

THE IMPACT OF THE CURRENT ECONOMIC CRISIS ON STRATEGIES OF MULTINATIONAL CORPORATIONS IN CENTRAL AND EASTERN EUROPE

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Abstract: The purpose of the paper is to contribute to the discussion of the effects of the current crisis on multinational corporations operating in Central and Eastern Europe. The crisis suddenly stopped the successful economic catch-up process of the CEE countries in the last years. The question arises if this major structural break will lead to a reassessment of the expansion strategies of foreign multinational corporations into CEE. Although being in the mid of the crisis and having no full information about the size of its devastating effects on economies and businesses, the author argues that the business model which guided the expansion into CEE will remain valid after the crisis. The huge market potential and the favorable cost and resource situation of CEE will not disappear. The big difference is the higher sensitivity towards country risk that will lead to a more differentiated view of CEE. The management will pay more attention to the country's competitiveness, the quality of its institutions and its political leadership. The shift of manufacturing and logistics capacity from Western Europe to CEE will continue as the crisis advances the division of work in Europe. The accelerated consolidation process changes industry constellations. Cash rich companies with competitive business models emerge as relative winners of the crisis. The downward pressure on prices favors companies with "value-for-money" business models as well as strong local producers, private labels, discounters and "money-saving" formats such as "do-it-yourself"-stores. This paper generates a scenario on the future role of CEE for multinational corporations operating in the region and their strategic options.

Key-words: Central and Eastern Europe; economic crisis; multinational corporation; strategy.

VPLIV SEDANJE EKONOMSKE KRIZE NA STRATEGIJE MULTINACIONALK V SREDNJI IN VZHODNI EVROPI

Povzetek: Namen tega članka je pripevati k razpravi o učinkih sedanje finančne in ekonomske krize na multinacionalke (MNC), ki poslujejo v srednji in vzhodni Evropi (SVE). V članku je opisan scenarij, ki opisuje vlogo držav srednje in vzhodne Evrope na poslovanje multinacionalk, ki poslujejo v regiji in o njihovih strateških možnostih v prihodnosti. Sedanje ekonomsko nazadovanje je zmanjšalo možnosti za

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uspešno dohajanje na gospodarskem področju srednje in vzhodnoevropskih držav, ki je bilo značilno za zadnjih nekaj let. Postavlja se vprašanje, če bo ta pomembni strukturni prelom pripeljal do ponovne presoje širitvenih strategij tujih multinacionalk v srednjo in vzhodno Evropo. Čeprav smo šele na sredini krize in ne razpolagamo s popolnimi informacijami o tem, kakšne razsežnosti bo imela kriza na ekonomijo in podjetja, avtor tega članka meni, da bo poslovni model, ki je vodil širitev v srednje in vzhodnoevropske države obstal tudi po krizi. Velikanski tržni potencial in ugodna stroškovna situacija ter razpoložljivi viri v srednji in vzhodni Evropi ne bodo izginili. Edina razlika, ki se danes pojavlja, je večja občutljivost za stopnjo deželnih tveganj. Zahodne multinacionalke, ki so vstopile na področje tranzicijskih ekonomij pričakujejo večja tveganja in so previdnejša, kot na domačih trgih, ko izbirajo ciljne trge in načine vstopa nanje, ko načrtujejo investicije in kadar tržijo svoje izdelke. V primeru SVE so se najbrž preveč zanašale na zmanjšanje tveganja, ki je posledica vpliva "EU dežnika", torej pojmovanja, da se bodo SVE države hitro prilagodile političnim, pravnim in mikroekonomskim načelom in smernicam, ki jih je postavila EU ter da bo državam članicam EU v primeru finančnih viharjev pomagala EU. To je pripeljalo do napačne predstave med tujimi investitorji, ki so menili, da so poslovna tveganja v novih članicah in državah pristopnicah manjša kot so v tipičnih tranzicijskih ekonomijah. Ta kriza je odpravila pojmovanje, po katerem je SVE homogeni blok, saj lahko opazimo, da finančni trgi in investitorji različno obravnavajo posamezne države. Management multinacionalk je bolj pozoren na dejavnike, ki določajo dolgoročno ekonomsko privlačnost posamezne države, na primer, konkurenčnost države, kakovost njenih institucij in politično vodstvo države. Seveda pa ugodni stroškovni položaj in razpoložljivi viri povečujejo vlogo SVE kot proizvodnega okolja. Prenos proizvodnje in logističnih zmogljivosti iz zahodne Evrope v SVE se bosta nadaljevala tudi v času, ko bo kriza še naprej spodbujala delitev dela v Evropi. Poleg tega bo pospešen proces konsolidacije spremenil gospodarsko sliko. V času, ko kriza razkriva prednosti in slabosti podjetij, skušajo multinacionalke optimizirati svoj portfelj aktivnosti na obstoječih trgih. Podjetja, ki niso trdno usidrana na posameznih trgih in ki so pod finančnim pritiskom, bodo svojo prisotnost na mednarodnem trgu ponovno ocenila in zapustila obrobne trge. ABInBev, ena največjih pivovarniških skupin na svetu, na primer, je junija objavila prodajo 11 pivovarn v SVE. Bogata podjetja s konkurenčnimi poslovnimi modeli se skozi krizo prebijejo kot zmagovalci. Ohranjanje denarnih sredstev in zasledovanje konservativnega finančnega modela sta izredno pomembna za preživetje v času krize. Poslovni model, ki je naravnan na pozicioniranje "vrednost za denar" bolj pomaga pri premagovanju krize, kot specializiranost v ogroženi tržni niši ali v primeru podjetja z nejasnim konceptom vrednosti. Splošni negativni pritisk na cene in zmanjšanje vrednosti lokalnih valut v primerjavi z evrom je v prid močnim lokalnim proizvajalcem, trgovskim blagovnim znamkam, diskontnim trgovinam in prodajalnam vrste

"prihrani čas in denar", kot so na primer trgovine "naredi sam" ali moderne samopostrežne prodajalne zdravil. Kriza predstavlja konec trenda, ki stremi k večji decentralizaciji poslovnih skupin, ki poslujejo v SVE. Sedaj se je nihalo ponovno obrnilo k centralizaciji. Sedeži podjetij želijo imeti večji nadzor nad investicijami, stroški, likvidnostjo in glavnimi računi. Ni prav jasno, kako bo ta trend kratkega in direktnega poročanja obrnil napredovanje povezanih organizacij s specializiranimi vlogami in odgovornostmi – razvoj, ki ga je mogoče opaziti v zadnjem času med regionalnimi igralci na trgu.

Ključne besede: srednja in vzhodna Evropa; ekonomska kriza; multinacionalka; strategija.

1. INTRODUCTION

The current economic crisis is the worst economic downturn the world economy has experienced for decades. The economies in Central and Eastern Europe (CEE) have been severely hit by the collapse of export markets, the drop in direct foreign investments, the credit squeeze, and depreciating local currencies. This raises the question how the economic development of the countries and markets in CEE will be affected and how foreign multinational firms will respond to the crisis. Although we are still in the middle of the crisis and statements on its further development are speculative, the management of multinational companies (MNC) is called upon to reassess investments and strategies in the countries of the region. Those companies have been major drivers of economic development in the last 20 years and the future economic outlook of the economic revival depends to a high degree on their assessment of the situation. Will they continue with their chosen expansion path or do we have to expect some structural changes in the way how markets are approached and products and services are marketed in CEE? The purpose of this paper is threefold: Firstly, to conduct an analysis of the impact of the financial and economic crisis on the economies of CEE; secondly, to judge if the business model for CEE that has been driving the expansion and market penetration of foreign firms in CEE since the 1990s is still valid and, thirdly, to see how MNCs will react to these challenges in their strategies.

2. THE IMPACT OF THE ECONOMIC CRISIS ON THE ECONOMIES OF CEE

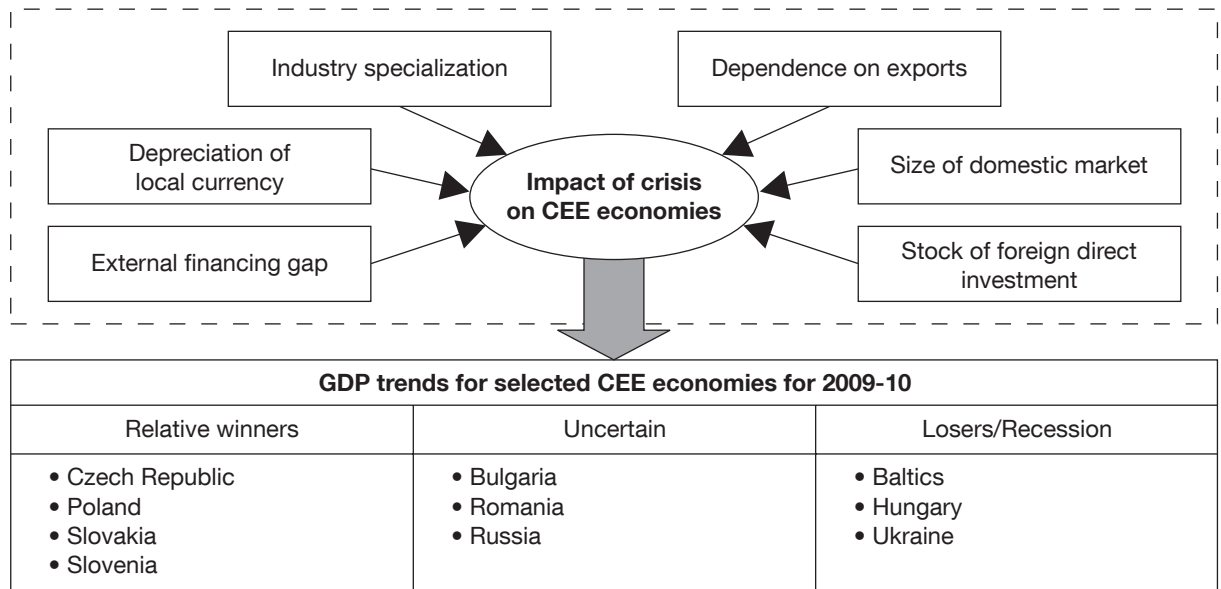
The current economic and financial crisis originated from problems in the financial sector in the U.S.A. in 2007. Unsound lending practices by financial institutions and unsatisfactory risk management triggered an unprecedented devaluation of assets and credit squeeze in inter-bank lending. The crisis developed quickly to a worldwide economic shock that soon reached the real economy too. From a CEE perspective the crisis was to a high degree imported. It hit the countries of the region in mid-2008 mainly via the collapse of the export markets. Especially the smaller export-led economies faced a huge drop in the demand for automotive supplies, cars and consumer electronics. The market collapse was accompanied by a drying up of credits from abroad and a fall in foreign direct investments. A massive depreciation of free-floating CEE currencies followed in late 2008, which caused a difficult liquidity situation for households and

businesses with loans in hard foreign currency. Of course, part of the current crisis was also "home-made". Extremely high economic growth rates over the preceding years, overheated real estate markets, excessive external debt and irresponsible fiscal measures by local governments contributed to the problem.

The major lesson so far is that the impact of the crisis on the economies of CEE varies. As shown in Figure 1, several factors determine the magnitude of the effect on individual economies: industry specialization, dependence on export, domestic market size, stock of foreign direct investment, external financing gap and local currency depreciation. Since the fall of the Iron Curtain the economies have been gradually integrated into the global economy. In particular, the smaller economies of Central Europe have placed their bet on a high degree of industry specialization and an export-led economic model. Slovakia is called "Detroit East" due to its high specialization in car making: 8% of its GDP and 40% of exports are related to this segment. The highest values of exports as percentage of GDP (Eurostat, 2009) can be found in Slovakia (77.4%), the Czech Republic (70.3%), Hungary (68.8%) and Slovenia (63.7%). When the primary export markets in Western Europe collapsed, the high dependence came to force. Not surprisingly, countries with a larger domestic market and a lower international economic integration such as Poland and Romania are less affected by the drop in external demand.

The inflow of foreign direct investment, the main driver of economic development in CEE in the last two decades, has stalled this year. However, a higher stock of FDI serves as a cushion against an outflow of capital (wiiw, 2009b): With respect to this indicator, Bulgaria (>90% of FDI stock/GDP), Estonia and Croatia (>70%) are in a more favorable position than Albania, Slovenia or Ukraine (<30%). The external financing need relates to estimates of the ability to refinance maturing external debts. The wider the external financing gap of a country, the stronger the depreciation pressure on its currency. Bulgaria, Ukraine, Baltics and Hungary are more exposed than other countries of the region. The strong depreciation of local currencies against the Euro in a short period of time ranging from 16% for the Romanian Lei, 20% for the Hungarian Forint to 23% for the Polish Zloty aggravated the effects of the crisis on those households and businesses which borrowed or had accounts payable in Euro (UniCredit Group Research, 2009a). Summing up the overall effect on the CEE economies, we can

Figure 1: Impact of current economic crisis on CEE economies



distinguish between relative winners and losers in terms of economic growth for 2009-10 (UniCredit Group Research, 2009b; Thorniley, 2009; wiiw, 2009a): the Czech Republic, Poland, Slovakia and Slovenia are seen as relative winners, while the Baltics, Hungary and Ukraine are facing a harsh recession.

3. THE IMPACT OF THE ECONOMIC CRISIS ON INDUSTRIES AND FIRMS

The effects of the crisis vary not only by country but also by industry and individual company. The Economic Climate 2009 Report of the international credit insurer Euler-Hermes (June 2009) only finds one industry in CEE, namely pharmaceuticals, for which the economic outlook for 2009 is regarded as good. First weaknesses are diagnosed for food, machinery, IT & telecom and construction, fundamental weaknesses for consumer electronics, cars & automotive and paper & pulp and a sharp recession for steel.

Even when in the same industry, companies can have quite different market, sales and performance situations. Two dimensions determine the current competitive position of companies. First of all, the liquidity position is a sign of strength in this current crisis (“cash is king”). Sufficient liquidity is needed to survive in a crisis which is characterized by a drying out of financial funds. Companies that are successful in preserving cash and pursue a conservative financing model are in a better competitive position so far. Financially highly leveraged businesses are facing pressure in refinancing. The

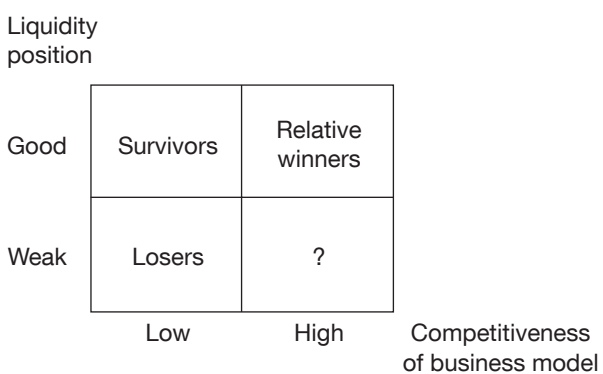
second dimension, the competitiveness of the business model, refers to the fit of the underlying business model with the industry and market conditions. Business models that are geared more towards a “value for money” positioning that show a higher level of diversification or that are based on a clear core benefit and have a loyal customer group will weather the crisis better than specialists in endangered niche markets (“monoliners”) and those with an unclear value proposition (“stuck-in-the-middle”).

By combining these two dimensions in a 2x2 matrix, four positions can be distinguished (Figure 2). The survivors are financially sound companies, however with strategic weaknesses. Typically, they are privately-owned businesses which offer second- or third-tier brands, with strong positions in sub-regions or in niche markets showing more or less stable demand. The relative winners include firms such as Zara and H&M in clothing, Nespresso, Lindt or Apple (iPhone) in premium consumer goods segments, generic pharmaceuticals producers such as Hungarian Gedeon Richter or Skoda and Dacia which are makers of affordable cars. They all benefit in the crisis compared to their competitors due to a better cost and market position, clear product advantages, and strong demand even in times of crisis. Companies falling in the question mark quadrant were hit unexpectedly by the crisis. Their business model is often tailored to a lucrative niche and is based on market and industry conditions that were common in the last two decades – rising living standards and the globalization of markets. Porsche, the German

sports car producer, and KTM, the Austrian producer of sport motorcycles, are good examples for this group. These worldwide leaders in their respective segments with competitive advantages in brand image, product design, and engineering are confronted with a huge drop in their global sales. These problems are aggravated by a high financial leverage which causes serious liquidity problems. The same is true of all highly specialized suppliers to the automotive or electronics industry which are suffering from the extraordinary decline in orders. It is realistic to assume that favorable market conditions will return in 1-2 years but in order to survive, these companies must adjust their capacity and have to stay financially healthy.

Companies which built their business expansion in the boom years on cheap external borrowing are trapped now. Financial leverage turns against them when a credit squeeze arrives as the current one. Those segment leaders in financial troubles become primary takeover targets for companies from the relative winners' category which see the crisis as a formidable chance to improve their market position. In consumer and business financing so called "monoliners" have to change their business model that was biased towards the lending side as they are suddenly cut off from cheap funding on global capital markets – a major premise of their success and growth in the last years before the crisis. It is hard to say if the business model is fundamentally flawed in this case or if they are just casualties of bad circumstances. In any case, the crisis highlights the weaknesses of business models. The more leveraged and risky the premises of a business model are, the lower is its competitiveness. The losers in the matrix are weak with regard to both factors. They run a high risk of going bankrupt if they do not succeed to adjust to the new demand

Figure 2: Winners and losers of the crisis – the company level



situation. The crisis forces all companies to reconsider their "profit model" and puts liquidity as the second cause of business failure back into the limelight.

4. STRATEGY REVIEW FOR CEE

A good starting point for a discussion of the impact of the current economic crisis on the strategies of MNCs in CEE is the reassessment of the business model that was guiding the expansion to the region in the last two decades. Is this model still valid or do we have to rewrite it? The answer to this central question will affect the decision on the changes to the existing CEE strategy. The focus of the following discussion will center on the future role of CEE in the strategic plans of the MNC.

4.1 THE "CEE BUSINESS MODEL"

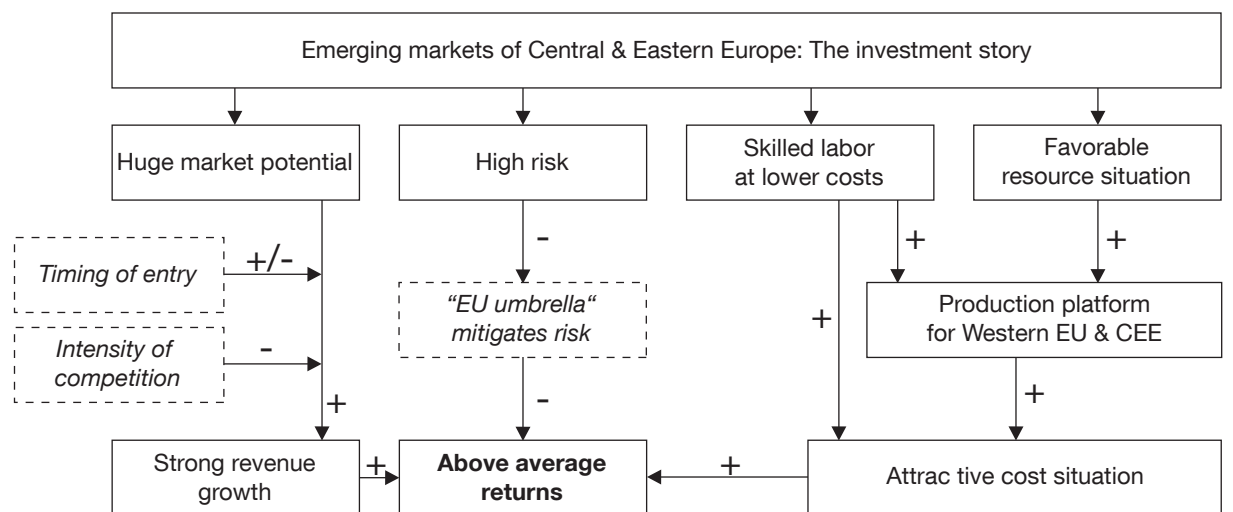
In Figure 3, the main pillars of the "CEE business model" and the assumed effects on the Western MNC's performance are shown. The main reasons for foreign companies to expand and to invest in CEE are similar to the ones put forward when entering other emerging countries of the world. From the perspective of mature Western markets, the major motivation for market entry is the huge market potential. Especially in those product and service categories that did not exist or were only offered in a basic and unsatisfying form under the socialist regime (e.g., mortgage, life insurance, car ownership, personal care products) a huge catch-up demand is given. The convergence to West European consumption and ownership levels due to the overall rise in living standards over the next decades is fuelling this growth story. The accession to the European Union or at least the prospect of becoming a member in the foreseeable future supports this development from the political and institutional side. While the enormous sales potential resulting from this development is undisputed the success of the individual firm entering CEE is contingent on its competitive behavior. Empirical studies show that early mover advantages exist in transitional economies (Jakobsen, 2007). They benefit by taking control of scarce assets, for instance, when they acquire dominant local production and distribution networks, local brands and natural resources. In addition, the typical focus on the relatively small upper segments of the markets leads to a very intense competition between the foreign entrants (Schuh, 2000). Thus, the timing of the entry and the existing competitive situation will have a major influence on the sales growth and profitability of the individual foreign entrant,

which in the worst case could end in a loss making venture.

A very high risk is typically associated with business ventures in transitional economies. This higher risk stems from the incomplete institutional framework. The transition process from a centrally planned economy to a market-economy encompasses a fundamental change of the legal system and the “rules of the game” (Newman, 2000; Meyer, 2001). Foreign entrants face a lack of information about local competitors and possible partners, they encounter unclear regulatory frameworks, inexperienced bureaucracies, underdeveloped court systems and corruption (Slangen & Van Tulder, 2009). While on a transaction basis instruments exist to mitigate the risk, the business risks stemming from unclear regulatory and legal frameworks are difficult to manage. However, the intention of most of the countries to become a member of the EU triggered a harmonization process and the adoption of many principles ruling the law in Western Europe. These efforts in the course of the accession process and finally the EU membership led to the view that the risk of doing business in those countries is lower than the one typically attributed to “normal” transitional economies. The supposed risk-reducing influence of the “EU umbrella”, namely the adherence of CEE countries to political, legal, and macroeconomic principles and guidelines set by the EU and a likely bailout by the EU in case of financial turbulences, led to the conviction among investors that the real business risk is lower than what typically is adequate to assume for transitional countries.

On the resource side the availability of skilled labor at lower costs than in Western Europe as well as the access to energy, raw materials and other resources to more favorable conditions than at home has lured foreign investors. They started to use CEE as a production platform for the whole European market. The automotive industry developed a strong industry cluster combining parts of the Czech Republic, Slovakia, Slovenia, Hungary and Poland. The latter two became favorite production locations for consumer electronics. The availability of skilled workers, graduates from technical colleges and universities, a strong engineering tradition, wages 50-70 % below the German level, lower energy prices as well as low taxes and other government incentives created an investment-friendly climate, particularly in Central Europe. The proximity to the West European markets should not be forgotten as another strong argument for a CEE location. In total, all these advantages add up to an attractive cost position and lead to a continuous emigration of production from the West to the East. This trend is particularly strong in “traditional industries” such as automotive, durable consumer goods, machinery, steel, building materials, and paper where the opening of CEE led to a revival of these industries and improved the competitiveness of West European companies. Overall, the business model that guided the expansion to CEE in the last two decades offered foreign entrants higher returns on investment than in their (Western) home markets fed by higher growth rates, lower costs and a manageable business risk.

Figure 3: The business model for CEE – the Western MNC’s perspective



The model in Figure 3 outlines the view of foreign entrants up to the outbreak of the current economic crisis. How is this business model affected by the crisis? Will foreign MNCs turn away from the region and withdraw from the countries? Even without a final account of the devastating effects of the current crisis on the CEE economies, it is realistic to contend that the key pillars of the business model are still valid in post-crisis times. The catch-up process to West European levels has been only interrupted by the crisis. There are still huge gaps in the development of product and service markets, in the levels of ownership of durable consumer goods, and in infrastructure development. The collapse of domestic and external demand has led to declining sales and it will take some time to reach pre-crisis levels again. The substantial demand and the need to upgrade and modernize private and public facilities will not disappear after the crisis, but rather come back in a more pressuring form. The advantages resulting from the skilled workforce and the favorable resource situation are not eliminated by the crisis. Although the wages increased considerably in the last years they are still lower than in Western Europe. Strong depreciations of local currencies (e.g., Zloty, Forint, Lei) against the Euro in the countries with floating exchange rates have offset rising labor costs and maintained or even improved the relative competitive position vis-à-vis other economies.

What has to be corrected in the wake of the crisis is the perception of risk. The country risk was underestimated in the boom years, the “EU umbrella” did not really shield against all risks associated with economies in transition (although EU support was preventing the worst in Hungary and in the Baltics). Hence, the business model for CEE has not become obsolete for foreign firms. In comparison with West European countries the region could emerge even stronger from the crisis. However, we will see a more differentiated approach in the assessment of the economic potential of CEE countries in the future. The management of MNCs will pay more attention to a country’s competitiveness, the quality of its institutions and its political stability.

4.2. THE IMPACT OF THE CRISIS ON MAJOR DECISIONS OF MNCs

In this section, we will look at the impact of the crisis on different decision areas of the MNC management. There are five major decision areas for the management of MNCs that are reviewed in the context of the crisis: The future role of CEE in the corporate strategies,

participation in CEE markets, activity location, product and marketing strategies and the organizational model for CEE.

Growing role of CEE in the strategies of MNCs

CEE will continue to outperform Western Europe in economic growth in the future. The region is such a huge and important market and the convergence process is such a strong driver of demand that foreign MNCs cannot turn away. Furthermore, the role of CEE as a production platform for Europe will further gain in importance. However, we will see a more differentiated approach of the MNCs towards the countries of the region. The crisis highlighted that CEE is not a homogeneous bloc. MNC management will pay more attention to the individual country’s risks and weigh more carefully the advantages and risks than in the past boom years. All this will be reflected in a more selective approach towards investment decisions in the future. The more defensive and selective investment approach of foreign MNCs will lead to a stronger competition between countries and locations for foreign direct investment. National governments will engage more in attracting investments.

Market participation – Focus on optimization of presence in CEE

For now, the expansion into new markets in CEE is on hold. MNCs try to optimize their portfolio of activities in the existing markets as the crisis brings out the strengths and weaknesses of businesses. Weak market positions in some country markets and the need to strengthen the overall financial position lead to a reassessment of the CEE strategy and to (partial) withdrawals from peripheral markets. For example, ABInBev, one of the large brewery groups of the world, announced in June the sale of 11 breweries in CEE. This is a good opportunity for cash rich companies which are already present in these markets to acquire weaker competitors. In any case, the crisis is accelerating industry consolidation in CEE and industry constellations will look differently thereafter. In addition, investment decisions focus more on the countries’ recovery potential. When trying to capture the recovery potential of economies, non-economic criteria gain in importance. Criteria such as the country’s competitiveness, the quality of institutions, and political leadership and consensus among the leading parties tell us more about a country’s ability to cope with the effects of the crisis than macro-economic figures alone. In the coming years we will see the resurgence of

country risk as a key criterion in the assessment of market attractiveness.

Activity location – Shift of manufacturing to CEE continues

West European manufacturers will continue with shifting part of their manufacturing to locations in CEE. The newly established production sites in CEE have state-of-the-art technology, are more flexible and cost efficient than the ones in Western Europe. Companies that announced relocations – and even increased investments this year in CEE countries – range from electronics, cars and household appliances to paper. It seems that we face a massive shift of capacity from the West to the East within corporate groups in order to stay competitive and profitable. This marks the beginning of a more pronounced division of work within Europe. MNCs use the CEE locations to serve the markets of the region as well as an export platform to Western Europe. Parallel to the shift in production we see the same happening on the distribution side. While the majority of distribution centers is still located in “old Europe”, namely the Netherlands, France, Germany and the UK, the highest growth rates and new construction can be found in the countries of CEE. The EU enlargements in 2004 and 2007 as well as the growth in sales and manufacturing lead to a shift of the center of gravity to the East (Capgemini, 2006). Moreover, CEE countries become more attractive as outsourcing location for IT and business processes (London School of Economics, 2009). Especially the educated labor force, good infrastructure, intellectual property rights protection and the good cultural fit with West European countries are favoring the Czech Republic, Poland, Slovakia, Bulgaria and Romania as nearshoring locations.

Product and marketing strategies – MNCs with diversified strategies perform better

Pure exporters from a Western home base are at a disadvantage today. The massive depreciation of several CEE currencies wiped out the import segments in many markets in CEE. Relative winners are the local producers which serve the lower ends of the markets. The downward pressure on prices and the growing “bottom-of-the-pyramid” (Prahalad, 2005) favors marketers with “value-for-money” offers. These include producers of local brands, private labels, discounters and new retail store formats help reduce expenses but still provide a pleasant shopping atmosphere such as “do-it-yourself” stores and modern self-service drug stores (“Drogeriemarkt”). CEE consumers still appreciate

strong brands and market leaders are benefitting from their loyalty. MNCs with multi-tier strategies and a regional production network are positioned best to weather the economic downturn. Having an assortment of different brands covering all price-levels from the premium to the economy segment immunize those MNCs against swings in demand (Schuh, 2000). Clever pricing, the streamlining of portfolios and a strong focus on the main business are typical responses to the new market situation.

Organization model for CEE activities – Centralization is in fashion again

With the increasing penetration of CEE markets and the gradual shift of production to the countries of the region the organizational model for CEE has become more decentralized in the last years. More locally performed activities and a stronger market penetration led to a higher autonomy in decision making for the local management (Schuh, 2006). This trend has stopped now. In times of crisis the pendulum swings towards centralization again. Headquarters want to have a better control over investments, costs, liquidity and key accounts. Cost reduction programs are launched, investments are put on hold and cash management is tightened (Roland Berger, 2008). The impact of the crisis on the trend towards more complex network structures with specialized roles and responsibilities (e.g., shared service centers, centers of excellence, sub-regional management centers) is still unclear. While centralized and simplified control mechanisms are favored by central management in difficult times, the network organization and more active participation of subsidiaries allows more knowledge sharing what could be helpful in coping with the effects of the crisis.

5. CONCLUSION

The current economic crisis in CEE can be seen as an interruption of a trend or a “structural break”. It mirrors a massive imbalance of existing capacity and (external) demand due to the collapse of markets, which leads to major adjustment processes at the company, industry and sectoral level. The accompanying credit squeeze is worsening the situation, even for companies with a sound core business. As a consequence, strategically weak and cash-strapped companies exit the market or are taken over by other companies. Industry consolidation on a national and regional level is accelerated, thus we will be faced with a changed competitive landscape after the downturn. Governments will

be more active actors in the economic arena again, be it as shareholders of banks, guarantors, regulators or stakeholders with a pronounced national interest.

However, compared to the transformation recessions in the 1990s this crisis is not (yet) a “system crisis” – maybe with the exception of the financial services industry. This crisis will not end up in a general reconfiguration of the economic system and in the establishment of totally “new rules of the game”. Therefore, I do not expect fundamental changes in the CEE strategy of foreign MNCs. The major assumptions for the expansion into CEE are still the same. The huge market potential and a favorable cost and resource situation of CEE will not disappear. What markedly changed is the perception of risk. MNC management will pay more attention to the country and business risk and will price it more realistically than in the past. This economic crisis marks the end of the perception of CEE as a homogeneous region. We are already observing a more differentiated approach. Economies with a good economic performance, solid institutional framework and stable political system will benefit from relatively stronger foreign direct investments inflows than weaker ones in the next years. The more selective investment approach of MNCs will lead to a stronger competition for foreign direct investments between countries and locations.

The shift of manufacturing and logistics capacity from Western Europe to CEE will continue as the crisis advances the division of work in Europe. While companies with a strong local presence and market position in CEE markets are among the relative winners, companies with a weaker competitive position have to ask themselves if they will be able to compete successfully in markets with lower market growth and a higher intensity of competition. For cash-rich companies the current situation offers plenty of opportunities to buy companies with financial difficulties. Especially distressed companies with a healthy core business are of interest. The downward pressure on prices favors companies with “value-for-money” business models as well as strong local producers, private labels, discounters and “money-saving” formats such as “do-it-yourself” stores.

With regard to the organizational model we can see a strong trend towards centralization again. Headquarters interfere heavily in local operations via cost cutting programs, capacity reductions, investment freezes, and streamlining of product portfolios. The question arises how this return to central control mechanisms will affect the more

complex network structures that emerged in the last years among the regional players. Organizational differentiation and specialization have been seen as a good way to make use of the competencies and knowledge that are available in the whole group. It would be a step back in organizational development when the increasing participation of subsidiary management in the multinational group’s decision-making process and the enhanced knowledge transfer among the organizational units, particularly the reverse one from the subsidiaries to the headquarters, would be stalled or even unwound by the current crisis.

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