering the time and experience the learning process involves, companies are able to dedicate more resources to the market.

Assuming a high degree of psychic distance between Sweden and Hungary as well as a lack of previous experience, the level of knowledge at the point of entry was low. The choice of entry mode was based on this lack of knowledge and the desire to learn. The companies, which chose to create joint ventures with local companies, did this in order to share the risks and to obtain access to the local networks. The local firms were a part of a greater network with certain market share, customers and suppliers. Employees also contributed to the learning process by delivering market specific knowledge, which in combination with general knowledge, made a perfect combination for an increase of market commitment. The choice of creating subsidiaries was a result of making more determined market decisions. The case of Tetra Pack, however, shows that even without market knowledge, a company may have a high commitment towards a market and establish a green-field production facility. This perhaps is due to the specifics of the production and the general knowledge available.

A presence in Hungary allowed the companies to learn about the region in general. This was a result of encounters with companies from neighbouring countries as well as local employee knowledge about the region. This was also the case in Romania, when this market was entered. However, the degree of psychic distance was lesser when the Romanian market was entered due to the proximity to Hungary, as well as the, at that time, greater amount of knowledge about the country. Moreover, as several companies mentioned, the

Transylvanian region was used for market penetration. The rationale behind this was similarities in culture and business conduct.

#### **6.2.4 Internationalisation - Concluding Remarks**

The companies analysed in this thesis have chosen to enter the CEE region gradually, considering their establishment in Hungary as a platform for further expansion. The entry modes that were chosen were believed to be the most appropriate ones, due to the high degree of risks. While growing in the Hungarian market, companies took advantage of the local environment, where they continuously learned and obtained experience. In Hungary, they were developing slowly with a medium degree of commitment towards the market and the region in general. Even though there is a psychic difference between the countries, it diminishes with the increase in knowledge.

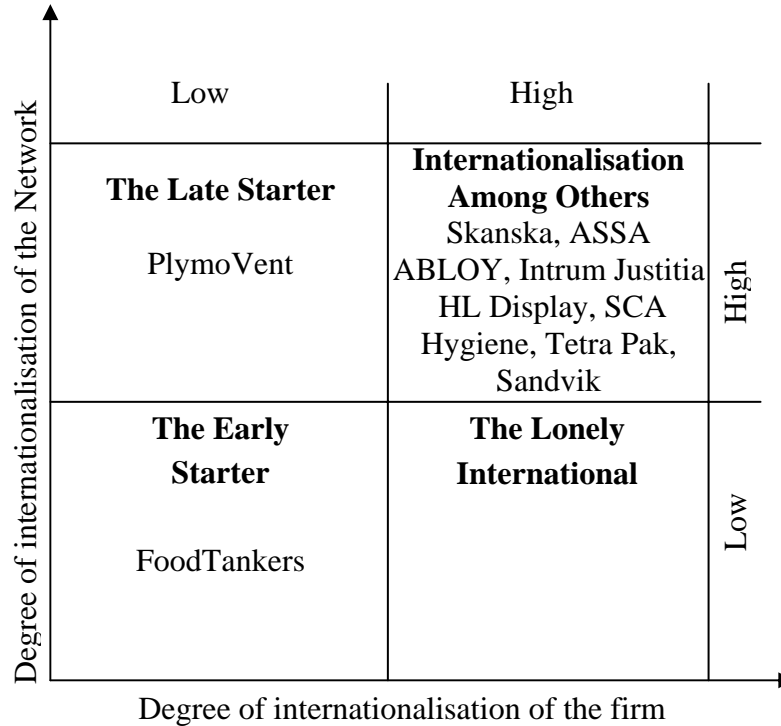
### **6.3 The Use of Networks**

As a result of internationalisation, companies establish and develop lasting business relationships with other companies in foreign markets. It is the networks that connect these business relationships where the parties build mutual trust and knowledge via interaction. The companies investigated in this study all have different business relationships and are part of different networks. Furthermore, their choice of foreign market entry, in this case Hungary and thereafter Romania, is not just a matter of changing institutional mode, such as from a distributor to a subsidiary. As mentioned before, in order for the companies to be able to succeed with this development, certain market knowledge as well as experience is crucial for the company's performance in the foreign market. This crucial market knowledge and experience is gathered via the companies' business relationships and the activities that result from these. The market knowledge is developed gradually via interactions locally in the foreign market. As a result of this obtained market experience; new business opportunities occur and result in even further market knowledge.

Each of the companies studied, which are present in the Hungarian as well as the Romanian market, are involved in an extended network of business relationships to certain degrees, and it includes several foreign distributors, agents, customers, competitors, public authorities, etc. Furthermore, after this



extension, they have all to different degrees, penetrated the market further by the development of their positions in the country-based networks. In addition, some of the companies have increased the coordination between positions in different country networks.



*Figure 6.3: The investigated companies' positions in the internationalisation and network model*

FoodTankers is the only company investigated that may be regarded as an “early starter” according to the internationalisation and network model presented in the theoretical chapter. There is a low degree of internationalisation of the network and a low degree of internationalisation of the company. Furthermore, FoodTankers has few and rather insignificant relationships with companies abroad. Therefore, the company has little knowledge about the foreign market and is not able to utilise relationships in the domestic market to gain this kind of knowledge. In an attempt to circumvent this problem, a company was acquired in Hungary, to obtain crucial market knowledge. This, however, turned out not to be such a successful strategy at the start. However, as the experience of the network in the country grew, the market could be penetrated even further and the company will soon become the biggest in the market within its field. Moreover, the increased experience of the market and the additional business relationships also resulted

in an attempt to expand towards the Romanian market by using these obtained business relationships. However, this turned out to be unsuccessful. Nevertheless, the ambition to build additional relationships with customers in the Romanian market is still being considered, but the necessary companies are unfortunately not present in the market at the moment.

When it comes to the “late starter” situation, suppliers, customers and competitors of the company are highly internationalised but the degree of internationalisation of the company is low. PlymoVent is to be found in this segment. For a small company to be able to enter a foreign market in this situation, it has to be highly specialised, which is the case of PlymoVent. Moreover, the late starter also has less market knowledge than its competitors, which is a disadvantage. However, this disadvantage was hoped to be avoided by an entry via a joint venture and as a result of this, to obtain some of the crucial market knowledge, which was absent. Furthermore, at the start it may be hard for a company to establish new positions since several distributors may already be linked to competitors. However, when it comes to the Romanian market, it can be said that customers within the network may have “pulled” PlymoVent into the market since the main clients in Romania are the ones that the company already have business relationships with in the Hungarian market.

In the “international among others” scenario, both the company and the environment are highly internationalised. This is the case for the remaining companies included in this study. To start with, Skanska and ASSA ABLOY are companies, which have high degrees of internationalisation as well as possessing networks that are highly internationalised. Both of these companies have chosen an alternative way of entering the Romanian market, by direct entry. However, since the companies are large multinationals, they also possess greater and more extensive business relationships, which are connected in even greater networks. Consequently, regarding both extension and penetration, these companies have the ability to use their wide-ranging positions in the networks to connect to other networks, even though they have done this in different ways. For example, ASSA ABLOY established a production facility in Romania and this was a successful way of obtaining sales in a foreign market. This was done from the Swedish headquarters; however, the company got an opportunity to buy a formerly state-owned company and grasped this

chance, which in turn resulted in an extension of the networks as well as a high degree of market penetration.

Intrum Justitia is also considered to be an “international among others” since both the company and its network is also highly internationalised, being present in a great amount of countries, which in turn are divided into regions. One must however note that since this company focuses on locality and building up regional synergies, it is a necessity for them to extend their business relationships. Moreover, this company may also be considered to be somewhat “pulled” into the Romanian market by its existing business relationships, since the main Romanian activities originate from Hungarian investors, which turn to Intrum Justitia in Hungary since they want them to offer their services in that market too. This occurs in order for them to continue their business relationship, which in turn is strengthened by this activity, since an amount of trust and reliability is built. HL Display is also considered to be in this category. The company extended to the market fairly early via a low commitment mode. However, further penetration of the market was soon embarked on. This company also uses its positions in the Hungarian network to enter the Romanian one, and in this case it is more of an extension of the Hungarian network since the Romanian market is still highly observed by Hungary. Moreover, a green-field investment was chosen for the Romanian market, since the necessary market knowledge was greatly obtained by the Hungarian entity after serving the market for several years. Furthermore, HL Display also followed some of their customers into the Romanian market and thereby extended their business relationships.

When it comes to the remaining companies; Tetra Pak, Sandvik and SCA Hygiene Products, they are all examples of Swedish owned companies with a high degree of internationalisation of both companies and networks, which date far back in history. They all possess great and extensive business relationships as well as wide-ranging networks. This also facilitates their extensions to additional markets as well as the penetration of these. Tetra Pak entered Hungary via a green-field investment of a production facility, which as in the case of ASSA ABLOY in Romania was a successful way of obtaining sales in the country, as well as in the region as a whole. The market company of Tetra Pak in Romania was established shortly thereafter and is responsible for

building and maintaining their own business relationships. However, the Hungarian production facility is included in their network since it supplies them, even though the Hungarian subsidiary, as in the majority of the other companies, is not responsible for the Romanian market. The two latter companies, Sandvik and SCA Hygiene Products have in common that they entered the Hungarian market before the fall of the Soviet Union. This results in the fact that the business relationships and networks present today are vastly different from the ones encountered when they first entered the market, which will be further discussed later on. However, when it comes to Sandvik it is a global company with a high degree of market knowledge in several markets. The main customers are often global companies, which usually utilise Sandvik in other markets in which they are present. Moreover, the company's extensive networks facilitates foreign market entries which in turn may result in only marginal changes in extension and penetration that on the whole, do not involve any qualitative changes in the company. The same situation is true for SCA Hygiene Products. The main reason for the latter company's success is that it entered the Hungarian market at such an early stage and at that time it was almost alone in the market. Nevertheless, this central position also facilitated the expansion into Romania.

In addition to this, since emphasis is placed on gradual learning and the development of market knowledge is gained via interaction in the networks, a company's position in the network is crucial. Therefore, one may note that the majority of the companies in this study have crucial positions in their networks since they are all, however to different degrees, well established within their markets. One must, however, note that well-known companies such as Intrum Justitia, Sandvik, Tetra Pak, SCA Hygiene Products, HL Display, Skanska and ASSA ABLOY have critical positions within their networks since their brand names are both well known and well established worldwide. Furthermore, they have been active within their segments for a great amount of time. However, this is not to say that the remaining companies of FoodTankers and PlymoVent are of lesser importance, but since they have not experienced internationalisation to the same degree and have not been present in the international market for as long a time as the others, their gradual learning and development of market knowledge have not reached the same kind of levels.

Consequently, after these companies managed to enter Hungary, they developed one or a set of exchange relationships in the market, which provided them with a base in order to be able to continue the business in the new market in a long-term. As a result of this, the companies extended their networks to comprise the new market. However, all the companies in this study are highly aware that a network is in need of continuous improvement and development, since the process is a changing one. In order to expand to an additional market, in this case Romania, the companies needed to find ways to climb over the country market barriers and the present relationships facilitated this process. This was done in different ways. One way was to enter the market via the northern part of Romania since the Hungarian minority present in this part, helped smooth the entry process. One may argue that the psychic distance was diminished as a result of this, since language and cultural barriers were eliminated and therefore an establishment of a business relationship was made more easily. PlymoVent used this strategy and Sandvik considers it for when they are to enter the market with a subsidiary. Foreign market entries may also be a result of companies that follow their partners abroad. When the company's network context consists of international actors, they might demand action by the company via direct or indirect relationships. As a result of this, the company is brought into new foreign markets. As mentioned before, this was the case to a great extent for Intrum Justitia, Sandvik, PlymoVent and HL Display, which conduct business with companies in the Romanian market, which are also customers in the Hungarian one. This is an example of a development and extension of a current business relationship. Further penetration of the Romanian market was facilitated by the fact that it was first supplied via low commitment modes, which involved business relationships with low commitment. These relationships, however, became more extensive and involved higher degrees of commitment as time passed and as increased market knowledge and experience was collected.

As mentioned previously, the companies, which entered Hungary before 1990, encountered an extremely different market situation than the one found today. At that time, SCA Hygiene Products and Sandvik's business relationships with the Hungarian market were governed by the State. The individual companies were not independent so therefore there were no direct business relationships with them as there is today. The fall of communism was welcomed by the

Western companies and resulted in a change in their networks. However, in some cases some of the business relationships that were present before the fall have been broken, while several new ones have been established. Another problem encountered when conducting business in these transition markets are the different agendas. Unfortunately, several of the Hungarian as well as Romanian companies do not have the same goals for the business relationship as the Swedish ones. This was the case with FoodTankers, where the Swedish parent company put a high degree of trust in the Hungarian subsidiary, only to become aware of that it was abused. The goal of the Swedish company was for the long-term perspective, whereas the Hungarian one was short-term and to obtain money as fast as possible. The result was that a manager with experience from a Western company had to take over.

Moreover, networks are of crucial importance in the transition markets and the business relationships are changing much more often than in the western market. The high emphasis on personal relationships may also be an explanation to why several of the companies that wish to enter the Romanian market from Hungary, enter via the Transylvanian region. As a result of speaking the same language and having the same culture, personal relationships are much easier to establish there. Additionally, the important degree of trust needed is also more easier obtained when conducting a business relationship with someone from the same “background” as oneself.

Furthermore, as a result of the changed business environment, the companies investigated, entered Hungary since they realised the importance of an establishment in the market. This is also the case for the entry of the Romanian market. By an establishment in Hungary, the companies established business relationships and networks, which were impossible to obtain if only providing the market from Sweden. The expansion towards the Romanian market is to a great extent a result of the company’s initial entry into the Hungarian market, since this establishment made it possible for the companies to extend and increase the commitment of their relationships in the Hungarian market as well as extending their networks more and more. Consequently, the network also came about to include the Romanian market.

### **6.3.1 Networks - Concluding Remarks**

The investigated companies in this study are, as mentioned, parts of different networks and have several different business relationships. They also have different degrees of internationalisation when it comes to both the own company itself and its networks, even though only two companies can be said to be greatly different than the others. They all do, however, have in common the realisation of the importance of being present in a market in order to obtain valuable business relationships and become a part of important networks. Their establishment in Hungary and use of it as a platform for further expansion facilitated the further process of entering the Romanian market. Moreover, their establishments also more easily obtained the important personal relationships in the markets in question. The extended networks and the additional business relationship also further facilitated the increase of commitment in the markets, which in turn even further extended the networks.





## CHAPTER VII: CONCLUSIONS

Throughout the research, our purpose was to explore the way Swedish owned companies via their subsidiaries, expand their activities in the CEE region. The analytical part presents the case companies, chosen to obtain this purpose, their pattern of internationalisation and more importantly, the rationale behind the decisions to enter. The gradual method of expanding in the region has shown its advantages, such as the ability to acquire knowledge and create networks. Moreover, by choosing a country as a platform for further expansion, more successful internationalisation is facilitated.

### 7.1 Facing the Purpose of the Study

Considering the main research question *how and why does a Swedish owned subsidiary in Hungary launch and extend its business activities eastwards*; the answer may be formulated by answering the sub-questions. In such a way:

#### *1) Why was Hungary selected as a market to enter and how was it entered?*

All the companies in this study selected Hungary as a market to enter since it is exceptionally well situated in the centre of Europe, connecting East and West, as well as because it is one of the fastest developing transition economies, which has come very far in their quest for a well functioning market economy. Several of the companies handled the market from Sweden first and then as it grew and developed, an establishment in the Hungarian market became crucial. Moreover, due to its location, it has an excellent opportunity to become a regional centre for the companies. The main aim for the majority of the investigated companies was to first establish in Hungary and then grow in this market and acquire a leading position and observe the development in the neighbouring markets. When the time was right, these markets would then be entered with the help of the Hungarian subsidiary. However, the two companies, which entered directly, considered Hungary a very attractive market to enter and did not have the intention to use it as a centre for continued expansion. They were merely just considering the chance to enter a new favourable market.

Even though the companies included in this study vary in size and business activities, the seven companies, which chose to use Hungary as a platform for their expanding eastward activities entered Hungary fairly rapidly. The market was for the majority of the seven, first entered with a low commitment mode. However, after a short time of activities in the market, a higher commitment mode was chosen such as an establishment of a subsidiary. However, currently only one of these companies has the high commitment mode of production in the country. Furthermore, two of the companies entered the market before communism fell since it was already seen as a potential market and was further developed than the other Soviet bloc countries. However, they were then forced to comply with the state. Therefore, their entry mode was more forced than chosen. Furthermore, the two companies, which did not use Hungary as a platform for their expansion eastwards, entered Hungary with different commitment modes. Skanska, like the other seven companies, entered with a fairly low commitment mode via a joint venture, while ASSA ABLOY entered with a high commitment right from the start by the establishment of a subsidiary.

***2) How did the Swedish subsidiary in Hungary enter the Romanian market and what was the intention of this additional market entry?***

The Swedish owned subsidiaries in Hungary were used as platforms for the seven main investigated companies in this study. After being situated in the Hungarian market for a period of time, expansion towards Romania was considered. Firstly, this market was handled via low commitment modes such as regular exports via for example, distributors, which were handled by the Hungarian subsidiary. However, after business increased as well as the Romanian market developed, the commitment modes were extended. Thereafter, in the majority of cases, a representative office was established. Moreover, some companies also chose to establish a subsidiary directly after some time of regular exports. However, the commitment is still low compared to the Hungarian ones. This is a result of the fact that Romania does not offer such a favourable investment climate as Hungary. However, all the companies perceive the great potential of the market and realise that it is crucial to take part and establish in one way or another as soon as possible before further competitors enter. When it comes to the two companies studied that chose to

enter the markets directly from Sweden, the subsidiary present in Hungary was not involved in the entering of the Romanian market, since it was believed it was more suitable to handle this from Sweden. The reasons for them to enter Romania were the same as for the others. However, the means of doing so were different. Skanska entered with the collaboration with the EBRD whereas ASSA ABLOY saw a chance of establishing a low-cost production centre.

Furthermore, as they were present in the Hungarian market, some of the companies were approached by Romanian actors, which were interested in conducting business in the Romanian market. Other investigated companies followed their Hungarian business partners into the market either by their own will or by request from the partner. However, the main intention of entering the Romanian market was as result of the companies' quest for expansion and growth. Moreover, several other multinational companies are situating themselves in the market, which also creates an increasing business opportunity since they represent strong partners for business. Since the East European market is not as saturated as the West one, it is a great target for companies. After having established in Hungary and accumulated strong market knowledge from the activities there, the step of entering the Romanian market was not a very difficult one compared to if it was to be entered from Sweden. The Romanian market is the second biggest emerging market in the region and since it is continuously developing and obtaining greater political and economical stability, it is an immense opportunity for a foreign company to be present in the market. Moreover, by establishing in the market now while it is developing, gives the companies a chance to get a good position before even further competition is presented as more companies decide to enter the market.

***3) What are the barriers encountered in the market entries, how are these handled and what implications will they have on future activities?***

Since the fall of the Soviet Union the two markets in question have experienced different paces when it comes to market liberalisation. Hungary is the country, which has come the furthest of the two, as well as being a leader in the whole region, and has as a result of this not posed so many barriers. The two companies that entered the market before the fall of the communist rule encountered the main barriers since they were not at that time allowed to own a majority of the shares in their entity. However, after this was allowed these companies

increased their commitment in the market. The entry of the market for the other companies, which entered then, as well as the further extension of business activities, proceeded fairly smoothly. A main barrier encountered for all the companies at the start was the lack of market knowledge and business practices. However, as time passed, knowledge was obtained and commitment increased. Moreover, since Hungary is to enter the EU next year, they have to follow EU standards, which to a high extent facilitate business activities in the market.

Furthermore, when it comes to the Romanian market, several more barriers are faced. Mainly, this is a result of the fact that the market is still perceived as fairly politically as well as economically unstable. This is also the reason for the companies' choice of starting with a low commitment in the market. Currently, the purchasing power is not considerably high, which results in a slim demand for products. The economy is improving and these problems are dealt with to a great extent. However, the process takes some time. Major problems, which have been mentioned by several of the investigated companies, are the lack of payments as well as corruption. Furthermore, as a result of the current harmonisation of the laws to follow EU standards, they are changing and in some ways contradictory. The payment morale is however improving and as a result of the Romanians quest for entering the EU, a quick harmonisation of the legal environment is necessary and then the problem of corruption and the contradictory laws will hopefully diminish. However, since there are barriers present in the Romanian market, the choice of using the Hungarian subsidiary as a platform eases the entry process since the subsidiary inherits great market knowledge as well as networks, which facilitating the business activities. However, in order to increase the commitment in the market, further improvements have to be made, but since Romania is to enter the EU in 2007, several of these barriers will most likely not be gone till then, such as tax and border impediments. Several of the companies investigated, intend to expand and increase their commitment and current activities in Romania, and several of them are already making plans for this.

However, the risks that are encountered in the region today compared to the ones in the beginning in the 1990's are very different. Since several of the countries are going to enter the EU, a great deal more information is available

and therefore the risks have been greatly reduced. As a result of the EU entrance, the business environments are going to be more favourable. In the short term, administrative routines will be faster, such as customs clearings, etc. In the long-term, the result will be a stronger local market.

***4) What are the benefits of expanding gradually by using a platform country?***

Gradual expansion and establishment for some time in a country, which serves as a platform, allow companies mainly to learn about the market and acquire a strong position. The seven companies under main investigation in this study reaped great benefits by channelling their further expansion eastwards via their subsidiaries in Hungary. As a result of this, the companies were able to obtain crucial market knowledge, such as business practices, and understand market preferences and specifics, as well as gaining experience in the region, which is highly different from the Scandinavian one. Assuming that market knowledge is the main driver of successful internationalisation, the use of a platform for further expansion allows for learning and acquiring market specific knowledge. Moreover, important networks were built that facilitated the further expansion. As mentioned previously, personal relationships are highly important in these markets and these are only obtained if a company is continuously conducting business in a country and is also present there. By this presence, the company proves that they are serious about their business in the region and aim to increase their degree of commitment. Furthermore, this kind of business relationship greatly diminishes the risks of entering a transition economy. These factors would have been impossible to gain to such a great extent if only operating from Sweden. Furthermore, companies present in a platform country have a great opportunity to establish, for example, a representative office in neighbouring countries governing these affairs from the platform country without any actual investments. This kind of activity would be harder to facilitate if it was done from Sweden since it is of a greater distance as well as a vastly different market.

The use of platform countries is a way of facilitating expansion especially for smaller and medium sized companies since it does not entail the same conditions as greater MNCs. MNCs that are large have the size, capacity and financial strength to enter a market directly and therefore have a greater ability of coping with risks. This is not to say that they will not benefit from the use of

a platform. It is merely that since they have a greater capability of, for example, acquiring a formerly state owned company, they can more easily grasp it. Two companies in this study entered the Romanian market without the use of a platform country, as a result they took a greater risk of entering the country directly since the gradual expansion via a platform country greatly diminishes the risks.

## **7.2 Recommendations for Companies**

The investigated companies in this study illustrate that the business environment in transition economies in several cases can be a risky activity as well as a complicated one. As mentioned previously, a way to diminish the risks is to increase the knowledge about the environment in which there is a preference to establish. When it comes to entering highly unknown and risky markets, the use of platform countries is in many ways a more favourable one. In the transition economies region, there are several countries that have come further in their development than others. By establishing in these more developed economies and then continuing with a gradual expansion to the neighbouring countries from this establishment, it greatly reduces the risks. While established in a platform country, important market knowledge as well as business relationships are made and it is important that these relationships are managed and developed. As a result of this, a company may come in contact with other actors in the market where it is established that in turn are active in neighbouring markets. As a result of this, it is easier to decide upon an entry of this additional market as well as its potential and the risks that are faced. The relationships built as well as the increasing knowledge obtained, facilitates these decisions. In several cases it is also possible to “follow” these clients into the additional market.

The use of foreign-owned subsidiaries of MNCs in Hungary to enter the Romanian market is especially favourable for small and medium-sized companies, since, as mentioned before, large MNCs have a greater capacity to enter directly. Since the Romanian market is still relatively unstable, the choice of gradual expansion is a wise one. As the market develops, the commitments will increase. Moreover, as the subsidiary in Hungary establishes itself further

in the market, and the expansion towards Romania is successful, expansion to additional neighbouring markets are likely to take place.

Even though in several cases, the foreign-owned subsidiary in Hungary was responsible for the activities in Romania to a great extent, the choice of investments were made at the headquarters in Sweden. In some case companies the subsidiary in Hungary had a great deal to say in the choice of investments, whereas in other cases this was not the case to the same extent. Therefore, it is crucial for the headquarters to actually listen and take into account the knowledge and business relationships that the subsidiary has obtained. The market is most likely considered differently when considered from Sweden than it is when viewed from a Hungarian perspective.

### **7.3 Recommendations and Further Research**

Considerable research has been conducted, with emphasis on internationalisation and the importance of knowledge and networks. However, almost none of this focuses on indirect internationalisation that considers companies that are willing to use a country as an incubator or platform for further growth.

The contribution of this research is twofold. Firstly, it presents an empirical ground for studies in indirect investments. Secondly, when considering the theoretical implication, the study has shown the importance of learning and gradual internationalisation.

However, assuming further studies, the authors would like to present some implications. Firstly, one may consider both a qualitative and quantitative approach. In such a way, the external validity of the findings may be enhanced. As a result of this a clearer path of indirect internationalisation may be presented. On one hand, a macro overview of all Swedish companies that use Hungary as a platform should be offered; and on the other hand, an explanation of how it is done should be made. Secondly, a division between company types can be made. Assuming the specifics of gradual internationalisation, one may find it easier to analyse companies that are focused on production. By doing this, the establishment chain may appear to be more evident. Thirdly, using the same number of companies, which follow a direct and indirect path of

investments, may also contribute to the validity of the findings. This allows for a comparison of the procedure of the market entrance and presents which way is more advantageous; using a platform or entering a new market directly. However, this fact is in turn, very much related to the size of companies and their financial abilities. Finally, the authors acknowledge the possibility of conducting research about internationalisation by different methods. However, as the purpose of this study was to focus on the use of a platform, theoretical alternatives are not known.



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## **APPENDIX: QUESTIONS FOR INTERVIEWS**

### **Company Information:**

- Number of employees, turnover
- Business idea and policy
- Main products and services
- International presence; most important markets
- Share of East European business
- When was the East European market first entered, why?

### **Hungarian Market:**

- When was the Hungarian market entered, what were the main reasons?
- What kind of entry modes was used?
- What kinds of operations are planned for the future?
- What kind of opportunities was anticipated, how did it turn out?
- What markets does the Hungarian subsidiary cover?
- Does the Hungarian subsidiary function as a base for entry into Romania and other Central European countries, for ex. Moldova?
- Was it planned from the start to enter the Romanian market via the Hungarian subsidiary?
- What was the market potential when you entered the market, how has it developed over time?
- What were your expectations about competition in the market?
- Who are the main competitors?

- Which risks did you anticipate at the start, and now?
- What are the main problems faced? How were these dealt with?
- How is the communication between headquarters and subsidiary handled?
- How much is invested in the Hungarian subsidiary; production resources, personnel, financial resources?
- How have these investments developed over time?

**Romanian market:**

- When was the Romanian market entered and why?
- What kind of entry modes was used?
- What kinds of operations are planned for the future?
- Who initiated the expansion into the Romanian market, headquarters or subsidiary?
- How is the responsibility shared between the two?
- How does the communication work between the Hungarian subsidiary and the Romanian activities?
- What kinds of business activities are present in the Romanian market?
- Has the activities in the Romanian market increased over time?
- How does the company perceive the Romanian market?
- What are the major benefits and problems?
- In what way have the political changes affected your operations in both markets?
- What kind of marketing channels were used in the beginning?

- How have the marketing channels and distribution channels changed over time?
- What kind of relations to other organizations; suppliers, customers, local authorities, did you have when entering the markets? How have these developed?
- What are currently the most important relationships to other organizations?
- How do you expect your business in these markets to develop in the future?
- What are the main problems, threats and opportunities and prospects?
- Are there any plans for future investments in these markets?
- How do you believe the East- European business environment to develop