

Internationalization of companies from former communist countries - OFDI from Central, East and South Europe and CIS countries.

Abstract and research questions

This study aims to assess the level of internationalization of companies from former communist countries in relation to companies from highly developed countries, as well as analysis of differences between the internationalization model adopted by companies from particular transition economies. The study focuses on the region of Central and Eastern Europe and South-Eastern Europe, as well as on the countries of the Commonwealth of Independent States (CIS), excluding Asian former USSR republics. The study uses statistical data concerning the FDI developed by Unctad in the World Investment Report, data concerning the investments in the CEE region developed by the Vienna Institute for International Economic Studies in form of Database on Foreign Direct Investment in Central, East and Southeast Europe 2010 report, as well as on the Knowledge Economy Index (KEI) developed by The World Bank Institute's Knowledge Assessment Methodology.

This paper consists of six sections. The introduction to the subject and reviews of the literature on the topic. The third section refers to the main research problems related to the FDI analysis in this region. The fourth section relates to the analysis of outward FDI from transition economies as compared to the global outward FDI. The fifth section is a detailed comparative analysis of MNEs from transition economies.

Introduction

A majority of publications concerning the multinational enterprises (MNEs) focuses on companies originating from the countries of the triad: Northern America, European Union and Japan. It is between these economic areas that there is at present the largest trade exchange in the world, most foreign direct investments - FDI are performed presently between these regions.

However, since the early 1980s, new MNEs have been created, originating from developing economies. Presently, worldwide most new MNEs comes from Asian countries and South America, that is why most publications concerning the issued related to the reasons of their growth and application of strategy on international markets concerns the companies coming from these two regions. Undoubtedly, a region which before 1990 did not contribute to the creation of companies operating at a international level, or even global level, is the region which was politically dominated by the Soviet Union. Lack of sound market mechanisms, dependency on political decisions and lack of private independent companies for 45 years hindered or even rendered it impossible for companies from this region to enter the competition. Companies operating in conditions of centrally planned economy were not only ineffective economically, but were also unable to efficiently compete with companies operating in market economies.

The above mentioned factors were the reason for the fact that in times of market transformation in early 1990s, the Central and Eastern European Countries – CEECs and countries formed as a result of disintegration of USSR were not only characterised by a significantly lower GDP per capita as compared to highly developed countries, but they were also disadvantaged technologically, except for some branches of industry. Additionally, the level of internationalization of their economies, measured by the level of export to GDP, lack of liquid exchange rates and insignificant share in global investment flows were a fundamental barrier to the creation of MNEs. This however does not mean that there were not, as early and the beginning of 1990s. any companies operating at international level functioning in these countries. A good example is the group of states formed after the disintegration of Czechoslovakia and Yugoslavia. In this case, basically over night, the companies which had their branches in federal countries - became international companies after the federal countries became independent. However, this was only the beginning of the process of internationalization of companies from this region.

The years 1990-2010 were a period of sudden political and economic changes in the analyzed region. Undoubtedly, these were these changes of political systems which caused the later economic changes. This was different from the situation in, for instance, South Korea, Taiwan or Chile, where the economical reforms were implemented, and the resulting gradual increase of wealth of the population led to political changes. From the twenty-year perspective, one must assess that the system transformation did not bring about uniform results. On one hand, the pace of economical reforms was not the same in all countries, on the other, the political changes - including geopolitical ones - were not always undisturbed (e.g. gaining independence by the Baltic states - Estonia, Latvia and Lithuania; Yanayev's putsch in Russia; disintegration and war in ex-Yugoslavia; war in Moldova and Transnistria; disintegration of Czechoslovakia). Ultimately, the above mentioned factors cause that at present, we are dealing with a very varied economic area. When assessing changes related to the system transformation, the analyzed countries at present may be broken down to the following groups:

- democratic states with market economy, with a large participation of the private sector;

- democratic states with market economy, with a relatively large participation of the state-owned companies sector;
- states with an authoritarian political system with a relatively large participation of the state-owned companies sector.

The first group includes the new EU member states (Bulgaria, the Czech Republic, Estonia, Lithuania, Latvia, Poland, Romania, Hungary, Slovenia and Slovakia) and countries from South Eastern Europe (Albania, Georgia, Bosnia and Herzegovina, Croatia, Montenegro, FYROM, Moldova, Serbia). The second group includes Russia and the third one Belarus, Kazakhstan (none of which is a member of the WTO) and other Asian former USSR republics. From the point of view of this study, the process of creation of MNEs and the strategy adopted by them depends to a large extent on the group of countries which the company belongs to. In this study, due to a negligible level of internationalization of companies, the analysis excludes, apart from Kazakhstan, the other Asian former USSR republics (Kyrgyzstan, Turkmenistan, Uzbekistan, Tadjikistan, Armenia and Azerbaijan).

1. Main streams of direct foreign investment theory

Direct foreign investment is the most advanced form of business internationalization. As a rule, the companies start their expansion in foreign markets by means of exports, then they set up foreign branches and only at the final phase of internationalization of their activities they make greenfield investment or purchase shares in the operating companies. The main task of theories addressing direct foreign investment is an attempt to answer the question: who, why and where makes foreign investment and what is the impact of the investment both on the economies of the countries making the investment and those receiving such investment? From the point of view of this study, it is a serious drawback of the existing FDI theories that there is no theory taking into consideration market transformation processes in the CEE countries – including first of all new European Union member states, and therefore, there is no uniform FDI theory describing the process of internationalization of the activities of the companies in post-socialist countries.

One of the earlier theories, considered as a landmark is the product life cycle theory (Vernon, 1966). R. Vernon made a theoretical generalization of M. V. Posner's theory interpreting structure and streams of international exchange. Buckley and Casson (1976) applied transaction costs in an international context for their internalization theory, which is concerned with imperfections in the markets for intermediate products, including technology, organisational know-how and marketing skills. At present, the theory which describes the mechanisms of making foreign investment in the broadest way is J. H. Dunning's (1980, 1993, 1996) eclectic theory of international production also known as the OLI Paradigm. One of quite frequently quoted theories is a development paradigm (K. Kojima and T. Ozawa 1984; T. Ozawa 1992), and the theory of R. Luostarinen and L. S. Welch (R. Luostarinen 1970; L. S. Welch and R. Luostarinen 1988). The first cross-sectional analysis of the outward foreign direct investment, concerning selected states of the Central and Eastern Europe was carried out only in the years 1999-2002 and related to a small group of states: Czech Republic, Estonia, Poland, Slovenia and Hungary (see Svetličič, 2003). At present, the rate of outward investment from Russia and the Central and Eastern Europe is continuously increasing. The increase relates mainly to the companies from the states being new members of the European Union.

Three advantages defined in J. H. Dunning's eclectic theory: ownership advantage, location advantage and internationalization advantage have impact on the decisions of the companies, relating to foreign investment. The eclectic theory is supplemented by investment development path – IDP¹, which shows the dependence between the economic development level and the investment position of the state (i.e. the relation between the inward and outward investment. Goldstein (2009 p. 82) concluded that the IDP model has indeed proven very useful for smaller European economies. Some emerging economies, despite their large size and potential, may suffer from a unwelcoming investment climate and therefore register relatively low inflows at the same time as their companies invest abroad. In other words, multinationalization may emerge as a defensive strategy to escape a harsh business environment.

According to the IDP model, the states pass through five development stages² depending on their economic development level, which in turn has influence on net outward investment (NOI) level. The assessment, at which stage the given state is, depends on the relation between outward and inward investment. Depending on the economic development level of the state (in this case measured by means of GDP *per capita*), foreign investors willing to make investment are motivated by reasons different than those affecting the decisions made by local entrepreneurs willing to invest abroad (with unchanged GDP *per capita* at the time of making the decision by local and foreign investors).

In the IDP model, in case where the states are at the same stage of economic development and have at the same time differentiated structure of the level of international investment engagement, such difference is explained on the basis of advantages described by J.H. Dunning in the OLI paradigm. At present, economic structure of highly developed states becomes more and more similar (this results, among others, from similar structure of the assets held). Particular states, according to their economic development measured by GDP *per capita*, pass on to subsequent, higher stages of the IDP model. More and more frequently, particularly in integration groupings such

¹ To describe the dependence between FDI and economic development level, the name Investment Development Cycle is also used

² Only in the 1990s, J. H. Dunning added the fifth stage of the state development to the economic development level theory, mainly due to the lack in his previous studies of the interpretation of investment flows between the highly developed states being at the same stage of the economic development

as the European Union, we note an increase in crossing FDI, characterized by similar value of both exports and imports of FDI between particular states.

From macroeconomic point of view, inward and outward investment depend on the level of economic development of the state receiving the investment as well as the states of origin of the investment. According to J. H. Dunning's eclectic theory of international production, this dependence is presented by means of the IDP model from which it results that both inward and outward investment are characterized by a growth trend as a result of economic development of the state. At an early stage of the development, the states achieve higher and higher level of attractiveness to foreign investors through the development of location advantages (local market, cheap labour force, various types of tax incentives). At this stage of development, the inward investment grows rapidly, whereas the outward investment remains at a very low level or simply do not exist. When GDP *per capita* starts to increase, the inward investment growth rate gradually drops with accelerated outward investment growth rate. This is due to the fact that as a result of the economic growth, part of companies in a given state obtains higher and higher revenues and becomes more and more focused on activities in international markets and because the rate of return on the capital invested in local market (both its relative value and absolute value) is gradually decreasing as a result of the increase of the ratio of capital cost to labour cost. As a result of a high level of income *per capita*, the value of outward foreign investment becomes equal to or higher than the value of inward foreign investment. At this development stage, a dominant form of the outward investment are the transactions carried out by large transnational corporations creating international networks of production relations. This type of gradual growth and evolution of the outward foreign direct investment was also outlined partially in the Scandinavian sequential internationalization model and partially in the product life cycle theory. The analysis of the Net Outward Investment index should consider the fact that in the period of 1990-2010 in market transformation economies, a so-called "bulk privatization" took place. This was caused by an unprecedented scale of privatization of entire branches of economy - which were state-owned before 1989. Therefore, if one could eliminate this factor (i.e. inflow of capital related to privatization processes), the value of NOI would probably take a different turn, however it is dubious whether it would be positive - mainly due to the fact that in the 1990s the outflow investments in this group of states was actually negligible. The inflow of FDI was also related with the need to liberalize and deregulate the market, which is discussed, for instance, by Cuyvers L, and de Beule F, (2005 p. 2).

It is important to remember that the IDP paradigm is not always a suitable tool for the analysis of the outward FDI. As it was correctly observed by Kalotay (2004, p.11-12) one of the relative weaknesses of the IDP may be due to the fact that, on the side of GDP per capita, it does not consider differences in income distribution. In other words, it is tacitly assumed either that national income is evenly distributed among population; or at least at a given level of development, the income distribution of countries is fairly the same. Kalotay concluded that there clearly are two different worlds: one of the "small" countries where there are signs of the applicability of the IDP and other standard analysis; and another one for the Russian Federation, where a combination of "system-escape" factors (capital flight) and global corporate strategic aspirations result in a major capital exporting world, without having the necessary GDP per capita usually assumed for that.

2. Main methodological problems

One of the main problems concerning the analysis of MNEs from Developing Countries MNEs (DC MNEs) is that there is no comparable and consistent statistical data concerning the foreign investments (FDI) made by companies. There are of course published data concerning particular countries or regions, however there are no edited financial data at the global level. Until today, the main source of statistical data concerning the global investment flows is the World Investment Report published annually by UNCTAD. Currently, a relatively large methodological problem existing when analysing MNEs is the lack of possibility to unequivocally define the "nationality" of the company. UNCTAD statistical data on which most publications on global FDI base do not contain information concerning the shareholders' structure of the company. Therefore quite often the investments of a company with seat in one country, which are reported as investments of a given country, may be in fact investments related with another entity (company) originating from another country. The problem with determination of the country of origin of the shareholders exists also (which is obvious) in case of companies listed at stock exchanges - especially in cases of quite a large fragmentation of the shareholders' structure. This does not however mean that all the authors omit the issue related to the determination of a company's nationality. For instance Rugraff (2010) in his work on OFDI from four CEECs (the Czech Republic, Hungary, Poland and Slovakia) analyzes OFDI with respect of shareholders' structure of MNEs which invested abroad, making a division into companies with home capital - i.e. originating from these four countries) and companies which are daughter companies of international corporations, which make foreign investments from these countries.

More extensively, problems with determination of corporate nationality were described by Goldstein (2009 p. 7-10) who analyzed four types of situations:

- companies established in developed countries by non resident entrepreneurs;
- companies that move their primary listing to an advanced country's financial market in order to benefit from lower currency risk and higher liquidity;
- companies incorporated in developing countries that are in turn subsidiaries of OECD MNCs;
- companies from developing countries that are owned by financial investors based in OECD countries.

Apart from the types of situations mentioned above, where the differentiation of MNEs nationality is undoubtedly difficult, the so-called "round-trip" FDI must be mentioned too, which is outward FDI by MNEs seeking to reinvest these same funds in the home country as inward FDI. In a greater scale, this relates to both Chinese and Russian companies which make investments through entities from Cyprus, Virgin Islands, Hong Kong and Cayman Islands. From the reasons mentioned above, when determining the country of a company's origin, this study will take into consideration only the country where the investing company has its registered seat (whatever the structure and origin of the shareholders). Such assumption seems justified, both due to lack of reliable data concerning the shareholders' structure of companies and with respect of methodological consistency of the study.

In this study, in order to systematize the methodology of division of companies operating on foreign markets, the division applied by Rugman (2008 p. 154) will be adopted; Rugman divides the companies with respect of geographic structure of sales into four types:

- home region firms (generate over 50 percent of their sales in the home region);
- bi-regional firms (generate less than 50 percent of their sales in the home region and over 20 percent in another triad region);
- host region firms (generate over 50 percent of their sales in another triad region, outside their home region);
- global firms (generate less than 50% of their sales in the home region and over 20% in each region of the triad).

In the above division Rugman understands a region as one of the triad regions. This means that according to this definition, in order for a company to be considered global, it should operate in Northern America, Asia and Europe. Rugman (2008 p. 150) have concluded that the theoretical literature indicates that MNEs expand abroad based on a complex interaction between firm specific advantages (FSAs) and country specific advantages (CSAs). The successful MNEs from this three regions in general expand abroad to exploit FSAs that they have developed in their large internal home markets. The activities of their foreign subsidiaries, to an overwhelming degree, tend to replicate for local distribution the FSAs developed in the home market. First investments are usually made in the closest region, and only later the activity is expanded to other regions. The essential question is whether in transition economies from Central and Eastern Europe global MNEs will be formed (and not only regional) and whether country specific advantages will be based on a knowledge oriented economy, highly educated workers, advanced infrastructure – which could guarantee the creation of companies operating outside the European region?

3. Outward foreign direct investment from transition economies in the global context

Despite a capital and technological advantage, the gap separating the developed economies from developing economies is gradually closing. The economic advantage of Europe and Northern America over the other economic areas (which to a large extent was started as early as in the 19th century in the industrial revolution era) starts gradually to decrease. This thesis is confirmed by the fact that the group of developed countries has been joined by Japan or South Korea, but also the advancing internationalization of BRIC countries (Brazil, Russia, India and China). The percent share of the level of investments (FDI inward stock) in developing economies with relation to the total of global investments between 1990 and 2008 increased insignificantly, from 27,3 to 29,5%. On the other hand, the share of developing economies in FDI outward stock in the same period increased from 8,1% to 14,7% (see table 1). This means that the rate of outflow of FDI from developing economies is much faster than the rate of inflow of FDI to these countries. This proves that the process of internationalization of these economies is progressing and that they efficiently compete with entities from highly developed countries.

Table 1. Stock of inward and outward FDI, 1990, 2008 (billions of U.S. dollars)

	FDI inward stock		FDI outward stock		FDI inward stock (% of total)		FDI outward stock (% of total)	
	1990	2008	1990	2008	1990	2008	1990	2008
Developed economies	1 413	10 213	1 640	13 624	72,7%	70,5%	91,9%	85,3%
Developing economies	530	4 276	145	2 357	27,3%	29,5%	8,1%	14,7%
World	1 942	14 489	1 786	15 980	100%	100%	100%	100%

Source: data from Unctad 2009.

In the opinion of Narul (2010 p. 12-13), the evolution of the ‘first wave’ MNEs towards the ‘second wave’ MNEs was initially enhanced by the fundamental (but gradual) change in the structure of the world economy, much of which is often generalised as being a direct result of globalisation. These changes can be considered from the developing country perspective as being of two kinds. First, there are those that have been largely *exogenous* to these countries but which have affected their economic structure both as members of the world economic order and as individual economies. Globalization – in the sense of greater cross-border economic interdependence between firms, markets and countries - has impacted on firms by creating broader and more competitive markets across countries. There have also been structural changes *within* individual countries in direct response to these exogenous changes, and as such may be considered as *endogenous* to most developing economies. These endogenous changes are primarily associated with the actions and policies of governments. One of the most important of these changes over the past decade or so has been a fundamental shift in the policy orientation of developing countries from an import-substituting role (or a centrally-planned one) to an export-oriented, outward looking one.

Table 2. Stock of inward and outward FDI, 1990, 2008 (billions of U.S. dollars)

Region	FDI inward stock		FDI outward stock		FDI inward stock (% of the world)		FDI outward stock (% of the world)	
	1990	2008	1990	2008	1990	2008	1990	2008
Developed Europe	809	6 933	888	8 997	41,7%	47,8%	49,7%	56,3%
New EU member States	4	471	1	78	0,3%	4,6%	0,1%	0,6%
North America	508	2 691	515	3 682	26,1%	18,6%	28,9%	23,0%
Asia and Oceania	358	2 584	68	1 697	18,5%	17,8%	3,8%	10,6%
Other developed economies	96	589	238	944	4,9%	4,1%	13,3%	5,9%
Latin America and the Caribbean	111	1 182	58	561	5,7%	8,2%	3,2%	3,5%
Africa	61	511	20	98	3,1%	3,5%	1,1%	0,6%
South-East Europe and CIS	0	420	0	225	0,0%	2,9%	0,0%	1,4%
New EU, South-East Europe and CIS	4	892	1	304	0,3%	7,5%	0,1%	2,0%

Source: data from Unctad 2009.

In regional breakdown, the largest percent share in the global FDI outward stock is held by the developed European countries (increase from 49.7% to 56.3% between 1990 and 2008). The second rank, with a decreasing trend, is held by Northern America (a respective drop from 28.9% to 23%). Asia and Oceania rank third (a respective increase from 3.8% to 10.6%). The countries of ex-Soviet block noted in the years 1990-2008 an increase from 0.2 to 2% of total global outward FDI stock. An over tenfold increase of FDI outward stock value from countries of this region is a result of a very low level of investment before 1990, which is turn is the result of a hampering of business internationalization processes resulting from the political and economical system before 1990. With 2% of FDI outward stock of former communist countries, as much as 1.3% are Russian investments, 0.6% are investments of new EU member states, while only 0.1% are investments from other CIS countries (see table 2). Value-wise, the FDI outward stock from CIS countries amounts to USD 216 billion (of which most are Russian investments of USD 203 billion), while the FDI outward stock from the new EU member states equals to USD 68 billion, and from South and Eastern Europe countries – USD 3.8 billion. The total value of outward FDI stock from transition economies equals to USD 288 billion, of which the first five countries have 90% of total investments with respect of OFDI stock value. These countries are Russia, Poland, Hungary, the Czech Republic and Slovenia. One must however remember that in Russia before 1999 most FDI outflows were of an informal nature and it is highly possible that before this date the outward investment position of the country was largely underreported (see e.g. Bulatov, 1998, Kalotay, 2010), perhaps this fact is the reason for publishing incompliant data by the Bank of Russia and Unctad concerning the stock of OFDI for 2008 (see e.g. Unctad 2009 and Kalotay 2010)

The values of FDI outward stock with relation to GDP are provided in table 3. For Russia itself, the OFDI stock/GDP equals 16.2 %, which visibly exceeds the value of this index for CIS and for the New EU members from CEE. Undoubtedly, the value of Russian FDI exceeds the average value of both OFDI stock per capita and OFDI stock per GDP in CIS countries. Detailed data concerning the value of both indices for the analyzed group of countries have been provided in Annex 2 to this study.

Table 3. FDI outward stock as a percentage of GDP, 2008 (per cent)

Region/countries	Population	GDP	FDI outward stock	FDI outward stock/capita	FDI outward stock/GDP
	mln	mln US\$	mln US\$	US\$	(%)
Commonwealth of Independent States *	217	1 569 930	215 864	996	13,7%
New EU members from CEE	102	1 158 394	68 359	671	5,9%
South and Eastern Europe	25	167 989	3 832	155	2,3%

* including Georgia a member till 2009 year, without Armenia, Azerbaijan, Kyrgyzstan, Moldova, Tajikistan, Uzbekistan;

Source: Own calculations, data for OFDI from Unctad 2009, data for population and for GDP from IMF (2010).

The average value of the OFDI stock / GDP index for developed economies in 2008 amounted to 33%, where the greatest value of this index was reached in European countries (46.7%), in Northern America it amounted to 23.4%, and in Asia and Oceania - 15.3%. It is visible that despite a constant rising trend, the level of internationalization of new EU member states, CIS and South and Eastern Europe remains all the time at a relatively low level.

Table 4. FDI stock as a percentage of GDP, 1990, 2008 (per cent)

Region		1990	2008
World	inward	9,1	24,5
	outward	8,5	26,9
Developed economies	inward	8,1	24,7
	outward	9,5	33,0
Europe	inward	10,7	36,0
	outward	11,8	46,7
North America	inward	8,0	17,1
	outward	8,1	23,4
Other developed economies	inward	2,8	9,5
	outward	6,9	15,1
Developing economies	inward	13,8	24,8
	outward	4,1	14,0
Africa	inward	12,5	33,2
	outward	4,8	7,2
Latin America and the Caribbean	inward	9,9	27,3
	outward	5,4	12,9
Asia and Oceania	inward	16,1	22,8
	outward	3,3	15,3
South-East Europe and CIS	inward	-	17,9
	outward	-	10,0

Source: data from Unctad 2009.

When analyzing the process of creation of MNEs in developing countries, one must stress that it based on the following factors:

- protection of the internal market using tariff and paratariff barriers against foreign competition;
- capital support from the national financial institutions;
- government support for the oligopolies operating on the internal market;
- access to relatively cheap labour;
- lack of patent protection and thanks to that, quick access to foreign technologies;
- relatively large internal market;
- utilization of natural resources.

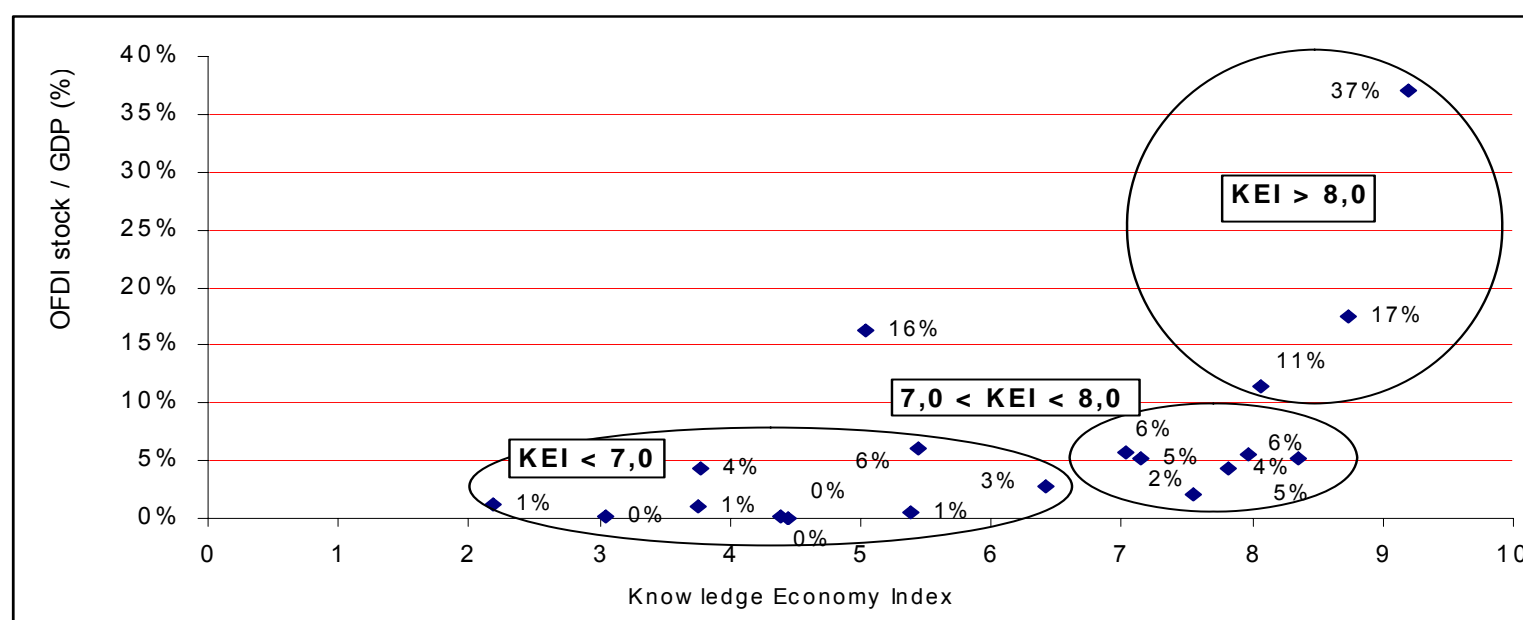
The above mentioned factors indicate that the process of creation of MNEs in developing economies was supported to a large extent by the governments of the respective countries. This means that a large role in reducing economic gap was played by the conscious formation of institutional regime. Currently, from among the former communist countries, the governments of countries which became EU members will not be able to support the creation of their MNEs in such an active way. This results from the fact, among others, that one of the objectives of the common economic area of the EU is to create conditions of free competition and counteracting oligopoly and monopolistic behaviours. Also the direct public aid for companies has been limited to a large extent. These factors directly cause that the tools used by emerging economies for the last decades cannot and will not be used in new EU member states. Therefore, the fundamental question arises - what competition advantages can be used by companies from new EU member states in developing activity on international markets?

4. MNEs from transition economies

In the first section of this study about the process of internationalization of companies from transition economies during the last 20 years, the analyzed countries have been divided into three groups - depending on the existing economic and political system. Governments of Russia and Kazakhstan, by influencing the key enterprises, actively execute the geopolitical and economical objectives. The possibility of influencing the latter, by creating at the beginning a favorable oligo- or monopolistic system in the internal market, with a strongly limited competition both internal and foreign external - enabled the creation of companies with an initial strong position in the region, which allowed these companies to develop at a global scale. Kalotay (2010 p. 138) thinks the same - he estimates that the role of the state is crucial in explaining the evolution of outward FDI from the Russian Federation. During the presidency of Boris Yeltsin (1991–1999), the Russian state actively contributed to the creation of large private monopolies which gave birth to future TNCs. However, at that time it did not have any particular policy actively promoting outward FDI. The situation changed under the presidency of Vladimir Putin (1999–2008). The participation of the state in some TNCs (especially Gazprom and Rosneft) increased, and the internationalization strategies of these state-owned TNCs became influenced by the course of the Russian foreign policy. Of course, the fact that in most cases the MNEs from these two countries are companies related to natural resources is also important for the development of these companies. This fact largely facilitated in the short period of 10 years the accumulation of capital necessary to expand on foreign markets. It should be stressed here that the model according to which MNEs from Russia and Kazakhstan develop is different from the Chinese model or the model in the Latin American countries, where an increasingly greater role is played by companies from the modern technologies sector, which efficiently compete with companies from developed economies. What is more, it seems that having natural resources is the main reason which caused the creation of MNEs in these two countries. As Goldstein (2009 p. 150-151) writes, for an emerging MNEs aspiring to become a profitable international player and recognized brand, the edge of low labour costs – one of emerging economies' advantages in competing with Western rivals – is becoming less and less important. Which in fact means that competing with low labour costs - at a global scale - is today practically impossible.

The companies from new EU members are in a different situation than companies from Russia and Kazakhstan. Accessing the EU and adopting rules applicable on the common market have caused an exclusion of possibility to actively support the companies in their internationalization. Additionally, these countries do not have natural resources which would enable the creation of MNEs. The creation of global firms (according to Rugman's definition (2008) quoted in the beginning of this study) – generating less than 50% of their sales in the home region and over 20% in each region of the triad seems to be possible only in a knowledge-based economy. In fact, without additional competition advantages, it is now difficult to compete at a global level. Therefore, a question is raised whether the economy actually based on knowledge stimulates companies or creates an appropriate environment - country specific advantages – which strengthen the international competition position.

Figure 1. Relation between The Knowledge Economic Index (2010) and OFDI stock/ GDP, 2008



Source: Unctad (2009) for OFDI stock/GDP, <http://data.worldbank.org/indicator> for KEI.

To be able to assess the relation between the level of internationalization of companies and the level of knowledge-based economy, this study uses two indices: the first one is outward FDI stock / GDP and the second is the Knowledge Economy Index (KEI). KEI has been developed by the World Bank Institute's Knowledge Assessment Methodology (KAM) – this is an aggregate index representing the overall preparedness of a country or region towards the Knowledge Economy (KE). The Knowledge Economy Index (KEI) is an aggregate index that represents the overall level of development of a country or region in the Knowledge Economy. It summarizes performance over the four KE pillars (Economic Incentive and Institutional Regime, Innovation, Education and Information and

communications technologies (ICT)) and is constructed as the simple average of the normalized values of the 12 knowledge indicators of the basic scorecard (see: Chen Derek H. C., and Dahlman Carl. J (2005)).

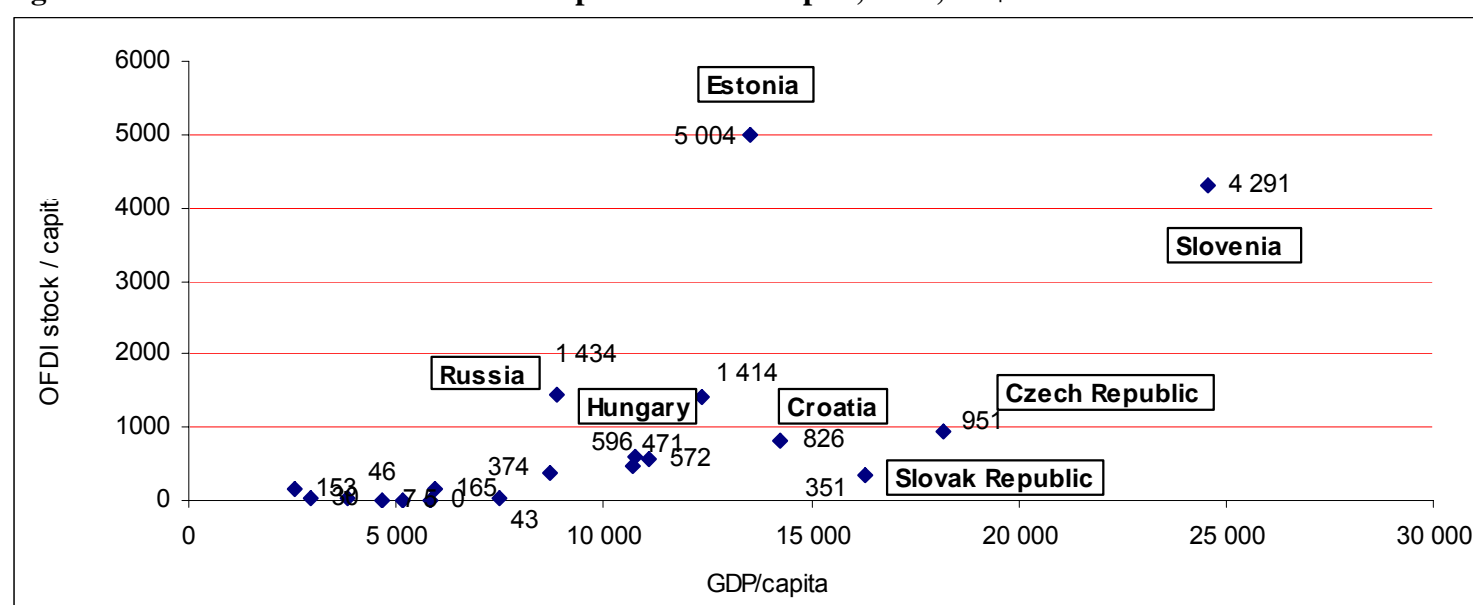
Figure 1 as well as Annex 3 presents the dependency between KEI and OFDI stock/GDP for the transition economies analyzed in this study. These countries have been divided into three clusters, depending on the KEI index adopted:

- first, where the value of the KEI index ≥ 8.0 ;
- second, where $7.0 < \text{KEI} < 8.0$;
- third, where $\text{KEI} \leq 7.0$.

As the Figure 1 shows, the states with a higher KEI index are characterised by a higher share of OFDI stock with relation to GDP. For Estonia, this index amounts to 37%, for Slovenia 17%, for Hungary 11%. However, in case of Russia, this index equals to 16% with a KEI of as little as 5.03. This in a way confirms that in the sector of latest technologies, MNEs from Russia will probably not be formed with the existing institutional conditions. A certain exception in the group of countries where $\text{KEI} > 8$ is the Czech Republic, where the OFDI stock / GDP equals to only 5%. Transition economies with a value of the OFDI stock/GDP index exceeding 10% are (apart from Russia) relatively small countries with a small internal market (respective populations: Estonia 1.3; Slovenia 1.2; Hungary 10 million inhabitants), which clearly was one of the factors leading to an early internationalization of companies from these countries. One has to remember that with a small internal market (in case of Estonia and Slovenia smaller than an average-sized European city), the companies had to start activities outside their country in order to achieve any scale effect. Additionally in case of Estonia - a leader with respect of share of OFDI related to the GDP among transition countries - the early liberalization of Estonian economy even before accessing the EU had an important role for the internationalization of the economy.

The second group of countries, where the value of KEI is between 7 and 8, includes Lithuania, Latvia, Slovakia, Croatia and Poland. Except Slovakia, in all these countries the value of OFDI/GDP ranges from 4 to 6%. In this group, all the countries are characterized by a small internal market, except for Poland. In the third group, the only EU members are Bulgaria and Romania, the other countries are countries either aspiring to EU membership or CIS countries.

Figure 2. Relation between OFDI stock/capita and GDP/capita, 2008, US\$

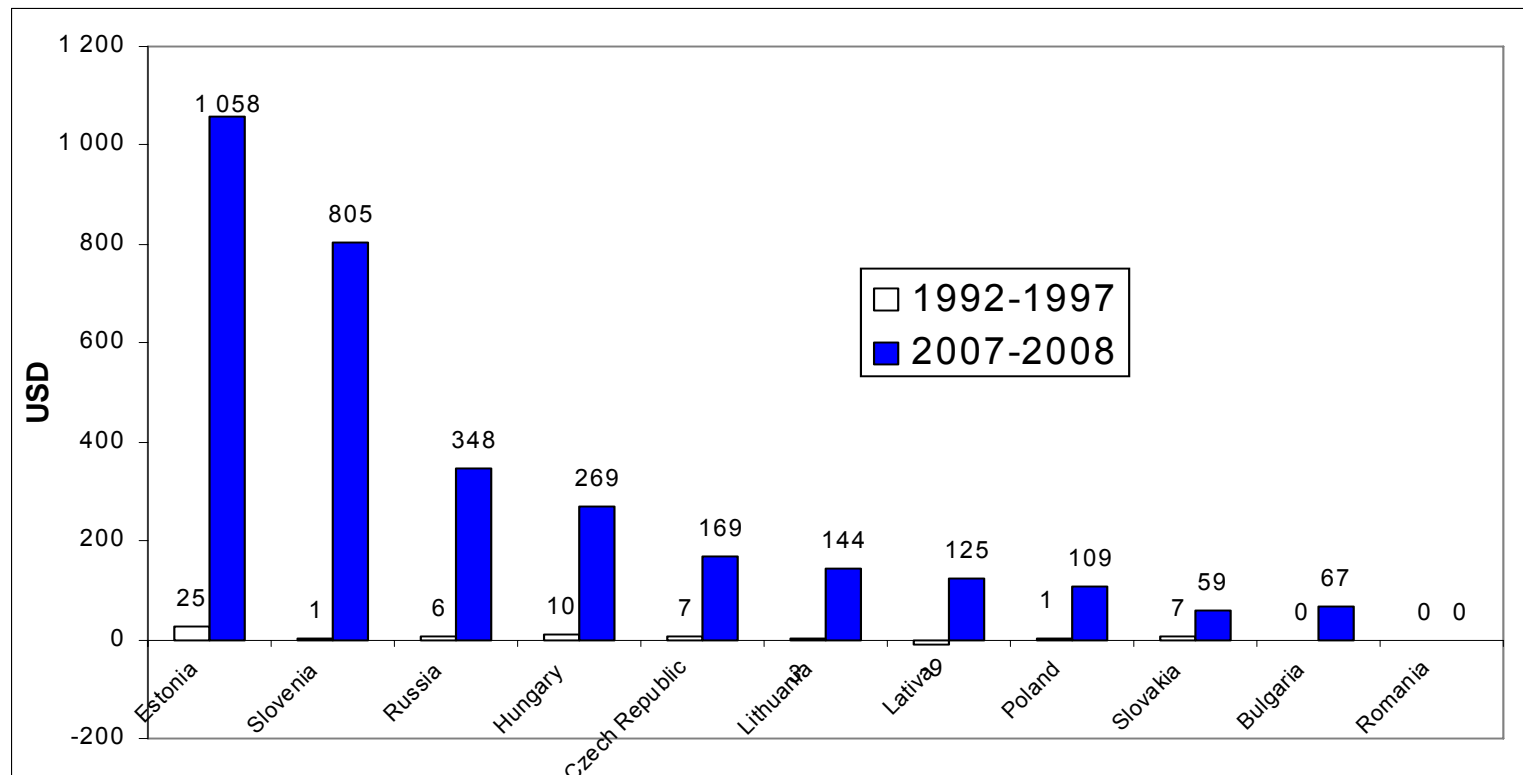


Source: Unctad (2009) for OFDI and <http://www.imf.org/external/datamapper/index.php> for GDP

Just like in case of the OFDI stock/GDP index, where the highest values were reached by Estonia (37%), Slovenia (17.5%) and Hungary (11.4%), in the transition economies the value of the OFDI stock/capita index in these countries also reached the highest value. It was the largest for Estonia – USD 5,004, for Slovenia, it amounted to USD 4,291 and for Hungary USD 1,414. The Russian economy is once again an exception, like in the case of the previous index, which with a relatively low value of GDP per capita reached the value of OFDI stock/GDP equal to USD 1,434. In case of transition economies, there is a regularity compliant with the J. H. Dunning's IDP model - the higher the value of GDP per capita, the higher the value of OFDI stock per capita is. Of course, one has to remember that the analyzed countries differ in their economic structure. As Rugraff (2010) notes, there is quite a large difference between countries which are the largest investors in the region when it comes to the model of companies investing abroad. In case of Hungarian and Czech investments, the group of largest investors is dominated by companies owned by foreign MNEs, which made investments in these countries. It results from a significant inflow of foreign investments of foreign corporations to these two countries in the last 15 years and in a sense, using the knowledge of Central European market by their Hungarian and Czech subsidiaries. When it comes to Slovenian companies investing abroad, these are mainly Slovene-capital companies, which results from a low penetration of this economy by foreign capital, as well as the support given by governmental structures to companies investing abroad. In case of Polish foreign investments, a large share is held by companies where the decisive votes are held by the government - these are often stock-listed companies in which some part of the stock is still held by the State Treasury.

The above analysis of foreign economies from transition economies is supplemented by the two figures below. These show two values: average OFDI flow per capita in 1992-1997 and in 2007-2008 years and OFDI stock/ IFDI stock in transition economies. The first one shows the dynamics of increment of the annual average value of OFDI flow in the years 1992-1997 and 2007-2008. As it can be seen, the difference of the rate of FDI outflow from the analyzed area between the two figures is very large. In fact, a clear thesis may be made that between these two periods, a sudden increase of average value of FDI outflow took place. With that, one has to remember that the 1990s were a beginning of the systemic transformation in these countries, which resulted in such a large growth dynamics of investments, though still at a significantly lower level than in the triad region countries.

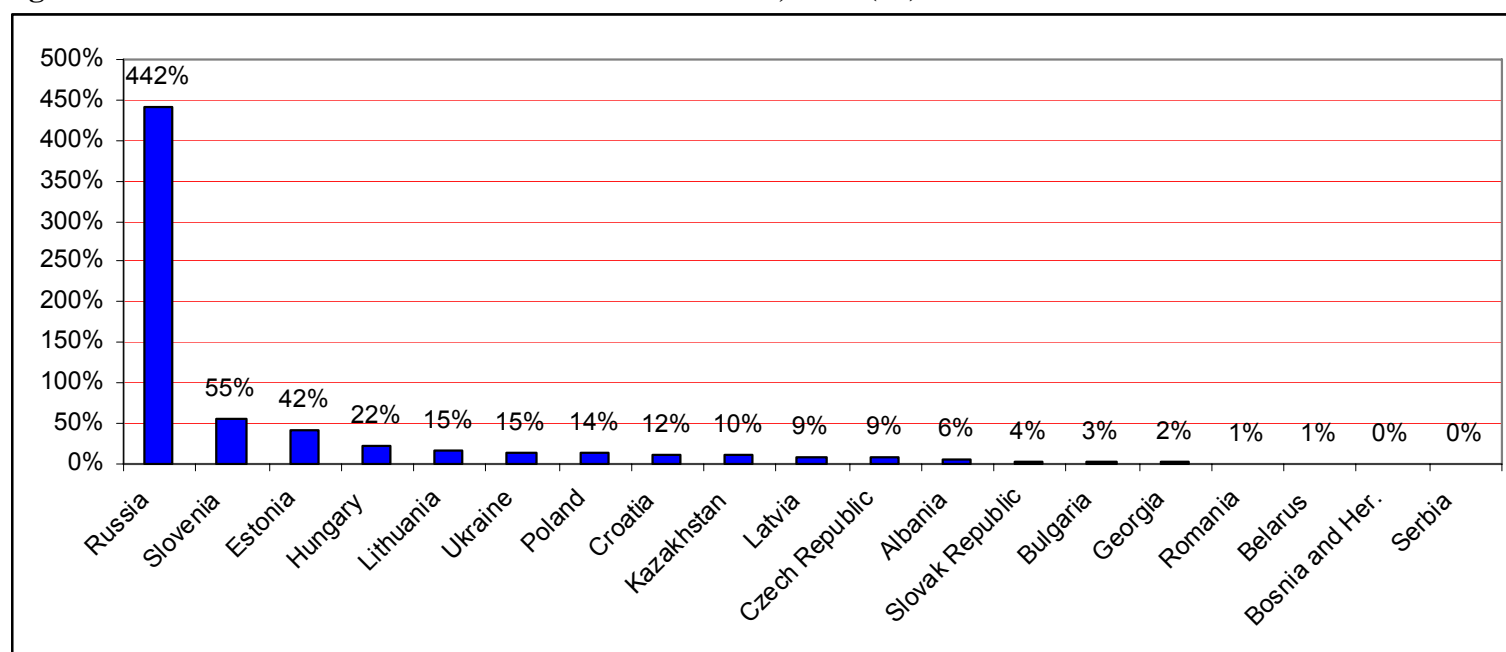
Figure 3. OFDI flow /capita for 1992-1997 average and 2007-2008 years, US\$



Source: own calculation Unctad (2009)

Figure 4 shows the share of OFDI stock with relation to IFDI stock in 2008. In case of 9 countries, the value of 10% was exceeded, and only in Russia the investments of Russian companies have exceeded the value of investment of foreign companies in this country. The countries with the largest value of this index are countries where the value of OFDI per capita is the highest in the region.

Figure 4. OFDI stock/ IFDI stock in transition economies, 2008 (%)



Source: own calculation Unctad (2009)

The main source of data relating to the geographical structure of OFDI from transition economies is the “*Data Base on Foreign Direct Investment in Central, East and Southeast Europe 2010*” developed by the Vienna Institute for International Economic Studies based on statistical reports of central banks of these countries. The data on geographical distribution of outward FDI stock show that most investments are located in the countries of the region - in principle, the countries neighbouring the investor's country. According to Rugman's (2008) division of companies (presented in the beginning of this study) dividing the companies to home region firms, bi-regional firms, host region firms and global firms, most TE companies are home region firms – which results from the fact that no investments are located outside Europe, which is a condition necessary for a company to be bi-regional. Lack of investments outside Europe indicates also a relatively weak internationalization of companies from the analyzed region.

In the geographical structure of TE investments, it is important that as much as 58% of outward FDI has been located in countries not located in the direct vicinity of the investor's country, such as Cyprus, the Netherlands, Switzerland and Luxembourg (see: table 5). The investments located in these countries do not result from attractiveness of these countries resulting from e.g. size of the local market or facilitated access to highly developed technologies. These are in fact countries where the location of investments is favorable from a tax perspective or interesting from the point of view of the company's headquarters and conducting further reinvestments from this country. It seems characteristic that from among transition economies, in the group of countries with the largest level of internationalization, the percentage of investments located in countries with favourable tax systems is lower than in countries with a lower level of internationalization. The countries with the largest percentage of investments made in Cyprus, the Netherlands and Switzerland are Ukraine (93%) and Russia (66%). In their case, the important factor for investment location in the above mentioned states is a quite unstable internal market and political system, which causes that from the point of view of the entities with capital, it is safer to make investments from Cyprus, Switzerland or the Netherlands than from the country of origin.

Table 5. Geographical distribution of outward stock by selected host countries, 2008 (%)

Country	Bahamas	Cyprus	Gibraltar	Liberia	Luxembourg	Marshall Islands	Netherlands	St. Vincent & Grenadines	Switzerland	Virgin Islands, British	% of total OFDI stock in 2009 r.	Outward FDI stock, 2008, mln USD	Outward FDI stock invested outside the CEE & CIS region
Ukraine		93%								0,3%	93%	7 005	6 529
Russia		30%			1%		28%		5%	3%	66%	202 837	134 075
Czech Rep.		11%	1%		2%		44%				58%	9 913	5 730
Croatia	1%			7%		5%	41%	1%		0,2%	55%	3 635	2 007
Poland					21%		9%		22%		51%	21 814	11 169
Lithuania		6%					21%				27%	1 990	533
Latvia		6%			2%				16%		23%	1 066	245
Hungary		4%			4%		2%		7%		17%	14 179	2 340
Bulgaria		3%			1%	5%		1%	4%		14%	1 248	180
Estonia		12%			0,1%		1%				13%	6 686	889
Romania		12%							1%	1%	13%	912	120
Slovakia		1%			11%						12%	1 901	234
Slovenia		3%	1%	3%			2%		1%		9%	8 650	787
Total											58%	281 836	164 837

Source: own calculation based on Hunya, G., and Schwarzhappel M., (2010), *WIIW Database on Foreign Direct Investment in Central, East and Southeast Europe 2010*.

The division of outward FDI from the point of view of economic activities in transition economies is not uniform, however four sectors prevail:

- manufacturing;
- wholesale, retail trade, repair of veh. etc.;
- financial intermediation;
- real estate, renting & business activities.

On the other hand, sectors with very small importance are: agriculture, hunting and forestry and fishing; construction, hotels and restaurants. The sectoral structure of investments clearly indicates the small share of vertical-type investments and predominance of horizontal investments, which may be caused by a large share - like in the Czech Republic or Hungary - of the predominant position occupied by services companies, and especially the foreign-owned banks, in the outward investments (see: Rugraff 2010). On the other hand, the Russian investments are dominated by two sectors: mining and quarrying and manufacturing, which together make up 76% of Russian investments. Russian Federation, where a combination of “system-escape” factors (capital flight) and global corporate strategic aspirations result in a major capital exporting world, without having the necessary GDP per capita usually assumed for that.

Main reasons, enabling this dynamic development of Russian MNCs, are:

- ⇒ one of the largest natural gas and oil fields in the world;
- ⇒ lack of possibilities to effectively re-invest profits in Russia (both for economic and political reasons).

Russian enterprises are investing abroad for various corporate strategic reasons rather than for limited seasons, such as export-supporting activities, as witnessed in the early 1990s. Their motivations have expanded to cover strengthening market positions, expanding markets overseas, internalizing control over value chains and accessing natural resources, including acquisition of strategic assets to improve competitiveness. The desire to diversify their activities out of the domestic business environment has also encouraged OFDI by Russian enterprises. These reasons have driven Russian enterprises to invest both in neighbouring countries and as far afield as

Africa, Australia and the United States (Vahtra and Liuhto, 2005). Surely, a serious obstacle for against dynamic expansion of Russian MNC in the CEE is the dependence of the region on the supply of Russian fossil fuels – natural gas and oil. The degree of dependence on Russian energy supplies together with its potential role in political relations has become a genuine threat. The examples of temporary restrictions in supply of natural gas to Belarus in 2004 and Ukraine in 2006 have shaken not only the energy security of those countries but also restricted the supply of those resources to end users (both Belarus and Ukraine are transit countries for the Russian exports of natural gas).

Figure 6. Outward FDI stock by economic activities, 2005-2008 (%)

	Croatia	Czech Rep.	Estonia	Hungary	Latvia	Lithuania	Poland	Russia*	Romania	Slovakia	Slovenia	Ukraine
Agriculture, hunting and forestry and Fishing	1	0	0	0	0	0	0	0	0	0	0	0
Mining and quarrying	6	1	0	7	0	0	0	39	65	1	0	0
Manufacturing	22	11	3	38	6	13	9	37	3	18	33	2
Electricity, gas and water supply	0	12	0	0	1	0	2	0	0	-7	1	0
Construction	8	3	2	0	2	1	1	2	0	1	1	0
Wholesale, retail trade, repair of veh. etc.	39	6	6	7	32	17	7	3	7	19	21	2
Hotels and restaurants	0	0	0	1	1	1	0	0	0	0	1	0
Transport, storage and communication	12	0	14	1	3	9	2	6	9	1	10	1
Financial intermediation	7	7	34	23	30	14	5	13	15	22	18	3
Real estate, renting & business activities	-1	57	38	21	20	41	7	0	1	41	15	86
Public administr., defence, comp. soc. sec.	0	0	0	0	0	0	1	0	0	0	0	0
Other community, social & pers. services	6	2	2	0	0	0	0	0	0	0	1	
Other not elsewhere classified activities	0	2	1	0	5	0	66	1	0	4	0	
Private purchase & sales of real estate	0			2		4	2	0	0	0	0	7

Source: Hunya, G., and Schwarzhappel M., (2010), *WIIW Database on Foreign Direct Investment in Central, East and Southeast Europe 2010* and for Russia UNCTAD, cross-border M&A database.

Conclusions and further research

The results of analysis of outward FDI from transition economies may be divided in two parts, firstly the evaluation of the level of internationalization of former communist economies with relation to companies and economies from developed countries, secondly conclusions concerning the differences between the method of internationalization in the transition economies. The conclusions concerning the level of internationalization are the following:

- despite a significant increase of value of outward FDI stock in the years 1990-2008 from transition economies, its value currently amounts to 2% of the total world investments and from the point of global economy is of low importance;
- the level of internationalization of transition economies is relatively low, the outward FDI stock/GDP index is almost two and a half times lower than its value in developed economies;
- the geographical structure of MNEs investments from transition economies indicates a negligible share of global companies and predominance of companies with only European reach;
- as opposed to FDI from developed countries, a very large part of investments from former communist countries (mainly from Ukraine and Russia) are the so-called “round-trip” FDI must be mentioned too, which is outward FDI by MNEs seeking to reinvest these same funds in the home country as inward FDI.

The conclusions concerning the differences of internationalization between the various transition economies are the following:

- from among former communist countries, the largest capital was invested abroad by MNEs from Russia;
- the leaders among Central European and South European countries with respect of outward FDI stock value are companies originating from the new EU member states, with respect of OFDI/capita, small countries lead the ranking, as due to the small size of internal markets, they started the process of internationalization of their companies fairly early.
- the analysis of the Knowledge Economic Index indicates that the knowledge oriented economies are characterized by a higher level of internationalisation of companies;
- with respect of the sectoral structure of investments, the investments from CIS - as opposed to the investments of companies from the new EU member states - are based mostly on the natural resources and power sector;
- due to the operation on a common European market, companies from new EU member states are in a different environment than companies from Russia, Kazakhstan or Ukraine, which may count for an active support of governmental structures in the process of expansion to the foreign markets.

From the point of view of internationalization of transition economies, a future important research problem is the definition of factors allowing the creation of global companies, as, what has been shown in this study, the companies from former communist countries are mainly companies with a local reach. From the point of view of internationalization possibilities, it is interesting to research in the future the factors determining the phenomenon of born globals. As compared to the traditional approach to internationalization of companies based mainly on sequential (gradual) expansion onto international markets, the concept of born global assumes the possibility of incremental internationalization of activities, which perhaps is at present the best way to speed up the internationalization of companies from transition economies.

Annex 1. The Knowledge Economy Index for former communist countries in 2010 year

Country	KEI		Economic Incentive and Institutional Regime		Innovation		Education		ICT	
	recent	1995	recent	1995	recent	1995	recent	1995	recent	1995
Estonia	9.19	8.73	9.38	9.34	8.78	7.46	8.60	8.45	10.00	9.69
Slovenia	8.73	8.76	8.52	7.63	9.86	9.53	8.27	7.89	8.26	10.00
Czech Republic	8.36	8.32	8.52	9.54	9.07	8.12	7.98	7.09	7.88	8.52
Hungary	8.07	7.77	8.89	7.47	9.51	8.84	6.15	6.42	7.75	8.33
Lithuania	7.97	6.39	8.52	7.39	6.63	4.72	8.63	6.89	8.11	6.54
Latvia	7.82	6.18	8.52	6.39	6.52	3.51	8.62	7.28	7.64	7.53
Slovak Republic	7.55	7.59	8.15	7.77	7.40	8.40	6.24	6.23	8.39	7.96
Poland	7.15	6.94	7.65	6.56	7.44	6.37	7.13	7.97	6.37	6.85
Croatia	7.03	6.85	7.78	5.67	8.72	8.57	4.13	4.89	7.49	8.27
Bulgaria	6.42	6.71	7.16	6.70	5.94	7.22	5.87	5.15	6.72	7.78
Ukraine	5.45	5.68	3.46	3.43	4.99	5.37	8.02	8.62	5.35	5.31
Romania	5.39	4.68	6.91	6.79	4.85	4.20	3.91	2.66	5.89	5.06
Russian Federation	5.03	5.65	1.48	2.80	6.87	5.53	5.91	8.10	5.87	6.17
Serbia	4.44	4.97	3.21	1.48	5.19	8.33	2.59	2.78	6.76	7.28
Belarus	4.38	5.65	0.86	2.49	5.05	4.64	7.75	8.99	3.84	6.48
Kazakhstan	3.77	4.29	4.32	3.33	1.92	2.22	5.86	6.60	2.96	5.00
Georgia	3.76	4.70	4.57	3.81	4.20	4.07	3.87	6.10	2.38	4.81
Bosnia and Herzegovina	3.05	3.06	3.46	4.81	1.85	1.48	2.51	1.67	4.37	4.26
Albania	2.19	2.53	3.21	5.04	1.32	1.67	1.74	0.38	2.50	3.02

Source: <http://data.worldbank.org/indicator>

Annex 2. Outward FDI stock as a % of GDP for former communist countries, 2008, %

	FDI outward stock	Population	GDP/capita	OFDI stock/capita	GDP	OFDI stock / GDP (%)
Estonia	6 686	1,3	13 509	5 004	18 048	37,0%
Slovenia	8 650	2,0	24 583	4 291	49 560	17,5%
Russia	202 837	141,4	8 874	1 434	1 254 784	16,2%
Hungary	14 179	10,0	12 386	1 414	124 241	11,4%
Czech Republic	9 913	10,4	18 194	951	189 669	5,2%
Croatia	3 635	4,4	14 243	826	62 669	5,8%
Lithuania	1 990	3,3	10 775	596	35 966	5,5%
Poland	21 814	38,1	11 098	572	422 962	5,2%
Latvia	1 066	2,3	10 701	471	24 195	4,4%
Kazakhstan	5 842	15,6	8 715	374	135 954	4,3%
Slovak Republic	1 901	5,4	16 315	351	88 299	2,2%
Bulgaria	1 248	7,6	5 916	165	44 780	2,8%
Ukraine	7 005	45,7	2 542	153	116 169	6,0%
Albania	147	3,2	3 825	46	12 240	1,2%
Romania	912	21,4	7 503	43	160 675	0,6%
Georgia	130	4,4	2 937	30	12 923	1,0%
Bosnia and Her.	29	4,0	4 636	7	18 544	0,2%
Belarus	50	9,7	5 165	5	50 101	0,1%
Serbia	0	7,4	5 808	0	42 979	0,0%

Source: Unctad 2009

Annex 3. Relation between The Knowlegde Economic Index and OFDI stock/ GDP, 2008

	KEI	OFDI stock / GDP (%)
Estonia	9,19	37%
Slovenia	8,73	17%
Czech Republic	8,36	5%
Hungary	8,07	11%
Lithuania	7,97	6%
Latvia	7,82	4%
Slovak Republic	7,55	2%
Poland	7,15	5%
Croatia	7,03	6%
Bulgaria	6,42	3%
Ukraine	5,45	6%
Romania	5,39	1%
Russian Federation	5,03	16%
Serbia	4,44	0%
Belarus	4,38	0%
Kazakhstan	3,77	4%
Georgia	3,76	1%
Bosnia and Herzegovina	3,05	0%
Albania	2,19	1%

Source: Unctad (2009) for OFDI stock/GDP, <http://data.worldbank.org/indicator> for KEI.

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