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DETERMINANTS OF ESTABLISHMENT MODE CHOICE IN CENTRAL AND EASTERN EUROPEAN COUNTRIES

Master’s Thesis in Marketing
International Business

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ABSTRACT

The last two decades have seen a vigorous upturn in global Foreign Direct Investment flows. From the time of Second World War the majority of FDI flows have had urbanized economies as both their origin and destination. However, during recent years the distribution of the flows into emerging and transition economies in Eastern European has been greater than before. This investigation elaborates the factors, which have significant impact on FDI in Central and Eastern European countries.

In this study two streams of foreign direct investment literature, choice between greenfield vs. acquisition has been elaborated. This study addresses country (market potential, investment risk), firm (organization learning, technological intensity, international strategy) and industry level (industry growth, industry concentration) factors and determines establishment mode choice in CEE countries. The research was carried out using the case study method. Previous theories of the topic were used as a mirror to compare empirical results.

The qualitative research was carried out via themed interviews of the specialists who manage the case company’s establishment mode choice decision in CEE. The main findings of the studies emphasize that decision of establishment mode choice effect country, firm and industry level factors. The study suggests that organization learning, international strategy, technological intensity, market potential, investment risk, industry growth and industry concentration are significant factors to be considered by firms when they make decisions regarding foreign direct investment in CEE countries.

KEY WORDS: Foreign Direct Investment, Establishment mode choice, Greenfield, acquisition, organization learning, technological intensity, investment risk, market potential, industry growth, global strategy, multidomestic strategy.
CHAPTER 1. INTRODUCTION

1.1. Introduction to the subject

In today’s international business environment, it is quite attractive, and mandatory for companies to sell their products and services in several physical locations of the world. To achieve this objective, foreign extension by companies is a core manifesto. These steps of spreading out are accomplished through different entry modes. Foreign entry mode decisions are the most demanding search topic in International Business Management (Brouthers & Hennart 2007).

According to Root entry modes can be defined “as an institutional arrangement that makes possible the entry of a company’s product, technology, human skills, management or other resources into a foreign country” (1998). Entry strategy consists of a complex set of decisions regarding entry into a market. When companies decide to invest equity in foreign markets, they have two broader options; whether to start from greenfield or acquisition (Barkema & Vermeulen 1998; Hennart & Park 1993).

Direct investment operations in transition economies is of meticulous interest as a research topic for developed economies and especially Nordic companies after the opening up of Eastern markets and as European amalgamation develops rapidly. Since 1989, all former European centrally planned economies have embarked on a path of transition in order to set up a market based structure. Most of the countries involved in this process have actively attracted foreign direct investment due to their persistent capital and technology needs and due to expectations associated with FDI as a powerful means for economic change. As a consequence, FDI in the form of greenfield and acquisition has become the most prevailing operation mode for multinational companies (Torstila 1999).
1.2. Research gap

Previous research on establishment mode choice, and most literature on entry modes, studies the effect of firm-level; industry level and country level dynamics in segregation, thus not succeeding in revealing the role of location in choice of establishment mode. It is a fundamental factor especially in CEE countries for FDI entry mode choice. Secondly, firm level factors have received much attention in earlier works on establishment mode choice. By contrast, research on the influence of country level and industry level factors is limited, to date, to testing the effect of cultural, distance on the establishment mode choice (Kogut & Singh 1988; Brouthers & Brouthers 2000; Larimo 2003). In this context, this research fills the gap and provides new direction for future research as well.

1.3. Purpose and limitations of the study

An intrinsic characteristic of academic research is that it is subject to a variety of restraints; the major ones fiscal, moment in time and cognitive. This is also appropriate for investigating foreign entry modes (Slangen 2004).

The main purpose of this study is to enhance our understanding of the determinants of firms’ establishment mode choice in Central Eastern European countries.

In order to achieve the main purpose of this study, the following sub-objectives are formed:

1) To analyze the decision of greenfield vs. acquisition in context of firm level analysis.

The first objective analyzes firm level factors. The first factor is organization learning. To which extent organization learning affects the decision of entry mode has been investigated. The second variable is examined by looking at the aspect of technological intensity of the MNCs and what impact it has on establishment
mode choice. Third factor is international strategy; whether it is global or multi-
domestic and what is the role of this strategic choice regarding the decision of establishment mode choice.

2) To analyze the choice of greenfield vs. acquisition interrelated to industry level factors.

The second objective is to explore, the industry level factors which play a vital role in the choice between establishment mode choice.

3) To examine country level factors which are important indicators for firms in deciding choice between establishment mode.

The third objective analyzes the determinants of host country; market potential and country risk.

According to Gatingon and Anderson (1988) environmental uncertainties, such as a country’s political, legal, cultural and economic environment intimidate the stability of a business operation. Therefore the intensity of risk perceived by MNEs plays a vital role in the entry mode decision (Ahmed et al.2002).

The market potential in the host country is a significant determinant of the MNE’s entry mode decision. It is obvious that market growth often attracts entry (Chatterjee 1990).

Luo (2001: 452) mentions “industrial sales growth conditions in host market affect expected net returns and firm growth during international expansion. This affects resource commitments, strategic orientation and entry mode decision”.

The proposed research has, of course, several limitations. The first is the insufficient number of respondents. Further studies may overcome this drawback by focusing on more case companies for a particular establishment mode choice. Secondly, results have been presented on the basis of establishment mode choice in Russia and Estonia; only
two countries. Further studies are needed to take into account companies, which have investment in more countries. Thirdly, the interviewees were the CEO, Directors and other top executives of the firms, who have been working in the company for a long time. Moreover this study is limited to foreign entry mode decisions by Finnish firms into CEE countries. Further work is needed to find out to which extent these research findings are generalizable to non transition countries and to MNEs from other parts of the world.

Although this research is limited to the manufacturing sector, this drawback can be overcome by examining more industries in future research. Finally, in this research other modes of entry, except acquisition and greenfield are not presented.

1.4. Definition of key concepts

Foreign Direct Investment (FDI)

According to Buckley and Casson’s (1976) typology, “foreign direct investment in an equity based, internal transfer of resources and rights that is unlimited in time.” Dunning’s emphasizes that FDI as investments are “outside the home country of the investing company, but inside the investing company”. He also states that FDI consists of a package of assets and intermediate products, such as capital, technology, management skills, access to markets and entrepreneurship.” IMF (1993) defines FDI as “investments that involve a long term relationship acting a lasting interest of a resident entity (direct investor) in an entity in an economy other than of the investor. The direct investor’s purpose is to exert an influence on the management of enterprise resident in other economy”.

Multinational Company (MNC)

A multinational company (MNCs) refers to a corporation operating in more than two foreign countries. According to Harvard Business School criteria for a MNC, an MNC has at least six subsidiaries abroad. There are two features that should be taken into account when analyzing any Nordic firm. First, the biggest Nordic companies are small compared to large companies from other countries, such as the U.S, due to the
compactness of their markets. Second, the internationalization of Finnish firms started in the 1960s and gathered speed strikingly in the 1980’s, which is very late by intercontinental standards.

Central and Eastern Europe

The subsequent Central and Eastern European countries included in this study are the Czech Republic, Hungary, Poland, and Slovakia, the Baltic States, Estonia, Latvia, Lithuania and Russia.

Transition Economy

After the revolution of the economic, social, and political systems of Eastern European countries that was set into motion in 1989, the countries of Central and Eastern Europe have broken down the old communist systems. According to Estrin (1994), the transition process which has taken place in CEE has been based on two intentions: first, the market is essential to organize production and trade, and second private ownership is necessary to motivate production and exchange.

In the next section earlier studies concerning to the subject are presented.
1.5. Previous studies concerning the subject

<table>
<thead>
<tr>
<th>Study</th>
<th>Theoretical perspective</th>
<th>Home country</th>
<th>Host country</th>
<th>Time period</th>
<th>Sample size</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meyer and Estrin (1997)</td>
<td>Various based on several earlier studies</td>
<td>Germany and U.K</td>
<td>Various</td>
<td>early 1990s</td>
<td>211</td>
<td>Binomial logit</td>
</tr>
<tr>
<td>Padmanabhan and</td>
<td>Organization learning</td>
<td>Japan</td>
<td>Various</td>
<td>1969-1991</td>
<td>752</td>
<td>Binomial digit</td>
</tr>
</tbody>
</table>
Table 1. Main characteristics of the studies reviewed (adapted from Slangen 2004).

<table>
<thead>
<tr>
<th>Study</th>
<th>Theories Used</th>
<th>Sample Countries</th>
<th>Time Period</th>
<th>N</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brouthers and Brouthers (2000)</td>
<td>Ownership-Location-Internalization (OLI) paradigm, institutional theory</td>
<td>Various</td>
<td>Various</td>
<td>?-mid 1990s</td>
<td>277</td>
</tr>
</tbody>
</table>

Above table describes the previous studies regarding the subject. There are almost fifteen studies, which used different theories of FDI. There is no specific theory which explains FDI clearly, as a result above table also shows that authors inducted different theories to compare the results.

In this investigation, few other studies included as well. Luostarinen, Johanson, Wiedersheim and Williamson used Internationalization theory, while Buckley and Casson, Anderson and Gatignon, Williamson, Hennart, Erramili and Rao used transaction cost theory. These theories have been discussed in this study.
1.6. Structure of the study

The study consists of six chapters. The first three chapters give attention to the theoretical presentation of the subject, explaining the previous theories and empirical findings. The methodology of the study introduced in the fourth chapter. The fifth chapter examines empirical results through case study method. Finally, the sixth chapter summarizes and presents the results and provides evidence for the managerial implications of the study. The study progresses as follows:

The first chapter starts with a short introduction to the study. The main purpose is defined with sub-goals. Also, the limitations of the study are discussed and a short review of the previous studies and literature concerning the subject are discussed.

The second chapter describes the background of transition economies and the heritage of administrative economic systems. The third section explains changes which happened during the transition phase. The last part sheds light on the theories of FDI and their implications.

The third chapter critically reviews the existing empirical literature on the determinants of an MNE’s choice between greenfield investment and acquisition.

In the fourth chapter the methodology of this study is presented. The concepts of the study need to be operationalized in a way that variables concerning the study can be calculated qualitatively. In addition, the validity and reliability of the study is discussed. A brief description of data collection and sampling is also presented in order to enhance the understanding of the reader.

The fifth chapter examines the empirical results of the study. The propositions, which are developed in the theoretical part, are proved through qualitative methods (interview).

In the sixth chapter, a summary of the study is presented. The results of the empirical part of this study are discussed and implications for decision-makers are also given. Adding up, it is important to compare the results of this study to previous findings regarding the greenfield vs. acquisition entry mode decision. Limitations and some suggestions for future research are presented.
1. Introduction to the subject
   - Objective, research questions and limitations of the study
   - Definition of key concepts
   - Previous studies and literature regarding to study

2. Foreign Direct Investment and CEE
   - Background
   - The heritage of administrative economic system
   - FDI during transition phase
   - Theories of FDI

3. Greenfield vs. Acquisition
   - Introduction
   - Firm level analysis
   - Industry level analysis
   - Country level analysis
   - Theoretical Framework

4. Methodology of the study
   - Research methodology
   - Research design
   - Validity and reliability

5. Empirical Results
   The relation and impact of firm level factors in establishment mode decision.
   The relation and impact of industry level factors in establishment mode decision.
   The relation and impact of country level factors in establishment mode decision.

6. Summary and Conclusions
   - Summary of the study
   - Conclusion of the study
   - Managerial implications
   - Suggestions for future research

Figure 1. Structure of the study
CHAPTER 2. FOREIGN DIRECT INVESTMENT AND CEE

This chapter is organized as follows: the first section looks at the period of planned economy and how policies toward FDI changed, when the transition process started. The final part identifies the determinants, which are important for FDI in Central and Eastern European countries.

2.1. Background

The last two decades have seen a robust increase in global FDI flows. Since the Second World War the majority of FDI flows have had urbanized economies as both their origin and destination. However, during recent years the allocation of the flows into emerging and transition economies in Eastern European has been greater than before. The common approach towards FDI has changed from the frightened, negative view that was prevalent until the 1980s to the modern view, where approximately all economies allow foreign investment and most of them dynamically promote inflows of foreign direct investment (UNCTAD 2008).

The reason for the constructive attitude towards FDI is the credence in the benefits, such as inflow of capital, transfer of management skills, job creation, increased exports and transfer of technology, provided by foreign direct investment (Johnson 2006). Though the change in attitudes towards FDI was slow in the developing economies, it was more rapid in transition economies. Transition economies changed their legal structure from a state in which FDI was enormously constrained to a situation where potential host countries actively compete for inflows of FDI. The characteristics of transition economies provide mainly interesting surroundings for the examination of not only determinants of FDI, such as market demand, but also transition specific determinants such as privatization. The constituency is replacing a system based on administrative control of the economy with a system based on market-economy principles and democracy. Whereas developing economies traditionally needed inflows of capital in order to start building an industry, the transition economies were in a very different position. This region was over-industrialized, when transition process started. They were dominated by heavy manufacturing, focusing on military and investment goods rather than consumer goods and services.

After that collapse of the iron curtain in 1989, the majority of countries of the former soviet block moved effectively from centrally planned economies to market based economies with parliamentary democracy. This methodical alteration now appears irretrievable as many institutions in both the
economic and political sphere that will be inclined to resist any reversal of this change have been established. However, the progress of transition varies within the region. The vise grad countries have changed their political systems to an enormous extent, while progress has been slower in south Eastern Europe. In Russia, the political changes have been more unpredictable and are still subject to high amount of political uncertainties. All these discrepancies in political reform are reflected in the progress of economic improvement and logical transformation. In the transition process, Central and Eastern Europe (CEE) opened to western business in 1989. For fifty years, the constituency tagged on a rule of economic autarky. International Business took place mainly in the form of barter trade. Foreign Direct investment (FDI) was impossible due to tight regulatory system. After the transition environment changed, it created suitable conditions for international investment. Many multinational enterprises (MNEs) entered into the CEE region (Meyer 1998: 3).

FDI is the relocation of funds to a host economy and requires an elevated degree of commitment to operating in the country. It is also a medium of knowledge transfer; introduces new management and marketing know-how and the advance production technology. Investment by western companies is expected to provide immediate capital for countries with limited access to international markets and to produce cash revenues through privatization for vacant government budgets as well. For the business community in Western Europe, the change from planned economy to market based economy brought fear to established business operations, but above and beyond potential opportunities for growth. The region offered major business opportunities for West-East business through its unexploited virgin markets and low labor costs. Customers in this region were keen to adopt the western lifestyle and purchase consumer goods that they knew of many years through media, but to which they did not have access due to the rule of the iron curtain (Meyer 1998:4).

European transition economies have been divided into two subgroups; the Central and Eastern Europe (CEE) economies and the economies of Commonwealth of Independent States (CIS) (EBRD, 2004). Appendix A. lists the economies included in these two groups.

2.2. The heritage of an administrative economic system

To achieve inflows of FDI, the host country must have a regulatory structure allowing foreign direct investment. It is mandatory to differentiate between this type of framework and policies designed to
keenly encourage FDI inflows. The earlier is generally referred to as facilitating framework while the latter is referred to as incentive policies (UNCTAD 2003).

During the period of administrative economy, when most Eastern European economic systems started in Eastern Europe, inflow of FDI into the region was at a minimum level. McMillan (1993) argues it was the economic system itself, to a certain extent, rather than the explicit FDI policies that prevented inflows of FDI. The system of central planning and administratively set prices and wages formed a setting, which severely constrained the manipulation possibilities of potential foreign MNE candidates.

Above data explains that, period of administrative economy prevented inflows of FDI, due to several barriers. MNC’s could not start operations there; even they knew that there is huge market and potential for them. Consumers wanted to buy international products and adopt advanced custom. But they did not have suitable environment for FDI. In this thesis, it has been focused that transition from administrative economy to market based economy brought opportunities for firms to invest and grow. But on the other hand, there is also issues regarding investment, whether firms start operations through greenfield or acquisition.

2.3. FDI during transition phase

The start of the transition process resulted in an absolute turnaround of FDI policies and regulations in the transition economies. East European governments began to remove the existing individuality for MNE entry through the establishment of new foreign investment laws (Zloch-Christy 1998: 70). The shift from centrally planned to market based economies has resulted in a situation where all transition economies are now enthusiastically competing for FDI through the use of inducement, such as reduction of corporate taxes, tax holidays and provision of social facilities (Mah & Tamulatis 2000).

To present an overview it is useful to take account of a short description of the global expansion of FDI. The changes in the flow of FDI going to the transition economies can then be connected to the development in the rest of the world. Table 2 presents essential data regarding FDI stocks, including the world total as well as data from diverse types of economies and regions. The last line presents the stock of FDI in Central Eastern Europe as a proportion of the world total.
The above diagram demonstrates the dominance of developed economies in terms of total stock of FDI. In 2008 around 69 percent of the world stock of FDI was in developed countries. It also shows that the world stock of FDI grew by about 323 percent from 1995 to 2008.

Central and Eastern Europe have an undersized, but rapidly increasing share of FDI stock. In the beginning of the transition process, the total inward stock of FDI in CEE was less than one percent of the world total. This was due to the unfavorable economic environment for foreign MNEs, as explained in above section. Conversely, the growth rate of the FDI stock in Central and Eastern Europe between 1990 and 2003 was greatly higher than the worldwide rate, and the transition economies improved their share of the total stock of FDI to around 3.5 percent in 2003. In 2008 Central Eastern Europe was accounted to approximately 3.4 percent FDI stock. Previous studies of FDI inflows have indicated large deviation in the FDI, which transition economies attracted during the start and especially in the first year of the transition process.

Table 3. Inward FDI in the CEE economies (adapted from EBRD 2008).
The above table illustrates that Poland received the largest volume of FDI, followed by the Czech Republic and Hungary. However, if we look at the figures in terms of per capita, the Czech Republic has been most successful in attracting FDI. When countries are ranked according to the inward stock of FDI as a share of GDP, Estonia has the highest share. Table 4 presents data from the CIS economies. Kazakhstan and Azerbaijan attracted the largest inward stock of FDI per capita. These two countries also have the largest share of GDP. According to UNCTAD (2008), petroleum industries in both countries are the destination for the majority of the FDI. Natural resources, such as oil, are a major attracting factor for FDI.

**Table 4.** Inward FDI in the CIS economies (adapted from EBRD 2008).

<table>
<thead>
<tr>
<th>Country</th>
<th>Cumulative FDI inflows 2003-2006 per capita, USD</th>
<th>Cumulative FDI inflows 2007 per capita, USD</th>
<th>FDI inward stock as share of GDP in 2008 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>1094 (1)</td>
<td>15730 (1)</td>
<td>60.1 (2)</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>873 (2)</td>
<td>72142)</td>
<td>117.7 (1)</td>
</tr>
<tr>
<td>Armenia</td>
<td>277 (3)</td>
<td>868 (10)</td>
<td>31.9 (4)</td>
</tr>
<tr>
<td>Georgia</td>
<td>272 (4)</td>
<td>1257 (7)</td>
<td>26.3 (6)</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>269 (5)</td>
<td>1613 (6)</td>
<td>16.8 (7)</td>
</tr>
<tr>
<td>Moldova</td>
<td>210 (6)</td>
<td>893 (9)</td>
<td>40.5 (3)</td>
</tr>
<tr>
<td>Belarus</td>
<td>200 (7)</td>
<td>1979 (5)</td>
<td>10.8 (10)</td>
</tr>
<tr>
<td>Ukraine</td>
<td>128 (8)</td>
<td>6213 (3)</td>
<td>14.1 (8)</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>85 (9)</td>
<td>413 (11)</td>
<td>28.6 (5)</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>35 (10)</td>
<td>917 (8)</td>
<td>10.6 (11)</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>34 (11)</td>
<td>223 (12)</td>
<td>14.1 (8)</td>
</tr>
<tr>
<td>Russia</td>
<td>31 (12)</td>
<td>4478 (4)</td>
<td>12.1 (9)</td>
</tr>
<tr>
<td>Average</td>
<td>292</td>
<td>3483</td>
<td>32.0</td>
</tr>
</tbody>
</table>

The figures from the CEE group are greatly different in comparison to those of the CIS group. The average cumulative per capita inflows are more than five times higher in the CEE countries than in CIS countries. CIS economies are more deeply influenced by the planned economic system than CEE economies and their transition process is also slower.
The introduction of foreign direct investment (FDI) into the Central and Eastern European (CEE) economies has been a dynamic factor in the main stages of the privatization process throughout the transition. As the privatization and reformation process comes to an end, the main motives to seek FDI are to improve output, encourage employment, stimulate invention and technology transfer, and to increase constant economic growth (Mueller & Goic, 2002).

Through the fall of communism in the former Soviet Union, almost all countries have been faced with shifting from a command economy to a market economy. The change in CEE economies has been expedited by the privatization of state-owned enterprises and the growth of the private business sector. Foreign direct investment (FDI) has played a significant role in the privatization and reform process of the CEE economies (Case & Fair, 2004).

The above data sheds light on the communist era and the change from a planned economy to a market based economy. It also illustrates which factors attract FDI after reformation. The next section describes different theories of FDI and their implications.

2.4. Theories of FDI

There are, at least, seven main theories that describe ways to investigate how firms choose between different alternatives. These include Hymer’s theory (1976), PLC theory (1966), Internationalization theory (1975), Location theory (1985), Internalization theory (1976), transaction cost theory (1986) and Dunning’s eclectic theory (1980). However, in the field of international business, there is no common agreement on what should be brand as theory or framework. Dunning’s eclectic framework, which is based on more than a few theories, portrays what aspects influence FDI choices.

In general, there are four paradigms, in which all the theories and frameworks are revealed. The four dissimilar paradigms are market imperfection paradigm, behavioral paradigm, the environment paradigm and lastly market failure paradigm. It is crucial to recognize these four paradigms in sequence to understand where the theories have been grounded.
Table 5. Classification of FDI related theories (adapted from Tahir 2003).

<table>
<thead>
<tr>
<th>Market Imperfection Paradigm</th>
<th>Behavior Paradigm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hymer’s theory</td>
<td>Internationalization theory</td>
</tr>
<tr>
<td>Product life cycle theory</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Market Imperfection Paradigm</th>
<th>Market Failure Paradigm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location theories</td>
<td>Internalization theory</td>
</tr>
<tr>
<td></td>
<td>Transaction cost theory</td>
</tr>
<tr>
<td></td>
<td>Eclectic theory</td>
</tr>
</tbody>
</table>

The market imperfection paradigm was the prevailing paradigm of the sixties and early seventies, when the behavioral paradigm emerged to dominate until the latter part of the 1970s.

2.5. Market imperfection paradigm

Basically, the market-imperfection paradigm, as described earlier, comes from Bain’s theory of the firm. Bain’s theory assumes that competition among firms in an industry is imperfect. Maintenance of such competition is essential for continuation of above normal returns on investments (ROI). According to Porter (1980), industries with less competition and higher entry barriers collect above normal returns. Therefore organizations form imperfect-markets by manipulating the number of presented and potential customers. This aim can be achieved in two ways; first firms decrease the number of rivals by engaging in mergers and acquisitions by forming co-alliances. Firms can also reduce the number of potential customers by building higher entry barriers to the industry through heavy investment in differentiation products (Caves 1980). In this way, firms can create a less certain situation, minimize competition, benefit from an increased market share, control output and prices and attain an above-normal ROI (Bain 1956).

Hymer’s theory and PLC theory fall within this framework.

2.5.1. Hymer’s theory of international production

This theory came into view from Hymer’s doctoral dissertation (published in 1976). The study paid attention to FDI operations of U.S firms. Hymer illustrates that the orthodox theory of international trade and capital movement did not explain the foreign operations of the firms. Hymer’s
explanation of why firms invest abroad is based on industrial organization and firm theory. He
states that a firm with a monopolistic advantage in a product market or factor market has an added
incentive to engage in international operations. This advantage creates a clear level of market
imperfection in a host country (Kindleberger 1969). Therefore, firm chooses an entry mode which
provides most (ROI) to its advantage.

There are three main assumptions to Hymer’s theory: (1) The assets of a monopolistic advantage
are a requirement for a firm’s foreign operations. (2) A market for a firm’s lead is imperfect. (3)
Above normal returns on a firm’s investment depend upon elimination of its competition (Tahir
2003).

Table 6. Studies using Hymer’s theory (adapted from Tahir 2003).

<table>
<thead>
<tr>
<th>Researcher</th>
<th>Center of the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gruber, Mehta &amp; Vernon (1976)</td>
<td>US firms</td>
</tr>
<tr>
<td>Miller &amp; Weigh (1972)</td>
<td>US investment in Brazil</td>
</tr>
<tr>
<td>Lall (1980)</td>
<td>FDI by US firms</td>
</tr>
</tbody>
</table>

Kindleberger (1969) argues that there are two key aspects of the theory are the monopolistic
advantage of the firm and the degree of market imperfection. “Monopolistic Advantage” of the firm
means an advantage that no host country firm has or can acquire transferability from the home to
host country. This advantage lies in production or distribution. Hymer’s (1976) theory has found
considerable empirical support. Hymer’s (1976) argument is that a firm’s possession of a
competitive advantage is essential for it to efficiently enter an international market; this has found
empirical support in several studies. Before Hymer’s theory (1976), FDI was measured as a firm’s
investment in portfolios of assets. He argued for treating FDI as an industrial phenomenon rather
than as a portfolio of assets. After Hymer’s theory (1976), FDI theories no longer refer to FDI as a
portfolio of assets (Tahir 2003).

2.5.1.1. Market demand and market-seeking FDI

The major motive for an MNE to perform direct investment is the market-seeking objective. A
market-seeking MNE invests in order to supply the host country’s demand for goods, resulting in
horizontal FDI, where the identical production activities are carried out in a number of locations.
The first is evidently the size of the market, as it can be described by absolute GDP. The second influence can be argued to come from the ‘quality’ of the market demand. A measure of this feature is represented by GDP per capita. A higher GDP per capita entails a larger host country demand for more advanced types of goods of a higher quality. More developed transition economies are therefore able to attract larger volumes of FDI. Thus firms find it easier to sell their products in these markets.

It is possible that market demand has descriptive power for the observed differences in the FDI inflows between the transition economies. The diagram below explains this by presenting the cumulative FDI inflows per capita. The economies have been ranked according to FDI inflows per capita.

Table 7. Cumulative FDI inflows per capita in CEE economies (adapted from EBRD 2008).

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Rep.</td>
<td>3710 (1)</td>
<td>8708 (1)</td>
<td>73 042 (2)</td>
</tr>
<tr>
<td>Hungary</td>
<td>3 364 (2)</td>
<td>8 281 (2)</td>
<td>65 949 (3)</td>
</tr>
<tr>
<td>Estonia</td>
<td>2 402 (3)</td>
<td>6 720 (3)</td>
<td>7 056 (11)</td>
</tr>
<tr>
<td>Slovakia</td>
<td>1 894 (4)</td>
<td>6 045 (5)</td>
<td>24 194 (5)</td>
</tr>
<tr>
<td>Croatia</td>
<td>1 857 (5)</td>
<td>6 518 (4)</td>
<td>22 967 (6)</td>
</tr>
<tr>
<td>Slovenia</td>
<td>1 647 (6)</td>
<td>5 726 (6)</td>
<td>21 732 (7)</td>
</tr>
<tr>
<td>Latvia</td>
<td>1 454 (7)</td>
<td>4 771 (9)</td>
<td>9 241 (10)</td>
</tr>
<tr>
<td>Poland</td>
<td>1 355 (8)</td>
<td>5 401 (7)</td>
<td>190 214 (1)</td>
</tr>
<tr>
<td>Lithuania</td>
<td>1 067 (9)</td>
<td>5 281 (8)</td>
<td>14 109 (9)</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>795 (10)</td>
<td>2 531 (11)</td>
<td>15 813 (8)</td>
</tr>
<tr>
<td>Macedonia</td>
<td>501 (11)</td>
<td>2 341 (12)</td>
<td>3 868 (13)</td>
</tr>
<tr>
<td>Romania</td>
<td>486 (12)</td>
<td>2 624 (10)</td>
<td>47 031 (4)</td>
</tr>
<tr>
<td>Albania</td>
<td>352 (13)</td>
<td>1 942 (13)</td>
<td>4 763 (12)</td>
</tr>
<tr>
<td>Average</td>
<td>1 606</td>
<td>5 145</td>
<td>38 460</td>
</tr>
</tbody>
</table>

Table 7 demonstrates that CEE economies that have received large inflows also tend to have high GDP per capita. It is obvious that FDI and GDP are highly correlated. Table 8 presents the same data for the CIS economies.
Table 8. Cumulative FDI inflows per capita in CIS economies (adapted from EBRD 2008).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>1 094 (1)</td>
<td>2 069 (2)</td>
<td>24 671 (3)</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>873 (2)</td>
<td>864 (6)</td>
<td>6 070 (6)</td>
</tr>
<tr>
<td>Armenia</td>
<td>277 (3)</td>
<td>896 (5)</td>
<td>2 431 (9)</td>
</tr>
<tr>
<td>Georgia</td>
<td>272 (4)</td>
<td>854 (7)</td>
<td>3 802 (7)</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>269 (5)</td>
<td>727 (8)</td>
<td>3 16 (8)</td>
</tr>
<tr>
<td>Moldova</td>
<td>210 (6)</td>
<td>451 (9)</td>
<td>1 623 (11)</td>
</tr>
<tr>
<td>Belarus</td>
<td>200 (7)</td>
<td>1 767 (3)</td>
<td>14 577 (4)</td>
</tr>
<tr>
<td>Ukraine</td>
<td>128 (8)</td>
<td>1 024 (4)</td>
<td>42 386 (2)</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>85 (9)</td>
<td>395 (10)</td>
<td>1 670 (10)</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>35 (10)</td>
<td>323 (11)</td>
<td>8 339 (5)</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>34 (11)</td>
<td>239 (12)</td>
<td>1 172 (12)</td>
</tr>
<tr>
<td>Russia</td>
<td>31 (12)</td>
<td>2 987 (1)</td>
<td>343 031 (1)</td>
</tr>
<tr>
<td>Average</td>
<td>292</td>
<td>1 050</td>
<td>37 745</td>
</tr>
</tbody>
</table>

The above table shows that, Russia has the highest GDP per capita, while also having the smallest FDI inflow per capita.

2.5.1.2. Production cost and efficiency seeking

Efficiency-seeking FDI means that MNE invest in order to reduce production costs. While market-seeking FDI results in horizontal investment, efficiency-seeking FDI results in vertical investment. The MNE divides the different stages of the production process between geographical locations in order to minimize production costs. For example, a production process, which is costly due to to high cost of of unskilled labor in the home country, is transferred to where the use of unskilled labor is cheaper.

2.5.1.3. Natural resource abundance and resource seeking FDI

A firm that has a resource-seeking motive invests in order to take advantage of natural resources or agricultural production in the host country. According to Dunning (1981) resource-seeking was the most important factor of FDI that took place during the late nineteenth century. There is also reason to consider that resource seeking is an important motive for FDI in some of the CIS economies. The
CEE economies usually lack important natural resources of the CIS economies, such as Kazakhstan and Russia that have large resources of oil and gas. Shiells (2003) argues that this abundance of oil and gas is important in attracting FDI inflows. Table 8 illustrates that the oil economies, Azerbaijan and Kazakhstan have received substantially larger inflows of FDI than the other CIS economies.

2.5.2. Product life-cycle theory

Technological transformation and the fast growth of multinational corporations soon made it obvious that the traditional theories based on economic advantage were no longer functional in explaining trade patterns. Vernon (1966) used a microeconomic concept, the product cycle, to help explain a macroeconomic phenomenon, the foreign activities of U.S firms in the post-war period. His preliminary argument was that, in addition to immobile natural endowments and human resources, the tendency of countries to engage in trade also depended on their ability to improve these assets and, especially, technology competence.

Exporting a product during the early stages of its life-cycle to the target country’s market in order to assure demand is appropriate primarily establishes a competitive position, which may depreciate as a product reaches later stages in its life-cycle. Therefore PLC theory suggests that the FDI choices should correlate with the life-cycle stage of the product. There are three key assumptions to the PLC theory:

1. Products incessantly go through changes over their life-cycles
2. Firms implement FDI operations in foreign markets when their competitive positions appear to be grinding down (Vernon 1966).

Home country organizations have competitive edge over other firms in their own country because the information flow across borders is not cost-free.

In the innovation stage manufacturers establish production facilities in their home countries for several reasons: (1) A greater awareness of the market; (2) A greater awareness of feedback regarding product performance; (3) They have a monopolistic price benefit due to stumpy price elasticity; (4) They have fewer degrees of autonomy in the choice of location of production, procedure of production and inputs, due to a lack of standardization (Vernon 1966). According To PLC theory, as the product crosses the threshold and enters in to the maturity stage of the life-cycle,
competitive firms begin producing substitutes for the firm’s product. Consequently, the exporting firm now feels in jeopardy and is forced to locate a production facility in the host market.

PLC theory distinguishes between constant progress and a firm’s competitive advantage because of new and persistently improved competition. This is agreed to be an important improvement on Hymer’s (1976) theory about the stagnant nature of a firm’s advantage. On the other hand, inside the market imperfection paradigm, a firm reacts to maintain competition when its advantage is vulnerable. A firm enters a market through FDI to be capable to compete more efficiently from inside.

However, the theory has made some critical input into FDI theories and the nature of a firm’s competitive advantage. Buckley and Casson (1976) argued that the theory is an over-simplification of the firm’s decision making process. They also mentioned that it was originally based on U.S. experience. Vernon (1971) acknowledged that the PLC theory did not include sociological, political and distinctive factors influencing investment behavior. Secondly, the theory is also criticized for not dealing with strategic organizational issues. Thirdly, PLC theory also does not succeed in meeting testability and the empirical verifiability by correlating the phase of the product with the marketing efforts of the firm. Lastly, it may be obsolete today, because of increased information and technology that play an ever-escalating role in marketing.

2.6. Behavior paradigm

Cyert and March (1963) argue that in this paradigm, a firm functions in imperfect markets generally because of a lack of information about the definite market. The knowledge of a firm grows steadily over time and therefore it should also gradually amplify its resources commitment. Primarily it is concerned with satisfying, before maximizing profits. Internationalization theory lies under this framework.

2.6.1. Internationalization theory

The internationalization theory argues a continuing pattern of expansion into international markets. The theory was introduced in the 1970s at the Uppsala School (Johanson & Weidersheim-paul 1975; Johanson & Vahlne 1977). The theory aimed to explain how firms get involved in foreign markets and how they establish resources commitment. The theory has been used to explain market
selection and has had a role in explaining other FDI choices (Luostarinen 1979; Johanson & Vahlne 1977).

The Internationalization theory has two dimensions: “market commitment and “market uncertainty.” Market uncertainty refers to the need to calculate present and future market factors approximately due to lack of experience, evaluate competition and the market itself. Internationalization theory argues that in the beginning firms do not invest in new markets. A firm sells its products in an international market through exports due to lack of sufficient market-specific knowledge and, as a result, a high degree of market uncertainty. Initial operations in a foreign market facilitate a firm to gain knowledge, which helps reduce market uncertainty. If market uncertainty decreases to a low point and a firm perceives an opportunity to expand further into the market, the firm increases its market commitment step by step. This in turn, leads into a lower level of market uncertainty and higher market commitment. A firm may choose higher market commitment modes at the time of entry, if the host market seems very attractive with lower commitment possibly being inadequate to meet market demands (Johanson & Wiedersheim-Paul 1975).

According to Luostarinen (1979), so-called physical, cultural and economic distance is collectively referred to as “business distance.” Nordic researchers have only utilized cultural and geographical factors and they are referred to as “psychic distance.”

The internationalization process model has been criticized for being deterministic. This theory claims that the firm will start from ground level and then go to the next stage. The firm’s ability to make strategic choices concerning appropriate modes of entry into in a foreign country’s markets is denied (Anderson 1997). Moreover, this model is primarily appropriate for firms at early stages of internationalization. On the other hand, rapid change in technology and today’s level of globalization might have changed this internationalization theory into a useless model for the majority of today’s firms.

2.7. Environmental paradigm

This paradigm is based on a body of literature that characterizes foreign operations of a firm as a function of location-specific factors. The majority of work under this paradigm investigates host country factors affecting the operation of a firm. More frequent factors have included economic,
cultural, infrastructural and social factors. Root (1987) argues that most studies suggest that firms enter foreign markets through foreign direct investment (FDI) to carry out host country production and marketing operations.

### 2.7.1. Location Theories

These theories endeavor to explain host-country location-specific factors in a firm’s FDI choices (Davidson & McFetridge 1985). The exact factors can be classified as Ricardian endowments or environmental variables. Ricardian endowments consist of raw materials, population, prospective markets, etc. The environmental variables consist of political, cultural, legal and infrastructural variables of a host country market. There are several studies which examine the relationship between host country location-specific variables and a firm’s choice of FDI mode.

Ricardian endowments of any country consist of natural resources, which exist inside the country. The market size of a specific location indicates the industry size of a market or potential to take up a firm’s production crop (Agodo 1978). The market size of a host country is a key element of FDI behavior of a firm in a particular country market; the larger the market, the better the potential to carry out FDI and thus to carry out production or marketing (Davidson & McFetridge 1985). There are several studies which found a strong relationship between market size and potential of FDI. Aharoni (1966), Korbin (1976), Agodo (1978), Davidson (1980), Sullivan (1985) and Sabi (1988).

A large population size, coupled with availability of raw materials, was considered a key factor of success for U.S FDI in Africa (Agodo 1978). Moxon (1975) argues that the size and local skilled labour force are to be regarded as key determinants of achievement for U.S firms’ foreign plant location decision. A number of studies show the correlation of raw materials and skilled work force in the success of marketing and manufacturing maneuvers. The four most frequently studied environmental areas are political, cultural, distance, host government policies and host country infrastructure factors.

Goodnow and Hansz (1972) found that U.S firms use lesser power over modes while moving from “hot” to “cold” countries, the lesser control modes such as wholly owned subsidiaries (WOS). They identified seven environmental segments: (1) economic development, (2) cultural unity (3) legal barriers (4) physiographic barriers (5) geo-cultural distance (6) market opportunity and (7) political stability. The distinct “hot” countries are those that scored high on political stability, market
opportunity, economic development and cultural unity and scored low on legal barriers, physiographic and geo-cultural distance. They defined “cold” countries as exactly the opposite.


Root and Ahmad (1978) discovered that a host country’s tax policy plays an important role in attracting FDI. Davidson and McFetridge (1985) argue that determinants shaped by a host government also attract FDI to a market. The consequence of screening process and government restrictions on equity holdings in a country’s market can also be viewed as prevention to a market.

Infrastructure is another important factor, or variable, in determining attractiveness of markets. Considering infrastructure is vital for efficient performance (Agodo 1978). Infrastructure comprises roads, railways, airports, telecommunication lines, information access, banking facilities etc. Bass, McGregor and Walters (1977) studied plant location decisions of U.S firms in Asia, Latin America and Europe. Their study suggested that four infrastructural factors are extremely important (1) cost of site development, (2) land and construction costs, (3) level of industrialization and (4) potential growth. The existence of an efficient infrastructure in the host country is important for FDI.

The bona fide variables of a host country are economic and political. It is arguable that firms preferably locate production or marketing facilities in a culturally similar market to their own. However, sometimes opportunistic behavior gives good enough reason for decision making.

Location theories successfully investigate the impact of host country factors on FDI choices of the investing firm. The actual role of location theories is the increasing economic understanding associated to host country market factors and their large impact of FDI choices.

2.8. Market failure paradigm

This paradigm is based on Coase’s (1937) theory of the firm, in which the firm and the market are two substitute modes that can be used to complete an economic function at an explicit location. The
selection of mode depends upon the well-organized mode and the type of rivalry. This theory has two types of competitive environments: (1) perfect competition and (2) imperfect competition.

Figure 2. Market failure paradigm (adapted from Tahir 2003).

There are three theories that are based on Coase’s (1937) theory of the firm: the internalization theory, the transaction cost theory and the eclectic theory. These three theories jointly encompass the complete market failure paradigm.

2.8.1. Internalization theory

In this theory, firms rise by internalizing international markets for intermediary products. The product markets include firm-specific knowledge, skills and technology, among other things. This theory was introduced by Buckley and Casson (1976), who attempt to explain the growth of multinationals in the era after the Second World War. This theory makes wholly owned subsidiaries (WOS) more attractive than licensing. Furthermore, this theory argues that firms grow and expand their operations internationally due to a lack of markets for firm-specific assets in the case of imperfect markets for key intermediate products, such as human capital, technology and management expertise. According to Datson (2000), internalization theory has two main streams: “market failure” and “firm specific knowledge.” Firm specific knowledge refers to skills and technology that are unique to the firm and market failure occurs when there are a limited number of buyers for the specific knowledge. Internalization theory is first and foremost concerned with recognizing situations in which markets for intermediary products are internalized and therefore those in which firms possess and manage value adding activities outside country boundaries (Penrose 1959).
Buckley and Casson (1988) argue that multinational hierarchies signify different methods for arranging value added activities crossing national boundaries to that of the market, and that firms are likely to keep in FDI whenever they sense that the disposable benefits of joint ownership of domestic and foreign activities, and the transaction arising from them are likely to go beyond those presented by an exterior trading relationship.

The foreign market entry mode choice is the most competent mode of a set below perfect market conditions. The failure of the market arises from factors such as buyer uncertainty, reduced availability of buyers or having the most valuable convention. If a firm chooses to license out its own knowledge, market failure circumstances can diminish the probability of full profits from its knowledge. Datson (2000) argues that the lack of empirical support for its predictions is a key limitation of the internalization theory. The reason may be difficulty of operationalization to the extent of market failure for intermediate products. This theory holds opposing views to the conventional perfect competition theory of the firm, mostly because of the measurement of competition.

The internalization theory assumes that markets are imperfect for specific types of firm-specific knowledge. The main hypotheses of theory are:

- The firm and the market are two different modes of performing an economic function;

- The objective of the firm is to maximize long term profits;

- Certain intermediate products are imperfect. The theory is unsuccessful in presenting any means of operationalizing in a specified host country
2.8.2. Transaction cost theory

The transaction cost (TC) theory of entry mode choice was introduced by Williamson (1975). Among the first to use the TC theory to examine entry mode choice were Anderson and Gatingon (1986).

![Figure 3. Transaction cost theory (adapted from Datson 2000).](image)

The concept of the theory of entry mode choice is “transaction-specificity”. The transaction-specificity of an asset refers to a firm’s investment that is requisite to make probable or absolute a transaction. The speculation can be made in physical hard assets, human assets or tangible assets. It is argued that when specificity is far above the ground, the specific in question cannot be easily reorganized in other practice. However, if specificity is low, assets could be deployed in other helpful resources (Datson 2000). According to Williamson (1985) a transaction cost occurs when a product is transferred across sequential stages of a production process under alternative governance structures. The most critical dimension is asset specificity. Transaction cost economies sustain that cost takes place due to the shared implication of the latter coupled with bounded sagacity and opportunism. Two factors influence the temperament of these transactions; namely uncertainty interrelated to the completion of the contract and the frequency of these transactions. Therefore, incentives for other than FDI operation modes in the course of vertical integration become weaker
as transactions become increasingly more distinctive, due to the less moveable nature of both human and physical assets, which become more focused on to a solitary use (Williamson 1987). Moreover, adjustments are implemented at whatever frequency in order to maximize the joint gain to the transaction (Williamson 1987). Competence through appropriate harmonizing of governance structures to the ascription of transaction is the essential benefit of bypassing intermediate markets in the Williamson framework (Borsos-Torstila 1999: 36).

According to Ermilli and Rao (1993) TCA seems particularly efficient in the amplification of vertical integration decisions, and has been used to forecast entry modes for manufacturing firms and service firms. Most of the studies on foreign market entry modes have, however, made some modifications to the transaction cost theory. Kobrin (1988) argues that the significant motivation for these changes is non-transaction cost reimbursement flowing from amplified control or integration, such as co-ordination of strategies in Multinational Corporation. The modified TCA expects an optimistic relationship between assets specificity and inclination for high control entry modes. The potency of this relationship is however contingent upon the influence of moderating factors such as external uncertainty (Anderson & Gatignnon 1986), internal uncertainty and firm size (Erramilli & Rao 1993).

Erramilli and Rao (1993) argue that when the cost of amalgamation is low and the capability of a firm to assimilate is high, the firm is more likely to select a higher control mode than a market mode because integration provide a firm with non-transaction cost benefits, such as expansion of market power, larger share of profits and implementation of global strategies.

TC theory provides a valuable framework for examining decisions that are important to the strategic operations of a firm. The theory can be employed to select between wholly owned subsidiary and joint venture.

2.8.3. Eclectic theory

There exists no common theory that can make clear the existence of MNEs and FDI, due to the large number of motives an individual firm can have to perform FDI to be considered. Put simply there is no general theory of FDI. As a consequence FDI literature is varied and range overs a number of different disciplines, including international business, international economics,
Hymer (1976) introduced the concept of firm-specific advantages. His argument is that to prevail over the information advantage that domestic endeavors have over foreign firms; a foreign firm that enters the economy must have some counteracting firm specific advantage such as economies of scale, brand name, managerial skills, superior technology and experience. John Dunning developed Hymer’s (1976) ideas further, resulting in the alleged OLI paradigm of FDI.

Figure 4. Eclectic theory (adapted from Agarwal & Ramaswami 1991: 5).

The Eclectic theory consists of firm specific advantages, location-specific advantage, and internalization advantage. The theory unifies the traditional trade theory with the internalization theory. It combines trade with foreign production operations of the firm. The amalgamation of theories provides it with more explanatory power than the individual theories it combines. According to Cantwell (1991) eclectic theory is not a substitute framework in the same sense; it integrates elements from diverse sources and can be equally practical at the micro and macro levels. It is to a certain extent a general organizing paradigm for identifying the fundamentals of each approach which are not appropriate in explaining a wide range of various kinds of international production, as well as the wide range of different environments in which international production has been established.
Dunning’s (1993) eclectic paradigm is mainly known as the ownership-Location-Internalization (OLI) paradigm. It emphasizes that the returns from FDI can be made clear by the competitive ownership advantages of firms (O), indicating who is going to produce in foreign location (Dunning, 1993: 145). This intention integrates, within the ownership or competitive advantages of firms seeking in FDI, variables such as property rights, intangible assets and management capabilities, marketing techniques and innovatory capabilities (Dunning 1993: 142).

The OLI paradigm was first presented by Dunning (1987). According to the OLI paradigm, a firm’s decision to invest in a foreign country is determined by the existence of three different types of advantages, namely ownership, location, and internationalization advantages. It is based on Hymer’s idea of firm-specific advantages, which come in the shape of assets such as patents, technology or management, and reduce the firm’s production costs so that it can overcome the information disadvantage of operating in a foreign economy. Ownership advantages are possible to be moved between different locations and can therefore be transferred to a foreign country.

Location advantages find out how attractive diverse locations are for production. A strong location advantage allows the firm to reduce production costs, take advantage of large orders or knowledge spillovers. Location advantage can never be moved to another setting, but can be used by more than one firm. For example, if supply of economical labour provides a location advantage, production will take place in the firm’s home country and the goods will be exported to meet overseas demand.

The second proposition includes, within definite locational characteristics (L) of different countries or regions, low input prices, productive and skilled labor force, well developed infrastructures, investment attraction policies and country level innovatory competencies, etc. (Dunning 1993: 43). Earlier studies on CESEC propose that key locational FDI determinants are demand, cost factors and the risk of investment in terms of both the political and the economic environment (Bevan & Estrin 2004).

The third proposition of OLI has to do with the internalization (L) advantages. It mirrors the degree to which firms consider internalizing actions rather than considering operations at arm’s length. According to Dunning, lowering search and negotiation costs, controlling market flaws and compensating for the absence of future markets are a few internalization incentive advantages (Dunning 1993). The paradigm stresses that it is the combination of ownership, location and internationalization dynamics and their literal configuration that defines, which firms become MNE’s and when they do so, where they locate their production activities, and how they involve in
international production. Dunning (2000) characterized the eclectic paradigm “as an envelope for complementary theories of MNC activity”. Thus, OLI serves as support in explaining multinational activity and acts both as inventiveness and a mechanism for accomplishing FDI development.

2.9. Characteristic of eclectic paradigm

This framework is a defined arrangement of the ownership-specific and location-specific internalization advantages and disadvantages facing firms, and the firms’ strategic responses to them, that will verify at any given instant of time, the nature, level, and structure of a firm’s activity (Dunning 1993). Dunning’s eclectic framework of international production suggests that firms select their FDI choices by considering three sets of advantages. Ownership-specific advantages are concerned with control issues, costs and benefits of inter-firm relationships and transactions. Location-specific advantages are concerned with resource commitment issues, the availability and cost of resources in a particular location. The third set of advantages is internalization advantages, which are primarily concerned with reducing transaction and co-ordination costs (Dunning 1993).

Agarwal and Ramaswami (1992) argue that the three sets of advantages influence a firm’s FDI behavior by affecting the management’s perception of asset power, market attractiveness and cost of integration.

Figure 5. The Tripod of Eclectic Paradigm (adapted from Stoian & Filippaios 2008).
The above diagram demonstrates that a firm’s investment choice in a foreign country depends on the OLI paradigm.

2.9.1. Ownership-specific advantages

Initially, for a firm of one nationality to contend with those of another by producing in the latter’s home country, it must possess certain advantages specific to the nature and nationality of their ownership (Dunning 1988). These advantages are normally referred to as ownership-specific advantages. Dunning identifies three types of ownership-specific advantages:

1. Those that emerge from special privileged possession of (or access to) particular income-generating assets.
2. Those that are usually enjoyed by a branch plant compared with a de nova firm.
3. Those that are consequence of geographical diversification or multi-nationality in isolation.

As stated above, the eclectic paradigm argues that the capability of a firm to engage in FDI is usually based on some viable advantage of the investing company. In producer goods industries, this advantage has typically to do with the nature of the product supplied and the firm’s ability to manufacture at a lesser cost or to take advantage of the economies of large-scale production. In the consumer goods sector, the ownership of branded products and trademarks mutually with the ability to offer a reliable product, customized to the wants of the local market, are the main O advantages habitually identified (Dunning 1993: 142).

2.9.2. Location-specific advantages

The second string of the eclectic paradigm is concerned with the “where” of production. Root argues (1987) that location-specific advantages are country specific factors associated with the market under contemplation, such as market potential and market risk available to all firms in that particular market. However, a number of firms are more capable of developing these location specific advantages than other firms, thus enhancing their competitive advantage within a fresh market, providing low cost labour, which would effect a cost advantage in all markets in which the firm’s products are put up for sale (Dunning 1988). Measures of location specific advantages include sales demand and potential demand, differences or similarities of market infrastructures and
the availability of lower production costs (Dunning 1993). The common denominator among location specific advantages is that they influence:

1. The expected profitability of foreign production in relation to exports
2. The expected profitability of having production located in different countries (Liansheng 1992).

Location specific advantage may support both the home country or a particular foreign country as a location for production. A firm holding ownership (O) advantages may make a decision to internalize in foreign locations, when it establishes that operating can be profitable in these locations (Kimura 1989). The most frequently estimated location specific advantages include market size and growth, factor endowments, source of supply transportation costs, trade barriers and physical distance (Caves 1996). Thus, location (L) advantages contain not only factor endowments, but also a number of location specific advantages derivative from structure, for instance restrictions in trade, and from transactional market failures (Dunning 1988).

Regardless of the conceptual differences between L and O advantages, the selection of location is not independent of present ownership specific O advantages or of the capacity to acquire or create new O advantages by establishing foreign production in different locations (Dunning 1988). Sleuwaegon (1991) argues that there is a close connection between O and L advantages. The selection of location is also determined by the actuality that various location alternatives may have diverse successive effects on a firm’s OLI configuration (Gray 1996). Consequently, it is the multifaceted interrelated interface between the ownership specific and location specific factors that sheds light on in a foreign country direct investment (Kimura, Y. 1989).

2.9.3. Internalization advantages

The ultimate provision for international production is that it is obliged to be in the attention of enterprises that own ownership specific advantages to transmit them across national boundaries within their own organization to a certain extent sell them, or their right of use to foreign based enterprises (Dunning 1988). Rugman (1981) argues that if an ownership specific advantage is formed by or is converted into the exclusive property of a particular enterprise, it has in some sense “internalized” the marketplace for it use.
When a firm is undertaking foreign production to internalize its O advantages in a foreign marketplace, the practice of internalizing may also cause new O advantages and augment the benefits of internalizing. The new O advantages may either be internally generated or acquired from other firms (Dunning 1993).

The ‘I’ advantages have an in-between position in the eclectic framework (Randoy 1994). They are intermediate in the logic that the advantages of internalizing foreign markets are determined by a firm’s O advantage (Denekamp 1995). As FDI has developed into the means by which new O advantages are formed, the benefits of internalization are more and more derived from the O advantages internalization might produce (Gray 1996). Dunning (1980) argues that internalization (I) advantages are also intermediate in the sense that they are inclined by the predictable profitability of operating production units in a particular location. Therefore, the requirement to reduce buyer, supplier and government improbability, the need to defend the quality of production, the need of possess a high level of control and, increasingly, the need to confine economies of independent activities, speak in support of hierarchies and persuade firms to undertake foreign production to a certain extent, rather than other servicing modes (Dunning 1993).

The principal proposition on which the eclectic paradigm is based, is that a firm will engage in foreign value-adding activities, if and when three conditions are satisfied:

1) The firm possesses O advantages in comparison with firms of other countries in serving particular a market. These O advantages mainly take the form of the ownership of intangible assets or the advantages of common authority, which are, unique to the firm possessing them.

2) Assuming the above condition is fulfilled, it is more valuable to the enterprise possessing these advantages to use them itself moderately than to put them up for sale or lease them.

3) Assuming conditions (1) and (2) are fulfilled, it has to be in the comprehensive interest of the endeavor to exploit these advantages in combination with at least some factor inputs (including natural resources) outside its home state. Otherwise foreign markets would be supplied completely by exports and domestic markets by domestic production.
### Table 9. Characteristics of OLI paradigm (adapted from Dunning 1988: 30)

<table>
<thead>
<tr>
<th>Factors</th>
<th>Country (home-host)</th>
<th>Industry</th>
<th>Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ownership</strong></td>
<td>Factor endowments (e.g., resources and character. Government policy towards innovation, protection of proprietary rights, competition and industrial structure, government control on inward direct investment)</td>
<td>Degree of technological intensity of product or process, nature of innovation, extent of product differentiation, production economies, importance of favored access to inputs and markets.</td>
<td>Size, extent of production, process or market differentiation, extent to which enterprise is innovation or marketing oriented or values security and stability, e.g. in sources of inputs, markets etc; extent to which there are economies of joint production</td>
</tr>
<tr>
<td><strong>Internalization</strong></td>
<td>Government intervention and extent to which policies encourage MNEs to internalize transactions, e.g. transfer pricing, government policies toward pricing, government policies towards mergers, differences in market structure between countries with respect to transaction costs, enforcement of contracts, buyer uncertainty etc; adequacy of technological, educational, communications, infrastructure in host country and ability to absorb contractual resource transfers</td>
<td>Extent to which vertical or horizontal integration is possible/desirable, e.g., need to control sourcing of inputs or markets, extent to which internalizing, advantages can be captured in contractual agreements, use made of ownership advantages cf. IBM with Unilever-type operation, extent to which local firm have complementary advantages to those of foreign firms, extent to which opportunities for output specialization and international division of labour exist.</td>
<td>Organizational and control procedures of enterprise; attitudes to growth and diversification (the boundaries of firms activities), attitude toward subcontracting ventures, e.g. licensing, franchising, technical assistance agreements etc, extent to which control procedures can be built into contractual agreements</td>
</tr>
<tr>
<td>Location</td>
<td>Physical and physical distance between countries, government intervention (tariffs, quotas, taxes, assistance to foreign investors or to own MNE’s e.g., Japanese firms investing in South East Asian labour intensive industries)</td>
<td>Origin and distribution of immobile resources; transport costs of intermediate and final goods products; industry specific tariff and non-tariff barriers; nature of competition between firms in industry; can functions of activities of industry be split? Significance of ‘sensitive’ locational variables, e.g. tax incentives, energy and labor costs</td>
<td>Management strategy towards foreign involvement; age and experience of foreign involvement; (position of enterprise in product cycle etc.); mental distance variables (cultural, language, legal and commercial framework); attitudes toward centralization of certain functions, e.g. R&amp;D; regional office and market allocation etc; geographical structure of asset portfolio and attitude to risk diversification</td>
</tr>
</tbody>
</table>
Eclectic theory provides a multi-theoretical approach for studying FDI choices: internalization theory, resource-based theory and transaction cost theory are the basic theories used. It is rather an overall organizing paradigm for identifying the variables from each approach that are most relevant in explaining a wide range of different environments affecting the entry mode choices of the investing firms. Eclectic theory claims that the FDI occurs when all three types of advantages are beneficial. Eclectic theory allows researchers to generate determinants sequentially to envisage FDI selection. The power of the theory can be distinguished by its, generation of new determinants and mixing of these with existing determinants (Anderson 1997).

Itaki (1991) criticizes eclectic theory; he argues that an ownership-specific advantage in fact comes from an internalization advantage. Consequently, it is redundant to regard these as two disconnected determinants. Despite a few shortcomings, Dunning’s theory is considered by many as one of the more inclusive frameworks for FDI choices. As a result, the OLI approach has been chosen as the framework in this investigation due to the above mentioned intermixing nature of the approach.

After reviewing different theories of FDI, the next section sheds the light on determinants of establishment mode choice; at the end of the section theoretical frame work is presented.
CHAPTER 3. GREENFIELD VS ACQUISITION

3.1. Introduction

An important strategic decision faced by firms is whether to expand through greenfield investment or acquisition. This is also known as establishment mode choice decision (Cho & Padmanabhan 1995). When a multinational company makes a decision to invest equity in foreign country, it faces at least two strategically important decisions first, whether to buy an existing foreign firm (acquisition) or establish foreign operation from scratch (greenfield).

The decision on whether to engage in greenfield or acquisition investment carries significant strategic importance due to the inherent benefits and risks of each foreign entry mode (Dikova & Witteloostuijin 2007). It is obvious that acquisition provides fast entry into a market, developed distribution channels, human resources etc. On the other hand, with entry through greenfield, companies have to start from scratch; it takes time to get established and to create networks in the vicinity. There are a number of studies in which the determinants of this choice have been examined, but few have researched the comparative performance of greenfield and acquired subsidiaries (Slangen & Hennart 2008).


This study addresses three tiers of analysis, which have significant importance in choice between establishment mode decision; firm, industry and country level variables. All variables are discussed below respectively.
3.2. Firm level analysis

Firm level analysis consists of three variables, organization learning, technological intensity and international strategy of the firm.

![Figure 6. Dynamics of firm level analysis (adapted from Dikova & Witteloostuijn 2007).](image)

3.2.1. Organization Learning

Experience is a major resource of learning in organizations, being extremely personified in organizational memory (Penrose 1959). Padmanabhan and Cho (1999) argue that a firm’s past experience remodeled into organizational practice generates a model for future proceedings and becomes a basis for competitive advantage. They state that general international experience and host country experience do not explain the choice between greenfield and acquisition. The authors argue that these two characteristics are more important in the decision as to either carry out or not carry out a direct investment in the first place, or to serve a particular market with a non-equity entry mode. Once the decision to engage in an overseas market country has been made, international and host country know-how becomes less important than experience with an explicit establishment mode (Padmanabhan & Cho 1999).

Tallman (1992) argues that in order to ease the intensity of uncertainty a multinational firm may emulate either its own formerly thriving strategies and structures or those of rivals in the new market. Firms tend to persist in the same type of activity over time because they are
conditioned to experience successful solutions (Greve 2003). If a prior positive practice with establishment mode can be transferred to a new situation, there is a high probability of undertaking the same entry mode investment as a result of this particular experience (Padmanabhan & Cho 1999). Organizations that usually enter into foreign markets through acquisition gain significant expertise that may be further exploited in successive acquisitions.

In the same way, because competencies are relocated to a foreign country mainly through greenfield subsidiaries, there is a high possibility that an investor with valuable company cultures will make imitations of them overseas (Chang & Rosenzwing 2001). It follows that once a firm commences either a successful acquisition or a greenfield investment, it is prone to preferring the same entry mode in the future (Dikova & Witteloostuijin 2007).

**Proposition 1 a:** The greater earlier greenfield experience, the higher the probability of a successive greenfield investment.

**Proposition 1 b:** Equally, the greater earlier acquisition experience, the higher probability of a successive acquisition.

### 3.2.2. Technological Intensity

The competitive gains of technology based firms are deeply rooted in organizational practices and their skilled labour force. The best way to transfer good practices and knowledge is by setting up a subsidiary from scratch, employing local labour and training staff accordingly. Frequently technologically advanced foreign investors acquire local companies with obsolete or inadequate technological capabilities and the investor makes production facilities competitive through post-acquisition investments, i.e. reorganizing the local enterprise and its hierarchy and corporate plan, engaging in technological upgrading and introducing ecological protection measures (Mayer 2001). Nevertheless, sturdy inertial forces within the local organization might prevent even technologically coherent alteration (Nelson & Winter 1982).

According to Villinger (1996), technology transfer is usually difficult in transition economies due to two main reasons. Firstly, extremely unstable conditions push local managers to stand firm against change and to stick to their previous practices. As a result, the local organization
may not be contributing to a thriving learning process (Hedberg 1981). Secondly, there is
divergence not only between technologies, but also between the systems, procedures and
practices of the foreign investor and the local company (Barkema & Vermeulen 1998). Bettis
and Parhalad (1995) argue that before learning new customs, the old knowledge has to be in
logic, untutored by the company. The challenge of unlearning old practices and routines may
be a main reason for investors preferring the greenfield mode (Barkema & Vermeulen 1998).

A technologically-oriented shareholder might choose another establishment mode to assure a
sufficient acquisition of new production specific knowledge. Organizations which engage in a
new line of business could be looking for supplementary resources to build up broader
competitive strength (Chang & Rosenzwing 2001). On the other hand, Hisy and Caves
(1985) argue that a firm may be looking for extra resources to extend its competitive potency.
Researchers have found that multinational companies which invest in a new line of business
abroad prefer acquisition to greenfield (Hennart & Park 1993). This is the approach for
companies that want to attain production capabilities and management expertise, which they
do not possess but are necessary for building broader competitive capabilities (Dikova &
Witteloostujin 2007).

Hennart and Park (1993) present experimental verification for Japanese technologically
intensive investors diversifying in order to obtain new production specific knowledge
prefer acquisition to greenfield. The reason for this is that acquiring added resources in the
market in intangible form tends to be more complicated than acquiring a local firm that
already possesses them. In effect, international expansion into a new line of business may be
an explanation for technologically intensive companies’ possible preference for the greenfield
investment mode.

**Proposition 2a: The higher the level of technological intensity of the investor, the higher the
probability of a greenfield investment.**

**Proposition 2b: The lower the level of technological intensity of the investor, the higher the
probability of a acquisition investment.**
3.2.3. International strategy

Previous studies have recognized a significant list of factors that might have an effect on the choice between greenfield and acquisitions; for example, R&D intensity, the degree of diversification, the level of foreign experience, cultural distance, the size of foreign direct investment in comparison to the size of the investing company, and the time of entry etc. A variable that has received very little consideration in previous entry modes studies, but one that may have a great impact on the firm’s choice of entry mode, is the firm’s international strategy (Harzing 2002).

An MNE’s international strategy implies to take advantage of the firm’s competitive advantages and establish complementary organizational competencies (Chang & Rosenzweig 2001). According to Harzing (2002), almost all studies distinguish two special types of international strategies, “global” and “multi-domestic”, though numerous studies include a third hybrid type, frequently called “transnational”. Few authors also take account of an “international” strategy. Global and multi-domestic strategies are generally accepted and specifically clear. Global strategies are defined by a high level of globalization and rivalry with nationalized products and focus on capturing economies of scope and scale.

The main concern in this strategy is efficiency. Consequently, these companies rationalize their production to manufacture standardized products in a very cost reducing manner. Multi-domestic companies’ practice at a lower level of global competition and they compete on a domestic level, while producing products according to the local environment (Bartlett & Ghoshal 1992).

Both strategies are associated with different types of firm-specific advantages. Rugman and Verbeke (1992) link international strategy with the eclectic paradigm. Their analysis states that foreign direct investment is regarded as the most proficient mode of entry. They distinguish two types of ownership advantages, which they entitle firm specific advantages (FSAs). The first type consists of location bound FSAs, from which a company can benefit in a certain location or in different locations. They cannot simply be relocated or used in other localities without significant alteration. Non-location bound FSAs are not dependent on being used in one specific location, they can be used worldwide. The major cause behind this
proposition is the possibility of transferring them to other locations at low cost without major adaptation.

In the context of location advantages, there are two sources: home and host country. Global companies have a propensity to focus on the utilization of non-location bound home-based FSAs, such as a proprietary technology. Firms utilize these advantages in host countries, but this is generally limited to low cost locations which permit global companies to practice their strategy based on cost efficiency (Bartlett & Ghoshal 1989). Building up a low cost assembly site is easier, when the site can be set up from scratch instead of acquiring an existing company.

In contrast, the interior competencies of multi-domestic organizations lie in the management of host location based FSAs, using the host country’s explicit advantages. These companies operate in markets that require tailoring products and strategy to confined requirements. To achieve this goal, companies need to be well aware of local trends and market knowledge. This is easier to achieve by acquiring an existing company with competent human resources and built up connections in local markets (Harzing 2002).

**Proposition 3a:** The higher the tendency to follow a global strategy, the higher the likelihood of a greenfield investment.

**Proposition 3b:** The higher the tendency to follow a multi-domestic strategy, the higher the likelihood of an acquisition.

3.3. Industry level analysis

Industry level analysis consists of two variables; industry concentration and industry growth. Both factors are discussed below.

3.3.1. Industry concentration

A key difference between greenfield and acquisition entry is that when new firm start operations from scratch, it raises local supply, which reduces profits and prices. It also raises a competitive reaction from rivals (Caves & Mehra 1986). When an industry is growing
gradually, and if it is concentrating, a greenfield entry will lead to a large decrease in prices and profits. Therefore, firms prefer entry through acquisition when industry is concentrating.

3.3.2. Industry growth

However, if an industry is growing swiftly, the supply increasing features of greenfield investment are less problematic, as overall revenue is hardly affected in this case. However, building a subsidiary from scratch takes time and this impediment may result in high inevitable profits, if an industry is growing very rapidly (Caves 1982). A foreign firm may choose an acquisition if the cost of delaying entry is high (Hennart & Park 1993). Most of the earlier data describes that firms choose greenfield investment mode when industry has space for new entrance and it is expanding. Moreover, it also does not become the reason of reducing prices and profits.

**Proposition 4a:** The higher the tendency of greenfield investment, if an industry is growing gradually.

**Proposition 4b:** The higher the tendency of acquisition investment, if an industry is concentrated.

3.4. Country level analysis

A number of country level factors affect an MNE’s establishment mode decision. The dynamics of host country location can be mostly classified into two types. The first type of elements is interrelated with economic theory (Ricardian): for example, natural resources cheap labor, and proximity to markets. Secondly, there are environmental variables that involve the political, economic, legal and infrastructural aspects of a host country. Both types of factors play a crucial role in a firm’s decision to enter a host country (Kobrin 1976).

The second type of host country location factors can be summarized as: market size and economic growth (Aharoni 1996; Kobrin 1976; Davidson 1980; Buckley & Meweh 1980; Root 1987; Sabi 1988), raw material and labour supply (Moxon 1975; Buckley & Casson 1985; Dunning 1988), political and legal environment (Goodnow & Hansz 1972; Kobrin 1979; Anderson & Gatigon 1986; Agarwal 1994; Root & Ahmad 1978), host government
policies (Davidson & McFetridge 1985; Goodnow 1985; level of industry competition in the host country market (Goodnow 1985; Harrigan 1985a, 1985b), geographical proximity and transportation costs (Goodnow & Hansz 1972, Davidson & McFetridge 1985), host country infrastructure (Dunning & Kundu 1995, Ulgado 1996) and availability of incentives and tax advantages (Loree & Guisinger 1995; Dunning 1993; Sethi et al. 2003; Demirbag, Tatoglu & Glaister 2008).

3.4.1. Host country investment risk

Risk can be defined as “the danger of a random incident which can negatively affect the company’s ability to reach its goal or jeopardizes one or many of these” (Sandin 1980). In entering a new market, firms intend to reduce the risks connected with operating in the new location. According to Gatingon and Anderson (1988), environmental uncertainties, such as a country’s political, legal, cultural and economic environment, threaten the stability of a business operation. Therefore, the intensity of risk perceived by MNEs plays a vital role in the entry mode decision (Ahmed et al. 2002).

When a company decides to enter into new market, the firm must take into consideration the country’s social, legal, economic, and political structure. In this context one of the most influential variables in entry mode decision is country risk. In a broad sense, this risk can include various types of consistent specific factors, e.g. uncertainty about the demand, the competitors, the costs and other market conditions, that put at risk the country’s actual financial solvency and the political risk (Quer, Clever, & Rienda 2007).

Political risk can be defined as political factors that may cause radical changes in a country’s business environment that unfavorably affect the profit and other objectives of business. Political risk tends to be greater in countries with social unrest and anarchy. Social unrest can result in abrupt government and policy changes, which may have a negative impact on profit of business. A change in political command can result in laws that are less favorable to international business (Hill 2007).

Economic risk and political risk are interconnected: economic mismanagement may give rise to significant social unrest. This is why political risk causes extreme changes in a country’s
business environment that upset the profitability of organization. The main indications of economic mismanagement are inflation and level of business and government debt. Other signs of changes in economic politics are import restrictions, currency restrictions, etc (Hill 2007).

Legal risks are present when the countries legal system fails to provide adequate safeguards in the case of contract violations or to protect property rights. When legal upholds are weak the chances of contract breaking and stealing of intellectual property may increase. In the occurrence of high legal risk an international business may feel uncertain about entering into a long-term investment in that country (Hill 2007).

According to Chan and Ghemayel (2004), 50 percent of senior executives believe that political and social disturbance, currency risk, country financial risk and government regulations are the most critical risk on their investment decision and critical determinants of foreign direct investment. Researchers suggest that firms with high host country risk or location unfamiliarity tend to avoid wholly owned subsidiaries in pursuit of lower resource commitment modes of entry (Kim and Hwang 1992). Quer et al (2007) argue that firms should not assume full commitment alone with their entry strategy, due to not being able to generate all the resources needed to enter a high risk country successfully. In this context an organization needs a local partner or may acquire a local firm, which can provide market knowledge, and minimize the exposure of the firm’s assets.

**Proposition 5 a:** The higher the perceived country risk, the higher the tendency of greenfield investment over an acquisition mode.

**Proposition 5 b:** The lower the perceived country risk, the higher the tendency of acquisition investment over greenfield mode.

3.4.2. Market potential

The market potential in the host country is a significant determinant of the MNE’s entry mode decision. It is obvious that market growth often attracts entry (Chatterjee 1990). Luo (2001:
According to Porter (1980), in a growing market, MNEs use a direct entry mode to capture market share and grasp augmentation targets, but if a firm wants to establish an early presence in a market, it may acquire the existing company rather than opting for greenfield investment. When monopoly exists in the market, the entrant favors acquisition over greenfield both in manufacturing and distribution (Buckley & Casson 1998). The main aim behind this approach is to establish long term control over domestic rivals’ production or logistics facilities. When a patron makes a decision to make a fast move and take advantage of being first mover, an acquisition of a local business with existing channels is preferred over greenfield investment, because with entry through greenfield investment the organization cannot achieve strategic objectives, such as capturing rapid market growth (Peng 2000).

According to Meyer and Nguyen, in a high growth market there may be opportunities to purchase an established business that is financially weak. There have been a number of entries of this nature in emerging markets with firms available for acquisition. Therefore, it may be assumed that a foreign investor is more prone to prefer an acquisition mode over a greenfield mode when significant market potential is perceived (Demerbag, Tatough, & Glaister 2008).

**Proposition 6 a:** The likelihood of an acquisition investment over greenfield investment mode is higher when significant market potential is perceived.

**Proposition 6 b:** The likelihood of greenfield investment over an acquisition investment mode is higher when market potential not significant.

On the basis of previous studies of establishment mode choice; this research propose following framework.
3.5. Theoretical framework

Figure 7. Framework of choice between greenfield vs. acquisition
The above diagram illustrates firm, industry, and country level factors and their effect on the decision of the firm’s establishment mode choice. In this figure greenfield vs. acquisition is dependent variable, while firm, industry and country level factors are independent variables.

Firm level analysis consists of three variables: organization learning, technological intensity and international strategy of firms. Industry level analysis explains the impact industry growth and concentration have on the establishment mode choice. Finally, country level analysis includes market potential, host country investment risk and their affect on establishment mode choice. Above framework make clears that, firm, industry and country level variables have great impact on establishment mode choice decision.

After identifying determinants of establishment mode choice, next section describes methodology of the study.
CHAPTER 4. METHODOLOGY OF THE STUDY

4.1. Research methodology

Concrete research requires the collecting of data on various variables at a range of levels. Such data is not easily available in published sources and thus it is collected from a variety of secondary sources, or obtained by surveys (Slangen 2005). This chapter justifies the methodological choices of the study. Qualitative methods are time-consuming and expensive data collection methods, and the main aim is to build a large scale dataset in order to test a limited number of relationships between dependent and independent variables. In this research three to four Finnish companies have been examined as case studies, and the previously mentioned variables examined through semi-structured interviews of managers of the companies.

This chapter endeavors to argue the methodological approach chosen for the empirical research on the determinants of greenfield vs. acquisition choice of Finnish firms. Further aspects of the research, the strategy and design of the research are described as well. Furthermore, information will be given regarding validity and reliability.

4.2. Research design

According to Yin (2003: 8), compacting information about the case companies using a variety of sources and methods, such as annual reports, archival records, published articles, interviews and direct and participant observation is both beneficial for a case study and necessary in research design. A flaw of case studies might be the creation of theory which cannot be generalized. (Eisenhardt 1989: 548). However, this problem can be eradicated with an inclusive case study design including adequate measures to guarantee consistency and legitimacy.
Two companies were selected for the multiple case study. The selection was made from a
definite population (Eisenhardt 1989: 536) of Finnish companies within two or three
industries. Importance was put on distinguishing cases from which most could be learned
(Stake 2005: 451).

The companies selected had to meet the following conditions:

I. The firms should originally be from Finland
II. The firms had to be headquartered in Finland
III. The firms had an investment in at least two CEE countries

The following firms meet the above conditions and were chosen as the case companies: Stora
Enso and Eurobiker.

Data was collected by semi-structured face-to-face interviews of the companies’ managers.
This interview form is also appropriate for exploratory studies such as this study, allowing
collecting rich data set in a short time. (Saunders et al. 2000: 244 - 248). Data was collected
over a period of four months. The interviews lasted approximately an hour. Interviews
included open-ended questions on a variety of issues, such as firm level, industry level and
country level factors, which play a vital role in the choice of greenfield vs. acquisition.
Questions were put together based on the theoretical framework and through screening prior
studies.

The open-ended questions allowed the investigator to obtain a deep understanding and gave
the respondents opportunity to elaborate on specific variables. Questions were asked based on
a prepared interview structure. The interviews were recorded and transcribed shortly after the
interview. Notes were taken throughout the interview, helping to form the case study analysis.
Additionally, firm presentations, annual reports, websites and press releases were used to
complement the data collection process. Saunders et al. (2000: 382) argue that there is no
consistent approach to the analysis of qualitative data. In this study, data was analyzed by
using cross-case analysis to recognize common patterns and important variations across the
cases (Yin 2003: 133; Maylor & Blackmon 2005: 253).
4.3. Validity and reliability

Validity refers the accuracy of the research, while reliability is concerned with research uniformity, i.e. the replication of the results at a later time by different researchers (Maylor & Blackmon 2005: 158 - 159). According to Yin (2003: 34), in case studies, construct, internal and external validity support reliability.

*Construct validity* incorporates the organization of correct operational measures for the concept being studied (Yin 2003: 34). Yin (2003: 34 - 36) argues the use of several sources, establishment of an evidence chain and the analysis of the case study plan by the interviewees during data collection and composition assist to acquire construct validity. To gain construct validity, this research makes use of multiple sources of evidence, using company presentations, websites, general press releases and other published material.

*Internal validity* is concerned with the establishment of a causal relationship with particular conditions leading to other conditions (Yin 2003: 34). External validity endeavors to obtain analytical, as an alternative to statistical, generalizing, and thus aims to “generalize a particular set of results to some broader theory” (Ibid 37).

*Reliability* measures the repeatability of the operations of the investigation without getting different results. Reliability can be protected by using a case study protocol and creating a case study database during the data collection period (Yin 2003: 35). Saunders et al. (2007:149-150) argue that there may be four threats to reliability; 1) subject or participant error, 2) subject or participant bias, 3) observer error and 4) observer bias. Validity implies reliability. A valid measure must be reliable. However, reliability does not essentially involve validity; a reliable measure may not necessarily be valid. In this study, reliability is typically jeopardized by matters of participant errors and biases.

With the above mentioned information on reliability in mind, the data of this study was confirmed through recorded interviews and cross-checked. It was collected through face-to-face interviews and the answers to the questions provided confirmation of propositions, and validated the reliability and validity of study.
CHAPTER 5. EMPIRICAL STUDY

This chapter illustrates the empirical results from the case companies. Each case company is presented independently subsequent a parallel configuration, which is alienated in theories of FDI, implications of theories, dynamics of firm, country and industry level analysis which affect the decision of greenfield vs. acquisition of firms. This formation tag on the sub-questions offered in the preliminary section finally answers the foremost research question of what are the determinants of Greenfield vs. acquisition for Finnish companies in CEE. The chapter will end with a cross case amalgamation.

5.1. Stora Enso

Stora Enso is an international paper, packaging and wood products company manufacturing newsprint and book paper, magazine paper, fine paper, consumer board, industrial packaging and wood products. The Group has some 27 000 employees and 88 production services in more than 35 countries worldwide, and is a publicity traded company listed in Helsinki and Stockholm. Its patrons include publishers, printing houses and paper merchants, as well as the packaging, joinery and construction industries.

Figure 8. Group Data of Stora Enso (adapted from Stora Enso home page).
Stora Enso’s company mission is to use and advance its expertise in renewable resources to meet the requirements of its customers and many of today’s global raw material encounters. It products deliver a climate friendly alternative to many products made from hostile non-renewable materials, and have a smaller carbon footprint. According to the Business Development Officer, so that is why the company went into foreign markets shortly after its foundation. Mol Bapties Stora Enso focused on global vision from beginning. Finnish market was perceived as too small from the inception.

![Strong position targeted in Corrugated Packaging in Central and Eastern Europe](image)

**Figure 9.** Stora Enso Position in CEE (adapted from Stora Enso home page).

Above bar graph illustrates the positioning velocity of corrugated packaging in Central and Eastern Europe.

Stora Enso is the biggest wood supplier in northwest Russia. Stora Enso started operations in 1998, producing corrugated packaging at Balbanovo, which is close to Moscow. Stora Enso main strategy was capturing the growing market of packaging. The annual growth rate of transport packaging is 5 to 10%; on the other hand the market growth is very fast. The company’s main focus is to become the market leader for corrugated board in the European part of Russia. It has two sawmills in Russia. Second plant of Stora is located in Nebolchi,
saw timber is produced here for building industry in Europe and deliverers to Stora Estonian sawmills for further processing.

It has third plant of corrugated packaging in Lukhovitsy, southeast of Moscow. This plant started working in first quarter of 2008. Stora Enso’s competitive edge is new high quality corrugated packages in the Russian market, which consider the needs of food, beverages, cigarette and electronics industries. It has strong brand awareness due to its quality products and high standards of services. Firm’s subsidiary Stora Enso Packaging BB today inaugurated its new corrugated board plant at Lukhovitsy, particular 130 kilometers southeast of Moscow. Demand for high quality corrugated packaging is increasing in Russia, and this investment continues the expansion of Stora Enso’s corrugated board production there. Stora Enso’s major industrial investment in Russia was the packaging plant at Balabanovo, some 100 kilometers southwest of Moscow, which was inaugurated in 1998. That year its production array extended to include high quality customer packaging. Another corrugated board plant in Russia taking place operations in Arzamas in Nizhny Novgorod region in 2004.

The yearly production volume of the plant is 150 million m square of corrugated packaging board. The new plant, costing euro 53 million, will mainly serve the Moscow area, which is one of the fastest growing markets for corrugated packaging board in Russia.

According to business development officer of the firm main aim of investment in Russia was capturing huge market and expanding operations of the company. Russia is emerging market especially in when company wants to increase its sales volume. When we decided to invest there, of course we had to see different factors which could affect our investment decision like country infrastructure, organization experience, market demand, competitors etc.

Stora Enso started operations in Russia from scratch. It built its own plant and hires some home country and host country employees. The main purpose and reason behind greenfield investment is building high standards of technology and culture, which is the part of the vision and mission of the company. It appears that investment from scratch is most likely be more appealing to technology-intensive firms as a mean to transfer and implement sophisticated technology, production and managerial practices in CEE.
According to business development officer there were several factors which considered when company decides to investment in Russia. At the firm level factors previous experience of the company in home country where it started already operations from scratch and they repeated this strategy for new investment in foreign country.

*According to Padmanabhan and Cho (1999) firm’s past know-how transmute into organizational practices that subsequently form a model for future activities and become a source of competitive advantage.*

Chang and Rosenzwing (2001) argue that when the firm entered into new market its international stratagem is a means to exploit the firm’s competitive advantage and launch complementary organizational competences. Firm’s publications, strategies and manager’s view explain that Stora Enso adopted Global Strategy in Russia. The main concern was behind this tactic high level of globalization of rivalry with nationalized product and focus on capturing economies of scope and scale. Firm integrate and vindicate its production to manufacture standardized goods in a very cost saving manner. A significant dissimilarity between greenfield and acquisition entrance is that the earlier rise in local supply, which reduce the revenues and rates as well raise a modest reaction from competitors (Caves & Mehra 1986).

*It occurs when, industry is going upward progressively, and if it is concentrated, as a greenfield entry will lead to a large shrinking in prices and profits.*

According to data in 1998 when case company start production in Russia at that moment industry was progressing gradually. Respondent also described that it was the main motive behind the decision of entry through Greenfield investment.
Above diagram illustrates the growth rate of different products of forest industry in Russia.

When company chooses to enter in new marketplace firm must take into attention the country’s social, legal, economic, and political structure. In this background one of the most significant variables in entry mode decision is country risk. Comprehensively, this risk comprises various types of constant specific factors: incredibility about the demand, the competitors, the costs and other market conditions, that put at risk the country’s actual financial affluence and the political risk (Quer et al. 2007).

According to case company respondent firm take into account political and legal condition of the country, he also explained that country level factors have significant impact on decision mode decision as well. The political risk and the improbability related with foreign ownership are exactly some of the possible costs that will be assumed in case of internationalization. Stability in the level of investment risk allows investors to integrate risk more exactly when approximating the rate of return.

Porter (1980) argues that in a growing market MNE’s use a direct entry mode to internment market share and hold intensification targets, but if firm wants to form an early existence in market than it may buy the existing company rather than Greenfield investment. In this way market potential affect the decision of entry mode decision especially choice between acquisition and greenfield. Respondent illustrated that at the time of investment firm tried to
buy any existing company but they did not find Target Company. Than firm started operations from scratch even it was time consuming as well.

“In high growth market there are chances to buying establishing business that is economically weak. There have been numeral entries of this nature in emerging markets when firms offered for acquisition. Therefore, it assumes that foreign investor is more likely to to favor an acquisition mode over a Greenfield mode when a significant market potential is perceived”. (Demerbag,Tatough & Glaister 2008).

5.2. Euro Biker

Euro biker established in 2001, its main business industry is Motorcycle accessories like leather suits, leather jackets and pants, textile waterproof jackets and pants, gloves, helmets, Boots, leather bags, oil products etc. The company is perhaps best known for its leather jackets and pants. In the start this company imports products from Pakistan, China and Taiwan and then supply in CEE countries like Estonia, Russia and Lithuania. After two years of its inception firm start manufacturing in Finland, Estonia and Russia.

During the data collection firm provided information of FDI in Estonia, only.


<table>
<thead>
<tr>
<th>Years</th>
<th>Net sales (€)</th>
<th>Sales from Finland (€)</th>
<th>Sales from Estonia (€)</th>
<th>Sales from Lithuania (€)</th>
<th>Approximate Percentage Increase in sales outside Home country</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>11 937</td>
<td>11 937</td>
<td>..</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>2001</td>
<td>20 713</td>
<td>15 902</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>2002</td>
<td>85 347</td>
<td>63 111</td>
<td>15 047</td>
<td>7 189</td>
<td>26%</td>
</tr>
<tr>
<td>2003</td>
<td>19 0636</td>
<td>99 281</td>
<td>4 1013</td>
<td>15 703</td>
<td>30%</td>
</tr>
</tbody>
</table>
Table 10 clearly depicts Euro biker rapid internationalization history in a decade. During the first 3 years of survival, Euro biker not only successfully survived itself but penetrate into other continents of the CEE. Euro biker successfully achieved by improving its sales figures in CEE countries. After the first 3 years of inception,

“Our initial idea was to deliver wide range of sport products in reasonable price. We focused on one segment at that time and then later widen ourselves in this field.”
(Interviewee)

The company started from a small narrow business segment i.e. for sports bike users then also broadened itself quickly in the same industry by moving itself into different sports products.

Entrepreneurs are the ones who possess a strong, long term, broad vision for a company to make it competitive and they are the people who show their managers a clear roadmap on how to drive the company towards rapid internationalization in the global market. Entrepreneurs of firm’s possess special skills, capabilities, and background that are not usually found in the traditional firms founders.
‘Eurobiker CEO have family background in sport industry so in that sense the company had a solid grounds for entering in this industry. It was a competitive edge for the firm as well.’ (Interviewee)

According to respondent domestic or national market doesn’t have much significant pull for them. Firm captured other foreign markets not due to their country of origin but due to their globally demanded products. “Our products have great international petition that’s the reason we are selling more globally as equate to our local market” (Interviewee). Eurobiker has small target market in its home country Finland. Firm found more potential for its products in CEE countries like Estonia, Russia etc.

According to respondent firm main aim of investment in Estonia was taking advantage of huge market potential and expanding operations of the company. Estonia is developing market especially in when company wants to grow its operations. “When we take decision that we are going to capture central eastern European market definitely take in to consideration several factors like firm, country and industry level variables” (Interviewee).

Estonia is considered one of the most highly developed transition countries in Central and Eastern Europe. Ever since re-establish independence in 1991, reform-minded governments have actively put into practice comprehensive reforms, creating one of the most constantly open-market-oriented economies and positive investment climates in eastern Europe. Consequently, Estonia has attracted among the highest rates of foreign direct investment per capita in the area. At the end of the year 2010, two countries, Sweden and Finland, have shares of 40.5 and 29.8 per cent of the total investment. Overall, the four Nordic countries account for more than 75 per cent of the total FDI stock in the country.

![Figure 11. FDI stock by country of origin (Adapted from Bank of Estonia homepage)](image-url)
According to Estonian Investment Agency the largest group of investors in Estonia is market-seeking investors. Respondent of case company told that the main motive behind investment in Estonia was capturing the market share and expand firm’s sales in future. In the next section, different variables of establishment mode choice of case company have been discussed.

The respondent of the company told that prior experience of acquisition investment provided the company with a developed path for further investment in a foreign country. It is one of the main reasons for acquisition investment in Estonia. MNE’s international strategy suggests taking advantage of the firm’s cutthroat advantages and determining complementary organizational capabilities (Chang & Rosenzweig 2001). According to Harzing (2002), practically all studies discriminate between two special types of international strategies “global” and “multi-domestic”.

Euro biker acquired Estonian sport goods firm. It takes advantage of already existing channel and company relations. As, respondent told company had more focus on multi domestic strategy so that is why authorized more control to management of acquired company. “We assured acquired firm management that they are part of us now and we give more authority than before they possess” (Interviewee).

According to the industry review of 2000, the sports industry growth rate was declining comparing with the period 1995 to 1999. It is one of what plays an important role in the decision of establishment mode choice. The CEO of the firm confirmed that analyzing the industry data lasted five years and that then they decided that entry through acquisition mode would be more appropriate mode in the Estonian market.

After collecting data from case companies, next section describes summary, conclusion and managerial implications of the study.
CHAPTER 6. SUMMARY AND CONCLUSIONS

The final chapter summarizes the main themes and the findings of the study. This chapter briefly describes the progress of the study and presents the conclusions. Finally, the suggestions for future research are given.

6.1. Summary of the study

The main purpose of the study was to analyze the determinants of choice between establishment mode choices in Central Eastern European countries. The main purpose was divided into three sub-purposes, which handled the effect of firm, industry and country level factors on choice of establishment mode.

In this study, three firm level variables, two industry and two country level variables were included. Firm variables of organization experience, industry growth and technological intensity were chosen to present the managerial implications for the choice between greenfield and acquisition. The study also bro the concept of industry level variables into the context of industry growth and concentration, and provides a clear dimension for firms in making the decision of establishment mode. The third analysis of country level variables consists of market potential and investment risk. It has been proved that the country level variables of market potential and investment risk are significant variables which are considered by firms in the decision of choice between greenfield vs. acquisition mode.

This study examined the impact of the above-mentioned variables in the choice of establishment mode in the context of the background of CEE countries. The background of CEE countries and change from the communist to market-based system has been explained and theories of FDI elaborated. The main focus was given to the OLI paradigm, which suggests three types of variable effects on cross border business activities: ownership-specific variables, location-specific variables and internalization variables. Ownership variables include the assets owned by the investing firm. Location specific advantages are critical in defining where firms will participate in cross border value-adding activities.
To achieve the main purpose of the study, three sub-purposes were established and seven propositions built in the theoretical part of the study and thereafter the empirical results are connected with managerial implications.

### Table 11. Summary of the results

<table>
<thead>
<tr>
<th>Firm level Variables</th>
<th>Stora Enso (greenfield)</th>
<th>Euro biker (acquisition)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organization learning</td>
<td>Medium</td>
<td>High +</td>
</tr>
<tr>
<td>Global strategy</td>
<td>High +</td>
<td>Low -</td>
</tr>
<tr>
<td>Multidomestic strategy</td>
<td>Low -</td>
<td>High +</td>
</tr>
<tr>
<td>Technological intensity</td>
<td>High +</td>
<td>Medium</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Industry level Variables</th>
<th>Stora Enso (greenfield)</th>
<th>Euro biker (acquisition)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry growth</td>
<td>High +</td>
<td>High +</td>
</tr>
<tr>
<td>Industry concentration</td>
<td>Low -</td>
<td>Low-</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country level Variables</th>
<th>Stora Enso (greenfield)</th>
<th>Euro biker (acquisition)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment risk</td>
<td>High +</td>
<td>Medium</td>
</tr>
<tr>
<td>Market potential</td>
<td>High +</td>
<td>High +</td>
</tr>
</tbody>
</table>
Above table consists of three parts, each part describes the empirical results of the studies. The findings of empirical results of firm, industry and country level variables have been presented respectively.

In this table results are presented through three dimensions low, medium and high. The first dimension low, describes that specific variable was not significant importance for the firm, when it invested in foreign market. The second dimension medium, illustrates that specific variable has moderate significant for the firm at the time of investment. The last one is high, it shows that certain variable has significant importance for the firm, at the time of investment.

The First part explains that, Organization learning was not significant indicator in case of Stora Enso, on the other hand, findings illustrate that, and it was significant in case of Euro biker. Second variable was global strategy, results shows that, when firm adopt global strategy, there is more probability of greenfield investment, but if firm adopt multi domestic strategy, than there are more probability of acquisition mode. In the case of Stora Enso technological intensity was high, but, it was low in the case of Euro biker.

The second part of the table explains industry level variables and their impact in decision of choice between establishment modes. Industry growth was high at the time of investment in both case studies that is why, in above table plus sign also shows industry growth has positive relation with both entry modes.

The third part of the table describes the result of country level variables in choice between establishment mode choice. Investment risk was higher in the case of Stora Enso, firm start operations from scratch in Russia. Findings make clear that investment risk was low compare to Russia in Estonia in the case of second case study. It is the main reason, that Euro biker acquired already existing company in Estonia.

6.2. Conclusion of the study

This research reviews literature on the determinants of an MNE’s choice between two alternative modes of foreign establishment choice: greenfield investment and acquisition. This study finds differing results and a considerable number of insignificant and unpredicted
findings. The research tries to combine these findings by identifying the main reasons for their deviation. Firstly, some variables do not always have clear consequences on the choice between greenfield and acquisition, as there may be controlling effects.

Table 1 reports the results more than 20 studies, with descriptive variables grouped into firm, industry, and country-level variables. The table illustrates that a great variety of variables has been theorized to influence an MNE’s foreign establishment mode decision. Some of these studies finding a progressive relationship between a precise variable and an MNE’s tendency to acquire, other finding the opposite, and others obtain irrelevant findings. It have been found in more than nine studies that firms with high expenditure of R&D prefer greenfield investment, presumably because their technological assets are to a certain extent firm specific and hence difficult to exploit through acquisitions. Another consistent finding is that the likelihood of greenfield entry initially increases with industry growth. More than three studies found that greenfield entry remains dominant. On the other hand four studies find that acquisition become more attractive, apparently because they make speedy entry possible (Caves and Mehra, 1986).

The main objective of this study was to examine the variables which affect the decision of greenfield vs. acquisition mode choice (firm level, industry and country level factors). The results provide wide provision for the hypothesized effects of the interrelationships, though at the same time confirming earlier findings on the separate effects of each type of element.

The findings of the study imply that, firms would like to establish market presence in CEE countries through direct investment, their ability to do so is constrained by their experience, technological intensity, international strategy, industry growth, industry concentration market potential and host country investment risk.

The main empirical finding was that companies with earlier entry mode experience are likely to choose the same establishment mode in CEE. However, it is questionable to assume that learning effects alone are the cause of pursuing similar diversification modes. Furthermore, following an identical investment arrangement in related industries can be the result of organization inertia rather than learning. Furthermore, following the identical investment arrangement in related industry can be the result of organization inertia relatively than learning. Barkema and Drogendijk (2007) argues that companies benefited from their
experience when expanding to other countries in the same bloc. This research also supports the findings of Barkema and Drogendijk (2007) results especially, in the case of CEE countries.

In the case of an MNE’s preference for greenfield production, managerial strategic decisions and valuable intangible assets are normally relocated from headquarters to subsidiaries. On the other hand, if an MNE pursues a multi-domestic strategy, local sensitivity requires local knowledge; thus the preference for an acquisition mode.

There are significant and negative indications that the technological intensity variable provides support for the hypothesis, indicating a negative relation between the likelihood of an acquisition and the technological intensity of the investor firm. It appears that investment from scratch will most likely be more appealing to technologically intensive Finnish firms, as they effectively transfer and implement sophisticated technology as well as production and managerial practices in CEE.

The results of the study indicate that market attractiveness is a significant factor affecting the entry mode decision. The findings support the hypothesis that when market potential is high, companies prefer acquisition over greenfield. CEE countries are emerging markets, characterized by high economic growth and a rapidly increasing population. This potential has been shown in a recent survey (Loewendah & Ertugal-Loewendahl 2000). Therefore, this study also supports some of the findings of that survey.

Contrary to popular belief, there is political stability and an active and reliable business climate in CEE. While each emerging market has its own growth path and institutions, the results of this study may fit to other emerging markets also with a stock of acquirable corporations. The investment risk hypothesis could be extended to other emerging markets, where institutional development has not yet reached the anticipated level.

According to Caves (1996), a lack of suitable takeover targets is a significant reason for greenfield investment mode entry. The findings of this study also confirm that in the absence of local takeover targets firms prefer greenfield investment.

Risk includes various types of consistent specific factors: uncertainty of demand, competitors, costs and other market conditions such as the country’s actual financial solvency and political risk (Quer et al. 2007). In this context, when a company decides to
enter a new market, the firm must take into consideration the country’s social, legal, economic, and political structure. This study found that country risk and market potential have a great impact on establishment mode choice.

6.3. Managerial implications

This study has investigated factors influencing the choice between acquisition and greenfield entry mode in Central Eastern European countries. Six propositions have been made in order to investigate the determinants of establishment mode choice. Each entry mode has its own implications for managerial practice and public policy.

The first proposition, namely that earlier greenfield experience means a higher probability of a successive greenfield investment, receives. On the other hand, the greater the earlier acquisition experience, the higher is the probability of a successive acquisition investment.

The second proposition, that technological intensity is an important determinant for establishment mode choice, receives partial support. In this investigation, case companies were taken only from manufacturing industries. This may explain why it seems that technological intensity does not have a high impact on the greenfield vs acquisition choice.

The third proposition, that the higher the tendency to follow a global strategy, the higher the likelihood of a greenfield investment, receives support. Instead, the higher the tendency to follow a multi-domestic strategy the higher the likelihood of an acquisition. This notion emphasizes that managers need to select establishment mode according to the international strategy of the organization.

In the fourth proposition, they received support after data collection from case companies. It is stated that the tendency to engage in greenfield investment is higher, if the industry is growing gradually; on the other hand, the tendency to invest through acquisition is higher, if the industry is concentrated.

The fifth proposition received support, implying that potential hazards were taken into account by MNEs during the establishment mode choice. It should be considered by
managers that political stability plays an important role in the firm’s decision between greenfield and acquisition.

The sixth proposition suggests that the probability of an acquisition investment rather than greenfield investment is higher, when significant market potential is perceived. On the other hand, the probability of greenfield investment rather than an acquisition investment is higher, when market potential is not significant. This proposition makes it clear to managers that market potential is positively related to acquisition investment. However, if market potential is not significant, greenfield investment should be considered.

The study identifies the determinants which affect the decision of establishment mode. The findings suggest that managers need to recognize and understand the role of these variables before making decision between choice of establishment mode. This study focuses on firm, industry and country level factors and illustrates the importance of these factors. Paying attention to these entry mode characteristics may provide practitioners with valuable information as to how these factors make their investment successful in foreign country.

Based on the empirical findings, choosing establishment mode requires analyses of industry, firm and country level factors and their impact on establishment mode choice. This is needed to evaluate the previously mentioned variables and to then make the decision of choice between greenfield and acquisition accordingly. Here, a focused approach should be adopted in order to examine the firm level factors, organization learning, international strategy of the firm and technological intensity.

Furthermore, managers should pay attention to industry level factors when making choice of establishment mode. As the results confirmed, industry growth is favorable for greenfield investment, and on the other hand acquisition is a more suitable entry mode in the case of a concentrated industry.

Finally, the results of this research make clear that country level factors are crucial to the establishment mode decision. Firms with high host country risk or location unfamiliarity have a propensity to avoid wholly owned subsidiaries, in pursuit of lower resources commitment modes of entry.
According to Chan and Ghemayel (2004), 50 percent of senior executives believe that political and social disturbance, currency risk, country financial risk and government regulations are the most critical risks regarding their investment decision and critical determinants of foreign direct investment. Researchers suggest that firms with high host country risk or location unfamiliarity tend to avoid wholly owned subsidiaries in pursuit of lower resource commitment modes of entry (Kim and Hwang 1992). Quer et al (2007) argue that firms should not assume full commitment alone with their entry strategy, due to not being able to generate all the resources they need to enter a high risk country successfully. In this context, organizations need a local partner or may acquire a local firm which provides market knowledge, and minimizes the exposure of the firm’s assets.

6.4. Suggestions for future research

Given these new results, this research raises proposals for future research. It is recommended that future research should examine the performance implications of MNEs’ establishment mode choices. The management of both entry modes, including the development of headquarters-subsidiary relationship and integration, can also be investigated. It is strongly recommended that future research in this field should look beyond the initial choice of entry mode in order to further explore the operational challenges of managing greenfield and acquisition investments.

Moreover, as the empirical research in this study was only based on Finnish companies; future research can include firms from other countries. This research gave an overview of the determinants of establishment mode choice, both companies being chosen from the manufacturing industry. In future research, it might be interesting and useful to study different industries, such as services, food, pharmaceuticals, etc. Further, factors such as cultural and integration could be studied in the future. On the whole, FDI and especially establishment mode provide many points for future research.

Finally, this study examined only firms which either successfully acquired or started a greenfield operation. Neglecting unsuccessful operations may have biased the findings. Future studies may wish to determine if such a bias exists.
REFERENCES


Euro Biker’s *Annual Reports*. (2001-2010).


APPENDIX A. Division of European Transition Economies

The EBRD uses the division of European transition economies described in Table A.1

Table A.1

<table>
<thead>
<tr>
<th>Central Eastern Europe and the Baltic States</th>
<th>South Eastern Europe</th>
<th>Commonwealth of Independent States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>Albania</td>
<td>Armenia</td>
</tr>
<tr>
<td>Estonia</td>
<td>Bosonia Herzegovina</td>
<td>Azerbaijan</td>
</tr>
<tr>
<td>Hungary</td>
<td>Bulgaria</td>
<td>Belarus</td>
</tr>
<tr>
<td>Latvia</td>
<td>Croatia</td>
<td>Georgia</td>
</tr>
<tr>
<td>Lithuania</td>
<td>Macedonia</td>
<td>Kazakhstan</td>
</tr>
<tr>
<td>Poland</td>
<td>Romania</td>
<td>Kyrgyz Republic</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>Serbia and Montenegro</td>
<td>Moldova</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Russia</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tajikistan</td>
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<td>Turkmenistan</td>
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<tr>
<td></td>
<td></td>
<td>Ukraine</td>
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<tr>
<td></td>
<td></td>
<td>Uzbekistan</td>
</tr>
</tbody>
</table>

For data presentation purpose, economies are divided into two sub groups as described in Table 2.

Table A.2

<table>
<thead>
<tr>
<th>Central and Eastern Europe (CEE)</th>
<th>Commonwealth of Independent States (CIS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Armenia</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Azerbaijan</td>
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<tr>
<td>Croatia</td>
<td>Belarus</td>
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<td>Estonia</td>
<td>Kazakhstan</td>
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<td>Macedonia</td>
<td>Kyrgyz Republic</td>
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<tr>
<td>Hungary</td>
<td>Moldova</td>
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<tr>
<td>Latvia</td>
<td>Russia</td>
</tr>
<tr>
<td>Lithuania</td>
<td>Tajikistan</td>
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<tr>
<td>Poland</td>
<td>Turkmenistan</td>
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<tr>
<td>Romania</td>
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</tr>
<tr>
<td>Slovak Republic</td>
<td>Uzbekistan</td>
</tr>
<tr>
<td>Slovenia</td>
<td></td>
</tr>
</tbody>
</table>
APPENDIX B. Email Pattern for Data Collection

E-mail pattern for contacting peripheral case companies

Dear Sir or Madam,

My name is Faisal Shahzad and I am a Master’s degree student at the University of Vaasa.

The reason I am contacting you is that I would very much like to incorporate your company in our investigation, as we believe it is an outstanding fit.

My specific research topic is *Determinants of greenfield vs. acquisition in CEE for firms*. In this study, I am going to analyze what are the fundamental dynamics, which affect the decision between Greenfield and acquisition choice, and your company has investments in CEE countries.

As a result, we would be delighted to include the development of your firm into our research. More precisely, we would like to ask for the chance to interview you at a convenient day/time, and we could make ourselves available whenever convenient for you, depending on your availability.

Should you require it, I would be pleased to give a recommendation from my Thesis Supervisor, Professor Jorma Larimo, upon request.

I thank you in advance for your support and look forward to your reply.

Best regards,
Faisal Shahzad
Master’s Student of International Business
University of Vaasa
APPENDIX C. Preliminary Questionnaire

Prepared interview form acting as a guideline for the interviews

Background information:

a- Can you describe your firm’s establishment and the personnel involved in it?
b- When was the company founded (initiated & registered )? 
c- Expansion of size of the firm in sales revenues and number of employees from establishment?
d- Share of sales outside Finland especially in CEE?
e- How many FDIs has your company made altogether?.

1) none   2) one   3) three   4) four   5) five   6) more than ten

f-How many of them were greenfield investments?

1) none   2) one   3) three   4) four   5) five   6) ten   7) more than ten

g)-How many of them were acquisition investments ?

1) none   2) one   3) three   4) four   5) five   6) ten   7) more than ten

h) -Has your company some kind of clear policy concerning establishment mode? 
Choice of either greenfield or acquisition, depending on the situation.

Clear policy for greenfield..........1   2   3   4   5   6   7

Clear policy for acquisition..........1   2   3   4   5   6   7

i)-Were there any local legal restrictions limiting either greenfield or acquisition mode?

No       yes     what kind of restrictions? Explain briefly

j)-Why did your company prefer the establishment mode that was chosen?

1) In cases of greenfield investments the main motives for the choice were:

2) In cases of acquisitions the main motives for the choice were:

a) In cases of acquisitions, how many potential acquisition firms existed in the target country?

1) only the chosen one ___    2) one alternative     3) two to three alternatives
4) four to five-------- 5) six to seven--------- 6) ten to fifteen------ 7) more than twenty------

3) How many alternatives did you analyze in more detail?
   1) only the chosen one ___2) one alternative 3) two to three alternatives
   4) four to five-------- 5) six to seven--------- 6) more than ten----------

5) Why did you select just that target firm?

6) What’s your evaluation of the performance of the foreign unit?
   1- very dissatisfied 7- very satisfied
   1 2 3 4 5 6 7

7) If you would make the same investment today, would you make the investment using the same establishment mode, or another mode?
   same___ other ___ why........

8) A previous decision of establishment mode with a positive response impacted your future investment decisions. 1 strongly disagree 7 strongly agree
   1 2 3 4 5 6 7

9) Industry growth has a great impact on your establishment decision for either greenfield or acquisition 1 strongly disagree 7 strongly agree
   1 2 3 4 5 6 7

10) Market potential has a great impact on your establishment mode decision of either greenfield or acquisition 1 strongly disagree 7 strongly agree
   1 2 3 4 5 6 7

11) Does your company have the same international strategy for all markets, or does it depend on the situation ?
   no       if yes.......than which strategy is being used by your company
global   multidomestic

12) Has your company assigned responsibilities and decision-making authority to national subsidiaries?
   1 strongly disagree 7 strongly agree
   1 2 3 4 5 6 7
13) Has technological intensity had any impact on your company establishment mode decision?

no  yes

If yes explain briefly........

14) How do you grade the general stability of the potential, social, and economic conditions for establishment mode decision?

1 strongly disagree   7 strongly agree

1  2  3  4  5  6  7

15) Could I consult some other persons in your firm about determinants of greenfield and acquisition choice in CEE? I would also be interested in interviewing them afterwards about points concerning my research topic. Could you inform me who would be the right persons for this?

Thank you very much: I appreciate that you have shared your valuable time with us.