Consequences of Convergence – Western firms' FDI Activities in Central and Eastern Europe at the Dawning of EU-Enlargement*

*Stefan Eckert, Frank Rossmeissl***

Comparing all kinds of market entry, foreign direct investment (FDI) appears to be the most appropriate mode of foreign market. So called Market seeking FDI can be differentiated into those activities primarily aiming to realise psychic market proximity and into those activities mainly undertaken to realise physical market proximity. This differentiation is crucial because the number of FDI activities primarily done for reasons of psychic market proximity could decrease due to changes taking place in the CEE as well as an increasing cultural homogeneity. These tendencies give (a) MNEs already operating in CEECs for reasons of psychic market proximity potentials to restructure their current activities in the region and (b) MNEs striving to establish market presence in CEECs the possibility to consider modes of foreign market entry, which are less capital intensive than FDI like exporting.

Wenn man alle Markteintrittsformen vergleicht, erscheinen FDI als die beste Art des ausländischen Markteintrittes. Sogenannte marktsuchende FDI können unterteilt werden in jene, die eine psychische Marktnähe anstreben und solche, die eine physische Marktnähe realisieren wollen. Diese Unterscheidung ist wichtig, da die Zahl der FDI-Aktivitäten, die auf eine psychische Nähe zielen, abnimmt und es zu einer zunehmenden kulturellen Homogenität in MOE-Ländern kommt. Diese Tendenzen geben a) MNUs, die schon in MOE-Ländern sind, aus Gründen der psychischen Marktnähe, die Möglichkeit, ihre Aktivitäten umzustrukturien und b) MNUs, die einen Markteintritt beabsichtigen, andere Formen anzuwenden, die weniger kapitalintensiv als Fdi sind wie der Export.

Keywords: EU accession/ Central and Eastern Europe / cultural convergence / foreign direct investment / subsidiaries of MNEs / foreign market entry mode

---

* Manuscript received: 02.04.04, accepted: 17.01.05 (1 revision)

** Stefan Eckert, Professor, International Graduate School Zittau. Main research interests: Internationalisation processes of companies, Corporate Governance, trust in international management. Corresponding address: Eckert@ihi-zittau.de

Frank Rossmeissl, International Graduate School Zittau. Main research interests: International networks, development of subsidiaries. Corresponding address: Rossmeissl@ihi-zittau.de

1. Inward FDI as an Essential Backing of the Processes of Transition and Integrationin Central and Eastern Europe[1]

Foreign direct investment (FDI) is a crucial component in the transition processes taking place in Central and Eastern European countries (CEECs). FDI does not only provide scarce financial capital for the highly indebted transformation economies (Black/Moersch 1997; Manea/Pearce 2001b), but also leads to a cross boarder intraorganisational transfer of knowledge, managerial as well as marketing skills, technology, entrepreneurship, international market access (Manea/Pearce 2001b). In addition, FDI "promote[s] the diffusion of new technologies through direct linkages or spillovers to domestic firms" (Altomonte/Guagliano 2001:4). Mickiewicz et al. specify this point: "(...) FDIs have strong influence on domestic employment through types of jobs created, regional distribution of new employment; wage levels, income distribution, and skill transfer" (Mickiewicz et al. 2000:5). Kaufmann and Menke (1997) estimate the creation of 300.00 jobs in the Visegrád states by German capital invested. Hence, FDI can be seen as an essential support for transforming the political and economic systems of these countries into democracy and market economy (Resmini 2000; Lankes/Venables 1996, Bevan et al. 2001).

In the meantime, these processes of transition have reached an advanced stage in many CEECs. prices have been liberalised, the privatisation of formerly state-owned enterprises has rapidly progressed, and the once closed economies have opened themselves to foreign trade and investment in many of these countries. Therefore, the integration into the European Union is close at hand for a number of Central European countries. Political negotiations and decisions inside the European Union as well as in the Eastern accession states have thus far lead to overwhelming results in favour of Eastern enlargement.This results in turn imply that the Central European countries Hungary, Czech Republic, Slovakia, Poland, Slovenia, Estonia, Latvia, and Lithuania (together with Cyprus and Malta) will gain member status in May 2004.

Despite these developments, however, academic knowledge concerning the implications of the described processes for foreign direct investment into these countries up to now appears to be rather scarce. Notwithstanding, the common line of argumentation in literature is that any delay to enlargement would be detrimental for FDI flows to CEECs (Bevan et al. 2001). We argue that enlargement might also have negative effects on FDI, which have not been considered sufficiently.

The paper proceeds as follows. Succeeding this introduction, section two gives an overview of the extant literature concerning FDI into CEE in the context of European integration. Section three introduces the theoretical framework

[1] This research was undertaken with support from the Fellowship Program of the German Academic Organization DAAD, 2003.

employed in this paper and section four gives an overall view of motives for FDI in CEECs. Section five deals with the effects that transition and integration processes exert on the business environment in CEECs and, subsequently, is followed by an analysis of the implications for Western MNEs' market entry strategies in section six. In section seven a case study, illustrating our theoretical proposition, is presented and in the last section we summarise our basic conclusions.

2. Enlargement and FDI-Activities – Literature Review

Baldwin et al. (1997) try to evaluate the economic consequences of the Eastern enlargement by differentiating between two scenarios. In the first one, only trade effects of enlargement are considered, whereas in the second scenario changes in foreign investment are examined, too. The authors assume that integration into the European Union contributes to political and economic stability and, therefore, induces a reduction in country risk. This reduction implies a decrease in the cost of capital for investment projects in these countries. Baldwin et al. estimate that "the relative return demanded by savers for investment in the region should drop by roughly 15%" (Baldwin et al. 1997:141). From the investors' point of view a reduction in the cost of capital alters the net present value (NPV) of potential investment projects. Projects whose NPV has been zero or has been below zero before will experience a rise in NPV due to the reduction in the cost of capital, which may lead to positive NPVs. Hence, an increase in foreign investment in Central European Countries is to be expected as consequence of further transformation and integration processes. This increase in foreign investment is interpreted as equivalent to an increase in foreign direct investment in the literature. E.g. Stankovsky (2000) argues on the basis of Baldwin's paper that foreign direct investment will rise as a consequence of enlargement (cf. also Estrin et al. 2001, the same kind of argumentation with explicit reference to Baldwin et al. is also found in Dyker 2000:16).

Similarily, Pournarakis/Varsakelis (2002) argue that EU accession will fundamentally improve the business environment in CEECs, thus leading to a higher inward flow of FDI. Comparing Ireland's accession to the EU with the CEECs accession, Barry (2002) maintains that "EU accession is an absolute requirement" (Barry 2002:2) for FDI's to support the CEEC's economic development because investment barriers like "uncertainty about CEE public policy (...) [and] CEE public administration (...)" (Barry 2000:22) will diminish through enlargement.

Therefore, it is not surprising that increasing FDI is also used as an argument for enlargement by pro–enlargement politicians in Central European states. In an interview, Leszek Balcerowicz, president of the Polish National Bank, claims that one of the main benefits of enlargement is the reduction in investment risk, which will induce an increase in FDI to Poland (BMWI 2002).

Yet, the argumentation described above contains some implicit premises that ought to be questioned. First of all, a reduction in country risk does not for sure lead to a decrease in cost of capital (at least from the viewpoint of foreign investors). According to modern financial theory, only the systematic component of risk is going to be rewarded to investors. Unsystematic risk, i.e. the part of risk that can be neutralised through diversification has no effect on the cost of capital. If, from the viewpoint of investors from abroad, the high risk of investing in Central European Countries could be diversified, e.g. by investing in other countries (an assumption that seems rather reasonable), no premium for political instability should have been charged as part of the cost of capital by foreign investors. Thus, the effects of enlargement on the cost of capital might be rather small if not non-existent at all. As a consequence, the promoting effects of enlargement on FDI activities could perhaps be much smaller than expected.

Furthermore, the argumentation outlined above suffers from the implicit equation of foreign investment and foreign direct investment. Yet, this concept represents a rather old-fashioned attempt to explain FDI, which was refuted by Hymer (1960). He differentiated between portfolio investment and direct investment and argued that theories appropriate to explain the flow of capital between countries might not be adequate to explain the amount of direct investment between different countries, i.e. the amount of foreign investment that is accompanied by activities of control from the foreign investor.

Consequently, some researchers are more hesitant with regard to the evaluation of the impact of EU-accession on FDI. Stadtmann et al. report about a survey, during which 728 large German firms were asked to judge their prospective foreign direct investment behaviour. With regard to most CEECs, the number of firms planning to increase investment is higher than the number of firms intending to decrease investment. Nevertheless, the share of firms intending to reduce foreign market commitment is considerable (e.g. 9.6 per cent in the case of Slovakia). Furthermore, the authors notice a shift in FDI flows away from countries which were most popular up to now, such as Poland and the Czech Republic (Stadtmann et al. 2003:7-8). The Economist Intelligence Unit (EIU) generally expects "buoyant inflows" of FDI into the CEE region for the medium term, but with reference to EU enlargement a decrease in FDI flows into traditional FDI destinations like Poland, Czech Republic, Hungary, and Slovenia (PRWeb 2003). Görg/Greenaway are not able to find any significant enlargement impact analysing the prospective investment flows between the UK and six CEECs (Görg/Greenaway 2003).

Other authors contribute to the question whether EU enlargement fosters FDI in CEECs by linking the macro level with the micro level perspective. A recent study of Benito et al. (2003) deals with the importance of environmental factors in determining MNE subsidiary roles in the Nordic countries Denmark, Finland and Norway. The scientists examined the impact of EU-membership and found that "countries differ with regard to EU-membership" concerning "the scope of activities performed by subsidiaries, and the level of competence of those subsidiaries" (Benito et al. 2003:443). The results of the study suggest (compared to Denmark and Finland) Norway as an outsider of the EU becoming less attractive to MNE activity as foreign-owned subsidiaries in Norway "scored significantly lower in terms of scope of activities and level of competence" (Benito et al. 2003:443). This findings might lead to the assumption that the locational factor "EU-membership" has a positive influence on the subsidiaries already present in Eastern European countries belonging to the EU. These subsidiaries are likely to gain advantages in terms of the scope of their activities and level of their competence. Therefore, we may conclude, that further FDI will primarily be undertaken in those CEECs that have EU member status.

In sum, although the majority of studies tend to confirm a positive effect of EU-enlargement on inward FDI for CEECs, the evidence is not beyond all doubt. We argue that in order to sufficiently solve this puzzle, the motives driving FDI have to be examined more closely.

3. Theoretical Considerations: Location Advantages and Different Types of FDI

Dunning explains FDI as result of a combination of specific characteristics of a firm, the so-called respective value chain activity, for which the appropriate mode of coordination as well as the adequate location have to be chosen. "The principal hypothesis on which the eclectic paradigm of international production is based is that a firm will engage in foreign value-adding activities if and when three conditions are satisfied" (Dunning 1992:196). A firm must have certain ownership advantages (strategic resources like intangible assets) and the exploitation of these resources "through an extension of its existing value added chains or the adding of new ones" (Dunning 1992:196) should be more profitable than the externalisation of these resources through contractual agreements between partners at arm's length (internalisation advantages). These conditions are necessary for FDI to arise, but they are not sufficient at all. As a further necessity a place abroad must have certain location advantages, compared to domestic places, concerning the value chain activity, which is going to be decided upon. Examples for location advantages are cheaper costs of production, lower costs of transportation, more favourable governmental regulations, or better social and natural general conditions.

Based on these considerations the question is how transformation processes and the integration of transition countries into the European Union affect the decision to invest abroad. Assuming that these systems work on the country level and not on an industry or company level, the implications of the macro processes will mainly influence the location characteristics of certain places. Therefore, the appropriate question has to be how transition and integration processes affect the location characteristics of CEECs.

However, the evaluation of the described effects on the attractiveness of locations in CEECs cannot be generalised about all kind of FDI activity. Instead, the differing motivations leading to FDI into these countries have to be taken into consideration. In this respect, a typology from Dunning seems to be helpful, which differentiates between market seeking FDI, efficiency seeking FDI, resource seeking FDI as well as strategic asset seeking FDI (Behrmann 1984; Dunning 1993; Agarwal 1996).

Efficiency seeking FDI implies the relocation of certain value chain activities to places providing lower input-costs in order to create or maintain a competitive market position. Owing to this type of FDI, “MNEs might assist the internationalisation of CEE economies by moving the production of some of their currently most price-sensitive goods to low-cost parts of the region, with these then being mainly exported back to their established (notably Western European) markets” (Manea/Pearce 2001a:6). However, efficiency seeking activity will only remain viable as long as the relatively standardised inputs retain their cost competitiveness. The recent developments in Hungary may illustrate this point. The introduction of minimum wages and salaries in the public and private sector by the Hungarian government in 2002 lead to an nominal increase of 11.5per cent until March 2003 (in comparison with March 2002) (Schieritz 2003). Though these changes might lead to positive effects like higher employee motivation and higher labour productivity, such tendencies could inevitably threaten the survival of foreign operations initiated in response to efficiency-enhancing local inputs.

The second type is resource seeking FDI. This kind of foreign investment is supposed to secure or improve the firm’s access to certain resources acquired abroad and is directed at reducing the uncertainty caused by the geographical spread of value chain.

Another type of FDI is characterised by Dunning as strategic asset seeking FDI. This type of FDI contains investments which are supposed “… to protect, sustain or advance the global competitive position of the investing company vis-à-vis its major national and international competitors” (Dunning 1993: 380) by acquiring strategic assets located abroad.

Market seeking FDI is a last type of foreign direct investment. Market seeking FDI is taken into account to achieve foreign market proximity. To understand how market proximity is affected through FDI, we have to differentiate between FDI seeking to attain physical market proximity and FDI targeting the reduction of psychic market distance, i.e. seeking to achieve psychic market proximity.

Physical market proximity describes the location of a firm in terms of its geographical range to a specific foreign market. This kind of market proximity can be accomplished by direct investment in a foreign market. A high degree of physical market proximity should for example be necessary for foreign market activities.The costs of transportation amount to a considerable proportion of the total costs of a certain product. Furthermore, a high degree of physical market proximity seems to be unavoidable for certain kind of services. E.g. a lot of FDI activities in the retail banking sector should be motivated by the desire to achieve physical market proximity.

Nevertheless, market seeking FDI may not only be due to reasons of physical market proximity, but also (and rather) to realise psychic market proximity. Therefore, this concept describes a firm’s ability to communicate and interact effectively with certain foreign markets. Communicating with foreign markets appears to be difficult, since these markets are shaped by actors who differ in their cultural background from the dominant cultural background of decision makers inside the firm. The degree of cultural diversity between firm and market has been termed as “cultural distance” or “psychic distance” in the literature. The influence of cultural distance on market entry decisions and market performance has been discussed intensively among international management scholars (e.g. Johanson/Wiedersheim-Paul 1975; Johanson/Vahlne 1977, 1990, Vahlne/Nordström 1992; Kutschker 2002). According to the Nordic School of Internationalization, the higher the degree of cultural distance between the firm and a foreign market is, the more cautious the firm will be concerning its foreign market commitment. Therefore, this theoretical approach implies that firms are more reluctant to establish FDI in markets with a high degree of cultural distance because then they perceive a higher probability of failure compared to markets culturally nearer to their home country. Actors from culturally distant foreign markets may interpret symbols that the firm transmits into these markets in a way not intended by the firm. E.g. Meissner (1997) quotes the case of Mitsubishi, which was quite unsuccessful when introducing a car named “pajero” in Spain due to the Spanish interpretation of that word (Meissner 1997:8).

However, one approach to significantly reduce psychic market distance is to establish a subsidiary in the foreign market. Scholars like Bartlett and Goshal emphasize the importance of achieving “local responsiveness”, i.e. being able to communicate and interact effectively with foreign markets, which corresponds to our definition of psychic market proximity (Bartlett/Ghoshal 1989). This psychic market proximity is attained as consequence of a higher degree of communication and interaction intensity between firm and foreign market in the case of FDI compared to other modes of foreign market entry. processes of learning are stimulated regarding communication with the foreign market on the individual as well as on the organisational level by these communicative interactions between firm and foreign market (Kumar/Epple 1997). Following Johanson/Vahlne (1990), especially firms with huge excess resources tend to be prepared to conduct FDI into culturally distant markets. On the one hand, they may face problems like Mitsubishi. On the other hand, they may also benefit from the lectures learned in these foreign markets quickly. Therefore, companies may be able to reach a high degree of psychic market proximity rather fast compared to competitors who prefer other modes of market entry like exporting. In sum, psychic market seeking FDI is considered to promote processes of learning that improve the quality of communication and interaction between firm and foreign market and, thus, accomplish psychic market proximity more than other modes of foreign market entry.

The need for psychic market proximity is not equally relevant for all kinds of business activities. Psychic market proximity should be of high relevance where national or local preferences exert an essential impact on customer decisions as for example in the fast moving consumer goods industry. In this sector, the response to distinctive preferences of customers is considered very important and rapid reaction to changes in these preferences is seen as crucial competitive advantage against competitors.

4. Motives for FDI in CEECs

In order to be able to assess the relevance of the various FDI types for CEECs, empirical data is necessary. An overall review of current research reveals that market seeking FDI clearly dominates as the major force driving FDI into Central and Eastern European transformation economies. A study of Manea and Pearce (2001b) illustrates the supremacy of market seeking FDI for Central and Eastern Europe.

Based on Dunning's typology of FDI, the authors differentiate between four different kinds of motives for FDI. Besides market seeking, which was operationalised by the item "to help our MNE group to effectively extend the supply of its established products into the host country and other CEE markets" (Manea/Pearce 2001b:125) and efficiency seeking, which was defined as "to help improve the competitiveness of our MNE group in supplying existing products to our already established markets" (Manea/Pearce 2001b:125), the authors take two other kinds of FDI into account, namely knowledge seeking 1 (KS1) and knowledge seeking 2 (KS2).

KS1 means "to use specific local creative assets (e.g. local market knowledge, original local technology) available to the subsidiary to develop new products for the host country and other CEE markets" (Manea/Pearce 2001b:125). KS2 was defined as "to use important creative assets and talents available to the subsidiary to help develop new products for wider markets (e.g. Western Europe) of the MNE group" (Manea/ Pearce 2001b:125).

88.2 per cent of the respondents of Manea and Pearce's study rated the market seeking motive as a "main" driver of FDI (Manea/Pearce 2001b:125) (see Table 1). The high relevance of this motive for FDI in CEECs, pointed out in Manea and Pearce's paper, is also strongly underlined by a huge number of other empirical studies: Engelhard/Eckert (1993), Genco et al. (1993), EBRD (1994), Borsos (1995), Engelhard/Eckert (1995), Neudorfer/Bach (1995), OECD (1995), Stankovsky (1995), Vincentz (1995), Lankes/Venables (1996), Petrakos (1996), Altzinger (1997), Kaufmann/Menke (1997), Neudorfer (1997), Pye (1997), Altzinger (1998), Altzinger et al. (1998), Meyer (1998), Witkowska (1999), Bevan/Estrin (2000), König (2001); Manea/Pearce (2001a).

Table 1. Evaluation of the motivations of MNE's subsidiaries in CEE economies

	Motivation (average response)			
	MS	**ES**	**KS1**	**KS2**
By industry				
Chemicals	2.71	1.57	1.71	1.57
Electronics	3.00	2.00	1.89	1.67
Mechanical engineering	2.67	2.33	1.33	1.17
Motor vehicles	3.00	2.00	1.33	1.33
Petroleum	3.00	1.50	2.00	1.50
Miscellaneous	2.86	1.71	1.14	1.00
By home region				
Asia	3.00	2.67	1.67	1.67
North America	2.93	1.73	1.53	1.40
Western Europe	2.75	1.88	1.56	1.31
Total	2.85	1.88	1.56	1.38

Source: Manea/Pearce 2001b:125

On the contraryNethertheless, efficiency seeking FDI only seems to be of minor importance. Manea and Pearce show that only 23.5 per cent of the firms they surveyed judged efficiency seeking as a main objective when investing in CEE. This results also appears to be consistent with other empirical studies (Lankes/Venables 1996).

In sum, the previous findings underline the high empirical relevance of market seeking FDI in the case of CEECs. Unfortunately, these studies do not differentiate sufficiently in order to identify the empirical relevance of different types of market seeking motives, i.e. the relevance of psychic market proximity seeking FDI versus physical market proximity seeking FDI. This lack of knowledge seriously impedes adequate forecasts concerning the further development of FDI flows into the CEECs. However, there is reason to assume that the kind of market proximity, that foreign investors seek to realise by FDI in CEECs is not only of physical nature, but that there should exist a considerable amount of FDI that is mainly done due to reasons of cultural proximity. This assumption is underlined by the huge cultural differences that have been prevalent between the Western European countries, which are the origin of the major part of FDI inflows into the CEE region, and the formerly state planned CEECs.

Occurring turbulences arisen during the course of economic and political transition did not reduce the psychic distance between foreign firms and those unknown markets. Furthermore, the diverse strategies of transition that the individual countries have adopted as well as the radical fundamentalist tendencies that emerged in these countries have fostered a tendency towards pluralism in

Central and Eastern Europe (e.g. the departure of the Czech and the Slovakian Republic, cf. also Savin 2002). From the viewpoint of foreign firms this pluralism implies the need to serve each local market by local FDI in order to realise a sufficient degree of psychic market proximity. This condition can not solely be achieved by greenfield investment but also through acquisition of formerly state-owned enterprises in the course of the privatization process. Hence, a considerable amount of FDI activities that are done in order to reduce psychic distance between firm and CEEC markets must be assumed among market seeking FDI in CEECs.

5. Implications of Processes of European Integration for CEE Markets

Based on these considerations, one has to ask how processes of transition and European integration affect the relevance of these different categories of market proximity and, therefore, the relevance of FDI activities that fall into the differing categories.

FDI activities, which target at improving physical market proximity, are expected to increase. The enlargement of the European Union may indeed strengthen political and economic stability in the CEECs. Consequently, foreign firms, that have to be geographically close to their customer, may dare to realise investment projects that were considered too risky before. If this assumption holds, integration should have a positive effect on market seeking FDI, where physical market proximity is essential.

In the case of psychic market proximity seeking FDI, however, divergent effects may result. The transitions of political and economic systems that have taken place in the CEECs for the last 14 years implied profound changes in the everyday life of Central and Eastern Europeans. Through these rapid and revolutionary changes they have been confronted with a completely different environmental context, which does not fit to people’s mental frameworks developed during the communist era. Since the fall of the “iron curtain” people in CEE societies more and more realise that their mental programming does not correspond appropriately with the environment in which they are embedded. Feichtinger and Fink (1999) compared the situation of these people to the situation of expatriates. According to this analogy and as a consequence of the dramatic political and economic changes, a cultural modification that resembles the U-curve of cultural adaptation of expatriates living abroad is expected for these countries.

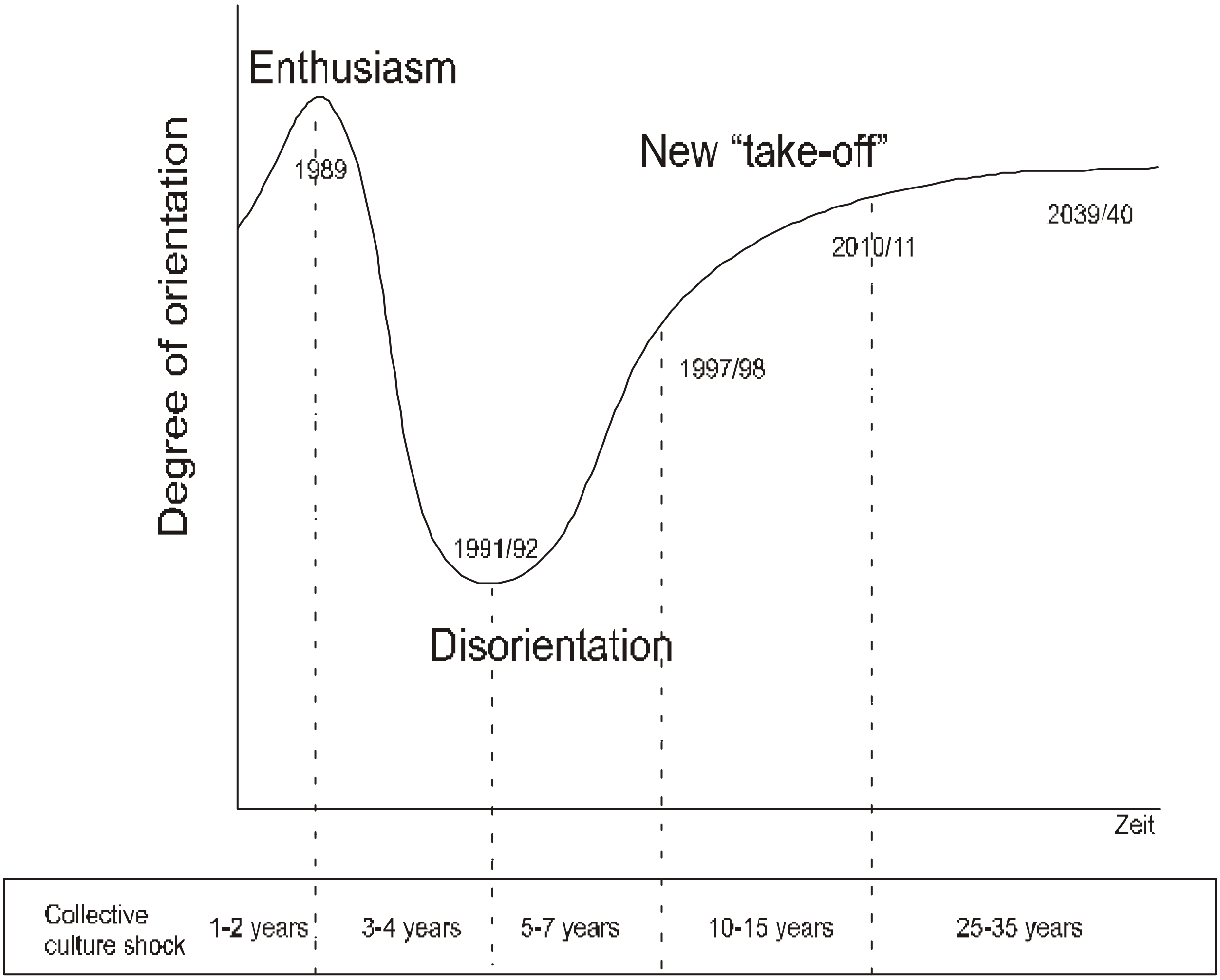
The acculturation during the process of the “collective culture shock”, as Feichtinger and Fink call the process of collective adaptation to suddenly changing systems, goes through four phases. Figure 1 illustrates the theory of the collective culture shock. According to the authors, phase number one is characterised by “euphoria”: illusionary and unrealistic expectations abound

(Feichtinger/Fink 1999:135). During the communist area a distorted picture of democracy and market economy emerged. The lack of information lead to a misinterpretation of the new system: the ultimate satisfaction of all needs. This exaggerated expectation mainly occurred during the first years after the collapse of communism. Phase number two is the phase where the culture shock itself shows. Symptoms like "loss of orientation and mental health problems, lack of self-confidence, apathy, passiveness, missing capacity to act and defensive strategies, retreat and retrospective reflections" appear (Feichtinger/Fink 1999:136). Correspondingly, confusion, rising uncertainty, missing trust as well as the wish to re-establish the old system could be observed in the CEECs in the younger past.

In a study on the value systems of Eastern Europeans, "keeping the national order" was found to be the imperative of most importance (Wolf 1998:134). Nevertheless, after this phase of rising disorientation has reached a certain crisis, a reorientation occurs. People tend to adapt to the changing environment. In phase number three the mastering and adapting begins. The associated transition states are lead towards integration by fulfilling the requirements set by the European Council 1993 in Copenhagen and by taking up negotiations for membership (Agenda 2000 of the European Commission). These integration processes support the establishment of a market based economic system and a democratic political system. Therefore, they may be interpreted as institutions that stabilise the modification of Eastern Europeans' mental frameworks towards stronger compatibility with Western Europeans' mental frameworks. This cultural convergence is going to be accelerated by increased economical relations, e.g. cross-boarder joint ventures, and by collectively shared norms and values which have seen their manifestation in EU laws and regulations. In phase number four the attainment of European standards is realised by obtaining EU membership (Feichtinger/Fink 1999:142).

Joining the European Union on May 1, 2004 the acquis communautaire applies to the ten new member states which then will have equal rights regarding their participation in EU executive bodies and committees. The acquis communautaire is the entire body of European laws which are obligatory for all EU member states. This body comprises all treaties, regulations as well as directives passed by the European institutions and all judgements defined by the Court of Justice. The acquis has to be adopted by the new member states (Stankovsky 2000).This adoption includes the implementation and enforcement of the entire body in order to be allowed to join the EU. Exemplary politics fields are agriculture, energy supply, traffic, and environment protection.

Figure 1. Cultural change in CEECs



Source: Feichtinger/Fink 1999:144

All EU citizens may move freely within the enlarged EU and live or work where ever they want to. (Except for citizens of Malta and Cyprus, the old member states have the possibility to restrict the immigration of employed labour force by not issuing work permits up to the period of 7 years.) Self-employed citizens and companies may not be restricted. Special EU-programs for enforcing the East-West exchange of students will continue to exist and the new member states will take part in EU-programs like "Socrates" and "Leonardo da Vinci". The Euro will be introduced after the Maastricht criteria are fulfilled. All these circumstances may contribute not only to a political and economical but also to a cultural convergence by standardising certain norms and an approximation of shared values. This kind of "collective acculturation" (Feichtinger/Fink 1999:142) does not only reduce the psychic distance between Central and Eastern Europeans on the one hand and Western Europeans on the other, but is also likely to significantly weaken psychic distance between people from different Central and Eastern Europeans countries.

Ullmann (2003) reports about a study of the Instytut Handlu Wewn trznego i Konsumpcji (Institute for Domestic Trade and Consumption) published in 2001 examining the behaviour of young Polish consumer at the age between 7 and 19 years: the convergence of buying behaviour – a tendency, which erases national differences and promotes the standardisation of marketing policies, and which has been hypothesised by scholars like Levitt (1983), Ohmae (1985) and Yip (1994) - was confirmed in the case of young Poles when compared to Western Europeans of the same age. The author concludes that Polish kids and teenagers are more and more adapting the buying behaviour of Western kids and teenagers. As the study found out, one important determinant influencing the buying behaviour of young Poles is the attribute "known brand" through which they want to express their identification with products from European and global companies.

6. Consequences for Western MNEs' Market Entry Strategies

From the viewpoint of Western firms, this collective acculturation taking place in CEECs may, therefore, lead to a rapid increase in psychic market proximity. A consequence of this development might be that FDI is no longer necessary to achieve the required degree of psychic market proximity. Hence, a decrease in psychic market proximity seeking FDI activities might occur in those regions.

On the one hand, This might imply that Western firms considering entry into CEE markets for reasons of psychic market proximity may soon begin to evaluate the benefits of direct investment in these countries more cautiously. Other modes of serving these markets like export activities may soon prove to be more efficient.

On the other hand, Western firms which are already running "psychic market proximity seeking"-subsidiaries in CEECs may find potentials for restructuring. In a study of more than 2000 European foreign subsidiaries Schmid and Schurig (2004) analyse if and to what extent an MNE's capabilities can be enhanced by their foreign subsidiary. They find that the potential to acquire new capabilities from the local environment declines with increasing homogeneity of the environment of an MNE's subsidiaries. This reasoning (perfectly) agree with our argumentation. As national cultures in Western and Eastern Europe converge (towards the Western European culture), the need to be geographically present at the market in order to communicate effectively with the market decreases significantly. Hence, the processes of cultural convergence create potentials for restructuring and standardisation for Western firms. Furthermore, they facilitate the establishment of pan-regional strategies, i.e. market strategies where the specifics of a local market do not have to be taken into account any longer. Procter & Gamble in Hungary is one good example for standardisation of customer communication: when launching a new product in Hungary, international copies of television ads from other Western markets are utilised word by word, simply adapting the language.

Thus, the fate of many CEE subsidiaries of Western MNEs may finally be at the crossroads: During the early stage of economic and political transition the business environment in these countries was shaped by an economic system, which still carried the characteristics of its state-planned heritage. Between the different CEE markets themselves as well as between the individual CEE markets and Western European markets the level of integration was rudimentary at best. Distinct strategies for economic and political transition were chosen in the CEECs (not the least in order to distinguish oneself from the others). Furthermore, strong tendencies of separatism could be found in these countries during the early stage of transition. All these tendencies strongly underlined the necessity to be physically present at the local market in order to realise a sufficient degree of psychic market proximity.

Consequently, many Western MNEs employed local subsidiaries in the CEE markets during this time. The local subsidiaries may be described as “local centres of transition competence”, accomplishing psychic market proximity to turbulent and diverging local Eastern European markets. These subsidiaries were often run as joint ventures (even after legal restrictions allowed hundred per cent foreign ownership) in order to acquire the capability to communicate effectively with the local market by a local partner. However, after these skills were acquired many of these joint ventures were transformed into wholly owned subsidiaries.

Yet, the processes of cultural convergence described above have lead to a situation in which the benefit of the additional psychic market proximity realised by a local subsidiary is going to be more and more marginal. These subsidiaries are left in a situation, where redundancies abound. Cultural changes in CEECs enable Western firms to move to panregional strategies covering the whole of the CEEC region or even the whole Europe.

Therefore, the CEE subsidiaries of Western firms, which have been installed due to reasons of psychic market proximity, may find themselves in a converging context. They perform functions similar to those of other subsidiaries of the same network. Consequently, many of these subsidiaries may lose competencies and resources through divestment activities. Thus, they will increasingly drift towards the role of implementing units (Bartlett/Ghoshal 1989) or even get liquidated. Subsequently, some of them may be replaced by foreign trade activities. Only a few Central European subsidiaries will face the chance to profit from the divestment tendencies and emerge from the restructuring processes as regional leaders, like the Hungarian subsidiary of Procter & Gamble.

7. Procter & Gamble in Central Europe

In 1991, Procter & Gamble (P&G) opened its first operation in Central Europe with the acquisition of Rakona in Czechoslovakia. Rakona, at first an Czech manufacturing company, established in 1875, had originally been a soap production plant. New subsidiaries in CEECs were established throughout the year in Hungary, Poland, and Russia. Soon after the break-up of Czechoslovakia in 1993, P&G started operations in Slovakia, too. In 1992, Bucharest was chosen as centre of P&G's Balkan activities. About one year after the peace treaty between the hostile parties, which was signed in late 1995, P&G started activities in Yugoslavia by opening an office in Belgrade. Further offices were opened in the Republic of Macedonia and in Moldavia in 1998. In addition, the Bosnian office was established in Sarajevo in 1999.

In 1999, this strategy of national fragmentation stopped: The Czech, Slovakian, Slovenian, Croatian, and Hungarian subsidiaries of P&G were brought together to a regional headquarters in Budapest. Budapest was chosen because of its central location. The subsidiaries in Slovenia, Crotia, and in the Czech Republic gave up their responsibility for marketing and finance activities. In the meantime country specific product management is realised from Budapest by managers regardless of their nationality. For instance, a brand manager of Croatian origin was transferred to Budapest. The scope of her geographical responsibilities included five countries – Croatia, Slovenia, Czech Republic, Slovakia, and Hungary. Due to reasons of cost efficiency, there are plans to replace the expatriates from other Central European countries by Hungarians in the medium term.

The same pattern of "regionalisation" can be found for P&G in Poland, the Baltic States as well as White Russia. After signing a joint venture agreement with a local Polish company Poll Ltd. operations began under the name Procter & Gamble Poll Inc. in early 1991. Later the name was changed to Procter & Gamble Eastern Europe. After a period of considerable growth regarding number of employees, revenues, and profits P&G runs its largest plant in Central Eastern Europe in Warsaw. Between 1997 and 2000 Procter & Gamble Polska integrated operations in Latvia, Estonia, Lithuania, and White Russia. Similar to P&G in Hungary, the Polish subsidiary profited in terms of regional competence and resources committed to the debit of subsidiaries in the Baltic States.

8. Conclusions

The essential conclusions to be drawn from these considerations are twofold. First, competition between Eastern European countries concerning FDI is likely to increase at the dawning of Eastern enlargement of the European Union (at least concerning psychic market proximity seeking FDI). Second, competition between MNEs' CEE "psychic market seeking"-subsidiaries as well as between MNE's CEE "psychic market seeking"-subsidiaries and MNE's Western European "psychic market seeking"-subsidiaries is going to intensify as the cultural convergence resulting from European integration creates potentials for restructuring.

The implications of this development should not be underestimated. On the one hand, the net flow of FDI (concerning efficiency seeking FDI) might also be directed outward from the perspective of Visegrad countries. As production costs are expected to rise in these countries as a result of European integration, efficiency seeking FDI activities might be moving further east (the so called "flying geese" effect).

On the other hand, of all kinds of FDI, psychic market proximity seeking FDI may be of special relevance for the process of industrial restructuring in Central and Eastern European transition countries. With this kind of FDI especially marketing skills should be transferred to the CEE markets in a rather intense manner. Exactly this capability still seems to be significantly scarce in the CEECs even 14 years after the collapse of the communist system. Thus, a reduction in psychic market proximity seeking FDI can be interpreted as the decline in the inflow of a critical resource that would help to strengthen the CEECs international competitive position.

These considerations notwithstanding, we do not mean to question the overall benefits of European integration for the Central and Eastern European countries. The beneficial effects on foreign trade that should result from EU-enlargement for all participants are beyond question. Perhaps, even the net effect on FDI flows into these countries may be positive, i.e. the inward flow of FDI is higher after the enlargement than it would have been if enlargement would have been postponed. This question can not be finally answered. Nevertheless, from the viewpoint of CEE countries there might also be negative effects resulting from EU-enlargement, that are worth considering. In spite of all benefits of convergence, there might be value in being (culturally) diverse, too.

References

Agarwal, J.P. (1996): Does foreign direct investment contribute to unemployment in home countries? – An empirical study. Working paper 765, University of Kiel.

Altomonte, C./Guagliano, C. (2001): Competing locations? Market potential and FDI in Central and Eastern Europe vs the Mediterranean. LICOS Centre for Transition Economics. Discussion paper 108/2001, KUL, Leuven.

Altzinger, W. (1997): Scope and structure of Austria's foreign direct investment in the CEECs. Background Paper, presented at the PHARE Conference on „Integration and transition in Europe", Budapest, September 11-14.

Altzinger, W. (1998): Austria's foreign direct investment in Central and Eastern Europe: „supply based or market driven". Working paper 57, Vienna University of Economics and Business Administration.

Altzinger, W. et al. (1998): Crossboarder development in the Vienna-Bratislava region: A review, in: Graute, U. (ed.): Sustainable development for Central and Eastern Europe – spatial development in the European context, Berlin: Springer, 89-114.

Barry, F. (2002): EU accession and prospective FDI flows to CEE countries: A view from Ireland. Working paper, University College Dublin.

Baldwin, R.E. et al. (1997): The costs and benefits of the Eastern enlargement: The impact on the EU and Central Europe, in: Economic Policy, 24, 2, 127-176.

Bartlett, C.A./Goshal, S. (1989): Managing across boarders: The transnational solution. Cambridge: Harvard Business School Press.

Behrmann, J.N. (1984): Industrial policies: international restructuring and transnationals. Lexington: Lexington Books.

Benito, G.R.G. et al. (2003): Environmental influences on MNE subsidiary roles: Economic integration and the Nordic countries, in: Journal of International Business Studies, 34, 5, 443-456.

Bevan, A.A./Estrin, S. (2001): The determinants of foreign direct investment in transition economics. Centre for Economic Policy Research, discussion paper 2638, William Davidson Institute, working paper 342, University of Michigan, and Centre for New and Emerging Markets, discussion paper 9, London Business School.

Bevan, A.A. et al. (2001): The impact of EU accession prospects on FDI inflows to Central and Eastern Europe. Policy paper 06/01, University of Sussex.

Black, S.W./Moersch, M. (1997): Investment and its financing during the transition in Central and Eastern Europe, in: Black, S.W. (ed.): Europe's economy looks East: Implications for Germany and the European Union, Cambridge: Cambridge University Press, 167-200.

BMWI (2002): Der Wirtschaftsbericht 2002 – Schwerpunkt Globalisierung – Interview mit Leszek Balcerowicz. Retrieved June 3, 2003, from http://www.bmwi.de/wirtschafts-bericht02/eu_osterweiterung/testimonial_balcerowitz.jsp.

Boros, J. (1995): Domestic employment effects of Finish FDIs in Eastern Europe. ETLA, B.111, Helsinki.

Dunning, J. (1992): Trade, location of economic activity and the multinational enterprise: a search for an eclectic approach, in: Dunning, J. (ed.): The United Nations library on transnational corporations – the theory of transnational corporations, 1, New York: Routledge, 183-218.

Dunning, J. (1993): Multinational enterprises and the global economy. Workingham: Addison Wesley.

Dyker, D. (2000): The dynamic impact on the Central-East European economics of accession to the European Union. Working Paper 06/00, University of Sussex.

EBRD (1994): Economic transition in Eastern Europe and the former Soviet Union. Transition Report October, London.

Engelhard, J./Eckert, S. (1993): Markteintrittsverhalten deutscher Unternehmen in Osteuropa, in: Der Markt, 32, 4, 172-188.

Engelhard, J./Eckert, S. (1995): Market entry strategies of German firms and industrial transformation in Eastern Europe, in: Culpan, R./Kumar, B.N. (eds.): Transformation management in postcommunist countries – organizational requirements for a market economy, Westport: Quorum Books, 153-171.

Estrin, S. et al. (2001): Institution building and the integration of Eastern Europe in international production. Working paper 16/01, London Business School.

Feichtinger, C./Fink, G. (1999): Der kollektive Kulturschock im Postkommunismus, in: Journal for East European Management Studies, 4, 2, 128-147.

Genco, P. et al. (1993): Private investment in Central and Eastern Europe. Working paper 7, London: EBRD.

Görg, H./Greenaway, D. (2003): Is there a potential for increases in FDI for Central and Eastern European Countries following EU accession?, in: Herrmann, H./Lipsey, R.E. (eds.): Foreign direct investment in the real and financial sector of industrial countries, Berlin: Springer, 165-183.

Hymer, S. (1976, originally written in 1960): The international operations of national firms: A study of direct investment. Ph.D. dissertation, Massachusetts Institute of Technology, Cambridge: MIT Press.

Johanson, J./Vahlne, J.-E. (1977): The internationalization process of the firm – a model of knowledge development and increasing foreign market commitments, in: Journal of International Business Studies, 8, 1, 23-32.

Johanson, J./Vahlne, J.-E. (1990): The Mechanism of Internationalisation, in: International Marketing Review, 7, 4, 11-24.

Johanson, J./Widersheim-Paul, F. (1975): The internationalization of the firm – four Swedish cases, in: Journal of Management Studies, 12, 3, 305-322.

Kaufmann, F./Menke, A. (1997): Direktinvestitionen und ihre Beschäftigungseffekte: Eine empirische Analyse mittelständischer Engagements in den Visegrád-Staaten, in: Osteuropa-Wirtschaft, 42, 2, 101-113.

König, M. (2001): Empirische Analyse des Zeitpunktes schweizerischer Direktinvestitionen in Osteuropa. Working paper 01/01, Socioeconomic Institute, University of Zurich.

Kumar, B.N./Epple, P. (1997): Exporte, Kooperationen und Auslandsgesellschaften als Stationen des Lernens im Internationalisierungsprozess, in: Macharzina, K./Oesterle, M.-J. (eds.): Handbuch Internationales Management, Wiesbaden: Gabler, 309-324.

Kutschker, M. (2002): Internationalisierung der Unternehmensentwicklung, in: Macharzina, K./Oesterle, M.-J. (eds.): Handbuch Internationales Management, 2nd ed., Wiesbaden: Gabler, 45-67.

Lankes, H.-P./Venables, A.J. (1996): Foreign direct investment in economic transition: The changing pattern of investments, in: Economics of Transition, 4, 2, 331-347.

Levitt, T. (1983): The globalization of markets, in: Harvard Business Review, 83, 3, 92-102.

Manea, J./Pearce, R. (2001a): Industrial restructuring in European transition economies and MNEs' investment motivations. Working paper, University of Reading.

Manea, J./Pearce, R. (2001b): Multinational strategies and sustainable industrial transformation in CEE transition economies: The role of technology, in: Taggart, J.H. et al. (eds.): Multinationals in a new area. International strategy and management, New York: Palgrave, 118-140.

Meissner, H.G. (1997): Der Kulturschock in der Betriebswirtschaftslehre, in: Engelhard, J. (ed.): Interkulturelles Management – Theoretische Fundierung und funktionsbereichsspezifische Konzepte, Wiesbaden: Gabler, 1-12.

Meyer, K. (1998): Direct investment in economies in transition. Cheltenham: Edward Elgar.

Mickiewicz, T. et al. (2000): The value of diversity: Foreign direct investment and employment in Central Europe during economic recovery. Working paper, University of Sussex.

Neudorfer, P. (1997): The opening of Central and Eastern Europe: The case of Austrian foreign direct investment, in: Oesterreichische Nationalbank: Focus on Transition, 2, 52-68.

Neudorfer, P./Bach, W. (1995): 5 Jahre „Ostöffnung“ – Österreichische Unternehmensbeteiligungen in Osteuropa, in: Informationen über multinationale Konzerne, Sondernummer: „5 Jahre Ostöffnung“, 14-21.

OECD (1995): Foreign direct investment, trade and employment, Paris.

Ohmae, K. (1985): Triad power: The coming shape of global competition. New York: The Free Press.

Petrakos, G. (1996): The new geography of the balkans: Cross boarder cooperation between Albania, Bulgaria and Greece, Volos: University of Thessaly Press.

Pournarakis, M./Varsakelis, N. C. (2002): Foreign direct investment in Central and Eastern Euriopean [sic!] countries: Do institutions matter? Paper prepared for the EIBA Annual Conference, December 2002, Athens.

Pye, R.K. (1997): Foreign direct investment in Central Europe – results from a survey of major investors. Finance working paper A.97/1, City University, London.

PRWeb (2003): FDI into Eastern Europe. Retrieved March 10, 2004, from http://www.prweb.com/printer.php?prid=81244.

Resmini, L. (2000): The determinants of foreign direct investment in the CEEs – new evidence from sectoral patterns, in: Economics of Transition, 8, 3, 665-689.

Savin, V. (2002): Homo (Post-)Sovieticus, in: Osteuropa-Wirtschaft, 47, 4, 376-406.

Schieritz, M. (2003): Ungarns Krise dämpft Osteuropa-Euphorie, in: Financial Times Deutschland, June 24, 16.

Schmid, S./Schurig, A. (2004): The development of critical capabilities in foreign subsidiaries: Disentangling the role of the subsidiary’s business network, in: International Business Review, 12, 6, 755-782.

Stadtmann, G. et al. (2003): Markterschließung und Expansion in den EU-Beitrittsländern Mittel- und Osteuropas. Köln/Vallendar/Hamburg: Manager Magazin.

Stankovsky, J. (1995): Österreichische Direktinvestitionen in Osteuropa, in: Europa 1996 – Auswirkungen einer EU-Osterweiterung, Bundeskanzleramt, Schriftenreihe Europa, 157-192.

Stankovsky, J. (2000): Institutionelle Rahmenbedingungen für die Osterweiterung der EU. Der Weg Osteuropas in die EU. Preparity Teilprojekt 1 (Kurzfassung). Wien: WIIW.

Ullmann, H. (2003): Der polnische Jungkonsumentenmarkt, in: Osteuropa-Wirtschaft, 48, 2, 150-158.

Vahlne, J.-E./Nordström K.A. (1992): Is the globe shrinking? Psychic distance and the establishment of Swedish sales subsidiaries during the last 100 years. Paper presented at the annual conference of the international trade and finance association, 22.-25. April 1992, Laredo.

Vincentz, V. (1995): Auswirkungen der wachsenden Arbeitsteilung zwischen Deutschland und seinen östlichen Nachbarn auf Arbeitsmarkt, Investitionen und Güterströme. Working paper 188, Osteuropa Institut München.

Witkowska, J. (1999): Motivation der europäischen Firmen für Investitionen in Polen. Die Rolle der Integrationsprozesse, in: Osteuropa-Wirtschaft, 44, 4, 403-427.

Wolf, J. (1998): Wertepluralität in post-kommunistischen Gesellschaften. Komparative Befunde eines empirischen Forschungsprojektes, in: Süssmuth, H. (ed.): Transformationsprozesse in den Staaten Ostmitteleuropas 1989-1995, Baden-Baden: Nemos, 127-148.

Yip, G.S. (1994): Total global strategy: managing for worldwide competitive advantage. New Jersey: Prentice Hall.