

Market orientation and the strategic development of MNEs in European transition economies

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Abstract

The paper analyses the market areas supplied as a key discriminating factor in the strategic roles played by MNE subsidiaries upon entry into the Central and Eastern European transition economies. Extension of the markets for established goods emerges as the key initial motivation, with the CEE economies themselves (most decisively the national markets of individual subsidiaries) the dominant early target of supply. This confounds an expectation of prompt integration, on a cost-effective basis, into the MNEs' supply networks for W.Europe. However, it is then speculated that an early phase of local-market responsiveness generates knowledge-seeking learning processes that inculcate distinctive quality elements into CEE subsidiaries' production. Evolution into product development (using CEE creative assets, e.g. technology, engineering expertise) may ultimately secure a more sustainable and embedded entry into MNEs' wider European networks.

Key words: networks & strategy; industrial transformation.

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I Introduction

This paper analyses the relationship between two of the factors that have been expected to play crucial roles in facilitating and influencing the industrial restructuring of CEE transition economies. Firstly, that the repositioning of industrial enterprise into market systems would ultimately be synonymous with the establishment of international competitiveness through the generation of effective export-oriented capabilities. The dominant context for this, then, would be expected to be the markets of Western Europe. This economic perception has been, in turn, reflected in the extensive political enthusiasm in many CEE countries for eventual membership of the EU. Secondly, that the activities of MNEs in transition economies can help to provide industrial capabilities, and reflect strategic priorities, that support the generation of an international orientation and external competitiveness. In essence these two perceptions coalesce in the expectation that as the CEE economies become an integral part of the wider European economic system so will MNEs' operations located there be positioned within their strategic networks targeting the whole region.

The relevant characterisation of the contemporary MNE here is that of a company which uses a wide diversity of international operations (including marketing networks, research laboratories and differentiated producing subsidiaries) in order to pursue a heterogeneous range of strategic objectives.¹ Two types of broad overarching objective are perceived. Firstly, to optimise the immediate competitiveness of *existing* goods, through their cost-efficient production and effective entry into all relevant market areas. Secondly, to continually revitalise the

competitiveness of supply through the innovation of *new* goods and the regeneration of the supporting technological scope. It can, in fact, be argued (Manea and Pearce, 1997a) that a distinctive stock of technology and of research capacity and competence, inherited by the CEE economies from the scientific commitment of the centrally-planned era, can allow subsidiaries in these countries to accede quite quickly to roles that pursue the latter of the two MNE objectives. However, our concern here is more decisively with the implications of the manner in which the initial strategic positioning of new MNE operations in these countries targets the first MNE objective.

Thus the prevalent expectation is that MNEs have secured their initial entry into CEE economies through the activation there of elements of their mature and standardised technologies as applied in the manufacture of commercially-established products. Though this may resemble the traditional ‘inward investment’ package (of capital, technology, management skills, marketing expertise), the implications for the host economy need to be comprehended in terms of the precise aims (within the MNE group’s wider strategic objectives) of its immediate operationalisation and its potential for development and enhancement of scope (Pearce, 2000). In the case of CEE economies both facets of the first set of MNE objectives indicated earlier can be relevant to the early activities of subsidiaries.

Firstly, extension of production into these countries may be perceived as the most effective means of accessing the market-expansion possibilities that become available with the opening up of these economies. This will certainly support improved competitiveness in local industry through the introduction of new goods and marketing practices, better production technologies and diminished X-inefficiency. However, the industrial structure of MNE operations, within which these benefits occur, will be determined by the emerging patterns of local consumer demand rather

than being one which builds on sources of static comparative advantage. The second immediate aim of MNEs' entry into CEE also involves production of their mature goods, but this time for export to those (mainly Western European) markets where demand for them is already well established. Because the aim here is to sharpen the cost-efficiency of supply of these goods the relocation of their production to the transition economies is now predicated upon the activation of local sources of comparative advantage and supports the growth of internationally-competitive industrial sectors.

Analyses of early (post-transition) trade data indicated two institutional arrangements through which CEE production could enter the existing Western European supply networks of MNEs. The first of these was through subcontracting relationships, within which still independent CEE enterprises undertook activities (mainly assembly or processing) on behalf of the MNEs. At the core of this was 'outward processing trade' (OPT) (Éltető, 2000; Lemoine, 1998; Eichengreen and Kohl, 1998) in which 'an industrial firm shifts some of its manufacturing (usually labour-intensive parts that are separable from the total manufacturing process) to a foreign country' (Éltető, 2000, p.216).² As the production processes involved here are likely to be very mature and standardised, and involve low-levels of very routine skills, the main benefit to the host CEE economy is an immediate favoured access to external markets. As Éltető (2000) observes 'the room for development of the performing [CEE] company and of relations between the two companies is very limited'. As the defining determinant of such arrangements was cost-efficient production it is likely that the dependence of individual agreements on low labour-costs often made them very transitory and, indeed, aggregate data has indicated a decline in the relative status of OPT trade.³

The second arrangement that has helped to insert CEE production into the existing supply networks of MNEs is through the activity of owned and controlled subsidiaries operating in these countries (i.e. through full scale foreign direct investments). Though the cost-based element in this can still provoke the risk of ‘footloose’ closure, it can also be argued that successful subsidiaries provide the potential for a deepening of local commitment in directions that are very unlikely to be available to OPT-oriented subcontractors. Effective subsidiary performance demonstrates the in-house possession of competences (in management, engineering, quality control, etc) that facilitate efficient application of other host-country inputs. These capacities can then provide a basis for systematic upgrading of subsidiary status, through accession to new parts of the current product range, a widening of functional scope and, ultimately, acquisition of product development responsibility. MNE subsidiaries can become embedded in host CEE economies in ways that allow them to develop interdependency with changing local input qualities and technological capabilities. Within processes of sustained host-country development the basis for MNE exports may move away from the cost-efficiency of production of existing goods towards the originality and quality of locally-created products.⁴ Here subsidiary managements and CEE governments may implicitly concur in building a basis for participation in the MNEs' pursuit of their dynamic second (technology regeneration and product innovation) set of objectives, as an escape from the vulnerabilities of a more static cost-efficiency.

Analyses of CEE trade data (Hunya, 2000; Rojec, 2000; Éltető, 2000; Lemoine, 1998; Eichengreen and Kohl, 1998) have indicated two stylised facts relating to MNE subsidiaries' early participation. Firstly, that the export/sales ratio for MNEs' operations in CEE economies is persistently, and often substantially,

higher than for comparable indigenous enterprise. Secondly, that the actual value of this export/sales ratio for foreign operations in CEE countries is, nevertheless, by no means consistently high and, in fact, only occasionally over 50%.⁵ Thus it seems that whilst MNEs' early production operations in the European transition economies do seem to have imparted a distinctive impetus towards an external-market-oriented restructuring this may nevertheless not be consistently indicative of the dominant strategic motivation of these subsidiaries. The survey evidence to be presented in the subsequent sections of this paper therefore seeks to investigate the range of strategic imperatives that are encompassed by MNE subsidiaries in the CEE region, and to see how they are reflected in the different market areas supplied.

The questionnaire was sent to the global or regional HQs of 408 leading manufacturing and resource-based MNEs, with replies received from 50 of them.⁶ Twenty-eight of these had manufacturing operations in CEE economies and 11 more had subsidiaries there which carried out other significant parts of the value-added chain (marketing, distribution, resource exploration, strategic planning offices).⁷ For the two questions reported in this paper respondents were requested to provide separate information on any subsidiaries in each of eight specified CEE host countries.

II Investment motivation

Respondents to the survey were asked to evaluate, for each of their separate subsidiaries in any of the eight specified transition economies, the relative importance of each of seven motives for the investment.⁸ The first three of these reasons for investing can be designated as demand-side motives, as they are perceived as reflecting directly ways in which the MNEs are responding strategically to different needs or potentials in the competitive development of their market environment.

These initial three motivations are most immediately distinguished by the geographical area targeted for supply, but beyond this the differential presence of other strategic imperatives can also be discerned as having crucial implications.

The first reason for investing offered for evaluation was described as ‘to establish a strong position in the market of the host country’ (HOSTMARKET). This is then a classic example of the *market-seeking* (MS) motivation in MNEs’ strategic expansion, since the aim is to produce inside a particular country or region as the most effective means of supplying the local market there (Dunning, 1993; Behrman, 1984). One element in such MS behaviour can clearly be the traditional import-substituting response to trade protection that prevents effective supply from outside.⁹ However, it also seems likely that within the normal behaviour patterns of the contemporary MNE other, more positive, factors may also be playing a role in the HOSTMARKET motivation.

Such host-country-focused operations are thus likely to be seeking both maximised responsiveness to distinctive elements in local tastes and consumer needs and expectations, and also to discern, from close experience, the quality of productive potentials in the industrial sector. The presence of this type of individualising focus on local conditions within the HOSTMARKET motivation suggests that *efficiency-seeking* (ES) will not be a systematic aim of such operations (though, obviously, productivity will not be gratuitously squandered). More relevant as a secondary facet of HOSTMARKET may be *knowledge-seeking* (KS), since responding to local market needs, and assimilation of distinctive elements of local skills and technologies, can build into such subsidiaries particular individualised capabilities that may eventually be leveraged in strategic development. As the summary data of table 1 shows, HOSTMARKET was the most prevalent motivation, being assessed as a

‘major’ reason for investing in 78.4% of subsidiaries and a ‘minor’ one in 13.0% more.¹⁰

The second offered motivation was ‘to achieve better access to a new regional market (i.e. CEE countries)’ (CEEMARKET). The defining imperative here remains MS since the initiating factor is again the emergence of a new market space (the CEE region)¹¹ and the subsidiary’s predominant objective is then to secure its MNE’s effective expansion into its supply. The supporting presence of other distinctive elements of MNEs’ strategic behaviour is, however, likely to be more notable than for HOSTMARKET. Crucially, once MS production within the CEE region is determined as necessary the precise location of facilities to secure this effectively remains a significant secondary decision. Thus ES becomes relevant to CEEMARKET operations, as these facilities may be located in the transition economies where local inputs can support the most cost-effective production of those parts of the MNE’s established product range for which regional market development is being pursued. However, this type of regional market development is, as for HOSTMARKET, likely to include a product-differentiating element of responsiveness. Here, though, the wider geographical market area and its likely greater diversity of consumer needs, may point towards emerging scope for more substantive local product *development* (rather than a limited adaptation of existing goods for the smaller national markets of HOSTMARKET operations). Thus KS behaviour, securing the leveraging of host- country creative attributes towards product development, is also likely to be more relevant within the CEEMARKET motivation. This reason for investment was rated as a major one for 43.9% of subsidiaries and a minor one for a further 34.5%. Overall CEEMARKET thus emerged as the second most prelevant motivation (table1).

Table 1 MNEs' evaluation of reasons for investing in CEE countries

	Reasons for investing (average response) ⁽¹⁾						
	HOST MARKET	CEE MARKET	EFFSEEK	LOW COST	LABSKILL	SCIENCE INPUT	NATION RES
By home region							
Asia	2.25	3.00	2.25	3.00	2.00	1.43	1.38
North America	2.73	2.30	1.34	1.55	1.39	1.18	1.18
Western Europe	2.93	2.07	1.36	1.92	1.24	1.07	1.18
By host country							
Bulgaria	2.70	1.90	1.10	1.44	1.18	1.09	1.09
Czech Republic	2.81	2.38	1.62	1.95	1.48	1.10	1.10
Hungary	2.71	2.38	1.47	1.90	1.33	1.19	1.19
Poland	2.88	2.32	1.60	2.04	1.44	1.08	1.16
Romania	2.91	2.18	1.18	1.64	1.27	1.09	1.18
Russia	2.94	2.18	1.29	1.82	1.24	1.31	1.47
Slovakia	2.63	2.19	1.25	1.80	1.44	1.13	1.13
Slovenia	2.80	2.00	1.10	1.44	1.22	1.10	1.20
By industry							
Chemicals	2.69	1.92	1.26	1.31	1.16	1.05	1.05
Electronics	2.90	2.23	1.38	1.74	1.62	1.31	1.31
Mechanical engineering	2.86	2.48	1.48	2.29	1.18	1.09	1.36
Motor vehicles	2.86	2.86	2.29	2.86	1.57	1.33	1.43
Miscellaneous	2.70	2.30	1.35	2.04	1.35	1.00	1.00
Total	2.80	2.24	1.40	1.83	1.35	1.14	1.18

Reasons for investing

- HOSTMARKET - to establish a strong position in the market of the host country.
- CEEMARKET - to achieve better access to a new regional market (i.e. CEE countries).
- EFFSEEK - to improve our MNE group's competitiveness in supplying its established markets (e.g. EU).
- LOWCOST - availability of low-cost input factors (e.g. cheap labour; energy; raw materials).
- LABSKILL - the skill quality of production labour.
- SCIENCEINPUT - availability of scientific inputs.
- NATIONRES - to access particular national research and technological expertise.

Note

1. Respondents were asked to evaluate each reason, for each country in which they had investments, as (i) a major reason for investing, (ii) a minor reason for investing, (iii) not a reason for investing. The average response was calculated by allocating 'major' the value of 3, 'minor' the value of 2 and 'not' the value of 1.

The last of these demand-side motivations was defined for respondents as 'to improve our MNE group's competitiveness in supplying its established markets (e.g. the EU)' (EFFSEEK). Once again the aim is driven by a direct environmental challenge, but here this is the need to *deepen* competitiveness in supply of a long-established market space through more effective production of existing goods (i.e. classic ES behaviour) rather than to pursue the *widening* of competitiveness into new geographical market areas (the mainly MS aims of the two previous imperatives). Thus intensification of competition in Western Europe would have been perceived to lead MNEs to extend their supply networks into the transition economies in ways that seek to secure enhanced cost-effective production of established goods through the operationalisation of these countries' sources of static comparative advantage.

In its pure form ES behaviour would allow no systematic presence for other imperatives. Though goods produced in such a way can obviously meet any existing local demand there is no scope for commitment of resources to an MS-type cultivation of these host-country markets. Since the products made in EFFSEEK subsidiaries are standardised ones with characteristics that are already honed to the needs of established customers (in the EU, etc.) there is no need for any form of creative work (product adaptation or development). Indeed, in general terms, any type of KS activity would be rated as an overhead expenditure that would be inimical to the stringent cost targets of these ES units. EFFSEEK in fact proved by far the least relevant of these demand-side motivations, with only 13.7% of subsidiaries rating it a major factor and 10.8% a minor one.¹²

The remaining four investment motivations we designate as supply-side influences. These factors can represent major reasons for setting up a subsidiary in a

particular country, whilst nevertheless serving as the *means* that allows the facility to secure strategic *ends* that are defined by one or more of the three demand-side imperatives. Thus from the point of view of the transition economies, these supply-side factors represent current or potential sources of comparative advantage which may be beneficially activated or developed through the operations of MNE subsidiaries.¹³

The first of these investment motivations was described as 'availability of low-cost input factors (e.g. cheap labour; energy; raw materials)' (LOWCOST). Such a cost emphasis is likely to derive from those undifferentiated inputs that represent a country's sources of static comparative advantage and to be effectively sought and activated where MNEs pursue production of mature and standardised parts of their product range in the most competitive way possible. In a manner that may, therefore, mirror the restricted status of EFFSEEK, LOWCOST was a major reason for investment for only 22.8% of subsidiaries, though it was a minor one for a further 32.4%. In terms of average response (AR) this does place LOWCOST somewhat ahead of EFFSEEK (table 1) which, we have suggested, may reflect a cost-related element in the CEEMARKET role.

The second supply-side factor was 'the skill quality of production labour' (LABSKILL). The most immediate relevance of the level of labour skill is likely to be in ensuring that existing production techniques of MNEs can be applied at their accepted levels of productivity (thus sustaining the competitive value of low input-costs) so that ES objectives are secured. However, where labour skill embodies quite strong differentiating elements of tacit knowledge, reflecting particular host-country characteristics and industrial traditions, it may provide support to the local-responsiveness aspects of MS or even play a role in the more ambitious attempts to

activate local technology in KS-oriented product development. Despite such potential strategic ubiquity LABSKILL was rated as a major reason for investing in only 3.6% of subsidiaries and a minor one for only 24.9% more.

The two remaining reasons for investing were defined as 'availability of scientific inputs' (SCIENCEINPUT) and 'to access particular national research and technological expertise' (NATIONRES). Pursuit of such host-country attributes represents aspects of the emergent KS imperative in the modern MNE, through which these companies apply decentralised approaches to the generation, assimilation and activation of technology and creative scope. From the point of view of the transition economies SCIENCEINPUT and NATIONRES represent forms of dynamic or created comparative advantage from which the innovation priorities of MNEs are often currently more capable of distilling any available competitive potentials than existing indigenous enterprise.

SCIENCEINPUT indicates a generally high level of scientific capability, which can therefore motivate a MNE subsidiary's aim of generating the in-house technological and creative competence needed to support product development ambitions. NATIONRES, by contrast, represents the availability of areas of much more specialised and distinctively high-quality knowledge (reflecting the country's technological traditions) and research capacity (e.g. the on-going agendas of university laboratories, which again may reflect aspects of the country's particular scientific heritage). Whereas SCIENCEINPUT may provide a subsidiary with the in-house competence to participate in the relatively routine evolution of its group's produce range, NATIONRES may supply the radical technological seeds for much more revolutionary forms of product innovation.¹⁴ Despite these important potentials

these motivations are not yet very prevalent in MNEs' CEE subsidiaries, with SCIENCEINPUT only relevant to 12.2% of them and NATION RES to 15.9%.

III Markets supplied

Respondents were asked to assess the importance to each of their subsidiaries of several geographical market areas. The replies are summarised, in terms of average responses (ARs), in table 2.¹⁵ Regression tests were also run with each of these markets as the dependent variable and including dummy variables for home country (Europe as the omitted source), host economy (Hungary as the omitted host country) and industry (miscellaneous as the omitted sector). The regressions also included, as independent variables, the seven reasons for investing discussed in the previous section. For the four supply-side motivations it was hoped that variations in their relevance to the supply of different market spaces might reflect on the implications for host-country development and for the nature of subsidiaries' potentials in their MNE's strategic evolution. Clearly the inclusion of target markets in the demand-side investment motivations indicates the basis for strong relationships, whilst not precluding results with valuable analytical content. In particular the formulation of subsidiary capabilities that are mainly aimed at pursuit of a specific strategic objective may determine which other markets it may also supply, either as an *ad hoc* spillover or as part of calculated expansionary processes. The regression results are reported in table 3.

Table 2 immediately provides confirmation of 'the national market of the host country' as the one that currently dominates the operations of MNE subsidiaries in the CEE transition economies. Thus the market of their host country was the 'only' one for 58.7% of units covered (no other market area was ever considered to be the sole target of a particular subsidiary), a major one for 30.3% and a secondary one for a

further 9.0%. In the regression test for this area HOSTMARKET was statistically significantly positive, as would be expected. On the other hand EFFSEEK was significantly negative (by contrast with its significantly positive relationship with all other market areas), which suggests a worrying degree of strategic isolation in subsidiaries targeting mainly the markets of their host country. That this may allow for the emergence of some of the inefficiencies associated with protected import-substitution may also be indicated within the regression results for HOSTMARKET. Thus both LOWCOST and LABSKILL provide their most strongly negative relationship in this regression (approaching significance in the former case and reaching this level in the latter). Overall both the pervasiveness of host-market supply, and the competitive indecisiveness with which subsidiaries appear to approach this role, can be interpreted as not being consonant with the more positive potentials of MNE expansion into the transition economy region.

The general dominance of a market-extension priority in the initial CEE operations of MNEs is reinforced by the status of 'other Central and Eastern European markets' as the second most important of the seven areas covered. This was rated as a major market for 16.5% of subsidiaries and a minor one for a further 24.8% (making it the only market, other than host countries, supplied by over 30% of subsidiaries). Whilst, in broad terms, using their operations in one transition economy as an export base for the wider region can still be interpreted as part of a MS drive by MNEs, the regression results indicate rather different behaviour patterns from the focus on national markets only. Naturally CEEMARKET is significantly positive in this regression. Interestingly, however, HOSTMARKET is here weakly negative, in a manner that precisely mirrors the weakly negative result for CEEMARKET in the previous test (i.e. with HOSTMARKET as dependent variable). This suggests that

strategically targeting one of these two facets of the overall transition-economy region does not systematically generate secondary supply of the other. More precisely differential aspects of approach to these markets is encompassed in the significant positive sign on EFFSEEK in this regression, compared with the significant negative relationship in the previous one. Thus the more subsidiaries generate the ES attributes needed to supply mature goods effectively to their established markets outside the CEE (EFFSEEK), the more they were able to leverage these abilities to also export to other transition economy markets (though, apparently, the rather different approach to host-country markets did not benefit from this). The more positive ES element in supply of these other-CEE markets (compared with host markets) is to some degree also suggested by the clearly positive (though insignificant) sign on LOWCOST (compared to the negative one in the previous test) and the very much weaker negative relationship of LABSKILL.

'European Union markets' represent the main target of those ES operations in the CEE that aim to assert a position in their MNE group's supply networks for their important mature market areas. Thus the EU economies were a major market for 10.7% of subsidiaries and a secondary one for 19.0% more, whilst EFFSEEK clearly obtains the expected significant positive sign in the regression test for those markets. The further sharpening of the cost competitiveness needed in subsidiaries when seeking to export to these mature and contentious markets is also reflected in the significance of the positive sign on LOWCOST (the only case where it is significant) and, less decisively, in the first (albeit marginal) positive sign on LABSKILL. Both HOSTMARKET and CEEMARKET are weakly negatively signed, indicating that pursuit of these strategic motivations have no systematic tendency to generate capabilities that can support spillover supply of EU markets.

'Other Western European markets' were considered a major market of only 6.6% of subsidiaries and a minor one of 13.2%. Once again EFFSEEK secures the expected significant positive sign and, in fact, apart from a weakening of the positive relationship for LOWCOST, the regression results are compatible with supply of these other Western European markets being a strategic complement or spin-off from supply of the EU.

Supply of the three types of non-European markets specified seem likely to be mainly spillovers from operations that target that region, rather than representative of frontline strategic objectives of CEE subsidiaries. Notably there are only two cases of subsidiaries considering one of these non-European markets to be a major one. Then 'other non-European developed countries (North America, Japan, etc.)' was a relevant market for 12.4% of subsidiaries, 'newly industrialised countries (Hong Kong, Singapore, South Korea, etc.)' for 5.0%, and 'developing countries (Middle East, Latin America, Asia, Africa, etc.)' for 9.1%. The most significant results in the regression tests of these three areas is again their positive relationship with EFFSEEK, confirming the expectation that access to such non-European markets is probably secured after successful pursuit of the ES priority that was initiated as part of MNEs' European supply programmes.¹⁶

IV Conclusions

Over half the subsidiaries covered supplied only the national market of their CEE host country, and only 11.5% rated this as less than a major part of their supply profile. This reflects the clear perception of responding HQs of market seeking (MS) as the dominant strategic priority for early entry into the transition economy region. By contrast, the efficiency seeking (ES) pursuit of new low cost production sites to

reinforce competitiveness in Western Europe emerged as notably less relevant, with only 29.7% of subsidiaries exporting back to that area.

This relative status for these two markets emerges as very different to that normally projected from the perceived developmental needs of both MNEs and the CEE economies in transition. Furthermore the evidence appears to suggest a certain degree of strategic alienation between MNE operations targeting the two types of market. However, it then appears possible that a third significant market space may be emerging as a basis for an evolutionary strategic reconciliation in MNEs' priorities. This takes the form of 'other' CEE markets, i.e. the targeting of the rest of the CEE region through exports from a particular transition economy subsidiary.

Overall 41.3% of subsidiaries exported to other CEE countries, with two-fifths of these rating this as one of their major markets. Though this represents a significant facet of MNEs' MS expansion into the new region, the evidence also suggests that its implementation by individual subsidiaries is much more than a convenient spillover from successful supply in host-country national markets. It is clear that initially an ES emphasis on low-cost production is a key element in export to other CEE markets, in a way that it is not for host-country supply. Beyond their initial assertion of a claim to supply these markets on a cost-effective basis, it can be speculated that subsidiaries may be able to seek to deepen their regional competitiveness through a move towards a more substantial product development responsibility.¹⁷

Thus the markets of the CEE region are likely to remain distinctively different from those of Western Europe for some time, and an active participation in their evolution through localised product development seems a logical extension of the

strategic scope of subsidiaries that seek sustained regional competitiveness. As a further extension it is then plausible that some of the more successful and distinctive of the new goods generated in this way should eventually lay claim to export markets in Western Europe and beyond.

Cost-effective production for Western European markets *has* played a significant role within the early operations of MNEs in the CEE transition economies, but not the strategically dominant one often originally envisaged. As these economies refocus their resource base, as part of sustained development processes, this motivation for MNE participation now seems less, rather than more, likely to prevail. It may be replaced, however, by a richer basis in the dynamic or created sources of comparative advantage emerging within the host-countries' growth processes. Thus the foundations of sustainable development in the transition economies may yet be built, in some crucial aspects, on the reactivation and reinvigoration of technologies, and of research traditions and capabilities, inherited from pre-transition scientific institutions. The knowledge-seeking and product innovation needs of MNEs may find both the quality and cost of these CEE attributes attractive as they pursue their second, more developmental, set of objectives. Ultimately the involvement of transition economies in the European networks of MNEs may be more completely and successfully secured through a shared and mutually-reinforcing interest in creative resources (and, therefore, product development) than through the dependency and strategic vulnerability of low-cost production.

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Table 2 MNEs' evaluation of markets supplied by subsidiaries in CEE countries

	Market supplied (average response) ⁽¹⁾						
	HOST	OTHER CEE	EUROPEAN UNION	OTHER W. EUROPE	NON EUROPEAN DEVELOPED	NIC	DEVELOPING COUNTRIES
By home region							
Asia	3.17	2.17	1.92	1.92	1.00	1.00	1.00
North America	3.26	1.43	1.54	1.29	1.31	1.06	1.17
Western Europe	3.57	1.55	1.26	1.15	1.07	1.07	1.07
By host country							
Bulgaria	3.88	1.13	1.13	1.13	1.00	1.00	1.00
Czech Republic	3.38	1.76	1.76	1.48	1.10	1.00	1.19
Hungary	3.43	1.86	1.43	1.38	1.10	1.05	1.05
Poland	3.46	1.63	1.54	1.33	1.13	1.13	1.17
Romania	3.89	1.33	1.33	1.33	1.11	1.11	1.11
Russia	3.71	1.47	1.29	1.06	1.06	1.00	1.06
Slovakia	3.40	1.67	1.14	1.07	1.00	1.00	1.00
Slovenia	4.00	1.00	1.00	1.00	1.00	1.00	1.00
By industry							
Chemicals	3.76	1.36	1.14	1.04	1.00	1.00	1.11
Electronics	3.45	1.58	1.42	1.36	1.21	1.18	1.15
Mechanical engineering	3.43	1.65	1.70	1.30	1.09	1.04	1.09
Motor vehicles	3.91	1.73	1.82	1.73	1.00	1.00	1.00
Miscellaneous	3.42	1.67	1.17	1.17	1.00	1.00	1.04
Total	3.44	1.58	1.40	1.26	1.13	1.06	1.09

Markets supplied

- Host - the national market of the host country.
Other CEE - other Central and Eastern European markets.
European Union - EU markets.
Other W. Europe - Other Western European markets.
Non-European Developed - Other non-European developed countries (North America, Japan, etc).
NIC - Newly industrialised countries (Hong Kong, Singapore, South Korea, etc).
Developing countries - Developing countries (in Middle East, Latin America, Asia, Africa).

Note

1. Respondents were asked to grade each market as (i) the subsidiary's only market, (ii) a major market of the subsidiary, (iii) a secondary market of the subsidiary, (iv) not a part of the subsidiary's market. The average response was calculated by allocating 'only' market the value of 4, 'major' market the value of 3, 'secondary' market the value of 2 and 'not part' of the market the value of 1

Table 3 Regressions with markets supplied as dependent variables

	Dependent variable (market supplied)						
	Host	Other CEE	European Union	Other W. Europe	Non-European developed	NICs	Developed countries
Constant	2.825*** (7.128)	0.768 (1.369)	0.705 (1.619)	1.120** (2.463)	0.865*** (3.098)	0.807*** (3.240)	1.126*** (4.413)
Asia	0.902*** (3.155)	0.831* (1.982)	0.674** (2.068)	1.093*** (3.216)	-0.107 (-0.511)	-0.224 (-1.204)	-0.423** (-2.219)
North America	0.248** (2.056)	-0.557*** (-3.356)	0.256** (1.990)	0.029 (0.216)	-0.114 (-1.382)	-0.190** (-2.579)	-0.012 (-0.161)
Bulgaria	0.318 (1.519)	-0.225 (0.795)	-0.020 (-0.090)	-0.035 (-0.155)	-0.090 (0.641)	-0.057 (-0.461)	-0.024 (-0.184)
Czech Rep.	0.027 (0.171)	0.108 (0.508)	0.207 (1.256)	0.185 (1.074)	0.017 (0.168)	0.051 (0.547)	0.131 (1.361)
Poland	0.109 (0.776)	-0.163 (-0.859)	0.004 (0.028)	-0.019 (-0.128)	0.022 (0.236)	0.028 (0.330)	0.068 (0.788)
Romania	0.268 (1.448)	-0.334 (-1.327)	-0.076 (-0.391)	-0.027 (-0.133)	0.020 (0.162)	0.034 (0.301)	0.069 (0.599)
Russia	0.109 (0.670)	-0.012 (-0.057)	-0.056 (-0.326)	-0.131 (-0.732)	0.027 (0.247)	-0.024 (-0.252)	0.037 (0.373)
Slovakia	0.047 (0.288)	0.127 (0.561)	-0.193 (-1.100)	-0.239 (-1.303)	-0.092 (-0.823)	-0.071 (-0.712)	-0.020 (-0.201)
Slovenia	0.562*** (2.520)	-0.438 (-1.453)	-0.328 (-1.399)	-0.291 (-1.190)	-0.131 (-0.873)	-0.111 (-0.825)	-0.081 (-0.590)
Chemicals	0.165 (1.088)	-0.354* (-1.710)	0.057 (0.355)	-0.284* (-1.690)	-0.089 (-0.869)	-0.099 (-1.075)	0.124 (1.318)
Electronics	0.059 (0.370)	-0.212 (-0.957)	0.240 (1.398)	0.065 (0.363)	0.137 (1.242)	0.140 (1.421)	0.154 (1.528)
Mech. Eng.	-0.033	-0.390*	0.488***	-0.071	0.034	-0.074	-0.063

	Dependent variable (market supplied)						
	Host	Other CEE	European Union	Other W. Europe	Non-European developed	NICs	Developed countries
	(-0.230)	(-1.980)	(3.188)	(-0.447)	(0.345)	(-0.841)	(-0.699)
Motors	0.353 (1.314)	-0.822** (-2.214)	0.133 (0.461)	-0.032 (-0.108)	-0.101 (-0.548)	-0.097 (-0.586)	-0.051 (-0.304)
HOSTMARKET ⁽¹⁾	0.520*** (4.385)	-0.057 (-0.323)	-0.092 (-0.672)	-0.051 (-0.355)	0.054 (0.608)	0.016 (-0.204)	-0.184** (-2.288)
CEEMARKET	-0.020 (-0.307)	0.258*** (2.868)	-0.047 (-0.665)	-0.033 (-0.462)	-0.021 (-0.460)	0.029 (0.736)	0.056 (1.364)
EFFSEEK	-0.212*** (-2.926)	0.471*** (4.805)	0.434*** (5.695)	0.275*** (3.458)	0.131*** (2.690)	0.159*** (3.639)	0.230*** (5.143)
LOWCOST	-0.138 (-1.558)	0.115 (0.959)	0.167* (1.786)	0.064 (0.654)	-0.043 (-0.717)	-0.037 (-0.697)	-0.004 (-0.082)
LABSKILL	-0.382*** (-2.948)	-0.162 (-0.896)	0.025 (0.176)	-0.025 (-0.169)	0.111 (1.232)	0.096 (1.193)	0.020 (0.241)
SCIENCEINPUT	0.052 (0.298)	0.102 (0.396)	-0.144 (-0.725)	-0.310 (-1.493)	-0.216* (-1.687)	-0.252** (-2.215)	-0.267** (-2.291)
NATIONRES	0.013 (0.082)	0.069 (0.298)	-0.014 (-0.077)	0.229 (1.221)	0.092 (0.801)	0.175* (1.705)	0.221** (2.102)
R ²	0.638	0.571	0.695	0.550	0.312	0.398	0.452
F	6.797***	5.080***	8.688***	4.656***	1.728**	2.516***	3.138***
n	102	101	101	101	101	101	101

(1) For full definition of reasons to invest, see Table 1

*** significant at 1% ** significant at 5% *significant at 1% n - number of observations

Notes

- ¹ Thus the view of the MNE reflected in the argument developed here reflects elements of the heterarchy (Hedlund, 1986, 1993; Hedlund and Rolander, 1990), the transnational (Bartlett and Ghoshal, 1989, 1990) and the horizontal organisation (White and Poynter, 1990).
- ² European OPT operated 'under a tariff regime that allows an EU firm to import processed or assembled products while avoiding regular tariffs as long as the parts to be processed or assembled by the outside sub-contractor are supplied by an EU principal' (Zysman and Schwartz, 1998, p.12).
- ³ Éltető (2000, table 10.7) shows that whilst OPT accounted for 12.4% of EU imports from Czech Republic in 1993, and for 20.2% of those from Hungary, 13.5% of those from Slovakia and 11.9% of those from Slovenia, the comparable figures for 1997 had declined to 8.5%, 10.1%, 9.3% and 5.2% respectively. Thus Lemoine (1998, p.159) suggests that 'although subcontracting had a crucial role in the redeployment of CEE industries toward Western markets in the first phase of transition, it seems to have rapidly exhausted its potential effect on export growth'.
- ⁴ In fact, intra-group political processes may favour this basis for exporting into Western Europe. Thus the relocation, on cost grounds, of supply of existing goods to new CEE operations may face strong resistance from the politically experienced Western European subsidiaries who face corresponding decline. Addition of new goods to the MNE's product scope (as exported from creative CEE subsidiaries) may impinge less decisively on established interests and therefore face less intra-group resistance.
- ⁵ For example, Rojec (2000) quotes an export/sales ratio of foreign operations in Czech Republic of 41.3% (for 1994), of 39.7% for those in Hungary (1996), but one of 65.3% in the smaller Slovenian economy.
- ⁶ The starting point was the *Fortune* listing of leading global corporations, published in August 1996. Since this, for the first time, covered all areas of business, only 207 relevant manufacturing and extractive enterprises were found. To increase the relevant population the last listing of 500 industrial companies (*Fortune*, July 1994) was consulted and 201 firms not already derived from the 1996 listing were added to the 207.
- ⁷ The remainder either exported to the CEE countries (three cases), or currently had no active commitment to the region (eight). These eleven only replied to questions on attitudes to the investment environment of transition economies and to possible future involvement.
- ⁸ Thirty-three HQs replied to this question, of which 27 were from those with production subsidiaries in the CEE region and six from those that operated there through other parts of the value-chain. In all, 135 subsidiaries were covered through separate replies reported in table 1. Of these, 74 were production subsidiaries, 19 were subsidiaries of MNEs that did have production operations in CEE but which themselves only operated at other stages of the value-chain, and 42 were subsidiaries of MNEs that only operated in CEE at non-production phases of the value-chain.
- ⁹ Cook and Kirkpatrick (1996, pp.181-2) suggest that 'a significant number of transitional economies have adopted an import protection strategy, aimed at attracting FDI into import-substituting production for the domestic market. A variety of trade related policies have been used, ranging from changes in effective rates of protection to the introduction of product-specific import quotas. In some cases, this has been as a result of lobbying by FDI interests and has been a precondition for the foreign investment to take place'.
- ¹⁰ Dominance of market-seeking behaviour has been a pervasive result of survey studies (Svetlicic and Rojec, 1994; Rojec and Svetlicic, 1993; Lankes and Venables, 1996; Mutinelli and Piscitello, 1997; Meyer, 1998; Manea and Pearce, 1997b, 1998) and case studies (Estrin *et al*, 1997).
- ¹¹ Dunning's (1993, p.58) definition of market seeking suggests that 'these are enterprises that invest in a particular country or region to supply goods or services to markets in these *or adjacent* countries' (emphasis added).
- ¹² Other studies often reinforce the view of the rather secondary relevance of either the broadly-defined ES motivation (Lankes and Venables, 1996; Manea and Pearce, 1997b, 1998; Rojec and Svetlicic, 1993) or its supply-side manifestation in input costs (Svetlicic and Rojec, 1994; Rojec and Svetlicic, 1993; Mayer, 1998).

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- ¹³ The four supply-side factors investigated here are aspects of the host-country economies that are selectively internalised by MNE subsidiaries in pursuit of their ability to fulfil mainly ES or KS elements of their strategic positioning. The main drivers for MS positioning remain the exogenous ones of market size, income characteristics and growth potential (including, perhaps, elements of market protection).
- ¹⁴ The more distinctively individualised product development potentials provided to a CEE subsidiary by the activation of NATIONRES may have two very different effects on the unit's strategic positioning in the group. Firstly, it may provoke resistance and suspicion from central planners, who fear the disruptive potential of radical new knowledge and product progress that lies outside the scope of the anticipated technological trajectory of the group (Pearce, 1999). Secondly, where radically new goods *are* developed from origins in NATIONRES, they may find it relatively easy to penetrate the MNE's established market spaces (e.g. Western Europe), simply because they do not compete directly with the mature products of existing (and politically adept) subsidiaries that are seeking to defend their status.
- ¹⁵ In all, information was provided on 122 subsidiaries. These including all those with production activity as well as others (mainly in distribution and marketing) that perceived their operations to target distinct market areas.
- ¹⁶ The general sparseness of SCIENCEINPUT and NATIONRES as reasons for investing precluded systematic comment on their results in the regression tests.
- ¹⁷ Evidence for this emerges in studies (Manea and Pearce, 2000 a, b) that analyse the use of different types and sources of technology in pursuit of different strategic objectives in these CEE subsidiaries.