MULTINATIONAL CORPORATIONS AND FOREIGN INVESTORS IN CEE
Western European Multinationals in the CEE Agro-Food Industry: The Cases of Nestle, Unilever and InBev

ABSTRACT. Using Systems of Innovation Approach (SI) and International Business (IB) literature, this paper analyzes the level of embeddedness of Multi-national Enterprises (MNEs) in Central and Eastern Europe (CEE). MNEs are discussed as they link the host country economy with the global economy by their regional and global networks. The expansion and successful embeddedness of West European multinational firms is crucial for the industrial integration of CEECs into the EU. The focus of the study is on the largest food processing companies, which invested in the region — namely Nestlé, Unilever and InBev. The paper discusses the motives of investment and the entry strategies of food MNEs, outlines their contribution to the local development and stresses on the national actors as forces to embedded foreign direct investment (FDI). The paper discovered that EU membership facilitated the processes of global reorganizations of Nestlé, Unilever and InBev in CEE. All the three MNEs object of this research closed partially or completely plants all over CEE (and Western Europe). Hence, in a liberal trade regime it is very difficult to talk about long-term embeddedness of MNEs. It seems that the global strategies of the companies and the size of the market are the factor, which pre-determines the level of embeddedness of food MNEs in a certain economy and not so much the national actors and institutions.

KEYWORDS: global strategies; food MNEs; Czech Republic, Hungary, Romania, Bulgaria, national actors

INTRODUCTION

The idea behind European enlargement and integration is that a wider Europe would enjoy more economic growth and political stability. However, what has been observed until now is mostly divergence rather than convergence between East and West. Effective catching up has occurred in just a few of the acceding Central and Eastern European countries (CEECs). Yet, if we
wish to have a strong and dynamic Europe, the benefits of enlargement need to be secured across the region as a whole.

This paper focuses on the industrial integration of the CEECs into the EU (European Union) at the firm and inter-organizational level. The major actors of the study are Multinational enterprises (MNEs) as they link the host country economy with the global economy by participating in the emergence and development of the networks at different levels, i.e. global, national and local, through the resources and capabilities embodied in them. Moreover, the MNEs are object of the following research as they contribute to the catching-up of the CEECs’ economies by transferring technological know-how, implementing advanced management structures and modernising manufacturing sectors. As Lall and Narula\(^1\) (2004: 3) point:

The role of the MNE as a source of capital and technology has grown over time, as other sources of capital have become scarcer or more volatile and technical change has accelerated. MNEs continue to dominate the creation of technology; indeed, with the rising costs and risks of innovation their importance has risen (with the exception of very new technology areas).

In brief, the expansion and successful embeddedness of the West European multinational firms is crucial for the industrial integration of CEECs into the EU.

The participation of CEE firms in multinational networks depends on the policies of the national economic actors and institutions. Liberalisation is no longer enough to attract and keep FDI in the host country. As Lall and Narula (2004:4) passionately argue, „The removal of restrictions on FDI does not create the complementary factors that MNEs need; it only allows them to exploit existing capabilities more freely‟. Thus, in a free trade regime like the one EU integration provides, MNEs would contribute to local development only in those places where local capabilities are strong. Put it differently, the creation of linkages and the internationalization of spillovers from MNE activities depend on local absorptive capacity. As Narula (2005:12)\(^2\) concludes „FDI per se does not provide growth opportunities unless a domestic industrial sector exists which has the necessary technological capacity to profit from the externalities from MNE activity‟.

Therefore the research question of this paper is, „What determines beneficial MNE embeddedness in CEECs?‟\(^3\) In other words, are MNEs embedded in CEECs with high absorptive capacities (Czech Republic, Hungary) and not embedded in the others (Romania and Bulgaria), which have weak local capacity? I attempt to answer this question by analyzing MNEs’ global strategies and regional strategies towards CEE subsidiaries. A special focus is given to the national innovation systems of the countries as a factor, which shapes the

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strategies of the companies in CEE. Building the analysis on Hungary and the Czech Republic, who are in the first wave of EU accession, it is possible to be projected the behavior of MNEs in Bulgaria and Romania after they joined the EU in January 2007.

The focal point of the paper is the Western European MNEs investing in the food processing industry in CEECs. The agro-food sector is selected as it answers to several criteria: 1) it is important in the process of EU integration; 2) it is involved in global production networks and 3) it is significant for the CEE economies (in terms of employment and contribution to industrial value added).4

The headquarters and subsidiaries of Nestle (Switzerland), Unilever (England-Holland) and InBev (Belgium) in CEECs were interviewed. These are the largest food MNEs in Europe and in the world, i.e. companies with global strategies and networks. They best present the current and near-future level of industrial integration between Eastern and Western Europe.

The paper is organized as follows. The next section, section 1, makes a theoretical overview. The framework, which this study applies to explain the embeddedness of food MNEs in CEE, is based on the Systems of Innovation (SI) approach and on the International Business (IB) literature. SI gives a macro level view as it stresses on the role of institutions and economic actors for the embeddedness of FDI, while IB literature explains that phenomenon from a micro-level perspective using firm strategies and investment motives. As the host country capabilities and government regulations have an impact over firms’ strategies, I use a synthesis of both SI and IB literatures in order to explain the level of embeddedness of MNEs in CEE. Section 2 presents the results from the interviews at the headquarters and at the subsidiaries of Nestle, Unilever and InBev in CEE. The last section concludes.

FACTORS INFLUENCING THE EMBEDDEDNESS OF FDI

External for the company factors. Narula (2005) shows that without the appropriate domestic absorptive capacity5 whether in the form of knowledge

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3 Beneficially embedded MNEs are those multinational companies, which are part of the national system of innovation, i.e. collaborate with local research institutes, universities, financial institutions, business organizations and contribute for the local development by helping domestic companies to upgrade.

4 For 2005, food industry provides 13—14% of total industrial value added in Hungary and the Czech Republic, Romania 30%, and Bulgaria 16,2%. It gives 13% of the industrial jobs in Hungary, the Czech Republic — 11% and Romania — 10,2%. For Bulgaria this percentage is even higher — 15%. Yet, despite the fact that for Romania and Bulgaria agriculture is much more important sector because of its scale, it is less developed than in Hungary and the Czech Republic (source: National Central Banks of Bulgaria, Romania, the Czech Republic and Hungary).

5 Narula defines absorptive capacity as the ability of catching up economic units (firms or countries) to absorb, internalize and utilize the knowledge potentially made available to them. Absorptive capacity can be decomposed into four constituent parts: firm-sector absorptive capacity, basic infrastructure, advanced infrastructure and formal and informal institutions (Narula, 2004).
infrastructure or efficient domestic industrial sector, FDI is unlikely to become embedded. Rodrik et al. (2002)\textsuperscript{6} argue that \textit{efficient institutions}\textsuperscript{7} contribute more to economic growth than location or trade. Xu (2000)\textsuperscript{8} and Lundvall (2002)\textsuperscript{9} emphasize on the importance of \textit{human capital} as a crucial condition for a country to benefit from the technology spillovers of MNEs.

In order to test whether food MNEs are embedded in CEE, this paper uses „system” view perspective as suggested by Narula (2002)\textsuperscript{10}. „Systems of innovation” is a new approach that has emerged only during the last decade. „SI is simply at the centre of modern thinking about innovation and its relation to economic growth, competitiveness, and employment” (Edquist, 2002: 225).\textsuperscript{11} The innovation system concept suggests the effective interaction between the different actors in the innovation system is a key to the successful embeddedness of MNEs (See Figure 1).

Narula and Marin (2003)\textsuperscript{12} conclude that governments have a responsibility for policies to promote linkages, to encourage the development of local firms, and the development of important infrastructure, which provide the raw material for absorptive capacity.

Apart from institutions, the other factor, which might influence the level of embeddedness of MNEs, is the period of investment in a certain country. MNEs build on location advantages of host economy and as those advantages develop during the time, the embeddedness of companies respectively increases. As the CEOs of Nestlé and Unilever admitted, the duration of investment in Hungary is among the factors, which influenced their decision to invest in the country. However, Lall and Narula (2004) note that the period of investments does not always result in deeper embeddedness; there are probably many more cases where linkages and spillovers have not substantially increased over time. This depends on the kind of subsidiaries, and the entry strategies of the companies.

\textit{Entry strategy and entry modes}. Estrin and Meyer (2004)\textsuperscript{13} highlight that to understand the mechanisms of spillovers, it is important to understand pro-

\begin{itemize}
  \item \textsuperscript{7}Institutions are all the laws, social rules, cultural norms, routines, habits, and technical standards that form the institutional context within which organizations interact.
  \item \textsuperscript{12}Narula, R. and A. Marin (2003), FDI spillovers, Absorptive Capacities and Human Capital Development: Evidence from Argentina, \textit{MERIT research memorandum} 2003—16.
\end{itemize}
Figure 1. — MNEs, domestic suppliers, and the linkages between the different actors of the National Innovation System
Source: The Author
cesses within the investing MNE. As Narula (2005: 4) argues, the motive of investment is crucial in determining the extent to which linkages and externalities develop. Scholars\textsuperscript{14} have identified four main motives for investment: 1) market seeking; 2) resource seeking; 3) efficiency seeking and 4) strategic asset seeking. Companies following strategic asset-seeking strategy have the highest willingness to lock in a certain economy. However, effective national institutions are capable to lock-in companies, which follow any of the other three entry strategies.

As far as food MNEs are concerned they followed market-seeking strategies when penetrated CEE market. In general, food companies have been interested in the extension of production into a new country or region. Hence, their focus has been on the status of the local market (size and income level of the population) and its growth potential. The opening up of CEE offered possibilities for growth for western multinationals, which operate in mature Western European markets.\textsuperscript{15} As Meyer and Tran\textsuperscript{16} (2006: 3) outline „the main attraction of emerging economies is their high economic growth and the corresponding expectation of rapidly increasing demand of consumer goods“.

The first years of investment in CEE economies have been characterized with unique challenges for MNEs as there were not sophisticated institutions and well developed supplier networks. Packaged food MNEs, which are focus of this study, were faced with a bunch of macroeconomic risks like non functioning market economy, no stable legislative framework, poorly developed marketing infrastructure, price conscious and not very brand-loyal consumers, and intense competition. In addition, the average consumption of typical consumer products such as toiletries, beverages, confectionary, detergents and household cleaners was well below Western levels. However, the potential for growth, which CEE markets offered, was a very strong stimulus for the MNEs to undertake the risks and invest in the region. Moreover, the early entrance into the region, ahead of other competitors was vital to success (Quelch et al., 1991; Schuh and Damova, 2001).\textsuperscript{17} ‘First mover advantage’ gave foreign investors the unique chance to buy leading local firms (this is a policy of Nestle for example), to first occupy consumers’ minds with their brands, to access marketing and distribution channels, to sign contracts with the best suppliers.

\textsuperscript{15} FDI inflows into the 10 EU-accession countries from Central and Eastern Europe rose by 69% in 2004, to $20 billion, with Poland, the Czech Republic and Hungary, in that order, receiving the largest FDI inflows. Reinvested earnings accounted for more than half of the FDI flows to these countries, whereas equity investments in new projects and privatization sales were the dominant forms of FDI in Slovakia, Latvia and Lithuania (UNCTAD, World Investment Report 2005, p. 84).
Apart from these advantages, production-oriented considerations also played a role in the decision for investment in the region as the lower local production costs allow Western firms to service price-sensitive mass markets that could not be covered by exporting.

The major entry modes popular among Western firms for CEE were exporting, forming a joint venture with a local partner, acquiring a local firm in the course of the privatization process and greenfield investments. The entry mode is an important part of the global strategy of the company as it influences firm’s efficiency and competitiveness. CEE was a risky and unexplored market, which made companies cautious when investing. In this respect, forming joint ventures between Western companies and CEE partners have been very popular especially in the early 90s (Shama, 1995). This form of cooperation was mutually beneficial for both foreign investors and local firms as the first could avoid market risks as well as sunk costs arising from Greenfield investments and the second could benefit from the knowledge and capital of the foreign firm. In particular, food MNEs brought along their global brand names, worldwide reputation, and global distribution networks. In return, the local companies provided them with their local distribution channels, with their knowledge of the local market, as well as with know-how concerning local tastes and preferences, and industrial processing techniques. These local market-specific assets helped the food MNE to keep pace with local market conditions, which could otherwise be particularly difficult to deal with. An example of how difficult might be for a company to get familiar with the local tastes and preferences is the case of Nestle, Bulgaria. The CEE manager of Nestle revealed that understanding the local consumer tastes was among the greatest obstacles to the success of the company in Bulgaria. Nestlé was reporting losses for years and the management could not figure out what was wrong. Finally, when the local management team has been changed the problem was solved. It became clear that local confectionary products, which Nestlé adopted and gave its brand name to, were low quality. For years, the company was misled that this was the local taste and did not do anything to improve the products.

Inviting FDI to Hungary, mainly in the form of joint ventures was a major policy aim during the 1980s and a large number of JVs were established. Because of the general openness of the Hungarian economy, long-term cooperation links were also developed rather frequently with major MNEs. However, most of the joint ventures in CEE were only temporary in nature. The major restructuring efforts happened only after the foreign investor obtained a qualified majority or full ownership of the firm (Szanyi, 2001). For example, such cases are Danone and Nestlé in the Czech Republic. For packaged food MNEs, the most common entry mode in CEE was acquisitions of plants.

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19 Interview with Mr. Gallagher, Nestlé CEO for CEE region, Vevey, Switzerland, November 2004.
through privatization. Chocolate, dairy products and beer are traditional, culturally embedded products. This fact made local producers attractive takeover candidates for foreign companies, and major players such as Nestlé, Unilever, Kraft Foods and Interbrew (since 2004, named InBev) seized the opportunity offered by the privatization process to establish a presence in the region. In the case of the acquisition of a former state-owned company, „the management’s task was to implant a market and profit orientation, improve overall productivity, optimize the product portfolio, revitalize sales and develop brand management” (Schuh and Holzmüller, 2003:187). The CEOs of the CEE subsidiaries have been western managers appointed by the headquarters. The reason was that CEE managers lacked knowledge about the market economy; did not speak foreign languages and were not familiar with code of conduct of the mother company. An „army” of western experts were employed in CEE in order to train youngsters and to help for the integration of the local affiliate to the global production network of the company. The managers of Unilever, for example, revealed in interviews by the author, that they consider the investment in their CEE personnel as equally strong contribution to the local development as the high standards, which they introduced to consumer goods.

Apart from entry strategy, the other force, which defines the extent to which a subsidiary would create linkages in the local economy, is the business strategy of the company.

The business strategy of the MNE. The business strategy, which an MNE follows, gives a picture about the organizational structure of the company, about the way it functions, about its willingness to embed or not in a certain economy, about its present aims and long-term plans. Hence, the question is, ‘What strategies drive food MNEs and how do they affect CEE subsidiaries?’

The subsidiaries of multinational companies operate in different national environments. In each country, they have to be responsible to the local consumers, business agencies and governments. Ghoshal and Nohria (1993: 26) name these factors „forces for national responsiveness”. The companies which activity is strongly influenced by local factors follow multidomestic strategy. However, it should be noticed that the different local environments could have something in common, like, for example, common consumer tastes. The linkages across national borders, which press MNEs to coordinate their activities, Ghoshal and Nohria (1993), describe as „forces for global integration” and the strategy, which the companies pursue, is called a global strategy. Global strategy stimulates MNEs to integrate their overseas subsidiaries with the parent company. Therefore, whereas in a multidomestic strategy the managers in

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each country react to competition without considering what is taking place in other countries, in a global strategy, competitive maneuvers are integrated across nations. The literature (see: Bartlett and Ghoshal (1989) defines a third type of strategy, which is a mixture of the multidomestic and global strategies and is called a transnational strategy. That is the strategy which global food MNEs follow.

Using Unilever as an example of a transnational company, Bartlett and Ghoshal (1989) shed a light on the reasons, which provoked the company to develop from a multidomestic to transnational company. They show that the trend towards converging consumer tastes and the lowered barriers between markets, especially in Europe, made it possible for Unilever to develop and diffuse innovations in a more coordinated way and to capture more of the scale economies gained via the integrated operations. In short, companies following transnational strategies try to simultaneously be globally efficient and locally responsible. Knowledge is spread throughout the organization with large flows of people, know-how and products between subsidiaries. Products and marketing are adapted to local markets and there is higher proportion of local production and R&D than in subsidiaries of global companies. Subsidiaries are more dependent on other subsidiaries for their inputs/outputs than on headquarters. In order to develop a transnational strategy companies are “building organizations in which multidimensional management perspective and capabilities are kept legitimate and viable, dispersed assets and resources are developed in a differentiated and interdependent network, and the whole system is integrated with a flexible coordinating process” (Bartlett and Ghoshal, 1989: 210).

The search for synergies between different business units leads to many restructuring operations. Those activities that do not correspond to a targeted profitability or return on investment ratio calculated on a mid-term or long-term basis are considered outlying activities and are sold off as soon as possible. Duplication of a number of functions by these hundreds of subsidiaries and dozens of divisions that composed these giant multi-product multinationals (e.g., Unilever, Nestle, Sara Lee Corp.) reduced the firms’ profitability and economic efficiency.

Using empirical evidence, Tozanli (2005) shows the move of the largest 100 food-processing MNEs towards globalization. She concludes that it is no more the company size or the breadth of activities in its portfolio that determine the efficiency of a multinational food-processing enterprise, but is rather a delicate combination of core activities and their geographical spread over the world that matters.

Host governments influence the globalization plans of MNEs through trade policies, technical standards and marketing regulations. Measures like

high import tariffs and quotas, non-tariff barriers, export subsidies, local content requirements, currency and capital flow restrictions, and requirements on technology transfer affect globalization strategies of the MNEs. The easing of government restrictions, Yip (1989:38)\textsuperscript{27} argues, „can set off a rush for expanded market participation”.

The EU membership is an example of such easing of government restrictions. Are the outcomes expanded market participation and concentration of production? Meyer and Jensen (2003)\textsuperscript{28} analyse the effect of EU membership on the corporate strategies of FDI in CEE. They confirm the argument that the removal of trade barriers and the consequent economic integration facilitates the access of western European business to CEE. As trade barriers do not exist any more, „operations across Europe will be integrated to a higher degree, which in turn may lead to centralization of production facilities and therefore closure of peripheral operations” (Meyer and Jensen, 2003: 295). Eden (2001)\textsuperscript{29} gets to the same conclusion, arguing that regional integration leads to improved economies of scale and scope, increased efficiency through the rationalization and reallocation of firms’ activities, and improved inter-regional linkages.

Benito et al. (2003:447)\textsuperscript{30} present similar findings, namely that „regional integration promotes the widening of markets, and because 'insiders' have easier access to the larger market they are, all else being equal, in a better position than 'outsiders' to exploit economies of scale as well as economies of scope”. The authors argue that the liberalization of trade and factor movements within an area should also increase the level of competition throughout the area. As a result, less-efficient actors will leave the market; those that remain in an industry are likely to be the most competitive ones. In this sense, one can suppose that MNEs as the strongest competitors on the EU market would go for restructurings and optimization plans when CEE countries join the EU club. In their study, Benito et al. (2003: 446) demonstrated that MNEs have reorganized their spatial distribution within the EU to exploit economies of scale and scope, and to exploit more efficiently the comparative advantages of the various member countries within the EU.

To summarize, the combination of IB literature and SI approach allows for better understanding of MNEs behaviour in CEE and more precisely of the forces, which determine the embeddedness of food MNEs in the region. SI approach stressed on the importance of linkages among the actors of national innovation systems to attract and to embed FDI. IB literature shed a light over the factors, which shape the business strategies of the companies. The synthe-


\textsuperscript{28} M e y e r, Klaus E. and Camilla J e n s e n (2003). Foreign Investor Strategies in view of EU Enlargement, in: H.-J. S t u t i n g, W. D o r o w, S. B l a s z e j e w s k i, F. C l a a s e n, eds.: Change Management in Transformation Economies: Integrating Strategy, Structure and Culture, London: Palgrave, 2003, pp. 291—308.

\textsuperscript{29} E d e n, L. (2001). Regional Integration and Foreign Direct Investment: Theory and Lessons from NAFTA, in: M. K o t a b e, P. A u l a k h and A. P h a t a k (eds.) The Challenge of International Business Research, Edward Elgar: London, UK.

\textsuperscript{30} B e n i t o et al. (2003). Environmental influences on MNE subsidiary roles: economic integration and the Nordic countries, Journal of International Business Studies 34, 443—456.
sis of these approaches provided me with a tool to explain the level of embeddedness of food MNEs in the first wave EU accession countries — Hungary and the Czech Republic and in the second wave countries Bulgaria and Romania. A phenomenon like EU membership helped a lot for identifying the factors, which have the strongest impact over the strategies of MNEs.

EMPIRICAL RESULTS FROM THE COMPARATIVE CASE STUDIES

Interviews have been conducted at the headquarters (HQ) of the three largest food MNEs in the world, Nestlé, Unilever and InBev. The conversations with the regional managers underscored the importance of transnational strategies as a factor, which defines the policies of CEE subsidiaries, and determines their level of embeddedness. In all cases, CEE subsidiaries are completely integrated in the global production network of the company and are object of strong centralized management. Local subsidiaries produce and/or distribute global brands as part of the global strategies of the companies to concentrate on several core brands. These are companies’ world famous products, which are standardized all over the globe. Like for example, in the case of Unilever Knorr, Magnum, Lipton, Rama brands; in the case of Nestlé Kit-Kat, Maggi, Nestea, Nescafe or InBev’s global beers — Brahma, Stella Artois, Leffe and Beck’s.

The world largest food MNEs have global/regional supply chains. CEE subsidiaries are integrated into these chains, which mean that the suppliers are chosen and approved by the HQ or by the respective regional center. It is not possible every subsidiary to decide on inputs on itself and hence there are limited possibilities to source locally. The CEOs underscored that external factors like trade barriers, import tariffs, logistics and transportability of products have an impact on the MNE’s strategy and force companies to source locally. However, despite the willingness of foreign companies to work with domestic companies, they faced serious problems to find good local suppliers, which could satisfy their quality and quantity requirements (this was the case in Bulgaria and Romania). The conversations with the managers revealed that MNEs have their own R&D centres in Western Europe and they do not have plans to internationalize R&D in CEECs. MNEs work with local universities to recruit personnel. Yet they are not interested in deeper cooperation with national universities and research centres on scientific projects as HQs have universities — partners at their home countries. As far as retailers are concerned, MNEs cooperate with both local and foreign retailers. Some companies like Unilever have global partnerships with large retailers like Tesco, and prefer working with the same retailer in CEE. However, if the global partner retailer is not

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31 1) Interviews with Dr. Manfred Stach, President Best Foods Europe, Unilever and Mr. Richard Oppenheim, Vice-president Best Foods Europe conducted at the HQ in Rotterdam, the Netherlands, September 2004;
2) Interview with the Corporate Affairs Office, Leuven, Belgium, November 2004;
3) Interview with Mr. Gallagher, Nestle CEO for CEE region, Vevey, Switzerland, November 2004.
present in the host country, than the MNE cooperates with the distributor who can offer the largest market share.

The economic and political environment proved to be decisive for investment in early and mid 90s. MNEs entered the CEE markets attracted by the growth possibilities of the domestic markets (followed market-seeking strategies). The purchasing power of the population, the duration of partnership, low labor costs, cheap raw materials and the prospects of CEECs to enter EU market have been among the variables, which predetermined the level of FDI of food MNEs.

Food MNEs contributed a lot for the local development. They increased the quality of the domestic workforce, by providing formal and informal training, and through the process of learning — by doing transferring their firm — specific technological knowledge to their domestic employees. Another strong contribution was the introduction of high quality local products on the market. Unilever, Nestle and InBev as market leaders and one of the strongest players on the local markets greatly increased the consumer culture and the consumer choice by offering great variety of products. In addition, they improved packaging design of many products, introduced modern marketing techniques in CEE, and gave easier access of CEE products to their export markets. Food Multinationals in the Czech Republic for example, played extremely important role in the process of harmonization of the Czech legislation towards the EU one. As the MNEs have large and very strong law departments, the Czech Food Federation could rely on companies’ experts for advices, consultations and assistance while working over the food legislation.32

The crucial finding of all the interviews was that the three MNEs applied the same strategies towards their subsidiaries in all four countries, i.e. the conclusions done above are valid for all CEE subsidiaries. However, the interviews, conducted at the subsidiaries of Unilever, Nestle and InBev in Hungary and the Czech Republic in the beginning of 2005, did not completely support this argument. It appeared that not all the subsidiaries were equally treated. For example, Hungarian and Czech subsidiaries turned out to be less dependent on the headquarters; they could take decisions about local suppliers; they got much more funds for modernization of their plants and they had larger product portfolios than Bulgarian and Romanian subsidiaries (the size of the product portfolio is a criterion for the power of a certain affiliate). In other words, the three companies had stronger production networks in Hungary and the Czech Republic compared to Bulgaria and Romania. Having in mind that headquarters underlined that they had equal attitude to all their subsidiaries, the question that arose was which factors influence the strategies of the companies in the countries so that at the end of day they behaved differently.

To explain this phenomenon I adopted an answer from SI literature — what made difference was the absorptive capacity of the country; the role of formal and informal institutions and economic actors. Put it shortly, Hungary and the Czech Republic had higher absorptive capacities than Bulgaria and Romania.

32 Interview with Mr. Miroslav Koberna, Director, Federation of the Food and Drink Industries, Czech Republic, April, 2005, Prague, Czech Republic.
Hungary and the Czech Republic had preserved agricultural supplier networks and this provided opportunities for MNEs to cooperate with them. In Bulgaria and Romania, the reforms in agro-food sector happened with a significant delay because of political disagreement and multiple changes in the legislation and regulations. In addition, when the land was finally returned to owners, this was done in historical boundaries and led to great land fragmentation, which hampered the modernization of agriculture and the persistency of raw agricultural supplies. All this resulted in failure in transition reforms in Bulgaria and Romania, and led to underdeveloped supplier networks. Put it differently, it was not that MNEs had different attitudes to their subsidiaries as far as suppliers are concerned, but simply Bulgarian and Romanian subsidiaries did not source locally as the gap between the local firms and the MNEs was too big.

A picture of the innovation systems of the four countries illustrates the importance of national governments and business organizations for the embeddedness of MNEs. It is not enough to attract FDI, but also to embed the foreign capital in the local economy. Czech government did so through linkage promotion programs. One such program is Supplier Development Programme designed to boost the number of foreign investors that are increasing their use of Czech-based suppliers. The Czech Republic was the only country in Central and Eastern Europe that had such a program. The agency responsible for the supplier program was CzechInvest — a national development agency attracting FDI and improving the Czech investment climate. In an interview, Vít Švajcr, Director Supplier Development Department at CzechInvest said that the outcome of the program was that the Czech supplier base became one of the country’s major competitive advantages. In addition, the agency tried to embed FDI by offering full tax relief for 10 years for newly established companies and partial tax relief for 10 years for expanding companies. In addition, the government could cover 35 per cent of the costs of training in the regions where the unemployment rate was higher than the country’s average. However, the total amount of the aforementioned investment incentives (with the exception of training and re-training) cannot exceed 50 per cent (65 per cent in the case of SMEs) of the investment made into long-term tangible and intangible assets.

It should be noted that the Czech food industry was the best prepared for EU accession among all new member states. Between 2002 and 2003, Ministry of Agriculture invested around 0.5bn Czech crowns (€ 17m) in business

33 CzechInvest was established by the Ministry of Industry and Trade (MIT) in November 1992. Its task was to promote the Czech Republic internationally to ensure a sustained inflow of foreign direct investment that would support industrial restructuring and development. Over the past eleven years, CzechInvest, changed into a development agency through the implementation of programmes supported by both the MIT and the EU. Among these are the investment incentives system, the industrial zones and supplier development programmes, which are among MIT’s most successful instruments in strengthening Czech industrial competitiveness. For more details see: www.czechinvest.org.

34 Interview with Vít Švajcr, director of Supplier Development Department, 12. 4. 2005, Prague, The Czech Republic.

incentives, and this support in turn generated €3bn in investments of domestic firms themselves in order to comply with all EU regulations. Most food-processing companies have answered to the EU requirements before accession. This means that the Czech food industry was placed in a strong position, which became possible thanks to Federation of the Food and Drink Industries (FFDI), which represented successfully the food industry in Brussels and had a strong lobby power in favour of the local food industry. Interviews with Czech-Invest and FFDI officials proved the major role of these organizations in the process of linkage creation between foreign and domestic companies by introducing different programs and initiatives to encourage that partnership. Moreover, the government interfered in the relations MNEs — domestic companies by introducing protectionist trade regime (tariff and non-tariff barriers, sector subsidies, etc.) and thus forcing MNEs to source locally. The general conclusion is that the Czech Republic had one of the most developed and dynamic innovation systems among CEE countries. This could be a possible explanation why Czech subsidiaries were deeper embedded in the local economy.

Similar to the Czech case proved to be the case of Hungary. The interviews with governmental officials showed that Hungary had a policy of strengthening the competitiveness of local enterprises and embedding MNEs already in the 90s. In order to root foreign companies, the government was applying broad policy measures such as high tariffs and customs duties, rules of origin, joint-venture requirements, etc. Tax incentives were introduced to stimulate firms spending more on R&D. Since 1997, Hungarian government introduced programs that encouraged linkage creation in general and programs that encourage the further development of the already existing links between suppliers and foreign companies. Moreover, since mid-1990s Hungary has been working to improve its innovation system. The greatest effort was done since Hungary’s entrance into EU in 2004 when a 200% rule was introduced for Business Expenditures for Research and Development to be accounted and Research and Technology Innovation Fund was established. The formation of such fund was a unique initiative for CEE Europe and it aimed at creating a stable and reliable financial ground for research, technological development and innovation activities. This measure served as a tool to motivate foreign and domestic companies to cooperate with the research institutes and universities for R&D services: they had either to pay contributions to the Fund or to invest in R&D and for every forint invested to get two forints back. Further schemes were designed to contribute to enhancing competitiveness via specifically targeting academia-industry relationships, usually by supporting joint development of new products, services and processes.

The results of all these initiatives was not possible to be evaluated as many of the programs were launched after 2000 and there was not enough time for the outcomes to be tracked. Yet it could be concluded that Hungarian innovation system is dynamically developing and together with the Czech innovation system among the best in CEE. The government initiated plenty of

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36 Interview with Mr. Tamas Balogh, Director, Innovation Department, Ministry of Economy and Transport, Republic of Hungary, January 2006, Budapest.
programs that encouraged the linkages between FDI and local companies. That seemed a plausible explanation why MNEs in Hungary established stronger production networks than they did in Bulgaria and Romania.

However, the interviews conducted at the subsidiaries of Nestlé, Unilever and InBev in Hungary and the Czech Republic presented a different picture. A good coincidence or not, but the conversations with the managers of the local affiliates happened in 2005 and 2006, some time after these two countries joined EU. Food companies which seemed embedded in these countries closed (completely or partially) sites and moved production to neighbouring economies, among which EU member countries. Hence, the closures of plants were not dictated by a desire for a cheap labor costs or cheap raw materials. Then, what provoked MNEs to reorganize?

The explanation is given in the strategic management literature and it is the following — worldwide competitiveness of MNEs requires efficiency. It could be achieved by finding synergies among the different subsidiaries in the global production network of food MNE. This requires centralized management of international business units; standardization of production; focus on core businesses; economies of scale and scope. The process of rationalization and product optimization leads to restructuring operations, which are difficult to initiate when there are internal obstacles like for example trade barriers, protectionist measures from the governments and slow logistics of goods. However, EU membership changed completely this situation.

As stated in UNCTAD (2001:5),

... Trade liberalization reduces the need for FDI to jump tariff barriers and intensifies competition in existing activities. It also increases the size of accessible markets, including for export activities. Both can lead to changes in the factors determining location. TNCs have to restructure their activities and deploy their assets to achieve “best practice” levels, reducing their presence where competitiveness is difficult to achieve and raising it where it is possible. This involves shifting production and marketing sites in line with costs, logistics and reliability factors. It also involves relocating such functions as R&D, financial management, procurement and strategic decision — making between countries to maximize corporate efficiency.

Since 2004, Czech Republic completely removed its trade protection measures. In addition, logistics of goods improved a lot. As a result, cheap import goods entered the country and producers faced fierce competition. The strong retail sector did not allow for dramatic increase of food prices and hence the producers had to invest a lot in order to optimize their production processes — a number of local companies went bankrupt, others had to be restructured. MNEs among which, Unilever, Nestle and InBev went for their global restructuring plans in order to keep their leading positions on the market (regionally and globally). Their optimizations plans led to plant closures, employee lay offs and redirection to global suppliers instead local ones.

The Czech subsidiary of Unilever had the largest product mix compared to Hungary, Bulgaria and Romania — food portfolio (margarines, dairy spreads, mayonnaise, tartar sauce, and mustards), and home and personal care portfolio.
(soaps, deodorants, creams). Pushed by tough global and local competition Unilever has undergone a process of restructurings. In 2005, the company closed the food plant in Zábreh, which was acquired four years ago within a global merge of Unilever with Bestfoods. The production of mayonnaise, tartar sauce and dehydrated food, which were produced in Zábreh, were relocated to the other Unilever plant in the Czech Republic, the one in Nelahozeves, and to other European manufacturing centres. The plant in Nelahozeves was specialized in vegetable oils and spreads and thus Unilever concentrated its food production in one place. In line with the optimization process, production of soaps and cosmetics was transferred from Nelahozeves to plants elsewhere in Europe. Thus from 2006 Unilever Czech Republic concentrates on foods portfolio only. Non-food products are transferred to other Unilever locations, primarily in Europe. In other words, EU accession and the liberal trade regime allowed the company to improve its efficiency through the reallocation of firms’ activities.

_Nestle Cesko_ closed down the factory where the oldest Czech chocolate, Orion was produced, in October 2004. The reason was that the cocoa processing factory in Modfany, Czech Republic, was not in line with European project of Nestlé. The essence of Nestlé’s project was to concentrate on core businesses and to withdraw from raw materials among which was the cocoa processing. On a European scale, a project was therefore under way to sell Nestlé’s cocoa processing activities to Cargill and the plant in Modfany was part of this global divesture.

_InBev_ also went through major restructurings in CEE and Western Europe. In Czech Republic, in first quarter of 2007, the mother company shut down Branik brewery (dated back in 1899). The plant had to be closed because the Branik brewery reached the maximum of its capacity and a further modernization and expansion of the facility was not possible. Although the closure of this plant was a very sensitive issue for Czechs because of the long traditions of that beer brand, the local authorities could not do anything to keep the brewery.

The impact of EU membership on Hungary proved to be comparable to that on Czech Republic; namely, it allowed for intensified processes of restructurings and optimizations. A good example was _Kraft Foods_ — the leading manufacturer of confectionery on the Hungarian market. The number one market share did not stop the company to shift confectionery to Bratislava in order to reduce costs. The company has also been the third largest producer of coffee on the Hungarian market. Despite this, coffee production was shifted to Vienna, Austria. In the first half of 2004, the company closed down completely its subsidiary in Hungary with the loss of 320 jobs. The management justified the closure of the Hungarian plant with its four-pillar plan for ‘sustainable growth’. The plan emphasized investment in brand development, whilst trying to reduce costs for the company’s overall structure. Although, in Hungary, Kraft Foods did not have any more production facilities, the company continued to supply the local market by importing Kraft products from Vienna and Bratislava plants.
European restructurings of Unilever touched also Hungary. The company closed its margarine and salad dressing plant in Budapest. The interesting fact here was that the company was owned by Unilever before it was nationalized in 1948, and afterwards, during the communism, it was manufacturing under Unilever license. In short, Unilever had a very strong links with this specific factory. After the acquisition in 1992, the company invested heavily in new equipment in order to increase plant’s production capacity and the quality of the products. The Budapest-based plant turned into one of the best Unilever plants in Europe. Despite this fact, Unilever shut it down in June 2006 and re-located production to plants in Katowice in Poland, Pratau in Germany, and Nelahozeves in Czech Republic. The motives behind the closure: the global plans of Unilever to cut operation costs and to serve better its largest central European markets in Poland and Germany from closer locations. The decision was based on European/regional supply chain restructuring study, which Unilever made in connection with EU expansion and status on the markets in which it operated. The aim of the company was to focus on those products/categories that had high growth potential and big enough volume on a certain market, and to move those products/categories, which did not have big enough production volume and growth potential to market locations where they had such growth perspectives.

Like Kraft Foods and Unilever, InBev Hungary was also affected by the global restructuring operations of the company. In 2004, the company sold its malt plant to its global supplier thus concentrating only on high value added activities. While talking about InBev, two major events, which happened in 2004, have to be noted as they marked significantly the strategy of the company: 1) Interbrew merged with AmBev and a new company global world leader was created called InBev, and 2) Hungary entered EU. These two factors influenced enormously the policies of InBev on its Hungarian subsidiary. First, the largest Hungarian brewery, Borsodi, which was very independent decision — making unit of Interbrew for more than 10 years, turned into a highly centralized subsidiary; every activity had to be agreed with the HQ and all decisions were concentrated on regional or global level (the only exception are sales issues). Second, InBev Hungary became completely integrated in the global supply chain of InBev. The suppliers, which before 2004 were local, became centrally approved after the merger. Third, the executive director of the affiliate has been a Hungarian for years, and since 2006, a foreigner was appointed from the HQ. This change has been in line with the global management reorganizations of InBev since 2005.

For Nestlé Hungary, EU membership brought increased competition. The salaries grew up with 3—4%, the energy prices went up, but the prices of Nestlé products could only grow with 0,5—1%, which meant only one thing, namely, that Nestle had to be more and more efficient. Efficiency improvement was crucial for Nestlé’s success on the Hungarian market. That is why the company introduced a regional strategy, whose essence was a specialization of different products in different countries and all other products from the portfolio were imported from neighboring CEE countries.
CONCLUSIONS

The general conclusion is that after EU enlargement the idea about MNE’ „embeddedness” might be seriously questioned in any country (Western or CEE) from the Union. Of course, some of the plant closures in CEE would have happened even if the countries did not join EU, as these closures were linked with the global divestment plans of the MNEs (the case with the cocoa processing factory of Nestlé in Czech Republic or with InBev’s malt plant in Hungary). However, the economic integration between Central and Western Europe was the major force, which provoked and facilitated the processes of company’s restructurings. Actors like national governments and institutions were just incapable to interfere. Countries like Hungary and the Czech Republic seemed capable to „root” food multinationals in the local economies: MNEs invested heavily in local plants; they were market leaders and they sourced products locally. In addition, national governments put efforts to improve national innovation systems and to encourage the links between local and foreign companies and between business and academy. Yet it seems that for food MNEs these efforts were not enough to keep them in the local CEE economies. There is strong business logic behind this — the competition is much stronger after EU and in order to be competitive, companies have to be efficient. To be efficient does not always correspond with the idea to be embedded in a given economy. It should be also noted, that none of Unilever, Nestlé, and InBev had a R&D center in any CEEC and there were no plans to be created any in the near future. The reason was not in the scarcity of highly qualified personnel to operate them, neither in the absence of effective protection of intellectual property rights, but was simply a question of strategic need. The headquarters did not have such needs for the moment and hence did not consider the possibility to create such centers in CEE in general. However, R&D is also related to the links between the MNEs and the local research centers, i.e. trainings of local researchers in the labs of the MNEs, hiring of local researchers for a certain project, joint projects between the MNE and the local institutes, grants for Ph.D. students, etc. Such type of partnerships between the MNEs and the national research centers and universities does not exist either.

For both Bulgaria and Romania, the effects of EU membership remain to be seen as they joined the club just recently, in January 2007. Most probably, restructurings will also happen there. However, as Romania is a large market with high growth opportunities it is hard to believe that any of the multinationals would leave the country. The question whether the national innovation systems have or does not have influence over the level of embeddedness of MNEs is irrelevant for these two countries as simply Bulgaria and Romania have very weak innovation systems, which never were an important factor for the development of local economies. The local authorities and the national governments did not introduce even half of the programs and measures that Central European countries did to embed FDI. However, having in mind, that Hungary and the Czech Republic had the strongest innovation systems among CEECs and still they did not manage to keep companies in the local economies, one can argue that innovation system is not a strong enough factor to
lock-in multinationals following transnational strategies. This is especially true when there is a liberal trade regime, like EU membership, which removes all trade barriers. For food MNEs, the factors, which determine the level of embeddedness, seem to be the global strategies of companies and host country characteristics like the size of the market.

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МУЛТИНАЦИОНАЛНЕ КОРПОРАЦИЈЕ И СТРАНА ИНЕСТИТОРИ У ЦИЕ.
Западноевропске мултинационалке у агро-прехрамбеној индустрији ЦИЕ:
Служајеви Nestlé, Unilever и InBev

Јорданка Чобанова

Резиме

Користећи приступ система иновација (SI) и литературу о међународном бизнису (IB), аутор анализира ниво укорењености мултинационалних предузећа (MNEs, MNP) у централној и источној Европи (ЦИЕ). МNP се узимају у разматрању јер она повезују привреду земље домаћина с глобалном економијом путем регионалних и глобалних мрежа. Експанзија и успешно укорењивање западноевропских MNP кључ је индустријске интеграције земаља ЦИЕ у ЕУ. Нагласак у раду је на највећим прехрамбеним компанијама које су инвестирале у регион; то су Nestlé, Unilever и InBev. Аутор разматра мотиве инвестирања и улазне стратегије прехрамбених MNP, приказује њихов допринос локалном развоју и указује на националне актере који треба да омогуће плодотворност страних директних инвестиција (FDI). У раду се открива да чланство у ЕУ омогућава процес глобалне реорганизације Nestlé, Unilever и InBev у ЦИЕ. Сва три MNP затворила су делимично или у потпуности погоне шиrom ЦИЕ (али и западне Европе). Стога је, у либералном трговинском режиму веома тешко говорити о дугорочном укорењености MNP. Изгледа да су глобалне стратегије компанија и величина тржишта фактори који предодређују степен укорењености прехрамбених MNP у некој привреди, а у мањој мери национални актери и институције.