EAST-WEST JOINT VENTURES

The New Business Environment

E. Razvigorova and G. Wolf-Laudon

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Edited by
Evka Razvigorova and
Gottfried Wolf-Laudon

Changes in the East European economies and the USSR began to take shape in the 1980s, paving the way for *perestroika* and the historic reforms of recent years. New forms of business between East and West are now possible; the most challenging and potentially rewarding is the joint venture.

This new book is the first, written by researchers *and* managers, to review existing joint ventures and assess how they are created, managed, and consolidated when the negotiations are over.

- The book is based on real management experience in East–West joint ventures.
- It represents the first systematic empirical study focusing on the problems as well as the potential that joint ventures present.
- It offers practical operational advice.
- Contributors are drawn from a range of Eastern European economies.
- Eleven major case studies are included from Poland, Czechoslovakia, Hungary, Bulgaria, and the USSR.

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BLACKWELL
Finance

First published 1991

Basil Blackwell, Inc.
3 Cambridge Center
Cambridge, Massachusetts 02142, USA

Basil Blackwell Ltd
108 Cowley Road, Oxford, OX4 1JF, UK

Library of Congress Cataloging in Publication Data
East-West joint ventures: the new business environment/
edited by E. Razvigorova and G. Wolf Laudon.
p. cm.
Includes bibliographical references.
ISBN 0–631–18054–0
1. Joint ventures – Europe, Eastern – Case studies.
2. Joint ventures – Soviet Union. 3. Investments, Foreign – Europe, Eastern. 4. Investments, Foreign – Soviet Union.
5. East-West trade (1945–). I. Razvigorova-I͡Anakieva, Evka.
II. Wolf-Laudon, G. (Gottfried)
HG5422.E37 1991 338.7'0947–dc20 91–10497
CIP

British Library Cataloguing in Publication Data

A CIP catalogue record for this book is available from the British Library.

Printed in Great Britain by
T. J. Press Ltd, Padstow, Cornwall.

This book is printed on acid-free paper

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Preface

Changes in the economic policies of the East European countries and the USSR gradually began to take place in the early 1980s. These changes developed at different speeds with different rates of success in the different countries and paved the way for *perestroika* and economic reforms. The business environment of the centralized economies started, though painfully, to open up to new forms of entrepreneurship and business initiative. The small East European countries were the first who tried to build a bridge to the market-oriented economic system of the free enterprise. New forms of business and trade between East and West began to occur. One form of East–West cooperation is the joint venture, which has become a real challenge for both systems. This book attempts to look into the daily problems of the joint ventures. When all *negotiations* are over, a period of consolidation begins, which is also one of the themes of the book.

The book has become a reality not only because of the contributions of scientists and managers, but also due to the shared understanding that in our efforts for an integrated Europe, joint ventures are one way in which we can learn about creative partnership.

The German Democratic Republic and Rumania are not included in the book. The first because at the time the project was carried out there was no legislation on foreign investment. The second because of the political climate and economic stagnation at the time.

The beginning of 1990 was marked by drastic political changes in all Eastern and Central European countries. In general, this had a positive impact on foreign investment activities with the exception of Bulgaria and Rumania where there is still political instability. The number of joint ventures increased to over 3,000 and, in addition, there were changes in the legislation in some of the countries. Many more changes are expected in the near future.

The changes that occurred have not had any effect in helping to solve the problems of joint ventures which makes this book interesting and of importance in the turbulent world in which we live.

The book was accomplished thanks to the cooperation and joint research of scientists from East and West, carried out with the assistance and through the mediation of the International Institute for Applied Systems Analysis. We would like to thank all scientists, policy makers and businessmen who supported this unique project and who gave their contribution in the form of expertise, commentaries, proposals, and ideas. Special thanks are due to the Chambers of Commerce in Hungary, Bulgaria, and Poland, the Club of Joint Ventures in Hungary, the All-Union Institute for Foreign Economic Relations in Moscow, the numerous joint ventures in all East European countries who shared with us their positive experiences and their problems.

Finally we wish to thank Laura Franz and Lourdes Cornelio for their competent and hard work in editing and typing the book.

Evka Razvigorova
Gottfried Wolf-Laudon

Introduction

The more high-tech, the more high-touch ...
We must learn to balance the material wonders of technology
with the spiritual demands of our human nature.

Naisbitt, J., 1984[1]

Robert H. Pry

The world today is experiencing revolutionary technological changes and challenges. In keeping with the new political thinking apparent in the Final Act of the Helsinki Conference and the first stage of the Vienna talks, humanity is embarking upon new business and economic opportunities. Today's technological innovations are triggering changes in industry, trade, and commerce:

- The rapid development of telecommunication and information technologies makes goods immediately available in a number of companies and branches of industry.
- The introduction of flexible and automated manufacturing systems has made it possible to separate the processes of quality control, service, and design from manufacturing, replacing high-volume production and economy of scale with small-batch, custom-tailored production, and economy of scope.
- The rapid development of telecommunications and the availability of cheaper transportation shorten delivery times and separate logistics from production.

[1]Naisbitt, J., 1984, *Megatrends*, Hestra Verlag.

- The tendency to separate certain business functions, such as design, marketing, distribution, logistics, etc., from manufacturing is already manifested in broker structures. This will increase the horizontal line of integration in the future, compared to the present vertical line of integration.
- Financial services, already specialized and internationalized, must be globalized in order to compete with marketing companies and other service industries.

What are the consequences of these revolutionary changes and new challenges in business? Manufacturing and services will become internationalized and horizontally integrated, without strong ties to any particular region, labor market, or capital infrastructure. If these processes in the world continue as evidence suggests, no nation will be able to pursue a protectionist or commercially isolated policy without inevitably destroying its standard of living. It will be unable to compete with the best and cheapest competitors in the new global business environment.

The new world realities caused by the internationalization of science, technology, finance, and industry call for new policies in all countries, including members of the Council of Mutual Economic Assistance (CMEA). Self-sufficiency and internal integration on which the economic policies of the CMEA countries have been based are no longer successful in an environment of internationalized technology and production. A policy of economic isolation is no longer viable and does not provide enough flexibility for any country.

Having realized the new circumstances in the world, the Socialist countries are gradually starting to introduce new economic measures and change management to overcome a centrally managed system of supply, production, and distribution. The first steps were taken by Hungary and later by Bulgaria. The Soviet Union started introducing changes three years ago in both the economy and the political structure.

Now, all CMEA members are changing their policies and struggling to find appropriate answers to technological challenges.

The reforms, while nationally tailored, are proceeding in similar directions:

- Different forms of property use, together with state ownership, is being introduced in production, services, and agriculture.

- Equal economic conditions for all types of organizations are being set out by legislation.
- The state monopoly on foreign trade has been removed to various degrees in many countries.
- The state monopoly on economic management is being overcome by giving business organizations the right to operate freely in both domestic and foreign markets, to decide independently on the profile of their activities, and to take responsibility for actions and decisions.

The reforms have resulted in a change in the investment climate of almost all CMEA countries. Gradually, laws and decrees have been adopted permitting different degrees of foreign investment in these countries. There are two different attitudes among Western business leaders concerning the opportunities presented by the new legislation in these countries. Due to the rapid pace of changing legislation and new policies, investments are considered very risky and their potential uncertain. Some businessmen recommend cautious strategies. Others believe the reforms are opening opportunities to create and develop new markets; they think investment, although risky, seems promising over the long run.

Even with these two different attitudes, East–West economic relations are developing and changing rapidly. Conventional trade has been gradually replaced by other forms of international industrial cooperation. Joint ventures currently rank as the second most widely spread form of cooperation and are increasing in number every month in all CMEA countries.

The most recent changes in legislation, which were introduced at the end of 1988 and the beginning of 1989 in practically all reforming countries, have given new impetus to the development of this process. Two months after the introduction of the law permitting their creation (January 1, 1989), the number of joint ventures in Czechoslovakia reached 25. In the Soviet Union, 60–80 joint ventures are being registered monthly. In Hungary, the number of joint ventures has surpassed 500.

Capitalization of a joint venture averages about US$3 million, but can range from US$0.2 million to US$80 million. Compared to total national investment, this is not an impressive amount. Analysis shows that the contribution to the national economies of the CMEA countries and even to branches of industry is far from significant to date. But this is just the beginning.

The strategy of most Western businessmen does not focus primarily on profit or access to cheaper resources, but rather on the potential markets in the Eastern European countries (see Chapter 3 on the Austrian experience). Western companies are accumulating experience about the environment of Socialist countries by working through joint ventures.

The objectives of CMEA countries in forming joint ventures are:

- To fully satisfy domestic demand for certain types of industrial goods and services.
- To transfer technology and managerial know-how quickly.
- To improve export capabilities, reduce imports and gain additional convertible currency, and improve quality.

Even with an insignificant contribution to the gross national product and very limited profit, joint ventures are part of the whole reform process in the CMEA countries and can be seen and analyzed only as part of it. After several years of experience, it is time to analyze the existing joint ventures and draw lessons from their success and failure, systematize the difficulties and problems, study possible barriers, and suggest solutions. The importance attached to the latest form of industrial cooperation between East and West may have been exaggerated, but joint ventures have attracted the attention of many organizations – international, intergovernmental, and bilateral. Studies have concentrated on commercial and business aspects, mainly from the legislative point of view. No special attention has been paid so far to the equally important organizational and managerial problems. The reason generally given is that joint ventures are enterprises like any other, and the partners are seeking first of all to achieve success in their business. This simple explanation, however, fails to take into account a set of problems arising from the nature of this new type of enterprise and its operation in a turbulent environment. A systematic and practically oriented empirical study can facilitate an understanding of the pros and cons of joint ventures as well as the dos and don'ts connected with their success.

The East–West meeting held in 1987 in Helsinki on the problems of management development of joint ventures demonstrated that no institution is studying the problems deeply, and presenting equally the viewpoints of CMEA and market economies.[2] The European Foundation for Management Development, established in 1971, has very few members from Socialist countries. The European Institute for Advanced Management Studies has members from Western Europe, Latin America, and North America; therefore, it does not focus on the problems of East–West relations. On the other hand, the CMEA countries have institutes that investigate the problems of joint ventures, but only those between Socialist countries. The sole institute whose main goal is to study global problems of East–West cooperation is the International Institute for Applied Systems Analysis (IIASA). IIASA's unique features are:

- The presence of scientists from both economic systems working jointly on various problems.
- The ability to carry out research using an international research network involving groups from all member countries, particularly useful for this kind of study.
- Perhaps the most important, a practical orientation to direct research results to decision makers and maintain close links with consumers. IIASA's purpose is to provide tools of analysis and decision support systems to policy makers so that they can develop a factual basis upon which to introduce a set of realistic options for the negotiation of agreements and management of systems.

This book shares the findings and experiences accumulated throughout the joint venture study organized at the beginning of 1988 by the Management of Technological Change group (MTC) within the frame of the Technology, Economy and Society (TES) Program at IIASA. National groups from the international network have studied different joint ventures hosted in their home countries and submitted national reports to IIASA. The common framework and methodology of the study were developed by the Institute's researchers to carry out comparative analyses based on questionnaires, statistical data, and interviews with participants in joint ventures in CMEA countries and with their Western partners. A study of legislation, its dynamics and main goals formed the basis of the analysis of administrative difficulties and barriers encountered by joint ventures during their first years of operation.

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[2]This meeting was organized jointly by the IIASA MTC group and the Finnish Institute of Management Development.

The entire study has the ongoing economic reforms in the CMEA countries as a background. The framework and main tendencies of these reforms are analyzed in Chapter 2. Business initiative is becoming a concern connected with all economic and managerial changes in the CMEA countries. The steps taken to date are characterized by economic restructuring and by the greater freedom of action in foreign trade operations given to individual companies.

The special national features of the process are explained in the second part of the book (Chapters 3 to 9). The analysis includes over 300 joint ventures (12 in Czechoslovakia, 12 in the Soviet Union, 16 in Bulgaria, 282 in Hungary, and about 25 in Poland).

The legal framework and its impact on the formation of joint ventures are illustrated by examples and data from empirical studies. The data from national reports were compared. Information from additional separate interviews and questionnaires aided the international team in describing common characteristics and problems and proposing some recommendations for solutions (Chapters 10 and 11).

Case studies are presented to illustrate different experiences in various countries; these are of interest to business people and policy makers alike. Practical experiences have rarely been documented; these companies have existed for such a short time that little information is available about their actual operation and management. Such information, however, can be found in the Appendix.

Future outlooks and such important issues as technology transfer through joint ventures and management development for joint ventures are also discussed (Chapters 12 and 13). The need to create a completely new style and type of management, that of cooperation management, is presented. This will call for special worldwide training of managers with specific abilities.

The term East–West joint venture signifies more than relations based on commercial and business interests. Rather, this is a new organizational phenomenon appearing for the first time in the world's economic environment. We have attempted to examine East–West joint ventures in a businesslike and empirical way because we are convinced it is essential to make the people involved in the process aware of the importance of this new organizational form.

Part I

Chapter 1

Radical Changes in the Economies of Socialist Countries: A Driving Force for East–West Cooperation

O. Panov

For a long time, the economic development of Socialist countries was tied to the concept that state ownership could dominate all other kinds of ownership as the supreme form of joint ownership. This not only resulted in significant economic limitations in the USSR, Bulgaria, and other countries, but also in limiting and subordinating cooperative ownership to principles that were valid for state-owned organizations. In Bulgaria, e.g., at beginning of the 1980s, over 90 percent of national income was derived from state-owned enterprises, and only 4 percent from cooperatives operating in trade, services, and light industry.

The domination of the state sector in the national economy combined with the theory that socialism was completely incompatible with a market economy, created a highly developed form of state monopoly in all spheres of social life. Along with other negative factors, this prevented direct contacts among producers from different countries, even Socialist ones. The following basic features of the system of state monopoly can be cited.

1.1 Centrally Planned Economic Activities

The national plan for socioeconomic development was valid for all structures of the national economy, from the government down to the enterprise divisions. In practice, this made the state a large economic unit that balanced incomes and expenditures on the national level, regulated material flows, and reallocated the accumulated financial resources. The size of the state did not play any essential role. Small countries like Bulgaria and Hungary did not have direct contacts with the Soviet Republics; all economic contacts had to go through the central government.

As a political organization, the state implemented mainly political and social goals, resulting in the subordination of economic criteria to political imperatives and social goals. Even without the necessary economic basis, impressive achievements were made in the social sphere: full employment, free health care, free education, unified pensions for all people retiring in all spheres of the national economy including agriculture, etc. The financial resources of efficient enterprises were redistributed, which inhibited speedy development at a time when they were flourishing and also prevented independent innovations.

The domination of political criteria in the economy led to a neglect of the basic requirements for production efficiency. As a result, branches of industry were developed for which no preconditions existed in the country. They were supported artificially for social or political reasons. At the same time, foreign economic relations were determined not by efficiency but by political considerations. What developed during this period of restricted economic relations were the numerous limitations of Coordinating Committee on Export Controls (COCOM).

1.2 Bureaucratic Administration Instead of Entrepreneurship

The business units – enterprises and their various associations – were practically turned into various levels of the state management hierarchy. Thus the business manager became simply a state administrator whose values were not oriented toward productivity and customer needs, but rather to the fulfillment of given administrative orders. In most cases, goals and decisions were defined on political grounds at a superior level. Business managers were not encouraged to take initiative and action, as each initiative required approval from a superior level. Efficiency and innovation were not developed, as losses were automatically covered from the state budget. In 1989, governmental subsidies for inefficient production and export, as well as compensation for prices held lower than international market prices, reached the enormous amount of 28 percent of the state budget of Bulgaria, or about 2.2 percent of the national income. Under these conditions, it was impossible to find suitable incentives for innovation and initiative on the part of business managers. This sharply reduced the level of their professional skills. Business managers and civil servants were predominantly trained and selected on political rather than professional criteria. Professional schools and colleges in management were noticeably lacking.

This situation became more significant in view of the management boom in almost all developed countries and the related introduction of new technology and professionalism in management. The main feature of today's manager is his independence and ability to take risks and responsibilities, to search energetically for innovative solutions and new niches on the global market. These qualities contribute very much to rapid technological development and large-scale innovation in all fields. These qualities, however, were almost unknown to business managers in the Socialist countries and did not receive social recognition and support. This resulted in a lag in scientific and technical developments and reduced the opportunities for partnership between business organizations from East and West.

1.3 State Regulations Instead of Market Forces

The objective processes of the market economy, which lead to an equilibrium of supply and demand and stimulate rapid liquidation of a deficit, were replaced in the Socialist countries by state regulation of the quantity of products and of the material flowing to each producer. The state also regulated distribution and sale of the entire output. Naturally, when a manager does not know where his goods are sold or what his consumers' needs are and when prices are not related to quality, the manager will not care about quality. At present, when the global market is dominated by high-quality products attractively offered, the production of the Socialist countries is far behind in technical level and quality, despite an abundance of raw materials. The development of resource-saving technologies (energy, labor, and materials) is not a driving motivation to improve production. In fact, the interests of business managers are oriented in exactly the opposite direction. Prices of goods are not determined by market demand, but by the volume and quality of materials, labor, and other resources used for their production. This naturally reduces the competitiveness of goods produced in the Socialist countries in the global market. Even new technologies and equipment and a highly qualified labor force cannot totally compensate for this. Ultimately, this lack of motivation creates serious difficulties in the contacts between Eastern and Western producers and between producers in the East and consumers in the West. Even high-quality products manufactured in the Socialist countries sell at low prices on the global market due to the lack of proper servicing and an inability to reach customers effectively.

1.4 Fully Centralized Foreign Trade

A basic principle of Socialist theory was the necessity to have a state monopoly on foreign trade, to limit personal profit from foreign transactions to the benefit of the whole nation.

What happened in practice was quite different. A strong bureaucratic barrier was raised, supported by a small and limited number of managers and other staff with access to foreign trade and, as a result, opportunities for increasing their prestige and living standard. The complicated procedures required by various state authorities to establish foreign economic relations reduced the practical opportunities for international trade.

During the last few decades, the Socialist countries produced 30 percent to 36 percent of the total global output but only about 4 percent to 5 percent of the total volume of international trade. Between CMEA countries, the exchange of goods was based on interstate agreements in which political criteria dominated over economic interests. A number of less developed countries, such as Bulgaria, managed to achieve quick success in their industrialization and become equal partners of other, more developed Socialist countries. For example, Bulgaria exports over 50 percent of the machines it builds and imports mainly raw materials from developed Socialist countries like the USSR. Product levels, however, in a closed economic community where economic agreements are made on the political level, could never create efficient economic relations. At the same time, such closed trade (75 percent of Bulgarian turnover with other countries, which is almost equal to its national income, is only with other Socialist countries) can neither secure convertibility of the national currency, nor successful financial transactions on the international market. Therefore, the CMEA producers are not permanently present on the global market. Foreign trade with the newly industrialized and developed countries depends mainly on barter deals and occasional small-volume sales and much less on long-term agreements for timely delivery and production cooperation. In their turn, the non-Socialist trading partners face difficulties in trying to penetrate the CMEA market and have relied on occasional sales of consumer goods and equipment. Western companies were unable to work out marketing strategies and develop successful partnerships with enterprises in the Socialist countries. It was always necessary to do this through the mediation of state authorities, which significantly complicated the business partnership.

1.5 State Monopoly on Financial Activities

Until now, CMEA countries usually had one foreign trade bank, with only domestic branches, and specialized banks for investment in industry and agriculture. Consumer savings were kept in special saving banks which did not have the right to use that capital and put it into operation. The interest rates were unbelievably low, around 1 percent. Several restrictions on withdrawing these savings were introduced, but at the same time interest rates for various bank loans were very low – around 2.5 percent – and payable in 25–30 years. (This is the case when obtaining a loan for building a house in Bulgaria.) During the past most successful years, the average inflation rate was approximately equal to the interest rate, making more money available in the national economy.

Practically speaking, the population was able to use its savings for consumer purposes but not for business activities. The enormous accumulated savings represented an amount equal to the annual national budget. (In Bulgaria, accumulated savings are now nearly 20 percent more than the annual budget.) The state has used these savings primarily for balancing internal debt or for state investment. All financial resources were under state control. The state was in a position to expropriate at any time and for any reason the accumulated capital of profitable companies and redistribute them to ineffective organizations or invest them in new enterprises, thereby impeding the process of modernizing production facilities and equipment.

The entire income earned by companies in convertible currencies was expropriated by the state. At the same time, the national foreign debt grew enormously. For example, Bulgaria, with nine million citizens, had a foreign debt of US$10 billion up to the beginning of 1990. The situation is similar in other East European countries, including Rumania. This debt is the obligation of the state and not of the companies.

This situation, together with an undeveloped banking system and centralized financial resources (in Bulgaria, state expenditures in 1989 were 78 percent of the national income), has made contacts between East and West companies almost impossible. In addition, the many difficulties connected with profit repatriation demonstrate the complications in organizing joint business activities between different economic systems.

1.6 Guaranteed Social Benefits Instead of Motivation

Until recently, the state completely controlled the salary level of workers and administrative staff through uniform salary scales that fixed payment for specific work. The state also regulated the level of salary funds in organizations, to prevent inflation and preserve a proper ratio between the growth of productivity and salaries. In practice, however, this eliminated the stimulus for labor productivity and initiative. Payment according to results was not a common practice, which paradoxically contradicts the main principle of socialism – distribution according to quality and quantity of labor. In fact, payment was granted irrespective of the quantity and quality of labor input. The lack of individual motivation reduced opportunities for efficiency and quality. This explains why staff who work on contract abroad usually obtain higher results than they achieved at home. Labor productivity and product quality in Bulgaria and other CMEA countries are several times lower than in Western European countries with similar opportunities.

In addition to general difficulties in social and economic development, this lack of motivation also complicated the contacts between organizations from East and West. The impossibility of applying motivation methods based on each person's contribution continues to impede efficient partnership in joint ventures.

The reforms currently going on, however, are opening completely new opportunities in the Socialist countries. They aim to raise the level of the economy and improve the fulfillment of domestic needs by adjusting to the requirements and standards already established in other countries. This means neither a turning away from existing relations with other Socialist countries nor that the basic principles of past development will be set aside. Rather, the importance of fundamental human values and achievements will be recognized, ending the isolation of the Eastern countries. Present values and social imperatives, however, are closer to those of an ideal Socialist society than to those of a capitalist one. Therefore, the dogmatic argument between socialism and capitalism should be replaced by constructive and creative cooperation and partnership. A safe and comfortable "home" should be created, in Europe and around the world.

The restructuring in the different Eastern countries is being carried out in a variety of forms, at varying speeds, and using various tools. The general lines, however, are the same. New opportunities are opening for direct contacts between companies from East and West; in turn these stimulate the development of production and act as an economic tool for accelerating the production process.

In the transition to a multi-sectored economy based on different forms of ownership, it is important to ensure that private property will be sufficiently developed. Currently, all forms of ownership are being enhanced. In addition to state ownership, possibilities are also being developed for municipal ownership, cooperative ownership, private and/or individual ownership, ownership of foreign legal and physical entities, etc. Various forms of mixed property are encouraged by enhancing the association of firms based on different kinds of property. By the end of December 1989, the total number of firms registered in Bulgaria, e.g., was 11,171, counting firms based on different kinds of ownership as well as mixed firms. The list below shows the composition of the existing Bulgarian firms:

State-owned	450
Subsidiaries (state)	22
Municipal firms	622
Firms of public organizations	34
Limited liability companies	109
Limited with foreign participation	40
Joint-stock companies	15
Unlimited liability companies	4
Foreign firms	16
Joint ventures	109
Partnerships	1,656
Cooperatives	32
Private companies	7,869
Private farms	3
Agricultural firms	10
Cooperative farms	180

A still greater step forward was the establishment of legal conditions for joint companies. Some countries already have companies in which shareholders are other state-owned firms. This is not yet a common practice, and therefore there is not yet a stock-exchange market, nor have securities transactions become a part of the global stock market. The new rules regulating the trade in securities make it easier for foreign partners to select the most suitable form of partnership with Socialist firms, either through the creation of joint ventures or as shareholders of national companies.

Another important factor in the economic reconstruction of Eastern countries is the type of conditions provided for profit orientation of enterprises. In spite of numerous attempts to delegate more rights to lower levels, no great success was achieved in eliminating bureaucracy before the creation of completely independent and self-regulating business units called "firms" in Bulgaria that are free from direct state interference. Registration of firms began in early 1989. The goal is to create economically independent and fully responsible business units operating on principles of self-support, self-financing, independent planning, etc. – principles that are well known in the West. Even state firms based on state property possess all characteristic features of independent and self-reliant business organizations. A new democratic form of direct control exercised by the firm's managers through elected council members is practiced in the state-owned, municipal, and cooperative firms but not in joint-stock companies or joint ventures. In spite of this, there is a general tendency toward reducing the level of state control in the firms, increasing their economic independence and more active involvement of personnel in the management process. This is a general tendency in all countries.

Current legislation allows direct contact between firms. On this basis, free movement of capital and formation of joint property is possible without the state necessarily being involved.

Another important aspect of the economic reforms is the introduction of market regulations, aimed at bringing it closer to global practices. Changes are being made in fiscal policy, credit policy, price control, etc. The goal of all CMEA countries is to have a developed domestic market in order to adapt to the requirements of today's global economy, and to do so without foregoing social benefits. This has proved an extremely difficult problem, however, intensified by the fact that business managers in both the state enterprises and the firms are not accustomed to working in an environment of developed market relations. The state monopoly used to protect the firms through the absence of any competition whatsoever. Stable prices did not allow an upsurge of economic activity, but created a feeling of security because their existence was guaranteed. Underdeveloped markets and a liberalization of tax and price policies in many countries led to inflation. These processes, which are regulated strictly by the state, in combination with existing deficits, leads to hidden inflation. From the point of view of enhancing international economic cooperation, the implementation of an anti-inflationary policy on the part of the state may have a stronger positive impact than the immediate swing of market relations without the necessary economic and psychological preparation and without providing the necessary numbers of trained managers. Under conditions of shortage and unsaturated markets, foreign partners have opportunities to accumulate assets quickly in local currency, which can be successfully used for reinvestments in the country to implement a long-term strategy for economic expansion, instead of seeking immediate results from the export of capital. High inflation rates make both strategies of foreign investors inefficient. Therefore, one of the main tasks of the state authorities in Bulgaria should be the prevention of serious inflationary processes.

It is impossible to develop economic cooperation within the new Europe without rapidly making changes in the monetary systems of East European countries. The Polish case is worth studying because it shows how the immediate introduction of free-market prices and internal convertibility of the local currency (zloty) caused inflation but stabilized the market. A more equal participation in private business has been created, and the share of speculative capital accumulated under conditions of a national deficit is drastically decreasing.

Another extremely important feature of the reforms in East European countries is the reform of the price system. The Polish example shows that without sufficient social guarantees, changing the price system can be a very painful process. Serious consequences can be expected without a socially guaranteed price reform in all East European countries, where at present one-third of the population is living below a minimum existence level. The problem is more complicated in the USSR, where prices have not been changed for decades. At the same time, without a price equilibrium of supply and demand, the transition to a market economy is practically impossible. That is the core problem for each political party and each politician in all CMEA countries.

The problem of capital export has been solved from a legal point of view, but in reality the three-fold effect is obtained only by those firms that export goods for hard currency. Therefore, the usual goal of joint ventures is not only to fulfill domestic demand but also to export to third countries for hard currency.

The main problem that remains to be solved for CMEA countries during the next few years is convertibility of the national currency. Needless to say, business partnerships and broad economic cooperation are very difficult with non-convertible local currency. The prerequisites to solving this problem quickly are already under way through introducing a more advanced and free credit policy carried out not only by the foreign trade banks and national banks but also by other commercial banks. Cooperation in the financial sphere, the accumulation of joint capital in the banks and the creation of joint banks could accelerate the processes of direct economic cooperation and speed the inclusion of Eastern European countries in the global monetary system. To attain this goal, many countries have already created a favorable political environment, but practical steps are still needed.

Serious opportunities to extend economic cooperation further between East and West are presented by including firms from the CMEA countries in transnational corporations. An example is the Hungarian firm Tungsram, which is turning into a multinational corporation. A number of Bulgarian firms, especially those in electronics, are planning similar developments.

Solving all these problems and developing the main reform directions will facilitate and intensify the development of economic cooperation between East and West. The success of the reforms in the CMEA countries depends to a large extent on the successful cooperation of companies from the East and West, which will also raise the general level of the global economy by including countries with great scientific, technical and resource potential in the overall development of science and technology.

Productive economic cooperation is stimulated by the economic policy, adopted by the majority of CMEA countries, that aims at structural changes and technological renovation of the already considerable technical base. The problem is not how to realize one-way technological transfer. For countries like Bulgaria, this is not the main goal. The CMEA countries are also prepared to offer high quality know-how that can be used to develop high-tech products. Obviously, the opportunities to do so increase with more liberal rules regulating the movement of people between countries, which became a reality after the Vienna agreement was signed in 1989. More important, however, is the good interaction between equal partners at a high level of technological and organizational development. This is better than the preservation or artificial establishment of significant economic and technological differences. The potential already existing in the CMEA countries would be sufficient to overcome technological backwardness independently, but this would mean that the separation between East and West would be encouraged, which in turn would endanger the future of mankind through the accumulation of both highly productive and highly destructive forces. Therefore East–West economic cooperation is supported by the developed countries and the reconstruction processes in the Socialist countries are one of the important warrants for the future of mankind.

What is the concrete manifestation of this support and how can it be realized by increasing constructive cooperation? In the first place, support must be directed toward fulfilling the demand of the CMEA domestic markets for consumer goods. These countries are paying a high price for making the development of heavy industry a long-time priority at the expense of light industries and food. Obviously, economic cooperation can and must be oriented to the production and exchange of consumer goods and services. This will be relatively simple and will not threaten the strategic balance of forces. The opportunities for cooperation in this field are so wide that no over-fulfillment of needs or excessive production can be expected. The appearance of new competitors on the global market will not have a negative effect as competition in this field at global levels is high. It will increase the opportunities of the whole world to solve the chronic problems of hunger and will help provide normal standards of living to each inhabitant of our planet.

Another important role of East–West cooperation in support of these reforms is encouraging the conversion of the military and parts of heavy industries. This not only complements the first trend but in addition creates mutual trust and still better opportunities for cooperation.

A third area of cooperation is the fields of ecology, non-polluting and resource-saving technologies. These are fields of mutual benefit, as it has now become clear to all mankind that ecological problems never remain isolated but affect the whole community. Continued pollution of the environment must be brought to a stop. There are good opportunities for cooperation because the previous economic systems in Socialist countries did not stimulate the efficient use of resources.

Last, but not least in importance, is cooperation in the field of management training. No fruitful cooperation is possible, even on the company level, unless managers are able to use a common professional language. There is no barrier more overwhelming than the barrier formed by lack of professional interpretation of the problems, methods, and means to resolve concrete situations. The management policy that has been applied in Socialist countries so far has created a deep gap in the interpretation of management problems between East and West. This gap is much wider than the one between the developed and the developing countries.

Management training is a field that can contribute greatly to drawing countries with different social systems closer together. One can expect quick and essential results from investments in management training using the latest achievements of management science. Management training activities also have an immediate economic effect because they guarantee that the foreign investment will not be threatened by unprofessional management. High educational levels currently present in the Socialist countries create favorable conditions for achieving significant results in the field of management training.

Chapter 2

Dynamics of East–West Economic Relations and the Role of Joint Ventures

E. Razvigorova and J. Djarova

The changing climate of East–West relations has gradually established new opportunities for business people. The tendency to replace a part of conventional trade relations by other forms of industrial cooperation is becoming constantly stronger. Beginning in 1960, East–West trade increased at the rapid rate of approximately 305 percent until 1979, and then continued to increase at a slower rate through 1987. Western exports to Eastern Europe have been concentrated in the fields of machinery, transport equipment, and manufactured goods. Exports from Eastern countries to the West consisted mainly of food, beverages, and tobacco (accounting for 30 percent); raw materials, minerals, and fuels (about 45 percent to 50 percent); and engineering products (accounting for only 10 percent).

The organizational aspects and forms of economic relations have developed as a consequence of commercial transactions between Western companies and the authorized foreign trade organizations of Eastern countries. Almost all Western industrial countries have signed bilateral trade agreements with various European CMEA countries for periods ranging from three to six years. Inter-governmental agreements have become broader in scope, including not only forms of commercial cooperation, but also of economic, industrial, scientific, and technical cooperation.

New driving forces have now entered into the development of trade relations. These forces involved mainly the process of extended internationalization, but they were also embedded in national strategies for rapid economic growth, expanded capacity, and market diversification.

Two main features of East–West relations from the early 1970s to the present can be pointed out. These are the gradual transfer from simple foreign trade relations to cooperation in the fields of economics, science, and technology, etc., and the development of different forms of this cooperation starting with sub-contracts and moving on to coproduction, joint projects, and joint ventures.

Another characteristic of East–West cooperative relations is that inter-firm cooperation is now more frequently established by direct company contact than by governmental agreements. This process is one of the pre-conditions in developing more diversified and more complex relationships, such as joint international trade, joint economic and joint R&D activities, etc.

More profound inter-governmental relations also helped avoid the type of anonymous cooperation that used to prevail in trade relations, whereby Western firms found themselves dealing with governmental agencies or ministries instead of with the individual enterprises involved. Knowing the characteristics of all the partners is a generally accepted practice nowadays.

The priority placed on the use of various cooperation forms has differed among the CMEA countries. For example, in 1988, joint ventures were the preferred form for Hungary, followed by the USSR and Bulgaria (see *Table 2.1*: ranking calculated as a percentage of the total signed cooperation contracts).

Table 2.1. Ranking of different forms of cooperation contracts (in 1988).

Type of contracts	Rank 1	2	3	4	5
Coproduction	CSSR	USSR	Bulgaria	Poland	Hungary
Licensing	Poland	CSSR	Hungary	Bulgaria	USSR
Joint ventures	Hungary	USSR	Bulgaria	CSSR	Poland
Delivery	Poland	USSR	Bulgaria	Hungary	CSSR

Table 2.2. Ranking of East–West industrial cooperation forms (by year and type of cooperation).

Type of contract	Year[a] 1973	1976	1984	1986	1988
Coproduction	1	1	1	1	1
Licensing	2	3	4	4	4
Joint ventures[b]	3	4	3	2	2
Delivery	4	2	2	3	3

[a]Only the years where changes occurred are shown.
[b]Including joint ventures located both in the West and East.

The history of industrial cooperation between CMEA countries and Western developed countries has shown a stable tendency towards using primarily the form of coproduction as opposed to licensing, joint ventures, and delivery. The substantial growth of the share of joint venture contracts as of 1983 indicates the increasing importance of this new form of joint economic activity and signifies the increased attention of both Eastern and Western parties (*Table 2.2*).

The development of the joint venture process was influenced by the changing legal conditions. Yugoslavia (an observer of the CMEA) was the first Socialist economy to permit joint ventures within its territory, starting in 1967. Rumania enacted legislation in 1971 providing for East–West joint ventures, followed the next year by Hungary. Bulgaria introduced a special decree in 1980. During 1986 and 1987, many changes evolved in CMEA legislation for establishing joint ventures. During these two years, three countries (Czechoslovakia, Poland, and the USSR), enacted legislation or issued policy statements making joint ventures located in the country possible for the first time. Two other countries (Bulgaria and Hungary) further revised their existing legislation.

The number of East–West joint ventures established during the 1970s remained moderate due to the unchanged economic environment in these countries. The end of 1988 and the beginning of 1989 were marked by the adoption of new legislation on joint ventures in almost all CMEA countries: Hungary, USSR, Poland, Czechoslovakia, and Bulgaria. Currently, there are several common characteristics and forms, as follows:

- More new opportunities for foreign investments are now open in all countries.
- The existing restrictions on foreign capital shares have been removed, and foreign citizens can now be employed and appointed managers in all countries.
- The reforms in Hungary, Bulgaria, and Poland have provided the legal ground for different forms of companies with foreign capital participation (limited liability companies, joint-stock companies, unlimited partnerships, deposit partnerships, etc.).
- The changes in joint venture legislation in Bulgaria and Hungary aim to equalize the economic conditions of joint ventures with those of national companies.
- In most of the CMEA countries, the recently introduced joint venture provisions are part of legislation that further liberalizes the country's business environment.

One very important factor must be pointed out in describing the conditions for establishing joint ventures, regardless of location. This factor concerns the many changes over the past three years in almost all Socialist countries. The major part of these changes involved the restructuring of the economy, economic organizations in general, and of foreign trade in particular. Greater freedom of action is being accorded to individual enterprises or associations of enterprises with regard to foreign trade operations in several CMEA countries. Towards the end of 1989, drastic political changes took place in many of these countries, further intensifying the economic changes. This has raised expectations for enhanced East–West trading opportunities among actual and prospective Western business partners. The fact that new markets and new forms of inter-firm cooperation are being opened has encouraged fresh interest on both sides.

Tables 2.3 through *2.7* give a general description of the main features of joint venture legislation in the CMEA countries. They

Table 2.3. Main features of joint venture legislation in Bulgaria.

Issue	Year when the rules were first issued 1980	1989
Maximum foreign participation	99%. At least one party has to be Bulgarian.	No limitation (100% foreign-owned company is possible).
Basic profit taxation	20%	The basic tax on profit is 30% in the following cases: – in limited liability companies where the foreign share is more than 49% and more than 5 million leva in convertible currency or more than one million transferable rubles. – in company's limited share where the foreign share is more than 20%. In all other cases, the basic profit tax is 50%.
Taxation incentives	Case-by-case; first 3 years, reduction negotiated yearly.	20% profit tax and 5 years' tax exemption in Bulgarian free-trade zones. Five years' tax exemption for companies in priority fields.
Dividends taxation	10% if transferred abroad.	10% on the dividends.
Profit repatriation	Foreign partner's profit share in hard currency earned by the joint venture can be repatriated.	– Foreign partner's profit share on hard currency earned by the joint venture can be repatriated. – Some relief concerning the repatriation of leva earned under contracts with state bodies. The leva are equally transferable into the desired foreign currency.
Management	Chairman of the Management Board and Chairman of the Board of Directors to be Bulgarian citizen.	No limitations on the nationality.
Rules on employee salaries (a) Domestic (b) Foreign	In Bulgarian leva; to be specified in the joint venture contract or in the labor contract.	In Bulgarian leva and hard currency to be specified in the labor contract.

Table 2.4. Main features of joint venture legislation in Czechoslovakia.

Issue	Year when the rules were first issued 1985	1989
Maximum foreign participation	49%	No limitations. At least one of the parties has to be Czechoslovak.
Basic profit taxation	50%	40%
Taxation incentives	–	Exemptions from taxes for the initial 2 years.
Dividends taxation	25%	25%; in case of double taxation the rate ranges from 5% to 10%.
Profit repatriation	Foreign partner's profit share in any foreign currency earned by the joint venture.	Foreign partner's profit share in any foreign currency earned by the joint venture.
Management	General Manager to be Czechoslovak citizen.	No limitations on the nationality.
Rules on employee salaries	CSSR rules for both domestic and foreign employees.	In national currency. The joint venture retains the insurance paid abroad for its employees who are not domiciled in Czechoslovakia. The joint venture has the right to freely transfer abroad sums for the payment of social security insurance of its employees abroad.

Table 2.5. Main features of joint venture legislation in Hungary.

Issue	Year when the rules were first issued 1972	1989
Maximum foreign participation	49%, exceptions possible.	No limitation.
Basic profit taxation	40%	32% on the part of the tax base not exceeding HFt 3 million (about US$60 thousand) and 40% on the part exceeding this amount.[a]
Taxation incentives	1. Case-by-case. 2. Production and hotels: – first 5 years – 20%; – from 6th year – 30%. 3. Activities of outstanding importance: – first 5 years – free; – from 6th year – 20%.	A company can enjoy some reduction and even exemption from the profit tax as follows: (a) The company is entitled to any tax allowance granted to other local business organizations. (b) If more than half of the company's sales receipts derive from the production of commodities or from the operation of constructed hotels: first 5 years – 20%; from 6th year onwards – 30%. The said 5 years start from the beginning of the sale of commodities or the rendering of the said services. (c) If the company carries on an activity of special importance for the Hungarian economy – as defined in the law's annex – no tax is paid for the first 5 years and 20% from the 6th year onwards. (d) If the foreign member (shareholder) invests his dividends partly or entirely to increase the property of the company, the latter is entitled to a tax allowance which equals the amount of tax due on the said sum. For cases (b) and (d) a precondition requires that the capital of the company should exceed HFt 25 million (about US$500,000) and the foreign capital should not be less than 30% at the time of establishment.
Dividends	None.	None.
Profit repatriation	Foreign partner's share in hard currency only out of the joint venture's own currency earnings.	Foreign partner's share in hard currency only out of the joint venture's own currency earnings.
Management	No limitations on nationality.	No limitations on nationality.
Rules on employee salaries	To be specified in the employment contracts for both domestic and foreign employees. The salaries are paid in Hungarian forints.	The salaries are paid in Hungarian forints. Foreign employees can transfer 50% of their salary abroad with special permission.

[a]In November 1989, Parliament decided to decrease the profit tax to 28% and 35% respectively.

Table 2.6. Main features of joint venture legislation in Poland.

Issue	Year when the rules were first issued 1980	1989
Maximum foreign participation	49%, exceptions possible.	20%–100% of capital stock, to be defined in consultation with the FIA (Foreign Investment Agency).
Basic profit taxation	50%	40% minus 0.4% for each percentage point of sales exported (the minimum is 10%).
Taxation incentives	– First 2 years tax-free. – Each 1% of production exported leads to 0.4% reduction in tax.	– First 3 years tax-free. – Tax exemption for another 3 years with the approval of the President of the FIA for joint ventures in priority areas.
Dividends taxation	–	30% if transferred abroad.
Management	Manager or Chairman of Management Board in principle to be Polish citizen.	No limitations on the nationality.
Rules on employee salaries	To be specified in joint venture contract or by decision of joint venture's management for both domestic and foreign employees.	While cash payments are generally in zloty, at least a certain percentage of payments are usually in foreign exchange.

Table 2.7. Main features of joint venture legislation in the USSR.

Issue	Year when the rules were first issued 1987	1989
Maximum foreign participation	49%	No limitations.
Basic profit taxation	30%	30% for ordinary joint ventures and 10% for those in a Far East region.
Taxation incentives	– Case-by-case. – First 2 profitable years tax-free.	Exemption for initial 2 years. For the Far East regions, tax exemption for 3 years after first profit is reported. The USSR Ministry of Finance can reduce or completely waive profit tax in individual cases.
Dividends taxation	20% if transferred abroad.	In general, the profit that is repatriated by the foreign partner is subject to a 20% tax payable in the respective currency. However, such profits can be exempt from taxes or enjoy reductions based on a special decision of the USSR Ministry of Finance (particularly in cases of double taxation with certain countries).
Profit repatriation	Foreign partner's profit share in hard currency earned by the joint venture.	There is no limitation on profit repatriation. Foreign partners have the right to transfer their foreign exchange profit share (in any currency) abroad without special approval and/or authorization. The foreign partner also has the right to receive and transfer in cash and foreign exchange the residual value of his contribution.
Management	The Chairman of the Board and the Director General of the joint venture to be Soviet citizens.	No limitations on the nationality.
Rules on employee salaries		
(a) Domestic	Salaries of Soviets have to be paid in rubles.	Salaries of Soviets have to be paid in rubles.
(b) Foreign	Regulated in individual contracts for foreign citizens.	Regulated in individual contracts for foreign citizens.

also show the ongoing process of improving conditions for establishing joint ventures in these countries, as compared with the year when joint ventures were instituted for the first time.

There are many similarities in the existing legislation in the European CMEA countries concerning joint ventures, particularly with regard to foreign participation in joint venture equity, repatriating earnings in convertible currency, and the nationality of the chairman or managing director. There is, however, a significant diversity of tax rates on income earned and repatriated, and a variable scope for negotiation of local salaries and access to the domestic markets.

The experience accumulated over the past years has shown the importance of making the legal conditions and regulations concerning joint ventures in the CMEA countries clearer and easier for the partners involved (*Table 2.8*).

The practice in Hungary shows that changes in the legislation, occurring almost every year since 1977, have significantly influenced the process. The changes are mainly concentrated in making the process of establishing and operating joint ventures much simpler and less bureaucratic for both partners. For example, the simplified procedure for obtaining a license to establish a joint venture and the introduction of some taxation privileges, adopted in 1986, resulted in an increase in the number of joint ventures established under the new regulations. In 1988, one of the most important acts in Hungarian economic history was passed. The so-called Company Act (corporation law) standardizes the operating conditions of all economic organizations in the country, including those with foreign participation. That was followed by a special act on foreign investments in Hungary, adopted in 1988, which also provided the rules for establishing and operating companies with foreign capital participation. The legislative changes accelerated the process significantly during the last two years. In 1988 alone, the number of joint venture companies doubled. By the end of that year, the number of East–West joint companies in the country had reached 282, representing over 25 Western countries. In the first four months of 1989, the number of newly established joint ventures was more than 300, and by the end of October the same year, the total number of registered joint companies reached 700.[1]

[1]Statistics from the IIASA MTC data base.

Table 2.8. Development of the legal basis for joint ventures in CMEA countries.

Country	Legislative changes (years)			Substantial influence
	1st year[a]	Change	Content of change	
Bulgaria	1980			
		1989	Further liberalization of the legislation; permission for fully owned foreign companies to be established in the country; encouragement for higher foreign investment especially in high-tech areas.	Doubled the number of joint ventures in 9 months.
CSSR	1985			
		1987	A special Act on Enterprises with Foreign Property Participation, defining concrete conditions and procedures for establishing joint ventures as well as for their economic activities.	Accelerated and increased the number of joint ventures.
Hungary	1972			
		1977	Modification of the regulation concerning trade associations operating with foreign participation, declaring that with the permission of the Minister of Finance, such associations may be established to offer trade and services in order to increase technical and commercial levels. An important change is the determination of the profit tax at 40%.	
		1978	Two decrees of the Minister of Finance were introduced; one made it possible to establish mixed companies in the form of a deposit company, the other clarified taxes.	
		1979	An order issued by the Minister of Finance describes the procedures to obtain permission for joint ventures. The regulation also commits the company to establish a risk fund, to disburse tax and social security fees upon wages and salaries.	
		1982	A joint decree of the Minister of Foreign Trade ruled on joint undertakings in the customs-free port areas.	
		1985	Considerable changes introduced. The requirement of a license application for commencing negotiations was eliminated, leaving only the obligation to declare the course of preliminary talks. The other important measure concerned taxation.	

[a]The year when the rules for joint ventures were first issued in the country.

Table 2.8. Continued.

Country	Legislative changes (years) 1st year[a]	Change	Content of change	Substantial influence
Hungary	1972			
		1986	Simplification of the procedure for obtaining licenses and introduction of some taxation privileges.	Increased the number of the joint ventures.
		1988	Regulation extending the right of foreign trade activities to the private sector, declaring that private persons as well as their companies are entitled to pursue trade activities.	Rapid development: in 1988 alone, the number of joint ventures doubled; in the first 4 months of 1989, the number reached more than 300.
		1988	The Company Act was passed to standardize operating conditions for all economic organizations in the country, including those with foreign participation.	
		1988	A special act on investments by foreigners in Hungary provided rules for establishing companies with foreign participation, operation, etc.	
Poland	1986			52 joint ventures over a period of two years.
		1988	A foreign investment law was approved to provide a more workable framework for the further development of mutually advantageous foreign capital investment in the Polish economy, and to guarantee the protection of foreign parties' investment.	61 joint ventures registered in 4 months.
USSR	1987			
		1988	Permission for the share to be decided by the partners and possibility for a foreign citizen to be appointed general manager.	Substantial growth by the end of 1988; in 1989, the average number of monthly registered joint ventures ranged between 60 and 80.
		1989	Some measures on state regulations of external economic relations.	

[a]The year when the rules for joint ventures were first issued in the country.

Before adopting a special act on enterprises with foreign property participation in Czechoslovakia, each joint venture with a Western partner was considered case-by-case. The Act on Enterprise with Foreign Property Participation, effective January 1, 1989, defined the detailed conditions and procedures for establishing joint ventures as well as for their economic activities. At the beginning of 1989, 16 joint ventures were in operation in Czechoslovakia. The introduction of the new 1989 legislation accelerated the process. Within only two months, the number of joint ventures increased to more than 22.

In Poland, joint ventures were permitted for the first time in 1986. Companies with foreign capital participation (joint ventures) were allowed without restrictions on company size or branch of industry. In 1988, the Foreign Investment Law was adopted to provide a more workable framework for the further development of foreign capital investment in the Polish economy and to guarantee the protection of the foreign parties' investment. Under the first legislative act that allowed foreign companies investments in Poland, 52 joint ventures were registered with Western partners in two years. The new Polish law of January 1989 accelerated the process, resulting in 61 joint ventures being registered from January 16 to April 20, 1989.

After the first permission for foreign investment in Soviet territory was granted in 1987, Decree No. 1405 of 1988 defined some additional conditions for joint ventures. It permitted the share to be decided by the partners themselves and foreign citizens to be appointed general managers. The substantial growth in number of joint ventures in the USSR started at the end of 1988. In 1989, the average number of the joint ventures registered monthly ranged between 60 and 80. Approximately 700 joint ventures had been established by the end of August 1989.

East–West joint ventures can be regarded as the most highly developed form of economic cooperation. In 1988, joint venture contracts represented 26 percent of all signed cooperation agreements between CMEA countries and Western highly industrialized countries.[2] The share of joint venture agreements among the total number of East–West cooperation contracts show a definite tendency toward

[2]At the time of writing the German Democratic Republic did not have any legal provisions for Western investment in the country, and therefore was not considered.

growth during the last few years compared with the other well-known forms such as licensing, delivery of plant or equipment, and coproduction (*Figure 2.1*).

The dynamics of the joint venture process vary in different countries. Rumania was the first CMEA country to initiate the process of joint venture establishment. A number of large joint ventures were created in the early 1970s. In the mid-1970s, however, because of the worsening political climate, the process came to a halt. The five joint ventures still operating represent a large but substantially decreasing share of Rumania in joint venture capitalization. Rumania is therefore not included in this study. In the early 1970s, Hungary became the most active country in promoting joint ventures. The Soviet Union has only recently taken a more active part, followed by Poland, Bulgaria and Czechoslovakia. The USSR is presently a driving force because of its economic capacity and the huge market it represents. The growth rate of the USSR share in the total number of East–West joint ventures located in the CMEA countries is changing rapidly (*Figures 2.2* and *2.3*).

Although the number of enterprises with foreign participation in CMEA countries is quite remarkable, the invested capital is still rather small. Total capitalization amounted to roughly US$1.87 billion by the end of 1988 (*Figures 2.4* and *2.5*), and to roughly US$2.5 billion by the end of February 1989. These figures, however, as well as the number of joint ventures tripled in 1988 as compared with 1987. The average joint venture equity increased to US$3.36 million in 1987 and US$3.7 million in 1988.

The recent development of the joint venture process is characterized also by national differences with regard to enterprise size. In Hungary, for instance, many small joint ventures have been established. The majority have less than US$800,000 invested capital, 32 percent of which range from US$800 to US$800,000 and 26 percent less than US$160,000. In the USSR, 57 percent of the joint ventures have less than one million rubles invested capital, but nearly 15 percent have over 5 million rubles, of which over 50 percent have an authorized fund of over 10 million rubles each. In general, joint ventures in all CMEA countries are relatively small (up to US$1 million initial capital). Some large companies, however, have recently been established in the Soviet Union. Total foreign investment was estimated roughly at US$242 million by the end of 1987 (*Figure 2.6*). It had

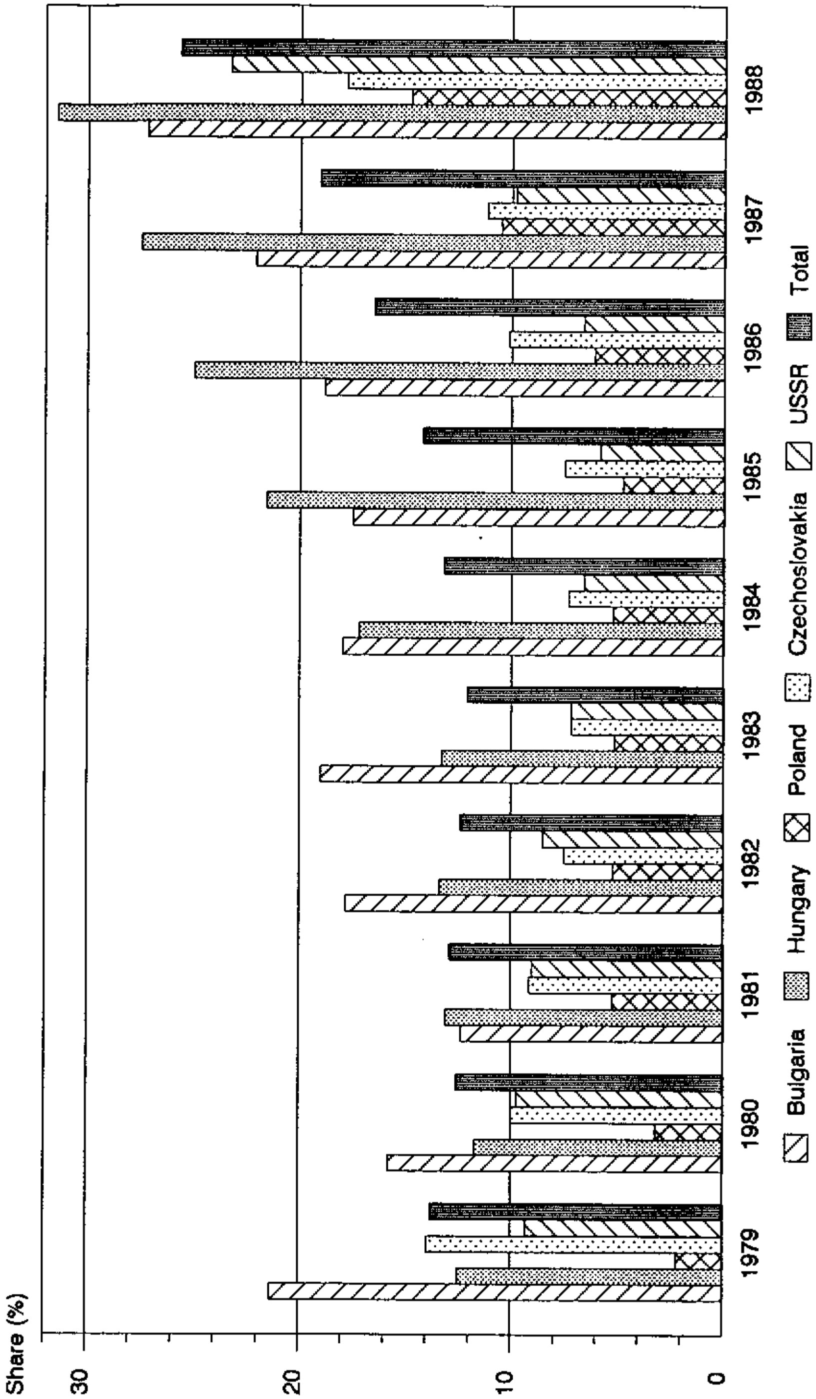

Figure 2.1. Share of joint ventures in the total number of contracts.

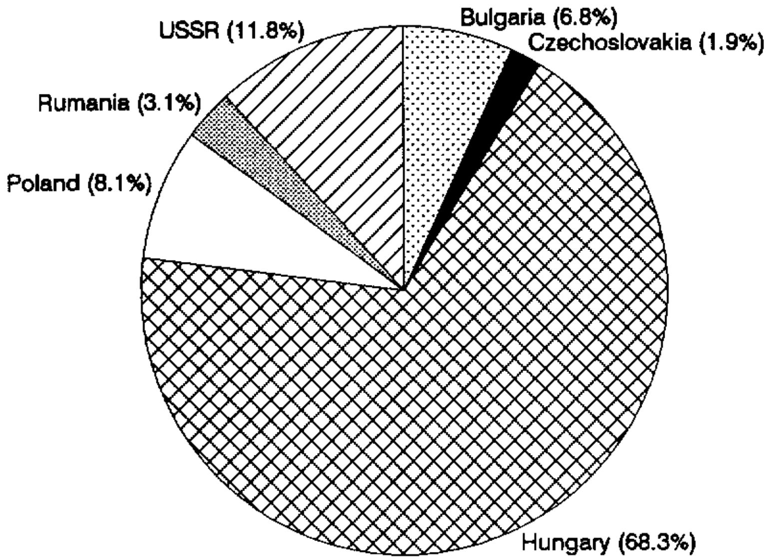

Figure 2.2. Number of East–West joint ventures in 1987 (total = 161). (Source: MTC Network.)

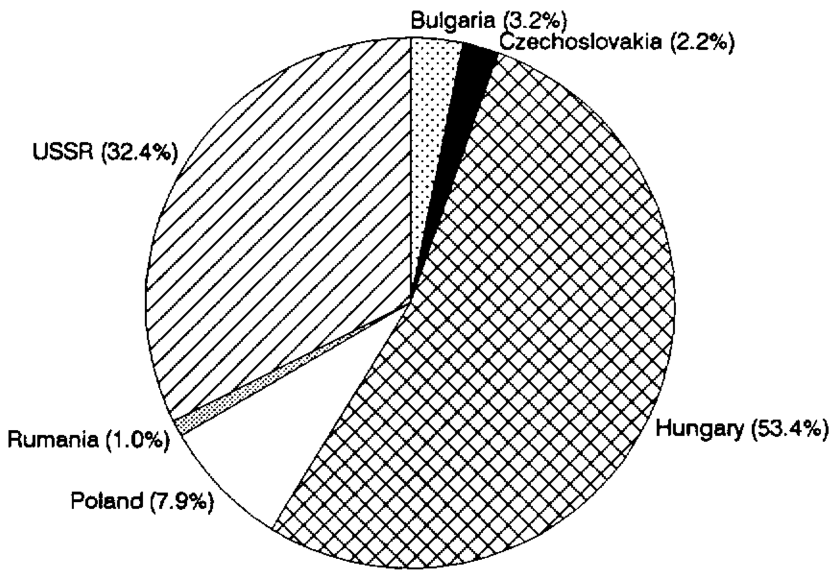

Figure 2.3. Number of East–West joint ventures in 1988 (total = 506). (Source: MTC Network.)

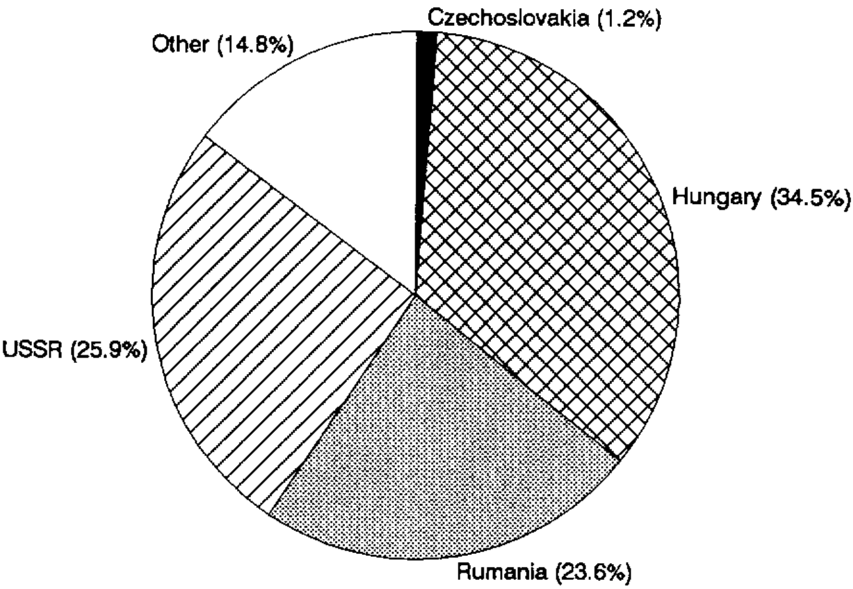

Figure 2.4. Share of joint venture capitalization in 1987 (total = US$580 million). (Source: MTC Network.)

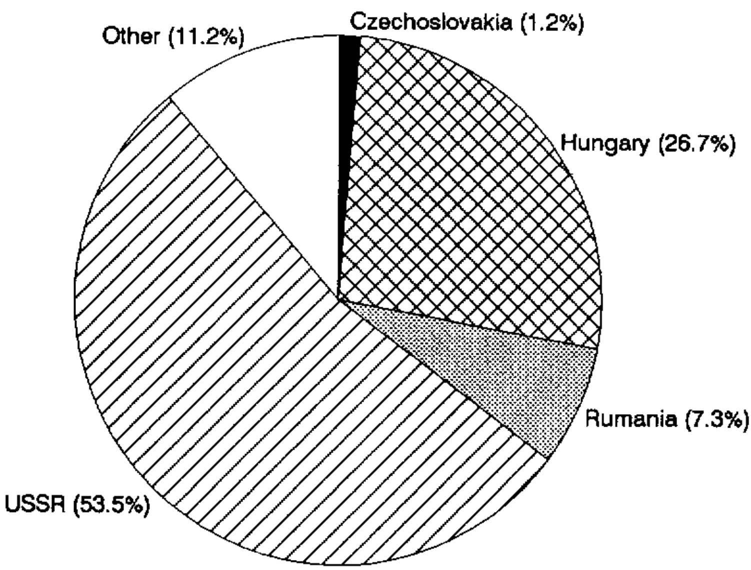

Figure 2.5. Share of joint venture capitalization in 1988 (total = US$1.87 billion). (Source: MTC Network.)

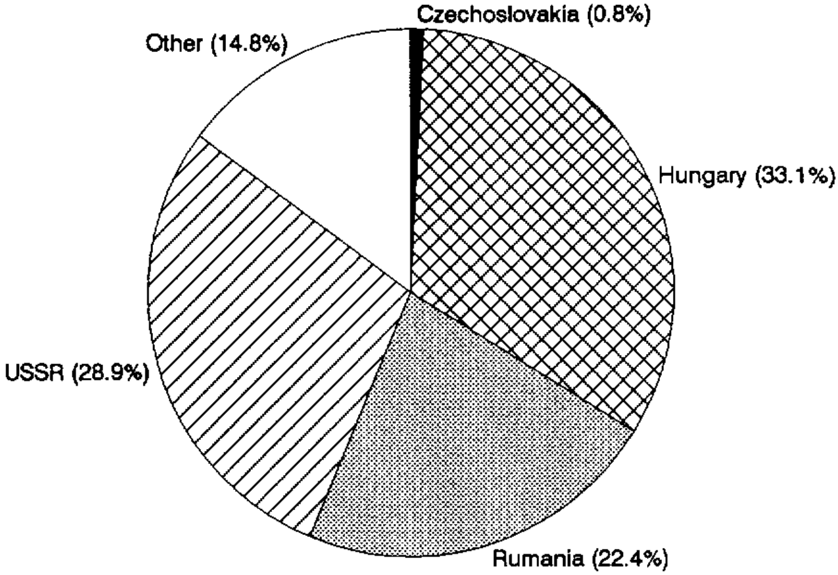

Figure 2.6. Joint venture foreign capital in 1987 (total = US$242 million). (Source: MTC data base.)

increased to about US$634 million by the end of 1988 (*Figure 2.7*) and to approximately US$900 million at the end of February 1989. Hungary, which led in foreign capital acquisition until 1988, has now been replaced by the Soviet Union, which attracted US$1,286 million in foreign investment by the end of August 1989.

The increased number of East–West joint ventures located in the CMEA countries is accompanied by a less intensive growth of the initial capital investment and a decrease in the absolute value of foreign investment per single joint venture. For instance, the average capital per joint venture in Hungary is about US$2,293,000. There are some cases of higher investments, mostly in the USSR, where the USA has only five joint ventures but the value of their investments is US$4 million. Joint ventures that do not need substantial initial investments are those involved in engineering, consultancy, information, and other services. In the changing environment of almost all Socialist countries during the last few years, it is natural for Western partners to have a trial period for their joint business. Both partners

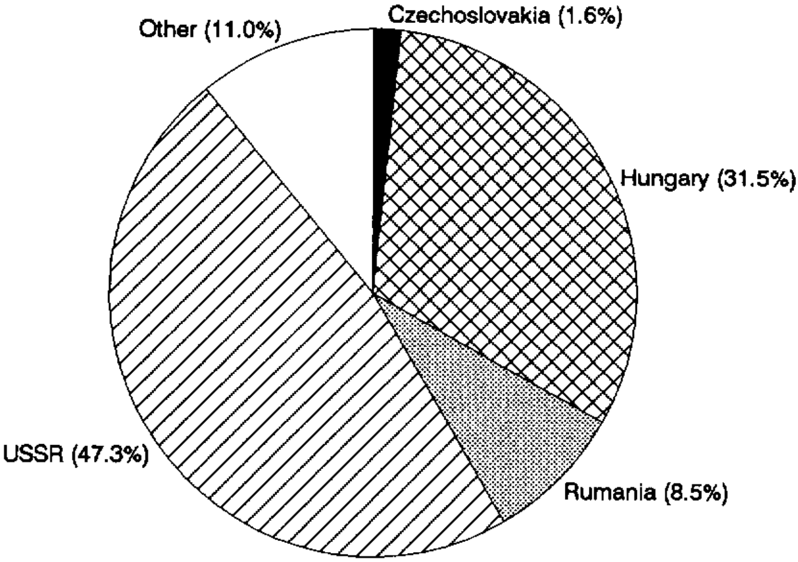

Figure 2.7. Joint venture foreign capital in 1988 (total = US$634 million). (Source: MTC data base.)

need time to acquire knowledge and experience in order to enlarge their joint activities in the future.

The participation of Western countries in joint ventures also varies. In 1987, when the process of establishing the legal framework was completed in almost all CMEA countries, the Federal Republic of Germany (FRG) took the lead, participating in the greatest number of joint companies. Austria closely followed; next were Switzerland and Japan. The FRG, Austria, Italy, the UK, and the USA are now the most active Western countries in the process. The tendency to form joint ventures based on the partners' initial relations is still dominant.

Political, geographical, cultural, and historical factors influenced the process of establishing East–West joint ventures and had an impact on the partners' choice. Finland is most active in the USSR, based on a history of mutual economic relations, with over 100 joint ventures.

Naturally, the dynamics of the joint venture process vary in different countries. In addition, the distribution by industry branch and the economic activities of joint ventures differ according to the partners' priorities and characteristics.

Generally, East–West joint ventures located in the CMEA countries concentrate their activities in industry, services, and other sectors such as R&D, engineering, consultancy, training, etc. Most started with trading, engineering, and technical services, and then moved towards small-scale production. Every country has its own orientation concerning distribution of joint ventures, depending on the country's economic and technical development, its priority areas and the interest of the Western partners.

The majority of the joint companies in Bulgaria are engaged in engineering services. In addition to their basic activities, most of them also have commercial functions that were previously performed by the Western partner's trade representative.

Hungarian joint ventures represent the broadest spectrum of industries. In the last two years, there has been a tendency to establish companies in services; 26 percent of the Hungarian joint undertakings are in that sector, 35 percent in manufacturing, and a relatively high percentage (30 percent) in finance. This is a specific feature for Hungary.

Drawing on the Czechoslovakian tradition of machine building and machine-tools, 25 percent of the established joint ventures in this country are engaged in these activities. Second priority is given to tourism and the production of spare parts.

Analysis of the joint ventures in operation (not those that have only been registered), shows that the process of transition to production activities is comparatively slow. Many joint companies consider production one of their main future targets. Joint production and R&D activities do not occur very often, however. This is natural in the initial stage of the joint venture process since sharing R&D know-how requires utmost trust between the partners. As the joint ventures develop, partners hope to move to more complicated activities such as joint R&D, joint production, and joint marketing, based on reaching a deeper mutual understanding and trust through joint activities.

Conclusions

East–West joint ventures present a serious challenge to the scientific community by addressing many questions of great importance to business people in both the East and the West. To be successful, an East–West joint venture must work toward a better understanding of East and West business environments and must create a harmonized international environment. What are the main problems in this process? What are the main features of the new international environment required by joint ventures?

The joint venture is an entity that should be analyzed in relation to the existing environment: distribution and supply; economic conditions and regulations; and managerial, operational, and environmental features. To study the systems, it is necessary to study not only the enterprise itself and its internal structures but also, more importantly, the relation between the enterprise and its environment and between management and operations (production or services). This also can serve as a basis for comparison among countries. Legislation is important, but it is more informative to see what happens after the partners finish their round table negotiation, and the joint venture is left to swim alone in the turbulent sea of Eastern economies.

Part II

Chapter 3

Joint Ventures From An Austrian Perspective

G. Plasonig and K. Buchleitner

Austrian companies have taken the lead in introducing joint ventures with CMEA countries for the following reasons:

- Austria's special geographic position between East and West.
- Austria's neutrality since 1955.
- Austria's traditional trade relationships with the countries of the former Austro-Hungarian monarchy.

Austria's share in new East–West joint ventures is currently about 10 percent. Considering Austria's position in world trade, this is a relatively high figure.

The results stated below are based on a theoretical and empirical study of Austrian companies operating joint ventures with partners from CMEA countries. The Austrian partners agreed to provide data[1] from all joint ventures existing at the time of the study.

[1]For the complete results including the theoretical framework, see Eschenbach *et al.* (1989).

3.1 Strategies of Austrian Companies with East–West Joint Ventures

The single most important aim of Austrian companies in setting up joint ventures with CMEA countries is to gain a foothold that will allow them to reach the entire CMEA market. Our research showed that other motives such as cost savings, tax advantages, etc. are only minor reasons. The most powerful market is undoubtedly the USSR, with two-thirds of the total volume of the CMEA market. Although joint ventures with Hungary are in the majority, these were set up to serve as a bridge to the USSR market. The concentration of about 80 percent of the Austrian joint ventures in the Hungarian market is due to Hungary's recent major improvements in introducing a free market economy, geographical proximity, and Austrian knowledge of the Hungarian market. Austrian companies have considerable experience with Hungary, thus minimizing the risk of entering new and unknown markets. Companies using this step-by-step approach have three possibilities for expanding their activities to other parts of the CMEA market:

- Exporting goods and services from the East–West joint ventures to other CMEA countries.
- Setting up other joint ventures between the existing joint ventures and partners in other countries.
- Setting up a new joint venture between the Austrian parent company and partners in the target country.

The choice of one of these opportunities will be influenced by the motives of the CMEA partner and the bargaining power of the Austrian company. It has to be considered that any additional joint venture in a CMEA country influences the relationship between the parent company and the joint venture partner of the original joint venture. Therefore, regulations must be stipulated clearly in the joint venture contract to avoid any misunderstandings.

Looking at joint ventures from the point of view of competitive advantage, it is clear that the motives of both partners play only a very minor role. There is evidence that joint ventures are useful in local and global competition, as shown by many East–West joint ventures. Joint ventures are especially appropriate when the firm seeks to expand its capability into new fields and less appropriate when it aims to exploit an existing competitive advantage. Some risks in East–West joint ventures lie in the transfer of technology and know-how from the West. This can, in the long term, endanger the position of the Austrian companies in the local Western market if the joint venture begins exporting cheaper products to the West. Because of the commitment to quality and brand marketing, however, there is no evidence that this question will be raised.

Joint ventures are currently the only way for Austrian companies to enter the market in CMEA countries. Despite possible long-term strategic disadvantages, Austrian companies should take the opportunity to use their specific know-how to expand into CMEA countries and to improve their overall position in the world market.

3.2 Environment

3.2.1 Legal environment

One of the strongest indicators of *perestroika* is the rapid change of the joint venture laws in CMEA countries. In 1989, with the exception of the GDR and Rumania, all CMEA countries introduced new joint venture laws with some revolutionary contents; the highlights are:

- Majority rights up to 99 percent (and in Hungary, Bulgaria and Poland even wholly owned subsidiaries).
- Abolition of restrictions on Western managers as managing directors of joint ventures.
- Abolition of compulsory permission to establish joint ventures where the Western partner holds less than 50 percent.
- Unrestricted profit transfer from Hungary to the West.

Although there has been little practical experience so far with these laws, they have created an improved climate for investment and more room for negotiations. In spite of these significant improvements, the host country still can refuse the application for a joint venture contract; no application has been refused.

It would be advisable to draw up a tentative list of possible reasons for refusal and provide for the possibility to lodge an appeal with an independent legal authority. The foreign investor could then be relieved of the insecurity that often results from time-consuming application proceedings.

From a Western point of view, practical interpretation of the joint venture laws and, to an even greater degree, the general rules of the CMEA countries present legal difficulties and uncertainties. This is mainly due to:

- Language barriers.
- CMEA countries' lack of experience with Western business practices.
- Comparatively strict "legality" of economic and everyday life in CMEA countries.
- High level of state discretionary powers in waiving decrees. The legislative process is less clear than in the West, and unexpected changes in the law can lead to difficulties in adjustment.
- Partly out-of-date economic law which can now be gradually aligned to the current changes of *glasnost* and *perestroika*.

Austrian joint venture partners who belong to the medium-sized sector and do not have separate legal departments will find it considerably more difficult than larger companies do to set up and operate joint ventures.

An improvement in the information policies of the CMEA countries could facilitate practices in this area. The information available at the moment on East–West joint ventures is not sufficient; it is very general and does not correspond to the needs of joint venture partners.

3.2.2 Economic environment

The economic climate of joint ventures is characterized by conflict between the directively planned economy and economic reforms. The particularly exposed position of joint ventures is also due to the fact that their success depends on the success of the reforms. On the other hand, they are themselves an important means in the process of reform.

The following major problems call for solution:

- Over-bureaucratization due to a high level of vertical organization as a condition of the extensive planning system.

- Promotion of large projects and industries without regard to efficiency.
- Ignoring market demand and instead promoting products that help to fulfill plans.
- Low productivity levels due to the lack of incentives for employer motivation.
- Considerable technological backwardness in many branches due to the lack of market orientation.
- Poor conversion of inventions or acquired technological know-how into products. Lack of incentives for application-oriented research.
- Poor international competitiveness due to lack of quality; therefore, foreign currency is earned only for raw material exports where price fluctuations can directly affect balance of trade.
- Domestic market price subsidies.

The Economic Commission for Europe (ECE) has categorized the objectives of joint ventures, most of which are explicitly stated in legal documents. The primary motives of CMEA countries are as follows:

- To obtain new technology and/or technical know-how.
- To expand the export sector and thus increase foreign currency earnings.
- To decrease imports and thus obtain foreign currency savings.
- To obtain foreign enterprise management know-how.
- To modernize the host industry.
- To introduce new goods to the host country market.
- To create new jobs, raise labor productivity, and train host country employees.
- To economize on manpower, material, energy, financial, and other resources.
- To increase profitability.

It is obvious that the aims of CMEA countries do not always correspond to those of their Western partners. The most commonly cited conflict with Austrian joint venture partners concerns sales. The CMEA countries expect an expansion of their exports to the West and an increase in their foreign currency earnings, whereas Austrian companies are mainly interested in sales to the CMEA markets. According to Austrian entrepreneurs, the fact that joint ventures replace expensive imports and help save convertible currency is too often forgotten in CMEA countries.

3.3 Operational Problems

3.3.1 Procurement

Procurement is one of the central problem areas of East–West joint ventures; problems mainly result from the economic environment of the host countries. Joint ventures generally prefer to procure their imports from the domestic market because it is cheaper and, above all, avoids extra foreign currency expenditure.

Procurement from the domestic market, however, is impeded in various ways:

- The joint venture is able to choose its suppliers freely, but there are often bottlenecks and delays, due to the restrictions of the suppliers.
- CMEA suppliers are not used to producing the quality required by the joint ventures and prefer uncomplicated trade with state companies.
- CMEA suppliers have an increasing tendency to demand special terms (such as payment in convertible currency).

If the joint venture procures from the West, it avoids the problems of domestic procurement but puts additional pressure on its balance of convertible currency. The Austrian companies have found some possible solutions, as follows:

- Supply by partners, mainly the Western partner. The drawback is that the joint venture is subject to the price monopoly of its partner who, in turn, can collect the joint venture profit to the disadvantage of the other partner.
- Partial integration of joint ventures into state plans by the joint venture, giving the planning authorities the opportunity to take its requirements into account. This is important to maintain independence of plans by simultaneous exploration of alternative sources of procurement.
- Maintaining minimum inventory levels to avoid production stoppages and to introduce better quality by repeated complaints. The drawback is increased inventory cost.

3.3.2 Production

Problems in the production of joint venture goods or services come in the area of procurement (delivery bottlenecks, lack of quality) and the areas of personnel/motivation and qualification. Moreover, joint ventures always work with technology obtained from Austrian partners and usually new to the host country.

Austrian partners view production as a relatively uncritical functional area because it receives a relatively high level of attention right from the start. The main measure taken is the gradual introduction of new technologies.

Apart from extensive training programs for staff and management by specialists from the Austrian partner, the Austrian specialists enforce close supervision of production in the initial stages to avoid increased production costs through defects, stoppages, or even damage to plant.

It is very difficult to ensure product quality that matches Western standards, according to the experience of Austrian joint venture managers. In particular, the lack of quality awareness of the Eastern employees has been criticized. The following measures have been recommended for quality improvement:

- Establish concrete quality standards and agreements as well as strict supervision and control by the Austrian partner.
- Control thoroughly all branches involved in production, in particular procurement.
- Promote appropriate quality awareness among Eastern employees as a part of joint venture corporate culture.

3.3.3 Sales

Sales of East–West joint ventures are influenced by two additional factors:

- Equality in trade between the partners.
- The need to obtain convertible currency.

The geographic boundaries of the market are laid down in the joint venture contract. The typical characteristics of an Austrian joint venture are:

- Restricted joint venture market.
- Sole distributor rights of the Austrian partner for joint venture products in the West.

Basically three geographic markets are available to East–West joint ventures:

- Sales in the host country.
- Sales in other CMEA countries.
- Sales in the West.

Convertible currency can be obtained in two ways:

- Sales in the West, which are often against the Austrian partner's interests.
- Sales in CMEA markets against convertible currency, which are very difficult to implement due to a shortage of foreign currency in CMEA countries.

From the empirical study, 20 joint ventures with Austrian interests showed the geographic sales distribution (*Figure 3.1*). The relatively low level of sales in the West consists mainly of supplies to the Austrian partner. There is no cause for complaint concerning the lack of demand for joint venture products or services in CMEA countries. Joint venture products have a quasi-automatic USP (unique selling proposition) to the CMEA buyer.

Reasons for Objective USP

- Products offered by joint ventures are *quantitatively* scarce on the CMEA market.
- Comparable products of state industries are *qualitatively* inferior.

Reasons for Subjective USP

- The CMEA buyer associates high quality and status with the Western image (brand name) of joint venture products. The advantages of status sometimes lead to an interesting result: if a product is priced too low, the subjective USP is destroyed and can have a negative effect on sales.
- Joint ventures produce and distribute goods and services from the Austrian partner's product range.

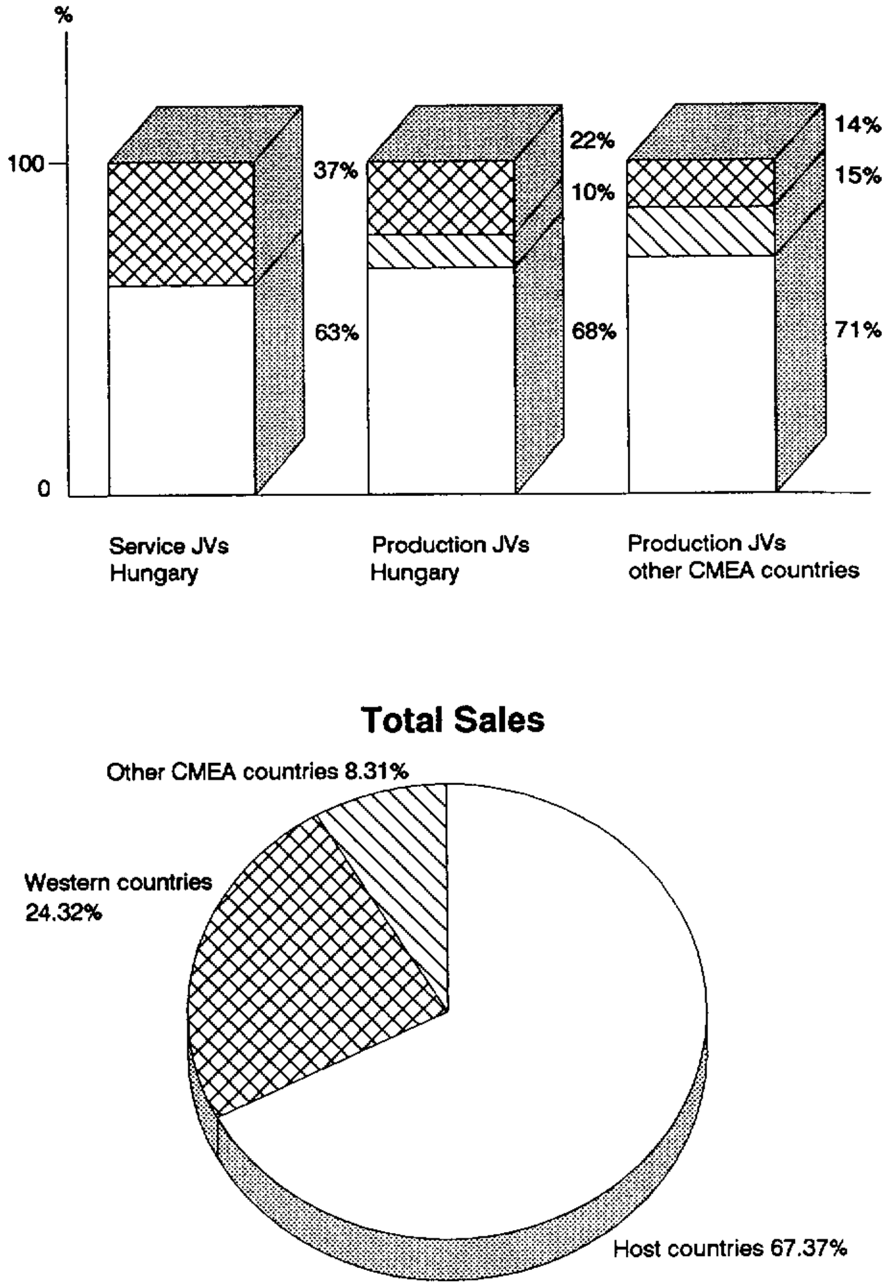

Figure 3.1. Sales distribution of joint ventures with Austrian participation.

Consumer goods are usually only adapted to the CMEA market in secondary product features such as design, packaging, and standard specification.

More extensive adaptations to CMEA conditions are often required for capital goods, technically sophisticated products in particular, since the infrastructure of the buyer is often underdeveloped for the use of Western products. (One example is surge protectors in EDP equipment to avoid damage from a different voltage.) Services, on the other hand, nearly always have to be redeveloped for the CMEA market because:

- The service sector in CMEA countries is underdeveloped and the requirements are much less complex.
- Legal, political, and social environments are very different from those in the West.

Difficulties arise for Austrian partners and joint ventures concerning market research in CMEA countries. Secondary data are difficult to obtain, incomplete and not up to date.

If the Austrian partner does not have enough market information based on many years of experience in CMEA countries and if the Eastern partner's market information is not sufficient, primary analyses are necessary. But these are costly and, in spite of numerous joint ventures, there is a lack of experienced agencies.

Good relations and contacts with political and economic decision makers in CMEA countries are also important in obtaining information. Especially in the branch of capital goods, these bodies have the advantage of being informed about purchasing projects well in advance and of being able to influence the buying decision. In addition, the image of joint ventures as CMEA companies carries an advantage in the buying decisions of state-run companies and institutions over that of Western firms who do not offer their products as part of a joint venture.

3.3.4 Finance

The financing of joint ventures is impeded by the lack of currency convertibility, since a joint venture must also be liquid in convertible currency. Joint ventures are not granted any considerable advantages concerning the supply of convertible currency. This means that they often suffer a shortage of convertible currency just as state companies do.

The basic principle of the joint venture's convertible currency is that of "zero-balance basis." The joint venture must cover all of its expenditures in convertible currency (including wage transfers to foreign employees and distribution of profits to Western partners) by appropriate earnings in convertible currency. This leads to great restrictions in the scope of East–West joint ventures:

- In procurement, where the joint venture is forced to procure as much as possible from the CMEA market.
- In personnel and management, where Western staff can be employed only restrictively.
- Particularly in sales, because the joint venture must try to sell on the Western market. This requirement is against the interests of the Western partner and makes the initial stage of a joint venture much more difficult.

The common ways of getting around these problems, such as counter-trade or establishing consortiums for the reciprocal exchange of foreign currency, put pressure on the joint venture right from the start and divert resources away from the core of business. Full convertibility would be desirable; the success of joint ventures can perhaps facilitate the process.

Austrian joint venture partners regularly try to keep their capital investments down for the following reasons:

- Uncertainty concerning political and economic developments.
- Lack of currency convertibility.
- Fear of currency devaluation.

In most joint venture contracts, the obligation to make further contributions is excluded. This indicates that the partners assume that the joint venture has a relatively high degree of independence. The undercapitalization of joint ventures makes credits necessary sooner or later. Convertible currency credits often cause difficulties. CMEA banks have to act restrictively due to the permanent shortage of convertible currency.

Western banks have been very cautious in granting credits to CMEA countries due to political and economic uncertainty; they demand high rates of interest as well as various provisions of collateral.

The latter also cause difficulties for joint ventures as their assets are very small and the desired collateral is often not feasible according to local laws. Austrian banks try to ensure larger credits through state guarantees.

The appropriation of profit (reinvestment or distribution of profits to partners) does not seem to cause problems for Austrian joint venture partners. Due to the long-term arrangements of joint ventures, in the first years the profits are mainly reinvested. Partners' disagreements and conflicts in the future cannot be ruled out but can be avoided by contractual agreements.

3.3.5 Personnel

Personnel are of particular importance in this form of cooperation. Not only do the varying corporate cultures of the partners meet, but also two basically different economic systems.

This situation calls for a high degree of flexibility and ability to adapt on the part of employees and workers, and demands great sensitivity in personnel management.

Recruitment and dismissal of staff do not cause problems. These are primarily the task of the joint venture management. The influence of state authorities or partners has only been involved in a few isolated incidents.

Austrian employees are involved in very small numbers and are limited to ongoing joint ventures in key technical and economic positions. The reasons for this are primarily:

- The transfer of know-how desired by the CMEA country or CMEA partner can succeed only if Eastern personnel are also employed in decision-making positions.
- The employment of Austrians means a considerable extra financial burden (one reason being payment in convertible currency).
- The number of Austrian employees who are willing to work permanently in CMEA countries is very small because:
  - The standard of living is lower.
  - Work in a CMEA country is not (yet) considered as a career milestone.

Sending Austrian managers or technicians over temporarily to solve specific problems seems to be the most common solution, e.g., to work out marketing strategies, to service or repair machinery, etc. It is often stated in literature that joint venture staff are unqualified. This is contradicted, however, by Austrian joint venture partners who rate staff qualifications relatively high. It must not be forgotten, that working in a joint venture is attractive for CMEA personnel; therefore, joint ventures can recruit the best qualified employees. The fact that the personnel have to be extensively trained in the initial stage is inevitable.

There is, however, a tendency among Eastern partners to pirate trained employees from joint ventures; this shows it will be more difficult for joint ventures to keep good staff members in the future. Austrian joint venture partners evaluate the attitude toward work of local staff as negative almost without exception. Since this is accounted for much less by an individually negative stance than a generally system-conditioned atmosphere of anti-performance, specific measures for motivation could relatively easily bring about changes in this respect. The most successful measures to increase motivation are considered to be those that improve the standard of living in the classic bottleneck areas of the CMEA economy. The most widely used are:

- Working stay in the West.
- Performance-linked bonuses in money and in kind.
- Training.

Austrian joint venture partners also stress the importance of corporate culture in this respect. There are regular attempts to build up a separate joint venture culture that should influence the joint venture employees' attitudes to work. Mere description of the Austrian partners' corporate culture is pointless and would result more in a shock effect on local staff than in a positive stance towards the joint venture.

3.3.6 Management

The demands on the management of joint ventures are, of course, especially great because:

- It must often put into effect opposing interests of the partners.
- It must operate in a radically changing economic system that is affected by many problems.

- Considerable state interests are also linked to the authorization of joint ventures that have both direct and indirect effects on the joint venture.

The demands on the abilities of joint venture managers are great:

- Mastering of tested management techniques.
- Effectiveness.
- Flexibility, mobility, and ability to learn.
- Ability to work with information.
- Creativity and innovation.
- Well-developed sense of environmental observation, especially with respect to unexpected changes in the environment.
- Social and communicative competence.
- All-round knowledge of languages.

There is no ideal manager for a joint venture. It would make sense to have a combination of managers from East and West. Western managers introduce Western management know-how and can guarantee effective internal work. The Eastern manager's strength lies in knowledge of the characteristics of the planned economy system, the CMEA market, and contacts with the authorities.

Austrian partners also prefer such a division of competence, but due to the difficulties involved in finding managers for the CMEA market they have to be satisfied with sending managers over in special cases.

The success of a combined East–West management team depends greatly on the personal relationship between managers. It is important that there is trust and a clear and well thought-out division of skills right from the start to avoid conflict in the future.

As far as planning is concerned, almost all joint ventures have short- and medium-term plans that are carried out relatively autonomously. Long-term planning for an East–West joint venture is considered very difficult since uncertainty is seen as extraordinarily high. Because of this, the joint venture should develop alternative strategies in time to be able to react as quickly as possible to environmental changes.

Reporting systems from joint ventures to their Austrian partners are not strictly organized in many cases. Language and poor quality data are considered the main problems. Small Austrian companies, in particular, should improve on these areas.

3.4 Conclusions

The study shows that in spite of various attempts by CMEA countries to facilitate joint ventures many problems still remain unresolved. These problems are mainly due to the position of free-market-oriented joint ventures in an area of conflict between directively planned economy and reforms. On the one hand, the success of joint ventures depends very much on the success of the reforms, and, on the other hand, joint ventures are an important means in the reform process and for future development.

The uncertainty about the future course of reforms is one reason why joint ventures do not fulfill the CMEA policy maker's expectations concerning capital investment and technological transfer. In particular for medium-sized Austrian businesses, a certain degree of political and economic security in foreign investments is essential.

Only when CMEA countries succeed in increasing guarantees for East–West joint ventures by means of more determined changes in the environment will the expectations of the CMEA economy be totally fulfilled.

Chapter 4

Joint Ventures in Bulgaria

E. Razvigorova, I. Nenov, J. Djarova, and M. Borrisova

4.1 Recent Reforms in the National Economy

The development of new forms of economic activities in Bulgaria moves according to internalization of manufacturing, technology, and research. Changes in industrial structure, and in form and subject of property are also taking place in the country. Self-management in business, administration, and regional organizations is increasing. Today, other kinds of ownership are also important – cooperative, private or mixed. The gradually changing legislation resulted in Decree No. 56 of the State Council on January 13, 1989. The new legislation continues the policy of democratization of the country's economic legislation and management, putting all forms of ownership on an equal basis.

Equal conditions are achieved through unified economic regulations. The basic features of the new legislation are the following:

- Further democratization of business management is carried out by the creation of firms, which continue the process of decreasing management hierarchy levels and of enhancing freedom for internal organization of business activities.
- The shareholder's principle is introduced in all forms of ownership. Different forms of shares and bonds are permitted. Shifting capital from one firm to another is possible. This is expected to lead to higher flexibility and investment growth, and to a greater interest and closer relationship between the employee and the firm.
- The economic methods for managing the national economy widen. Contracts become the main form of relations between companies as well as between companies and the state.
- Together with economic incentives there are increased possibilities for Bulgarian firms to enter the international investment market and for foreign firms in Bulgaria.
- For the first time, a significant attempt has been made to liquidate the state monopoly on foreign trade. At the same time, the state's interests are guaranteed through a unified foreign economic policy.

At the end of April, only a few months after Decree No. 56 was approved, 265 state-owned, 27 regional, 17 cooperative, 6 public, and 6 joint-stock companies were registered.[1] The number of private firms registered was more than 1,600. By October 1989, the total number of private companies exceeded 7,000, but the majority are very small in terms of both capital and personnel.

The process is still at the beginning. The new conditions impose higher demands on all companies and on individuals. New knowledge is necessary to deal with the new business situation in the country. Therefore, business schools, courses, and consulting companies are being opened. The responsibility of individuals and of separate firms will be recognized in the future.

For the first time, any company in Bulgaria can go bankrupt, irrespective of its form of ownership. Inefficiency and inflexibility based on state support and donations can no longer exist. Existing administrative procedures are being simplified.

[1] *Robotnichesko delo* (newspaper), May 6, 1989.

Table 4.1. Level of Bulgarian foreign trade.

	1970	1980	1985	1987
Foreign trade volume 1970 = 100	100	262.9	362.4	362.9
Exports	100	294.1	416.6	408.6
Imports	100	228.6	306.1	313.5

The economic security that used to be associated with the proper and punctual fulfillment of the state plan is being replaced by economic competition and uncertainty. This means that companies not only must fulfill "state orders," but also must identify new opportunities. Trade with foreign countries takes different forms: independent foreign trade organizations that offer commercial services to business organizations and commercial departments in the firms or in foreign trade organizations belonging to the firms. The firms are orienting themselves to more active trade activities and cooperation. Income and expenditures in hard currency as well as profit and loss from imports and exports now should come more under the control of the producers. The amount of income in foreign currency will directly affect the opportunities to buy high technology from Western companies. This calls for quality improvement and new skills.

4.2 Dynamics of the Joint Venture Process

The movement toward new opportunities is also reflected in Bulgarian participation in East–West economic relations. Like almost all CMEA countries, Bulgaria developed mainly conventional trade with Western partners during the 1970s. Although the growth rate of trade has not increased during the last decade (*Table 4.1*), Bulgarian firms have developed more direct contacts with their partners. The most widespread form of economic cooperation used for years by Bulgarian firms is coproduction, followed by delivery of plant and equipment (*Table 4.2*).

Compared with other forms, coproduction is complex, involving parties in production procedures connected with the delivery of know-how, documentation, designs, drawings, and sometimes R&D, cooperation in marketing, etc. Coproduction also provides opportunities that usually make the country-trade arrangements easier. This form of cooperation can be regarded as a transitional form toward

Table 4.2. Bulgarian participation in East–West industrial cooperation (by year and type of cooperation).

Type of cooperation	1979	1980	1981	1982	1983
Coproduction	50.0	47.4	45.8	42.9	52.4
Delivery	21.4	31.6	25.0	21.4	14.3
Licensing	0.0	0.0	4.2	3.6	2.4
Joint ventures	21.4	15.8	12.5	17.8	19.0

Type of cooperation	1984	1985	1986	1987	1988
Coproduction	50.0	51.0	48.8	47.0	44.8
Delivery	13.6	13.3	12.8	12.2	12.1
Licensing	4.5	4.4	4.2	4.1	3.4
Joint ventures	18.0	17.7	19.1	22.5	27.6

joint legal entities or joint contractual ventures. Starting in 1983, joint ventures replaced delivery of plant and equipment as the second most widespread form of cooperation. This category includes the contractual and equity joint ventures located in the West as well as those in Bulgaria. Thus coproduction and joint ventures were the most prevalent forms during the early 1980s; joint ventures showed a slightly higher growth rate (*Table 4.3*). The number of Bulgarian joint ventures located in West European countries is considerably higher than the number located in Bulgaria because of the legal provisions supporting their establishment.

It is important to note that many of the Bulgarian joint ventures located in the West were created on a contractual basis, mainly for the better promotion of mutual trade. They can be classified as commercial companies, since they deal mainly with advertising, warehousing, marketing, and distribution of export goods.

The first Bulgarian joint venture with a Western partner was established in 1981, shortly after the first legislation on foreign investment in the country was passed. Fanuk-Machinery Ltd was created on the basis of formerly established business contacts between the Bulgarian ZMM company and the Japanese Fujitsu Fanuk company. Such cases of previous cooperation can be seen in many joint ventures established in Bulgaria, considerably speeding up the process of setting up new companies.

Table 4.3. Growth rate of Bulgarian participation in East–West industrial cooperation (by years and types of cooperation).

Type of cooperation	1979	1980	1981	1982	1983
Coproduction	0.00	−5.20	−8.40	−14.20	4.80
Delivery	0.00	47.66	16.82	0.00	−33.18
Licensing	–	–	0.00	−14.29	−42.86
Joint ventures	0.00	−26.17	−41.59	−16.82	−11.21

Type of cooperation	1984	1985	1986	1987	1988
Coproduction	0.00	2.00	−2.40	−6.00	−10.40
Delivery	−36.45	−37.85	−40.19	−42.99	−43.46
Licensing	7.14	4.76	0.00	−2.38	−19.05
Joint ventures	−15.89	−17.29	−10.75	5.14	28.97

Source: IIASA, MTC (1989).

The number of joint ventures registered through January 1, 1989 reached 20, but only 13 actually started business during the time the study was conducted (*Table 4.4*). The number of joint ventures under negotiation and in the start-up period is more than 25. Under the new decree, 25 joint ventures have been registered.

Most of the joint ventures listed in *Table 4.4* are in the field of engineering services. The joint venture of Bioinvest and the British firm APV, e.g., constructs food factories and implements the transfer of biotechnology. The French firm Sormella, leader in the field of manipulation and FMS production lines, has created a joint venture named Electron-Sormel-Electroimpex (ESE). It produces unique manipulating systems that can replace human workers on assembly lines, based on licenses provided by the French firm. The activity of the joint venture Systematics, which provides engineering and foreign trade services for the implementation of management information systems (MIS) developed by the Western partner, Honeywell Inc., is highly esteemed. Systematics designs and engineers systems for measurement and control, develops software for various Honeywell systems, and writes programs for all kinds of computers, especially for control of production, energy, and maintenance.

Table 4.4. Bulgarian joint ventures.

Joint company	Founded	Foreign partner	Bulgarian partner	Type of business
Fanuk-Machinery Ltd	1981	Fujitsu Fanuk (Japan)	FTO Machinoexpoert ZMM	Maintenance and service of machine tools, NC machines and development of NC machining centers.
Tangra	1981	Tangra Switzerland	Neftochim Company FTO Chimimport	Manufacture and export of plastic and metal products.
Sofia-Mitsukoshi	1982	Mariuchi Shoji and Mitsubishi Dept. Store (both Japan)	4 FTO 2 retail chains 3 manufacturing companies	Design, development, manufacture, distribution, and export of consumer goods. Trade.
Futex Ltd	1984	Fukuzawa Chemical Laboratory (Japan)	FTO "Technica"	Manufacture, sale, and export of liquid fuel oil additives.
Chimtrade Ltd	1984	Dow Chemical Co. (USA)	FTO Chimimport FTO Chimkomplect	Manufacture, trade, import, export, engineering, marketing for pharmaceutical industries.
Systematics	1984	Honeywell Inc. (USA)	Ministry of Chemical Industry	Engineering, development, and trade of automation control systems.
ESE	1984	Sormella (France)	Elprom Comp. FTO Electroimply	Design, engineering, deliveries start up, etc., and sales in the electrical and electronic industries.

Table 4.4. Continued.

Joint company	Founded	Foreign partner	Bulgarian partner	Type of business
APV-Bioinvest	1985	APV-Paracel Intl. (UK)	Bioinvest Engineering Comp.	Engineering and consulting in biotechnology.
Medicom Systems	1986	Tokyo Mariuchi (Japan)	FTO Technica Institute for Technical Cybernetics	Development, production, and marketing of medical equipment.
Festo-Machinex	1987	Festo Maschinenfabrik (Austria)	FTO Machinoexpoert Institute for Complex Automatic Manufacturing Companies	Engineering, development, and trade.
Medabyk	1987	Byk Gulden (FRG)	Bulgarian Academy of Medicine	Development and production of medical products.
VWTM	1988	Volkswagen AG (FRG)	Heavy Machine Building Asso.	Trade in automobiles and other goods.
Bimax	1987	Hollis Industries (UK)	Bulgarian Industrial Asso. Economic Bank	Trade in machinery and equipment; investment projects in Bulgaria and the third world.

Some joint ventures also perform commercial functions that were previously obtained from a trade representative of the Western partner. This is the case of Chimtrade, which was set up for production, technical assistance, engineering, marketing, and trade in the fields of chemistry and pharmacy. In performing these activities, Chimtrade applies technical innovations from the American partner, Dow Chemical.

Other joint ventures perform design work, introduce high technologies, and carry on wholesale trade and import and export: Sofia-Mitsukoshi; Medicom Systems; VWTM, a joint venture between Volkswagen and the Heavy Machine Building Association; the Rossa Company, a recently registered joint venture of Bayer (Federal Republic of Germany) and Industrialimport FTO, etc. There are joint ventures with mainly production activities: Futex, Tangra, Fanuk Machinery, etc. In many cases, however, production activities are combined with engineering, marketing, design, etc.

The parallel development of different activities (design, engineering, production, marketing) enables joint ventures to fulfill the goals of both partners. By means of simultaneous design, engineering, and marketing, it becomes possible to use Bulgarian machines, equipment, and know-how (engineers and designers) to organize and equip production plants. Thus joint ventures stabilize themselves faster and start to provide services that are in demand by Bulgarian companies. This, in turn, contributes to the stabilization of their position in the domestic market. At the same time, they often gain a position in the foreign market by using the channels of the Western partner.

To create production facilities and put them into profitable operation requires considerable time (up to five years on average). Therefore, the combination of production and other activities accelerates the development and stabilization of East–West joint ventures.

4.3 Equalizing the Legislative Conditions: Dynamics of Legislation

Companies located in capitalist or developing countries with Bulgarian investment participation have been legal since the early 1970s.

In 1980, however, joint ventures with foreign participation located in the country were permitted by Decree No. 535.[2]

According to the provisions of this decree, each joint venture is a part of the Bulgarian economy, but is not subject to regulations valid for all other Bulgarian socialist business organizations. They are not subject to the rules and regulations applied to socialist property.

Joint ventures are subject to the general regulations only with regard to production and services in the country as well as all problems related to construction, technical security, environmental protection, sanitation, fire prevention, statistics, accounting, labor conditions, etc. These rules apply to everyone in Bulgaria, irrespective of their origin and type of property.

With the introduction of Decree No. 56 of the State Council of the People's Republic of Bulgaria[3] the first step was taken toward equalizing conditions of economic activity for all organizations in the country. This includes companies having a foreign share or fully owned by foreign entities. With Decree No. 56, special legislation was created for firms, companies with limited and unlimited liabilities, and companies limited by shares. A month later, regulations were issued to implement the ordinance. Detailed rules for firms of all kinds were established. The two legislative acts are the basic documents containing the legislative framework, principles, rights, obligations, and responsibilities of all companies, including joint ventures. The competent state bodies can issue instructions and rules for each aspect of joint venture activities.

In order to stimulate foreign investment in the country, the joint ventures are grouped legislatively into two categories based on the amount of foreign participation. This is important during the period of their establishment and for the specific regulatory state rules applied to joint venture activities.

The first group contains limited liability companies with more than a 49 percent foreign share and with more than five million leva in convertible currency or 50 million transferred rubles invested, as well as companies limited by shares of more than 20 percent. For this group, it is necessary to obtain permission from the Ministry of

[2]Published in the *State Gazette* No. 25, March 25, 1980.
[3]Published in the *State Gazette* No. 4, January 13, 1989.

Economy and Planning and the Ministry of Foreign Economic Relations, but the economic conditions for their operation are more favorable (Article 105 of Decree No. 56). The second group, with smaller foreign shares, functions according to the economic conditions established for all national firms.

The right to work under more favorable conditions can be granted to joint ventures with less than the above-mentioned foreign participation by special permission. It is important to stress that the current legislation contains a legal definition of "foreign person" and "foreign investment." Foreign persons are those domiciled abroad and foreign citizens with permanent residence in other countries, as well as Bulgarians living permanently abroad. Foreign investment is considered to be all those investments by a foreign person in a branch of industry or an economic area, participation in a company or the right to movable properties in relation to any business activity.

There is new motivation for foreign persons to invest in high-technology business defined by the Ministry Council. These investments enjoy exemption from taxation of their profits. Other tax reductions are also possible.

In Decree No. 535 of 1980, the joint ventures were not allowed to build on state-owned land. This right was granted only to the Bulgarian partner. Today, Decree No. 56 gives joint ventures the right to construct and the right to use immovable properties during a certain period of time with the permission of the Ministry Council.

The new legislation protects foreign investments, as did former legislation. The state ensures equal economic and legal conditions for business activities of all foreign persons; it is not responsible, however, for the firms' activities and debts or for state-owned or other companies' debts. This certainly makes the firms with foreign investments more independent, but also demands greater responsibility, particularly from the Bulgarian partner. Legal and naturalized foreign persons are not allowed to own land, minerals, forests, or water.

Investments of foreign persons, according to both new and previous legislation, cannot be subject to confiscation or expropriation by the state, with one exception: If state or public needs cannot be satisfied by any other means, investments can be confiscated, but must be paid on the basis of mutual agreement. If agreement cannot be reached, the amount of payment is subject to the local courts.

The repatriation of profits received in convertible currencies, payment for expropriated properties, or liquidation quotas equal to the amount of the initial share in convertible currency is guaranteed by law.

Guarantees are also given to foreigners working in joint ventures. All disagreements that may arise should be solved according to the provisions of the individual labor contract.

According to the legislation of January 1989, all kinds of companies must to be registered by the court, including joint companies with foreign investment and fully owned companies. This can be done on the basis of the foundation act (or agreement), the company's adopted statutes, and approval where required. Different requirements exist for registering different companies; for example, for a limited company, 30 percent of the capitalization funds must be available. Distribution of all shares and the amount of foreign shares that must be paid, etc. are specified.

The opportunity to have more than 49 percent, but not over 99 percent foreign shares under Decree No. 535, was extended by Decree No. 56 to permit an unlimited number of foreign shares. In other words, it is also possible to create fully owned branches and subsidiaries, acquire shares in national stock companies, etc. The act provides for trade representations to be opened in the country under two conditions – permission must be obtained from the competent bodies and at least 50 percent of the employees must be Bulgarians. The economic conditions created within the country for joint venture operations are of great importance. Special attention should be paid to taxation, fund allocations, prices, supply, labor, and personnel.

Following the policy of Decree No. 56 to encourage foreign investment in the country, the law sets a different taxation system according to the size of the foreign share in the two groups mentioned above. The basic tax on profits is 30 percent in the case of predominant foreign shares established by the legislation. In all other cases, the companies (in the second group) are treated like all Bulgarian companies and are subject to a profit tax of 50 percent. Profits from an independent economic activity are basically taxed at 40 percent, and the profits resulting from dividends, shares, and author's license remunerations are taxed at 15 percent. In the case of companies with foreign participation, dividends are taxed at 10 percent. These tax regulations tend to promote joint business activities as well as companies fully owned by foreigners.

The funds can be freely established, but all companies are obliged to set R&D funds at a minimum amount as defined by the Council of Ministers. While giving independence to the firms, the state still wants, to a certain extent, to ensure the companies' development.

The state policy is supported by possibilities for tax exemption in cases of high-tech operations (for five years), or exemption from customs duty on goods imported by foreign persons for the production of export goods.

The joint venture companies can establish contracts for production with the State and the Ministry of Economy and Planning. In this case, even profit in Bulgarian leva can be repatriated abroad when transferred into the desired foreign currency according to the exchange rates of the Bulgarian Foreign Trade Bank.

Until the beginning of 1989, Bulgaria was the only CMEA country to allow more than a 49 percent foreign capital share to establish a lower profit tax for joint ventures. Decree No. 535 also enabled the partner to participate fully in the management of all activities. With this in mind, the dynamics of the process of establishing joint ventures in Bulgaria should be considered low compared with other Socialist countries. Two reasons, aside from political considerations, appear to be the main factors for this. First, more attention is paid by Bulgarian organizations to other forms of industrial cooperation. Coproduction remains in first place as Bulgaria's favorite form of East–West cooperation, although with a slight decrease. Western companies in the Bulgarian market can be considered traditionalists[4] because they have a stable, long-lasting relation to the domestic market and companies. Newcomers in business from abroad lack information on the rapidly changing legislation. In spite of efforts made to provide information on this topic, small and medium-sized firms – potential partners of Bulgarian companies – have not yet been reached.

Simplification of foreign economic relations by Decree No. 56 brings up new possibilities and stimulates different enterprises to make use of these new opportunities. There is already an obvious

[4]This was one of the conclusions of the Bulgarian–German study performed in 1986.

interest in new forms of cooperation. A few months after the adoption of the recent legislation, a number of contracts were signed and others are being negotiated.

Analysis of the legislation and its development shows that the barriers gradually have been removed; this will surely stimulate collaboration with Western companies. The mutual benefit of both partners is the main goal of the legislation and the resulting changes in foreign economic relations. Solutions to all problems acceptable to both partners are being explored.

4.4 Joint Ventures in Action: Problems in Creation and Operation

Decree No. 535 created a considerable number of opportunities for economic cooperation between business organizations of the People's Republic of Bulgaria and companies from other countries. Joint ventures started to appear, and their number increased gradually during the period 1986–1988. At the same time, a number of problems emerged in relation to the preparation, creation, and operation of joint ventures in Bulgaria.

The following analysis is based on the study of joint ventures established under the provisions of Decree No. 535. The main goal of the study was to identify the problems in administration and daily business activities that were beyond the scope of legislation. The analysis is based on questionnaires, interviews, and discussions with the joint ventures' general directors, staff members, and partner representatives as well as with the decision makers from different state organizations and a reading of company documents. Results of previous studies on the country's economic relations with Western companies and partners' comments on joint ventures in Bulgaria also were taken into consideration. The conclusions summarize and generalize the current problems and make an attempt to formulate ideas for possible solutions.

All joint ventures registered by January 1989 were approached with questionnaires, but four who had just registered were not able to make any statements concerning the problems of the two groups. Some refused to fill in the questionnaires but gave interviews. Of the entire sample, eight joint ventures had been active for more than two years and were objects of an in-depth analysis. The operational joint ventures were distributed by Western countries in the following way: Japan – 2, USA – 2, UK – 2, FRG – 2, Austria – 1, France – 1, Switzerland – 1.

4.4.1 Initial problems

Choice of a Partner

In the majority of cases, the Bulgarian enterprises play a passive role in contrast to Western firms, which are actively searching for market opportunities and an environment for implementing efficient business. As a rule, the Western partners in the joint ventures created in Bulgaria have been present in the Bulgarian market for a long time and have been maintaining close contacts with Bulgarian foreign trade organizations (e.g., Tokyo Mariuchi and Dow Chemical).

The right to operate in foreign markets and to perform foreign economic activities was given to all domestic companies, but their knowledge and experience in the field are not correspondingly large and in-depth. Therefore, some Bulgarian partners seem to be slow and insufficiently competent in the process of negotiating and establishing joint ventures.

The feasibility studies for joint ventures that were conducted between Bulgarian and Western companies during this period are based on incomplete and rather general information, i.e., sales of the products to be produced, innovative competitiveness, long-term goals of the joint venture, etc. The weaknesses and deficiencies in the preparation of technical and economic appraisals pose the question of whether there are methodological handbooks[5] and recommendations for the Bulgarian partners to use when selecting a partner. Such a methodology is extremely necessary, especially because of the wider field of opportunities open today for foreign investment; it would help Bulgarians to evaluate better the more favorable economic conditions offered by Western partners in regard to credit terms, capital investments, provision of materials and components, sales, etc. Consulting companies, both local and foreign, also can contribute to solving the problems.

[5]UNIDO methodology is used in some cases, but is not widespread.

Establishment of Joint Ventures

The weaknesses in partner selection affect the length of time needed to prepare and set up joint ventures in Bulgaria. In many cases, foreign partners were discouraged by the inefficiency of the authorities and of their Bulgarian counterpart in obtaining permission for economic activities. Decree No. 56 handles this issue considerably better, as the Bulgarian partner is now allowed to present the declaration and to secure permission for joint activities without involving the foreign partner. Joint ventures with a minority foreign share do not have to obtain permission.

Apart from this, foreign persons may perform economic activities alone after receiving permission to do so. The activities for which such permission is required are specified. Foreign persons also are permitted to establish limited companies and joint-stock companies, to open branches and subsidiaries, and to perform economic activities independently without necessarily registering the firm. This facilitates the procedure considerably and avoids some of the administrative difficulties, but the process still lasts longer than might be expected (several months to one year).

Of great importance in decreasing the duration of this process is the goodwill participation of the interested state authorities, organizations, and banks that support the preparatory work and evaluate the economic activities of the projects.

The problems related to the process of negotiating and establishing joint ventures require careful observation and also should be given maximum assistance. The following suggestions can be made:

- Rapid development of a wider range of consulting companies in Bulgaria (local, foreign, and joint) to perform feasibility studies, organize administrative formalities, and assist internal organization of joint ventures.
- Assistance in advertising their activities in Bulgaria and abroad from the Bulgarian Industrial Association, Chamber of Commerce, etc. to help newly established joint companies build up commercial and economic prestige, create and maintain a certain profile, and increase their popularity in the domestic and international markets.
- Tighter control of the administrative procedures to reduce bureaucracy.

4.4.2 Operational problems

Access to Markets

The main problems in operating a joint venture, according to the study, stem from the production and market monopoly that still exists in Bulgaria. This creates many complications in the procurement and supply of materials, assemblies, and parts from Bulgarian subcontractors.

Another main problem is the difficulty in reaching a compromise agreement fulfilling the interests of the two partners. It is important for the Bulgarian partner to gain access to the Western markets and therefore he agrees to terms that will secure his competitiveness and a corresponding influx of hard currency. The foreign partner's goal is to increase his share in the domestic market, to reduce some expenditures, and to obtain profit or, in several cases, strategic goals in positioning himself in the Bulgarian market. Some companies wish to avoid the higher expenses of maintaining trade representation and therefore use joint ventures as trade companies.

The conflict in goals can in some cases lead to reduced interest by the foreign partner, who may become passive regarding the sale of products to third countries. The expected export of products and services (even through the distribution network) may remain unrealized.

Problems arise also concerning access to foreign and domestic markets for the products produced by the joint ventures. The control exercised on exports and imports to third countries by the state authorities sometimes prevents joint ventures from quick stabilization and free access to the potential markets of other CMEA countries.

Decree No. 56 and regulations for its application will play an important role in solving these problems. According to these documents, the foreign physical and juridical persons are offered equal economic and legal conditions in performing economic activities. Joint ventures (and foreign firms in Bulgaria) should perform their activities bearing in mind the national goals for social and economic development and the impact of market mechanisms. Joint ventures are given free access to the domestic market and export of goods is free, with the exception of certain quotas for the import and export of a limited number of goods and services that are fixed by the Council of Ministers.

Goals and Scope of Activities

The analysis has shown the existence very often of another major problem in the operation of joint ventures: the difference between the initially fixed goals and field of activity and actual activities and results. After the majority of joint ventures were established in Bulgaria, their main goal and tasks gradually recede to the background. Most of them orient themselves toward engineering and trade activities because they quickly generate profits in hard currency and are less capital-intensive. This is in contrast, however, to the main idea behind extending the economic cooperation of Bulgaria to the developed Western countries and firms.

Simultaneous development of production and engineering activities, or the priority given to the latter, helps to stabilize the joint venture and its economic status. It also helps to establish its prestige quickly. But a balance of both types of activities is necessary. Analysis shows that joint ventures become profitable after four to five years of operation. Even after that period, their contribution to the economic results of the branches in which they operate and to the gross national product is far from significant.

Prices and Taxation

The unresolved problem of convertibility of Bulgarian leva is an impeding factor. The study finds, however, that inconvertibility is not a problem at present at the level of the individual joint venture. With the accumulation of profit, the issue will become more urgent. As to profits and their taxation and conversion, the situation is unclear to some extent.

The prices of goods and services bought and sold by the joint ventures on both domestic and foreign markets are negotiated freely with the exception of those goods and services for which the Council of Ministers has fixed price limits.

Starting in 1989, the joint ventures could make transactions in hard currency with Bulgarian firms and other juridical persons in Bulgaria. The free zones in Bulgaria are areas where payments can be made in hard currency by following a certain procedure.

One of the main motives of the Western partner for starting his own or a joint firm in Bulgaria is connected with the opportunity to make a profit. This is especially valid for the medium-sized and small firms. The foreign partner can make a profit by various means: by using cheaper labor and free capital, by sharing the risk of business activities with the Bulgarian partner, by using raw materials and know-how available in Bulgaria, etc.

Bulgarian legislation guarantees the joint ventures the right to transfer part of the profits in hard currency and this procedure does not create problems. Decree No. 56 brought a positive development in this respect. According to Decree No. 535 (Article 19), the profit regime for the foreign partner was defined rather generally, and it was stated that the foreign partner could use his share of the profits either in Bulgaria or abroad. In practice, this statement created problems, as it did not specify the type of currency that could be transferred abroad. The new decree:

- Clearly and definitely expressed the right of the foreign partner to transfer all of his share of profits in convertible currency.[6]
- Provides several opportunities for converting an amount of money from Bulgarian leva to the currency in which the foreign investment was made.[7]
- States the natural right of the foreign partner to convert the payment obtained for expropriated investment of his liquidation quota from leva into hard currency up to the amount of his currency input at the time of liquidation.

One problem that is directly related to the profit regime in joint ventures is the transfer rate. The ordinance for business activities states that this rate will be that at which the Bulgarian National Bank buys currency from firms and individuals.

The application of a common transfer rate will be economical and reasonable, bearing in mind the long-term foreign economic relations of the country; also, it creates better conditions for the operation of joint and foreign-owned companies.

The legislation does not clarify questions related to the reinvestment of profit by Western participants. The profit tax itself is reduced for the joint activities, but the mechanism for determining the profit is rather complicated and far from the Western idea of profit. Apart from this, Bulgaria requires that foreign investment be self-financed.

[6] Decree No. 56 for business activities.

[7] *Ibid.*, Article 119 (2).

Evaluation of the Capital Investment

The problems related to the assessment of the capital in kind are mainly regarding convertibility, legislation, and methodology. The authorized fund of joint ventures in Bulgaria has the following provisions:

- The Bulgarian partner provides the land, premises, equipment, and cash in leva.
- The Western partner provides, in general, the technology (mainly in the form of patents, licenses, and know-how, which are subsidized), and hard currency.

According to both previous legislation and Decree No. 56, the evaluation of the in-kind capital of a Bulgarian partner must be made in national currency, taking into account prices on the international market. The evaluation of this foreign share is made by transferring foreign currency into national currency using the official rates of the National Bank at the time of signing the contract. Since national rates are different from those in the West, the evaluation of the property is performed on the basis of two completely different rates, which often presents problems. If joint ventures are to be successful, a standard and realistic approach to evaluate initial and further capital must be guaranteed.

If a competent state authority decides to liquidate a joint venture, the foreign partner redeems his share in cash and in kind on the basis of the remaining value of his share at the time of liquidation, provided that he has fulfilled his obligation to third parties. The problem of property assessment emerges, together with the problems of currency exchange and distribution of joint venture funds. If the initial capital was fixed, it can be transferred back to the country of origin in the form of hard currency. The problem of additional capital investment made in the course of operation of the joint venture remains. Such cases did not exist at the time of this analysis.

4.4.3 Management problems

To become a viable organization, the newly created joint venture should introduce and develop a common management approach, methods, and style. Joint ventures are the crossing point not only of two cultures (sometimes even more) but also of two economic systems. Each joint company faces fundamental difficulties in creating its organizational culture and image. Representatives of two different organizations have to work together most of the time. They may be technically and technologically well prepared but, unfortunately, without a deep knowledge of each other's business environment. Only a few of the constituent contracts include provisions for training the staff, especially management.

The findings are summarized as follows:

- Training and upgrading of personnel to meet standards and norms accepted in the global economic system is still a problem. Although some joint ventures show positive results in developing a separate entity and a good management system, the general picture is far from encouraging.[8]
- People who work in joint ventures should not only be highly qualified but also multi-functional (because of their limited number). Present practice puts heavy demands on employees and calls for adequate salary levels, which should be specified in individual contracts. Very often, administrative difficulties are created artificially, with the direct or indirect participation of the Bulgarian employee.
- Bulgarian managers of joint ventures are ambitious and work hard for the success of their companies. Joint companies already in operation are good examples of the transfer of managerial know-how. The experience of those companies should be studied and used for management training.
- Consulting activities should be organized and made available to joint ventures on a larger scale.
- Because accounting procedures and bookkeeping are done differently than in the West, these procedures are either done twice or created especially for the company.

Decree No. 56 created a number of provisions to solve some of the labor problems:

- Labor relations are defined in labor contracts.

[8]These conclusions about the personnel of some operating joint ventures were made by Western partners.

- The parties to labor contracts can agree which part of the salaries of both foreign and Bulgarian employees will be paid in hard currency.
- Foreign persons can perform economic activities in the country and can be employed by foreign and joint companies.

To transfer management know-how and to develop management in Bulgaria, opportunities are given by the legislation, namely:

- Foreign persons can acquire personal shares and set up joint-stock companies, thus participating in the firm's management.
- Foreign persons can be elected members of the board of directors even if they are not employed by the company.
- Foreign persons can be elected chairman of the board and managers of any firm.

These steps will allow a quicker adaptation to the Western style of corporate management and make it possible for Bulgarian managers to develop experience and accumulate managerial knowledge and skills. In this connection, business schools have been established as well as specialized firms and offices for economic, accounting, and legal support. The Joint Ventures Club of the Bulgarian Chamber of Commerce also contributes by providing managers with information and consulting services.

Other problems such as lack of market information, insufficiently clear relations with local authorities, and the need to define specific legal regulations of organizational structure in joint ventures were stressed in the analysis. It was reported, e.g., that the salaries of the Bulgarian staff do not always reflect the higher demands of joint venture employment. It is interesting and useful to study the motivation of employees, both local and foreign,[9] in order to assist the management of joint ventures in establishing good social relationships.

[9]Such a pilot study based on methodology developed by a group of Bulgarian sociologists was carried out in a few Bulgarian and Hungarian joint ventures.

Chapter 5

Joint Ventures Are Taking Root in Czechoslovakia

O. Bečvář and E. Vosicky

5.1 Czechoslovak External Economic Relations and their Possible Evolution

The present distribution by country of Czechoslovak external economic relations dates back to the beginning of the 1980s. At that time, the West was alarmed by the financial situation of some of the Socialist and developing countries, and as a consequence tight credit policies were established. Czechoslovakia opted for a very cautious credit policy, which allowed it to remain a financially sound country. A reticence about borrowing large sums reduced the number of credit-based projects imported from the West. As a result, a major shift in the flow of trade occurred, considerably increasing the share of the CMEA countries in Czechoslovak foreign trade. While the share of these countries averaged around 65 percent in the 1970s, this share increased to around 75 percent ten years later.

The 1980s have also seen a steady decrease in the share of the developing countries in Czechoslovak foreign trade. Due to the economic difficulties of some of Czechoslovakia's major partners from the developing countries, this trend will continue to reduce the role of these countries to a very marginal level unless new incentives are found.

A clear difference exists between the evolution of trade with the developing countries and with the Organisation for Economic Cooperation and Development (OECD) countries. While the share of the former continues to sink, the share of the OECD countries dropped in the beginning of the 1980s, but has grown moderately since.

The major changes in the overall management of the Czechoslovak economy resulting from various restructuring processes also have affected external economic relations. These changes can be summarized as follows:

- The possibility of handling foreign trade exclusively through specialized foreign trade corporations has been to some extent abandoned.
- The specialization of these foreign trade corporations is increasing as many of them create their own trading departments, dealing with other goods than originally planned.
- A procedure allowing production enterprises to become fully or partially active and independent in their foreign trade activities has been established.
- Rules for the negotiation and conclusion of contracts on industrial or production cooperation have been simplified.
- Incentives to stimulate exports have been improved.
- A law covering the establishment of joint ventures in Czechoslovakia came into force on January 1, 1989; the first agreement calling for mutual promotion and protection of investments was signed in Belgium in April 1989, serving as a precedent for other agreements in the future.

At the same time, a dramatic change has occurred in the economic management of some major Czechoslovak trading partners such as the USSR, Poland, Hungary, and Bulgaria. These countries are tackling their economic reforms in a radical way, uniting the opportunities for traditional central coordination of trade with other CMEA countries and giving a wider degree of independence to production enterprises.

In this new environment a Czechoslovak enterprise must react not only to local processes, but also to the new situations of a number of major trading partners. It must develop expertise in doing international business, an activity that until recently was reserved for foreign trade corporations. This expertise involves both marketing and languages.

An attempt has been made to evaluate the future development of Czechoslovak external relations. Some of the restructuring processes in the Czechoslovak economy could cause a shift of priorities in the Soviet Union. For example, buyers from the Soviet Union have been interested in the full range of the Czechoslovak machinery, equipment, and engineering products. Until recently, the trends and priorities leaned toward equipment and machines for the production of consumer goods and foodstuffs. Continuing this way would expose the Czechoslovak producers to keen competition from Western countries and would encourage them either to change their product range, making it similar to that of Western companies, or to search for substitute markets. The consequence could be a temporary decrease in the Soviet share of Czechoslovak foreign trade.

Although the business situation among small CMEA European countries sometimes appears confusing and unclear, one can assume that the existing system will allow them to maintain trade at the present level, with a dynamic increase over the medium term. This increase will depend on the economic modernization of these countries and also on their capacity to produce more market-oriented products. A satisfactory solution to the monetary problems prevailing in the CMEA would contribute greatly to a new economic take-off.

The growing independence of Czechoslovak enterprises in their foreign trade activities would speed up remarkably the country's trade with the neighboring OECD countries – the Federal Republic of Germany (FRG) and Austria. A logical hypothesis is that the Czechoslovak newcomers to international trade will mainly speak German and will know their German and Austrian partners better than others. This tendency will be strengthened by the steady and long-lasting activity of German and Austrian firms in the Czechoslovak market. These two countries already represent nearly one-half of the

Czechoslovak OECD trade. We can expect the volume of their trade with Czechoslovakia to grow in both relative and absolute terms.

They also seem to be prepared to tackle the problem of "global solutions" with Czechoslovak partners, offering them buy-back deals, leasing, joint ventures, cooperation contracts – all tailor-made. Contacts between Czechoslovak industries and their German partners also may ease some of the negative consequences for Czechoslovakia when a single market is formed in Western Europe.

The role of the OECD countries (specifically France, Italy, Sweden, Denmark, Canada, and Japan) remains very active in the Czechoslovak market and can be expected to increase in the future. The current trade policy between Czechoslovakia and the USA, resulting from the USA's suspension in 1951 of Czechoslovakia's *Most Favored Nation* status, keeps trade at a low level, not exceeding 2 percent of the Czechoslovak trade with OECD countries.

We expect further development of Czechoslovak trade relations with China. Since 1985, many producers of machines and equipment in Czechoslovakia have been focusing successfully on China. Assuming their efforts remain steady, we may witness further growth because both partners complement each other well: Czechoslovakia produces equipment and China produces a variety of consumer goods popular on the Czechoslovak market.

Ongoing development in Czechoslovakia, particularly the self-financing of enterprises, will trigger the selection of sectors where Czechoslovakia is highly competitive. The limited range of products produced in the country and increased competition in the remaining sectors could bring Czechoslovakia into the international division of labor.

5.2 The Law on Joint Ventures

After a period of experimentation, the Federal Assembly of the CSSR on November 8, 1988 adopted a law on enterprises with foreign capital participation, effective January 1, 1989. It provides that joint enterprises are subject to the following taxes: income (or profit) tax, social security contribution (known also as a tax on wage volume), and turnover tax.

The tax base for joint enterprises consists of the profit derived from the activities forming the object of the tax. The basic sum is increased with the amounts paid by the enterprise in the form of penalties, sanction interest and other sanctions, and the amounts of increased production costs or decreased yields.

The rate of income tax for joint enterprises is 40 percent. It is possible to ask the Federal Ministry of Finance for tax relief, which can mean complete exemption from the tax for a maximum period of two years. If the tax base does not exceed Kčs 100,000, the rate of income tax is only 20 percent.

The social security contribution reflects labor costs in relation to technology assessment. The basis of this contribution is the total volume of wages paid by the enterprise in the current year; the tax rate is 50 percent. The income or profit tax base is reduced by deducting this contribution. As with income tax, it is possible to request a reduction or modification of the base of the social security contribution for a maximum period of two years. For dividends, the generally applicable rate in Czechoslovakia is 25 percent.

Czechoslovakia has concluded agreements to avoid double taxation with a number of countries, which further lowers rates. This taxation, however, applies to foreign partners only. For Czechoslovak partners, the dividends are included in profits and are taxed accordingly. A total of 17 bilateral treaties with Western countries have been concluded so far based on the OECD model treaty.

The law requires that the joint enterprise provide for the following funds: a reserve fund, a fund of cultural and social needs, and bonus funds.

Beginning January 1, 1989, another change took place in Czechoslovakia: the so-called single-component rate of exchange was introduced, issued by the State Bank of Czechoslovakia in absolute figures. Until December 31, 1988, only the so-called official rate of exchange was listed officially, while the rates for commercial and noncommercial payments (in Czechoslovakia different rates are used) for internal purposes were determined by means of coefficients.[1]

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[1]As of January 1, 1989, the respective rates are given directly on the official list. For instance, in January 1989, the rate for non-commercial payments was US$1 = Kčs 9.39 and the rate for commercial payments was US$1 = Kčs 14.49. The use of other rates is prohibited.

Bank credits to joint companies are also possible. The types include operation, investment, and foreign currency credits. Operation credit can be granted for working capital, current accounts, and other short-term assistance. Investment credit serves for purchasing fixed assets and for bridging time intervals between the need for resources and the information. Foreign exchange credit is granted by the bank to enhance both exports and imports. Short-term credits payable within one year have a 5 percent rate of interest, medium-term credits payable within three years a 6 percent rate, and long-term investment credits 7 percent.

The interest rate of foreign exchange credits is based on rates and conditions of international money markets, the type of currency, and the repayment period. The bank also can grant credit to pay a share in a joint enterprise (venture) or to purchase stock. This credit is payable within five years at 6 percent interest.

Protection against measures limiting property rights is of major interest to foreign partners. Some states endeavor to increase business security by proposing to conclude intergovernmental agreements on investment protection. The first of them was signed with Belgium on April 24, 1989. The law itself contains important provisions in this respect.

In those cases when it would become necessary to expropriate or otherwise limit property rights, the foreign partner must be afforded compensation corresponding to the actual value of his property at the time of execution without delay. That is, compensation must be paid simultaneously with the invocation of the decision to expropriate. It must be freely transferable to another country in foreign currency.

The prices at which joint enterprises will buy and sell both in Czechoslovakia and abroad, and the procedure for their formation represent one of the decisive aspects that must be taken into account during a feasibility study.

The prices of products manufactured in Czechoslovakia or supplied to Czechoslovak buyers are currently uniform throughout the entire territory of the CSSR.[2] An exception in this respect consists of imported products or products intended for export and products whose prices are determined by an agreement between seller and

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[2]According to the Order of the Government of the CSSR No. 112/1982 on state control of prices.

buyer. The price proposals must be submitted for approval to the respective authority. The determination of prices at which joint enterprises sell to and buy from other countries depend on conditions of foreign competition.

Under the conditions described above, joint ventures can exist as joint-stock companies[3] and also in the form of an association.[4]

A supplement to the law is the Decree of the Ministry of Finance on auditors and their activities, which codifies the procedure for nominating and recalling auditors and their activities in joint ventures. The provisions were applied for the first time in auditing annual balance sheets and economic activities of joint ventures for the year 1989.

Regulations differ regarding record-keeping and financing methods for joint ventures. Except in free trade areas, all accounting is done in local currency. Observing local regulations is unavoidable when dealing with financial institutions and banks. Records of capital assets and operating results should always be available to shareholders in the West and disclosure cannot be refused. Until uniform regulations in both systems are achieved, top business executives in joint ventures must do double accounting to satisfy both parties.

Difficulties in bookkeeping arise because of the different accounting procedures used in the Eastern European and Western countries. The main differences are in accounting for business profits and losses abroad, in the value of goodwill, stocks and work in process, loans, research and development expenses, and depreciation. While in CMEA countries the information system must follow the fulfillment of a central plan, Western bookkeeping serves as an exact description of the commercial standing of a corporation to the date of closing the books. These facts are directly linked with auditing. The auditor states whether the record-keeping corresponds to generally accepted methods and whether consolidated accounts have been found true and fair. The cooperation of the auditors for both parties is useful, particularly with regard to the correctness of the reported amount of profits and expectations as to the return of invested capital.

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[3] Codified in Czechoslovakia by Law No. 243/1949 on joint-stock companies.

[4] Section 625 ff. of Law No. 110/1963 of the Foreign Trade Code. Under this law, only the association as a legal person (Section 636) can be considered for joint enterprises.

The assistance of consultancy agencies is recommended especially during the establishment stage of an East–West joint venture. Specialists from large international firms would be able to analyze and solve almost all aspects and problems mentioned. For medium-sized and small enterprises, a consultancy service should be available. This service must not be considered as belonging to either side, but rather as an interconnection between both sides in the joint venture and highly beneficial for potential partners.

5.3 The Process of Establishing Joint Ventures

The establishment of enterprises with foreign capital participation in the Czechoslovak Socialist Republic began experimentally in keeping with the government's decision in 1987 in sophisticated production sectors (chromatographs and video recorders). Before that, two joint enterprises were set up with partners from Socialist countries – one for the processing of waste rock following black coal extraction (founded in 1983), and the other for research, development, and production of components for robotics (founded in 1985). A third joint enterprise, in maritime shipping, was established in 1987 with a partner from the People's Republic of China.

The drive to launch joint ventures started in earnest in 1988. Nine ventures involved partners from developed Western countries; two ventures had partners from CMEA countries. This accelerated pace continued into 1989. Another 17 joint ventures were set up with partners from Western countries and two with partners from CMEA countries. By the middle of 1989, a total of 36 joint ventures existed in Czechoslovakia, seven of which were with partners from CMEA countries.

At first, joint ventures were established in industry. Then came a period of setting up joint ventures in hotel and spa-facilities construction. Recently, both of these categories are well represented. The present breakdown is as follows: Industry – 1, Tourism – 9, Health – 3, Construction – 1, Transport – 1, Services – 3.

Most of these joint ventures are small enterprises. This explains their relatively small influence on the overall trade exchange of the country. The Enterprises with Foreign Capital Participation Act passed in November 1988 has considerably improved the conditions for entrepreneurial activity and has also simplified the approval procedure. In turn, this has greatly speeded up the establishment of new joint venture companies.

This short history of joint ventures in Czechoslovakia does not permit a thorough analysis of the results of their operations. For the sake of the future, however, it is necessary to gather and analyze these results. Draft recommendations are being prepared for operating joint companies as well as for working out conceptual resolutions. The partial evaluation of the data that has been gathered may be generalized, although with a certain risk. Bear in mind that the great majority of joint ventures in Czechoslovakia are still in a preparatory stage, not yet in regular operation.

Given these reservations, the following may be stated:

- The key but non-specific cause of the limited development of joint ventures is a number of obstacles in external economic relations, particularly in exports. These obstacles have been identified by experts as insufficiently high technical standards, high production costs, inconvertibility of the Czechoslovak currency, or commercial-political impediments applied to Czechoslovakia and also affecting the production of joint venture companies.[5]
- On the other hand, management conditions obviously do not constitute the principal cause of the restraint shown by potential partners. The safeguarding of foreign investments also was reinforced by the Enterprises with Foreign Capital Participation Act, which clarified the possible transfer of the share of net profit (dividends). In the case of repatriation of profit earned in local currency, a new option was introduced on July 1, 1989 with the launching of the so-called limited foreign currency market as an experiment in which a joint venture company can participate.
- Despite the publicity given to the possibilities of joint ventures by the Czechoslovak Chamber of Commerce and Industry, a considerable information gap still exists in foreign entrepreneurial circles. The practice of issuing lists of offers by parties interested in setting up joint ventures, already common in some other

[5]These obstacles may possibly be removed after the current political changes go into effect.

countries, has not yet been introduced in Czechoslovakia. Preparations, however, are under way for the establishment of a Joint Venture Club.

- Substantial untapped resources for joint ventures still exist in the national capacities available in basic and applied research as well as in other intellectual work, notably in the preparation of software, the need for which still is not covered worldwide.
- The concept of establishing joint ventures does not always follow the optimal relationship between basic capital and the amount of credit. Profitability based on high credit sources will be influenced by interest payment obligations. Similarly, it appears that the national resources of the suppliers are not always used. Preference is sometimes given to deliveries from abroad in cases of investment construction (new hotels or health facilities).

  In contrast to other CMEA countries, Czechoslovakia's banking services are conventional and banks have refrained from establishing joint banking institutions locally. The same applies to the consulting field, including services related to consultations on joint enterprises.

  As far as the human factor in joint entrepreneurial activities is concerned, notably the competence of management in decision making and in relationships with partner organizations, no negative signals have been apparent as yet.
- Very little is being done to rationalize management and administrative activities. Despite this finding, it will be useful to intensify the systematic training of managers so as to broaden the scope of joint entrepreneurial activities. Considerable care must be taken in choosing the curricula and lecturers. It appears that this kind of training cannot rely exclusively on either national or foreign sources. Instead, there must be a combination of domestic and advanced foreign methodology in training.

Under existing Czechoslovak conditions, no preparations have begun to establish free zones where joint ventures can operate as they do in other countries, including landlocked countries. Despite the assumption that establishing free economic (duty-free) zones will not play a decisive role, a re-examination of this issue must be made.

Some of the established joint ventures have extended the scope of their activities to other foreign investments. A joint venture in Western countries has a good reciprocal effect in the allocation of capital and most frequently in the rational division of labor. Multilateral joint ventures are being set up in Czechoslovakia as well. The incorporation of a Czechoslovak supplier into an East–West foreign-based joint venture provides an opportunity to participate in an entity with a much larger operational range.

5.4 The Practice of Czechoslovak Joint Ventures

At the beginning of 1989, 16 joint ventures were operating in Czechoslovakia, five of which were East–East joint ventures. Eighty percent of all joint ventures are companies limited by shares. The rest are associations (*Table 5.1*).

The list of joint ventures by sector in Czechoslovakia shows that:

- 25 percent are engaged in machinery and machine tools.
- 13 percent are engaged in chemistry and timber industry.
- 6 percent are engaged in transport.
- 6 percent are engaged in electronics and software.
- 6 percent are engaged in civil engineering.
- 18 percent are engaged in service and trade.
- 13 percent are engaged in health care.
- 13 percent are engaged in other areas.

No joint venture has been established in the consulting and banking sectors.

Act No. 173/88 on Enterprises with Foreign Property Participation in Czechoslovakia became effective on January 1, 1989. This law provides conditions for establishing companies with foreign, legal, or individual participation. Compared with the former status, many conditions have been simplified and facilitated. For example, permission from only one central authority of the State administration is required to set up a joint venture. Other key provisions:

- An authorization can be granted to any branch of the national economy (except those sectors related to national defense and security).

Table 5.1. Joint ventures in Czechoslovakia at the beginning of 1989.

Name	Partner	Share %	Field of activity	Capital funds in millions	Founded
TESSEK Prague	SENETEK PLC, Aarhus, DK TESLA BRNO	49 51	Chemical production, transfer of technology	Kčs 30	30 Dec. 1986
AVEX Bratislava	NV Philips, Eindhoven, NL Transakta FTO, Prague	20 80	Production of consumer electronics, video recorders	Kčs 140	12 Aug. 1987
HOTELINVEST Prague	Warimpex, Vienna, Austria Cedok, Prague	49 51	Tourism, building of hotels	Kčs 50	14 Jan. 1988
LUWEX Prague	Warimpex, Grassi, Waema, Vienna, Austria ZVS Milevsko	49 51	Projecting and engineering activities, export and import of blast air equipment	Kčs 10	11 Mar. 1988
BALNEX Prague	Warimpex, Vienna, Austria Cedok, Prague	49 51	Treatment, building of medical institutions	Kčs 15.7	16 Mar. 1988
BALNEX I. Prague	Warimpex, Vienna, Austria Balnea, Prague	31 69	Treatment, building of medical institutions	n.a.	16 Mar. 1988
RECOOP TOUR Prague	Grassi GmbH, Vienna, Austria RECREA FTC TRADEX	49 51	Tourism, building of hotels	Kčs 15	16 Mar. 1988
MSZ Dolni Nemci	MSZ Seligenstdt, FRG JZD Javorina, Dolni Nemci	45 55	Breeding of fur animals	Kčs 13	30 Mar. 1988
TOURINVEST Prague	CBC, Paris, France Cedok, Prague	49 51	Tourism, building of hotels	Kčs 50	26 Apr. 1988

Table 5.1. Continued.

Name	Partner	Share %	Field of activity	Capital funds in millions	Founded
DANCO Prague	Naturgas Syd, Vejen, DK	49	Production of pipes, pipe fittings, and couplers for gas pipings, building of gas pipings	Kčs 135.3	1 Jul. 1988
	CPP Koncern, Prague	51			
AGROTOP Straznice	G. Topham & Co. GmbH, Vienna, Austria	40	Processing of wood and lumber	Kčs 20	26 Jan. 1989
	Agropodnik, Hodonin				
	Transakta FTO, Prague	60			
HALDEX Ostrava	Tatabanya Szenbanyak, Tatabanya, Hungary	50	Processing of waste rocks from mining of black coal	Kčs 65	3 Jan. 1983
		50			
ROBOT Presov	2 Soviet organizations	50	Research and production in the area of robotics	Rbl 10	19 Apr. 1985
	7 Czechoslovakian organizations	50			
CHINA-CZECHOSLOVAK CO. FOR OCEAN SHIPPING	China Ocean Shipping Co., PRC	50	Ocean shipping	US$10	26 Apr. 1987
	Czechoslovak Ocean Shipping Co.	50			
INTER-KOMPRESSOR Prague	Kompresormas Kazan, SSSR	50	Cooperation in production of superchargers, coordination of scientific and technical activities	Rbl 1	9 Jun. 1988
	CKD, Prague, Kombinat	50			
SKODA URALMAS	Uralmas, Sverdlovsk, SSSR	50	Direction of scientific research and developing activities, projection and deliveries of rolling mills	Rbl 0.5 + US$0.3 Kčs 5.0 + US$0.3	1 Dec. 1988
	SKODA Koncern, Pizen	50			

Collected by Ing. Jindrich Blaha, TESLA ELTOS-IEVEP, Prague, February 10, 1989.

- No tasks can be imposed on the corporation by the State Plan for Economic and Social Development.
- The corporation has the right to dispose freely of funds for the purposes for which they have been created.
- Upon payment of taxes due and allocation of the necessary amounts into the respective funds, the earnings available may be distributed among the shareholders.
- The corporations are not obliged to offer their own exchange for sale to a bank.
- There are no limitations regarding the share of foreign capital participation.
- No special nationality is required for the corporation's chairman.

Necessary steps have been taken to clarify significant problems, such as the material supply of joint venture companies or the system of price stipulation. On the other hand, self-financing of joint venture companies is a categorical requirement.

Summarizing this deliberation on the feasibility of joint ventures in Czechoslovakia, it seems that the necessary conditions have been established to support the positive development of joint ventures.

This analysis is based on the IIASA questionnaire.[6]

While evaluating the answers to the questions, bear in mind that most joint ventures in Czechoslovakia had been established (and registered), only recently, i.e., in 1988. Only two had been operating for more than one year. Most were in the beginning stage, shaping their own entrepreneurial policy and preparing investments and other initial undertakings.

The distribution of joint ventures among the different branches of activity is as follows:

Manufacturing	Tourism Hotels	Medical care	Projects and engineering	Total
42%	25%	16.5%	16.5%	100%

[6]In the first quarter of 1989, all 12 East–West joint ventures in operation on Czechoslovak territory were approached by the Research Institute of Economy in Electrotechnical Industries and asked to share their experiences, viewpoints, and recommendations according to the uniform IIASA questionnaire. In several cases, the firms were given assistance in filling in the answers. By the given deadline, 66 percent of the questionnaires had been returned.

The distribution of foreign partners is as follows:

Austria	Holland	Denmark	FRG	France	UK	Total
52%	8%	16%	8%	8%	8%	100%

Joint ventures established as joint-stock companies predominate. Only one joint venture was established as a consortium and one as a limited company.

In all cases the capital share of the Czechoslovak partners is larger, which is partially due to previous legal stipulations; the law concerning joint ventures with foreign participation permitting a foreign capital majority has been valid only since the beginning of 1989. The enterprises are mostly medium sized. The total amount of basic capital lies within the limits of two to 140 million Czechoslovak crowns (Kčs). The ownership participation of Czechoslovak partners in the joint ventures consists in all cases of invested financial capital and long-term leasing of buildings or land and, to a smaller extent, provision of machinery and licenses.

All joint ventures were established for an unlimited duration of time. This is due to the considerable investment in buildings or technology and the subsequent possibilities for production innovation, all factors contributing to long-term entrepreneurial objectives. The activities within the joint ventures include marketing and technical pre-production stages (development and also partially research). In nonmanufacturing activities, no financial or consultancy services are represented. The Czechoslovak and foreign participants know each other from previous business activities, mostly foreign trade. Joint ventures involved in the construction of hotels and spa facilities are often newly established relations.

In the joint venture turnover that has been seen to date, home market deliveries are predominant. The size of the share achieved by exports reflects the fact that the joint ventures are newcomers in the world markets although they receive the assistance of the foreign partner.

The products introduced and technology used in the new joint ventures have, in general, a progressive character. In joint ventures that have been operating for more than one year, positive results have been achieved in local currency. Reserves are carried over from achieved profit to the next period to be used for further investment in the company.

The joint ventures employ local manpower in agreement with the foreign partners. The percentage of administrative staff to the total number of employees is lower than in national enterprises. (This comparison is not relevant for joint ventures still in the stage of constructing premises.)

The motives for establishing joint ventures are as follows:

(1) The local partners:

- Ensuring new product manufacture with foreign assistance.
- Obtaining freely exchangeable currencies, often to purchase components and technology.
- Providing capital for construction (particularly hotel and spa facilities).

(2) The foreign partners:

- Extending their activities to new markets.
- Obtaining economically more advantageous basic materials in some cases.
- Utilizing suitable local conditions for developing tourism and health resorts.

The initiative for negotiations leading to the establishment of a joint venture cannot be determined precisely; it usually resulted from previous trade relations.

The establishment of the joint venture is negotiated with the highest authority in the given branch, the foreign trade activity licensed with the Federal Ministry of Foreign Trade. In addition to registration at the competent local court, the new joint ventures open accounts with a bank, and in most cases, obtain authorization to raise credits in foreign currency.

A positive tendency is that usually a number of persons involved in the preparation continue as executive members of the joint venture.

Consulting agencies usually are not involved until foundation documents are prepared. The responding companies found that elaborating a technical-economic analysis, as is customary in Czechoslovakia, has an important influence on the successful establishment of a joint venture. The foreign partners devote the same attention to preparing a feasibility study. Market studies, performed by both sides in their respective regions, serve a decisive basis for both analyses. The other segments of the approval process are considered less important.

The firm's standing is the most important criterion for choosing a partner. In itself, standing is the result of a number of factors, such as the production program or staff qualifications. Priority is given to modern technology in manufacturing organizations, based on licenses and know-how, and to products.

Specific factors that favor the establishment of joint ventures exist in Czechoslovakia. First is the highly qualified manpower in manufacturing, research and development, designing and engineering services. Second is the planning system and material supply structure, which can sometimes affect the delivery of materials and parts, often forcing the participants to adopt individual solutions, e.g., joint ventures. It is necessary to consider the important and complicated issues of currency convertibility. These call for special solutions when import requirements are not covered by adequate exports.

The initial stages of preparing to establish a joint venture have been gradually shortened. The Law of Enterprises with Foreign Ownership Participation considerably simplifies administrative procedures. Applications are approved currently within three months.

In setting prices, the joint ventures foresee no important obstacle. The method of price setting is not regulated in foreign trade; prices always are agreed upon under contract. For setting prices on the domestic market, a gradual rationalization is now envisaged. Foreign trade monopoly does not seem to be a major problem. Monopoly can be avoided by issuing authorizations for foreign trade activities. The prescription of planned delivery tasks has been abolished by law. Responding companies expressed certain apprehensions about provisions during the transitional period, when there is a tendency to limit the budgeting system before applying a full free supply mechanism on the basis of actual demand.

The joint ventures' view is that a technically and economically competitive product only can be produced through the application of modern technology. This appears to be a decisive element for the success of joint ventures. Increased profits only can be achieved through modern technology and good market position.

In identifying potential problems, the economic issues associated with realizing entrepreneurial objectives are cited. Problems of an administrative nature are considered less important. From the technical point of view, the problem of ensuring first-class quality consistently ranks first. Such personnel issues as remuneration and management style, effectiveness, and culture are regarded as important but less problematic.

Among environmental uncertainties, the responding companies stress increasingly changeable consumer preferences and the difficulty of predicting them accurately. In manufacturing, the influence of competition is also important; this aspect does not apply, however, to joint ventures operating in the field of tourism and spa facilities.

In most cases, the management structure of the joint ventures has a standard form typical for joint-stock companies. The joint ventures mention no particular problem in relations between managers of different nationalities. The executive jobs are held by local specialists with the agreement of the foreign partners.

Decisions on strategic issues must be taken unanimously. In some instances, special consulting groups (policy committees) are used. The responding companies mentioned some isolated factors as being risky, e.g., to adapt to changing foreign technical standards and to provide supplies, both local and imported ones.

In analyzing the advantages of joint ventures compared with traditional foreign economic relations, foreign capital investment is dominant. The main feature of the integration formalized by establishing an independent organization (joint venture) is the rational management system of the enterprise, which could never be provided to such a degree by other forms of industrial cooperation.

The short period of practice has shown that joint ventures bring an improvement in management procedures, including the application of new methods. This is considered to be a second important benefit from the development of joint ventures.

Chapter 6

Hungary: Pioneer in Joint Ventures

T. Benedek

6.1 National Economy and the Reform

After World War II, an autocratic strategy was introduced in Hungary that led to a very weak economic structure:

- Traditional Hungarian agriculture was nearly destroyed by forced methods of collective activity.
- Ineffective new industries were created, while traditional industries stagnated.
- Heavy industry without a basis in basic domestic materials and traditions was overdeveloped.

Finally, the country itself was burdened with an unhealthy industrial capacity, greater in some fields than what the domestic market required. A more serious problem was that general product quality was not high enough to compete in Western markets. This remains one of the main problems of the Hungarian economy. Production requires a great quantity of Western materials, spare parts, machines

Table 6.1. Hungarian foreign trade partners.

	Thousand million Ft		Percentage	
Foreign trade 1987	Imports	Exports	Imports	Exports
CMEA countries	242	247	52	55
Developed countries	191	165	41	37
Developing countries	30	38	7	8
Total	463	450	100	100
Of which:				
Ruble account	210	214	45	48
Dollar account	253	236	55	52

and know-how, and this situation has led automatically to problems with the balance of payments.

Industry is the main active earner in Hungary with a 31.2 percent share of gross domestic product (GDP). The second branch is agriculture (19.3 percent), followed by services (12.5 percent), trade (10.5 percent), construction (7.6 percent), and transport (6.8 percent). For the last 5 years, the GDP has increased on average by 1 percent to 1.5 percent per year, and the increase in the national income has been slightly less.

Foreign trade and international economic relations have played a very important role in the life of Hungary. The main partners and the quantity of foreign trade are shown in *Table 6.1*. The net debt of the country is currently about US$11 billion.

Economic and political reforms began in 1974. The tasks were enormous, and included solving many economic problems such as:

- Handling the balance of payments and the debt problem.
- Changing the unhealthy structure of the economy.
- Opening trade to Europe.
- Changing old-fashioned methods of direction and management.
- Aiding the privatization process.
- Strengthening East–West cooperation in all fields.
- Solving unemployment and raising the standard of living.
- Solving problems which arose as a parallel effect of the reform.

These are the main problems that have to be solved in Hungary within the next decade.

6.2 The Effect of Legislation on the Establishment and Operation of Joint Ventures (1970–1989)[1]

The law-decree concerning trade companies was passed on August 7, 1970, and was offered in accordance with a new economic mechanism introduced in 1968. During the economic boom of the following years, it first became legally possible for foreigners to participate in Hungarian economic ventures. This possibility, however, existed only theoretically because the competent authority had unlimited discretional powers regarding approvals. This meant that the legal basis for establishing such companies had to be approved by the authorities.

A significant step was the decree of the Minister of Finance at the end of 1972, regarding "economic companies operating with the participation of foreign entities, and containing a more detailed regulation concerning the operation of such ventures." According to this decree, such economic ventures may be established in the form of an unlimited partnership, joint-stock company, company with limited liability, or joint company.

The share of the foreign partner(s), in general, could not exceed 49 percent. Although the possibility of a foreign share majority was not excluded, the first instance of such occurred only in 1979, when the Central European International Bank was established as an "off-shore bank."

An important element of the regulation was the guarantee of the National Bank of Hungary to allow profits due to the foreign party to be transferred in convertible currency and, upon request, to reimburse any loss suffered by the foreign party as a result of government measures in convertible currency up to the amount contributed by the foreign party to the joint venture.

After five years, the government authorities extended the possibility of establishing joint companies in production fields. In 1977, the Minister of Finance modified the regulation regarding trade associations operating with foreign participation and declared that, with the permission of the Minister of Finance, associations may be established that offer trade and service activities aimed at economic development at the technical and commercial level.

[1] This section is based on the study of Ferenc Revsanyi, IGI, 1989.

The decree was an important change in taxation: the extent of tax on profit was determined uniformly at 40 percent. It also declared that no other tax or tax-like fees would be imposed besides the profit tax. Another clause states that the Minister may grant the company a more favorable tax rate than the one foreseen by the decree.

In 1978, the Minister of Finance issued two decrees concerning trade partnerships involving foreign participation. One of them made it possible to establish mixed companies in the form of deposit companies. The other decree regulated the former profit tax, currently called "company tax." The rate was left unchanged at 40 percent. An additional tax, "extra company tax," covers commissions, prizes, attendance fees, and honorary fees as well as lump-sum grants, undocumented confidential expenses, and the costs of a company car for personal use. The rate of this tax was 20 percent until the end of 1988.

An order issued by the Minister of Finance in June 1979 described the formalities to be observed by the Hungarian party in obtaining permission to participate in a joint venture. This procedure involved three phases:

- Declaration of intent to found the company must be filed with the Ministry of Finance and the Ministry of Foreign Trade prior to preparatory negotiations.
- Upon approval, an application for a permit to commence negotiations must be filed.
- Finally, application (in ten copies) must be made for approval of the agreement that is to govern the joint venture.

The last-mentioned application (in original language and in translation) had to be accompanied by the contracts, agreements, minutes of meetings, and other documents (statutes, associations, agreement, agenda, etc.) that regulated the founding, internal order, and operating conditions as well as the rights and commitments towards the company and towards each other if not regulated in these documents. These procedures, taken together, explain why the approval process lasted six months to one year for each joint company.

Among other requirements, the regulation also committed the company to establish a risk fund to disburse tax and social security fees upon the wages and salaries (35 percent at that time and 43 percent in 1989).

Until 1982, a total of 12 joint companies were set up with only two or three of major importance: SICONTACT (see Chapter 12), Central European International Bank Ltd (acting as an off-shore bank), and a pharmaceutical plant jointly owned with Ciba-Geigy, Switzerland.

A joint decree of the Minister of Finance and the Ministry of Foreign Trade issued in 1982 represented a step forward. It regulated joint undertakings established in customs-free port areas. The decree exempted the parties from a number of bureaucratic regulations concerning:

- Company revenue.
- Wages and salaries.
- Prices.
- Investment process.
- Government control, company and interior supervision.
- Establishment of various funds and allocations (except the risk fund), the extent and methods of handling the company funds.
- Purchase and use of motor vehicles.

Goods brought into the country from the free port are considered as goods imported from abroad, i.e., as hard-currency imports subject to extremely high customs duty, particularly for products of the latest technological level.

During the first half of 1980, partly as a result of more intense publicity, the number of joint companies increased but both the number (annual average: 10) and the foreign investment of operative funds remained far below expectations. Two fields required radical changes: permits and taxation. This was recognized by the government, and considerable changes were effected by the end of 1985.

The requirement for license application was suspended. There remained only the obligation to declare that, in the course of preliminary talks, the parties have reached a conceptual agreement to establish their association in Hungary. The simplified approval process reduced the duration of the process from six months to a year to between two and three months.

The other important measure concerned taxation. If the company's activity was of particular importance to the Hungarian economy, the joint company could be fully exempted from taxation for the first five years and, from the sixth year, the rate could be set at 20 percent. The sphere of such important activities was defined jointly by the Planning Office of the Ministry of Finance and the Ministry of Foreign Trade. These fields were electronics, packing technologies, pharmaceutical products, and tourism.

The regulation covered mixed companies in such nonpriority activities as direct production and hotel operation. It declared that if the companies were prepared to use their tax-net profit for investments and

- The amount of such investment attained 50 percent of the preceding year(s) (maximum period of five years) but not less than Ft 5 million, 50 percent of the paid-in company tax would be reimbursed upon request; or
- The investment attained 100 percent of the tax-net profit of the preceding years but not less than Ft 10 million, 75 percent of the paid-in company tax would be returned upon request.

The simplified procedure of obtaining license and taxation privileges went into effect on January 1, 1986. These measures accelerated considerably the influx of foreign capital and correspondingly increased the number of joint companies. Through 1985, a total of 45 joint companies had been established with foreign funds amounting to US$50 million. From 1986 to the end of 1988, another 200 joint companies were founded with an additional US$250 million foreign-authorized funds.

A decree of the Minister of Finance concerned the first line joint companies: setting Ft 500,000 as basic capital for limited companies and defining the minimum basic deposit as Ft 100,000 and Ft 5 million with a minimum share extent of Ft 100,000 for joint-stock companies.

Another significant measure was the regulation issued in 1987 by the Minister of Trade with regard to the administrative order of foreign trade activities; it became effective on January 1, 1988. An interesting feature of this regulation is the extension of the right of foreign trade activities to the private sector, declaring (under Section 8) that private persons and their companies are entitled to pursue trade activities. After having obtained permission from the Ministry, they may sell their own products and/or services to foreign markets.

This liberalization of foreign trade activities refers to hard-currency regulations only.

By the end of 1988, the above regulation resulted in approximately 200 private persons and over a thousand trade organizations obtaining the right to pursue independent export/import activities, a significant increase since the beginning of the 1980s when the number had been no more than 30–40.

One of the most important laws enacted in the past 40 years is the Act VI/1988 concerning trade companies, which opened up important new possibilities to promote foreign investments in Hungary. The law covers partnership relations established between Hungarian legal and natural entities (Hungarian citizens), with the participation of foreigners or foreigners alone for trade and economic activities or their promotion. Consequently, foreign parties may own 100 percent of such trade companies, including the means of production, i.e., real estate or mobile assets.

It is important to make clear to the foreign parties that they can participate in the founding or be members of such companies only if they are already owners of a company or are respectively registered as a company in their own country in accordance with the prevailing legal regulations. Any foreign, natural, or legal entity may be a shareholder of the company established in Hungary.

If the share of the foreign partner is less than 50 percent, no special permission is required, not even that of the foreign exchange authority. A company contract signed by a lawyer and the registration of this contract signed by the Court of Registration are sufficient to establish the company.

The law declares that the share of a company's profit due to the foreign party or, in case the company ceases to exist or the foreign share becomes partly or entirely alienated, the amount due to the foreign party may, upon its disposal, be remitted in the invested currency and out of the funds at the company's disposal without special permission from the foreign exchange authorities.

The main new possibilities offered to foreign investors by the new company law are: investments, 100 percent foreign possession, acquisition of real estate, establishment of partnership with Hungarian natural entities and, in case of less than 50 percent participation, establishment by court registration only.

The government decree set up an operating committee to coordinate and accelerate the governmental tasks involved in establishing trade organizations with foreign participation. One of the deputy prime ministers acts as chairman of the committee and the members are the Minister of Trade, the Minister of Finance, and the President of the National Bank of Hungary. The President (Chairman) of the Cabinet Bureau appoints deputy ministers as members who can substitute for the committee chairman. The important tasks of the committee are to coordinate the work of all government organizations involved and to arrange and/or initiate the elimination of obstacles to trade development.

Act IX (Section 14) of 1988 defines the tax privileges to be applied as follows:

(1) If the foreign share in the statutory funds attains 20 percent or Ft 5 million, a 20 percent tax on profits is imposed.
(2) If more than half of the price returns arise from the output of products or from operating a company-built hotel and if statutory-comprising funds exceed Ft 25 million comprising a foreign share of 30 percent, a 60 percent tax reduction is granted for the first five years and 40 percent from the sixth year onwards.
(3) Finally, if the stipulation under (2) is complied with and the company pursues *an activity of particular importance*, a 100 percent tax exemption is granted for the first five years, and from the sixth year a 40 percent tax reduction is granted, i.e., can be retained from the tax imposed.

Fourteen activities of particular importance are listed by the legislation, including: electronics, manufacturing of vehicle components; machine tools; machineries for agriculture, food industry, and forestry; manufacturing of machine elements; packing/wrapping; telecommunication services; tourism; and biotechnology.

A decree issued by the Ministry of Finance concerning modifications in the law regarding planned foreign exchange policy is part of an effort to update regulations in this field. This decree makes the exchange affairs of foreign investors in Hungary less complicated. It declares that no permission from the foreign exchange authorities is required for the foreign party to take or send his shares out of the country, provided the joint-stock company confirms that the foreign party obtained such shares in accordance with the pertinent regulations.

The company can keep the hard-currency contribution of a foreign member of the joint-stock company as part of its original foreign exchange being held by a Hungarian bank. It can use such funds to procure means of production or permanent stock items without obtaining special permission from the foreign exchange authorities.

Law XI of 1988 concerning central funds for technological development was effective on January 1, 1989. The act declares that a central fund for technological development must be established to serve as a financial source for realizing the government's development policy. This is a commitment that refers to the trade companies, including those with foreign participation. Such companies must also contribute under this heading to the central funds. The rate of contribution is 4.5 percent of the base for profit taxation of the preceding year.

The last act pertaining to joint companies is Act No. XXIV of 1988, which concerns the investments of foreign parties in Hungary. Actually, this act can be considered the code of investments because it summarizes all the important elements of earlier legal regulations in this field and offers a clear survey to foreigners who wish to invest in Hungary. This act refers to investors of highly developed and developing countries alike, and also to investors from the CMEA countries.

The regulations concerning influx of foreign operating capital have been liberalized and provide for trade companies involving foreign funds, conditions that compare favorably with internationally offered solutions. A number of other regulations currently in preparation deal with such questions as changing state-owned enterprises and cooperatives into trade companies, and setting up and establishing the statutes of a stock exchange.

All these endeavors stem from the understanding that the structural changes in the economy and the increase of exports will necessitate the efficient production, trade and service activities of companies engaged in foreign participation. Intensifying participation in the international division of labor and attaining international levels of production technology make these concepts of immediate concern.

The figures reflecting the development of joint companies speak for themselves. Between 1972 and 1985, their number totaled 50 with foreign investments amounting to US$50 million. From 1986 to the present, 250 permits have been issued, totaling US$250 million, and most of these companies already have been launched. Among the joint companies, 65 percent are engaged in the field of machine building, food, textile and synthetic industries; 30 percent offer services (software, tourism, etc.); 3 percent are engaged in trade; and 2 percent in financing. The list includes a number of small and medium-sized concerns, but also several worldwide organizations of high renown.

The increasing amounts of foreign investments in joint companies constitute another important feature. In this respect, the two agreements signed in November 1988 with South Korean parties are of paramount importance. Signed by the Hungarian Credit Bank (a joint-stock company) and the Daewoo Concern, one acts as a banking house under the name Investment Trade (with a statutory fund of US$100 million), and the other purchases and operates hotels under the name Szent István (St Stephen) Hotels with funds of US$90 million. In both arrangements, the parties are each 50 percent owners.

In June 1988, the contracting parties signed the founding document of the DUNAMANI Polistyrol Factory Ltd, a joint company involving the largest investment volume in Hungary to date. This is an Italian-Hungarian company in which the investment of the International Financial Corporation (IFC) amounts to US$34 million. The foreign shareholders in the joint company, representing a total investment of US$73 million, are Montedison and IFC. IFC, playing an important part in this sphere, has participated in four undertakings with approximately US$12 million in funds and more than US$53 million in financing.[2]

Generally, most of the foreign capital so far has been invested in the following fields: banking (financing), hotel construction and operation, polystyrol production, float glass, computing peripherals, robot production, glass-cotton insulation material, plywood, chipboard, concrete roof tiles and other roof elements, textile printing, telecommunication products (color TV, videotape, etc.), production and assembling.

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[2]By the end of October 1989, the number of registered joint ventures in Hungary had reached approximately 700. The total invested capital is calculated to be around US$800 million, 48 percent of which represents foreign share. (Source: IIASA MTC data base.)

6.3 Profile of Joint Ventures[3]

At the end of 1988, there were 282 joint venture companies in Hungary. All of them were licensed by the Ministry of Trade. The new law (Act XXIV of 1988) that eliminated the requirement to apply for a license if the foreign share is less than 50 percent became effective on January 1, 1988. More than 25 countries are represented in these 282 companies (*Table 6.2*).

Table 6.2. Countries with joint ventures in Hungary.

Country	Number of joint ventures	Country	Number of joint ventures
Austria	77	Greece	2
FRG	62	Japan	2
Switzerland	26	France	2
USA	20	Canada	2
Sweden	15	Norway	2
Holland	11	Portugal	1
Italy	10	India	1
Great Britain	10	Belgium	1
USSR	4	Cyprus	1
Finland	3	Spain	1
Denmark	3	Australia	1
South Korea	2		
Liechtenstein	2	Anonymous	2
Luxembourg	2	Mixed	17

The total capital of these 282 companies is Ft 38,111,320,000 or about US$635,189,000. The foreign share of this capital is Ft 17,361,530,000 or about US$289,359,000. This means that the average participation is 45.55 percent. The average capital is Ft 137,586,000 or approximately US$2,293,000 (*Table 6.3*).

The process of establishing joint ventures developed rapidly in recent years. In 1988 alone, the number of joint venture companies doubled; in the first four months of 1989, over 300 new joint ventures were established. The first joint venture company in Hungary VOLCOM with the Swedish company Volvo, was established in 1974. The most successful joint venture to date, SICONTACT KFT, was founded in the same year (*Table 6.4*).

[3]The profile concerns only those joint ventures analyzed within this study.

Table 6.3. Distribution of capital.

Number of joint ventures	Amount of capital	
15	over Ft 500 million	(over US$8.5 million)
41	Ft 100–500 million	(US$1.6–8.49 million)
36	Ft 50–99 million	(US$850,000–1.59 million)
91	Ft 20–49.9 million	(US$333,000–849,000)
23	Ft 10–19.9 million	(US$160,000–332,999)
71	below Ft 10 million	(below US$160,000)
5	unknown	

Table 6.4. Growth of joint ventures from 1974–1988.

Year	Number of joint ventures	Year	Number of joint ventures
1974	2	1983	8
1975	1	1984	12
1979	1	1985	16
1980	2	1986	22
1981	1	1987	57
1982	6	1988	155

The joint venture companies cover a wide range of activities in the Hungarian economy. There are 48 joint ventures in the machine building industry, two of them dealing with metallurgy. Sixteen joint ventures are in high technology or computer businesses. Light industry includes 35, of which 15 are in textiles and clothing. Two companies, Adidas and Levi's, not only have factories but also specialty shops in Budapest. Twenty-five companies belong to the chemical industry, and another 25 to the agriculture and food industry. There are 19 joint venture companies producing construction materials. These companies offer planning and other services in the construction business. Sixteen specialized companies deal with packaging, and nine with construction. The service sector has nine joint ventures, six of which produce industrial services. The hotel and tourism industry is also an attractive sphere, with 18 joint ventures. New areas are auditing with nine and consulting with 24 joint venture companies. There are eight banks and financial institutions. Transportation has five and special trading companies number six. One is specialized in

R&D activity and one in energy. The activity of six joint ventures is unknown.

6.4 Current Problems of Joint Ventures in Hungary

Expectations

Joint ventures are the most sophisticated level of international business relations. It is said that simple export-import activity is followed by the hiring of manpower and then by international cooperation. The joint venture, as a form of international economic or business relations, can integrate all other forms, but it is much more important and interesting as an organizational system. It is not only a development of quality but a change of quality as well.

This fact itself would be enough to underline the importance of joint ventures, but there are many other national arguments for joint ventures. Practical economic and governmental demands and expectations have been growing in Hungary during the recent period.

With the help of new laws the number of such companies should multiply and help the entire economy directly and indirectly. The initial governmental idea was to use the joint ventures to solve the balance of payments problem: If moving capital would come into the country, the shortage of hard currency to finance research and development activities could be partially alleviated. It also was estimated that this process would allow the government to maintain the standard of living and to pump additional money into the economy. The second expectation was that, with the help of newly established joint ventures, advanced technology and techniques would come into the country and, with the help of foreign entrepreneurs, would be adopted within a shorter period of time. Thirdly, it was expected that the permanent problem of economic and industrial restructuring would be solved or at least the main directions established with the help of new joint ventures.

The next intention was to give direct help to the budget. The main factor in the balance of payments is the trade balance. If the new joint ventures could increase export activities, the result could be a better trade balance.

The fifth expectation was to establish and disseminate advanced methods of management, data processing, computer techniques, marketing, and software. Within this frame, there could be two variations. One could be the effect of the new joint venture companies developing a good and vital relationship with the mother company. The other could be a specialized joint venture company selling consulting services to the Hungarian market.

The sixth expectation was to improve the marketing management of Hungarian companies abroad. With the help of joint ventures, the domestic companies could find a better way to learn about international markets and to establish relations to create organizations.

Only a few of these expectations have been realized. With the help of a better economic and legal background, however, we think that the advantages listed above will be realized and perhaps additional ones as well.

The Problems We are Facing

The periodical *International Management* regularly publishes an advertisement about Singapore. It lists the important factors in venturing:

(1) World's top airport (rated by business travelers) and busiest seaport.
(2) World's best workers, rated for attitude, productivity, and technical skills eight years in a row.
(3) Multilingual capabilities making Singapore an ideal gateway to the rest of Asia.
(4) Modern and reliable telecommunication services at competitive rates.
(5) Free enterprise policy with freedom for business ownership and repatriation of profits.
(6) Well-developed supporting industry with wide range of competitively priced quality parts and services.
(7) Ready-built factories, fully-serviced industrial parks, and modern office space, enabling a quick start-up.
(8) Wide range of competitive financing available from 280 leading financial institutions.
(9) Safe, modern cosmopolitan city offering excellent living conditions for foreign expatriates.

All these factors raise the question, "Is this why over 3,000 global companies have chosen Singapore?" If this is the international standard, it is difficult to rate Hungary as an attractive country for moving capital. Hungary is not able to offer most of these facilities to its partners. We have attempted to get a picture about the demand from some foreign businessmen through personal interviews. We asked them about the estimated advantages and disadvantages of the Hungarian economy (market) in supporting joint venture activities.

Market expansion was mentioned most frequently by the foreign entrepreneurs as a reason for coming to Hungary. They meant not only the small Hungarian market but also the possibility of exporting to other CMEA countries, primarily the Soviet Union. Hungary is seen as a possible bridge between East and West. Its location is also a positive factor that was mentioned especially by Austrian and West German businessmen.

Low-priced manpower. Wages are relatively low in Hungary and this implies low-priced manpower. Labor costs are one of the most important questions when a company is considering an investment. Although the Boston Consulting Group mentioned in a study that the "low-priced manpower in Hungary is only a myth, and we must forget about it," this statement cannot be substantiated without first investigating actual productivity under a related business structure and company organization. We collected nine important factors to be examined when a foreign person is considering investing capital abroad. Hungary's standing according to these nine criteria is outlined below.

(1) *Product knowledge*: Highly advanced products are mostly unknown and product knowledge is very often not sufficient. Knowledge of the entire business sphere is also necessary (competition, technology, demand, market situation, raw materials, etc.).
(2) *Market knowledge*: The company must know the existing demand in its market. Without this, the company and its managers will not be able to build a minimal level of trust with its Western partners. Without trust, cooperation is impossible.
(3) *Professional knowledge*: The level of technical skills and technical professional knowledge in Hungary is not bad. Sometimes the operation or preparation of a project is not worked out on

an advanced level, which may give a worse impression than the situation really merits.

(4) *Organization of meetings and discussions*: Anyone can lose an opportunity if he/she is not able to organize or chair a meeting. This is one of the main weaknesses of Hungarian managers.

(5) *Organization*: Most Hungarian companies are over-organized. External bureaucracy will be enough to deal with, so internal bureaucracy should be kept to a minimum.

(6) *Flexible and fast decision-making process*: If a company is over-organized, the decision-making process may be slow and bureaucratic. This is a sensitive area to Western partners. Who makes a decision? When? How is it presented? We must answer these questions if we want to encourage more joint ventures in Hungary.

(7) *Keeping the terms of an agreement*: Without keeping these terms, a firm is out of the competition. Correct behavior in personal contacts is as important as the terms of delivery.

(8) *Realization of contracts*: Reliability is the most important factor in business relations. It is very difficult to achieve and very easy to lose. In normal competitive circumstances, no one can ignore or forget written or verbal agreements.

(9) *Productivity and performance*: Competitors always try to propose something better: better quality, better price, better package, etc. To be better depends on the most important element of competitiveness: productivity and work performance. Without better performance, long-term profitable results cannot be assured.

Some Weaknesses of Hungarian Enterprises

In this study, we have tried first to compare Hungarian companies and their economic conditions with the main competitors such as Portugal, Turkey, Greece, and some economies in the Far East. The main negative characteristics are as follows:

Government guarantees: We are not able to offer the same guarantees as our competitors.

Free market situation and free competition: The monopolistic situation is still strong.

Balance of payments aspect: The currency/market is not convertible.

Old products, old-fashioned methods: There are difficulties in adapting to new ideas.

Difficulties in Western import and Eastern export: It is not easy to obtain licenses.

Shortage of capital: The interest is to remain poor and small.

Difficulties in bookkeeping and accounting: Differences exist in balance and calculations.

Most of the existing joint venture companies can be described and compared with traditional firms through the following differences:

- Dealing with customers.
- Work discipline.
- Business organization.
- Human-oriented management.
- Internal and external contacts.
- Small and flexible.

Wages are definitely higher in joint venture companies. The average difference is about 40 percent to 50 percent, but we find cases ranging between 10 percent and 20 percent. The salary of blue collar workers is higher by 50 percent to 70 percent in a new joint venture company. The salaries of managers depend strongly on the results of the firm and the difference can be much higher. The other important factor when comparing new joint venture companies with traditional national firms is the speed of reaction time. Letters and telephone calls are answered within three days; offers and pre-contracts are prepared in half the time it would take a traditional Hungarian firm.

We deeply hope that the cases of joint ventures in Hungary and elsewhere in the world can help to build stronger relationships among nations, cultures, and people. Mark Palmer, US Ambassador to Hungary, was interviewed by *Newsweek*'s Michael Meyer in April 1989.

After listing several US companies that were doing business in Hungary, the Ambassador said that the West plays a critical role in reinforcing East Europe's reformers.

> If we simply lend more money, we will actually hurt them by removing the impetus for reform. I would like to get the American media involved, perhaps by helping to set up an independent newspaper,

> radio or television station. The great danger in East Europe is not explosion but stagnation. People in these countries are not going to tolerate falling further and further behind the rest of the world. [*Newsweek*, April 3, 1989]

6.5 Conclusions

In summarizing the main problems of joint ventures in Hungary, three groups of difficulties must be considered. They are closely followed by the different stages in a joint venture development, as follows:

- Problems of establishing the joint venture (including legislation).
- Problems of connecting the partners.
- Problems of operating within the new economical circumstances.

Without the first step, we are not able to deal with the problem of the second, and we must consider the second step to be able to understand the third.

First, it is necessary to solve the bureaucratic problems in establishing joint ventures. The new law helps to create a joint venture company within one month. This possibility cannot be exploited if the country is not attractive enough for the foreign investor or if it is unable to help the foreign and Hungarian partners to meet. Finally, a joint venture company cannot become a relevant factor in the economy if it is highly isolated. If ordinary companies and the whole economy do not want to change or change slowly, the joint venture companies remain "islands in the Socialist Sea."

Chapter 7

Joint Ventures in Poland

R. Maciejko

Next to *perestroika* and *glasnost*, the fashionable term in discussions of East–West relations for the last few years has been "joint ventures." The volume of analysis of this phenomenon to date has far exceeded results. Nevertheless, Poland's business and government community has tried its best to push this form of economic cooperation with the West, and it will most likely play a significant role in changes in the local economy. This chapter reviews the current structure for foreign investment including Poland's new joint venture legislation, reflects on the significance of over 100 joint ventures with permits as of April 1989, and suggests changes that can be made to improve foreign interest and investment in Poland.

Relationships in Europe and the continent's ties with the outside world are undergoing dynamic change. In Western Europe, the countries are tugging and pulling to define a new economic and perhaps political unit under the EC umbrella. The Eastern Europe CMEA countries are struggling to make their economies competitive on a world level. At the same time, North America, especially the United States, is trying to define its new role in these two tumultuous regions. These relationships must be understood to see the possibilities for Poland's economy and for trade-driven joint venture enterprises in particular.

Almost all of the investors in Poland (97 percent) have come from countries in Europe and North America, and this trend is likely to continue. These countries have warmed to Poland's new-found impetus for reform. All are involved in the Conference on Security and Cooperation in Europe (CSCE) which may provide a multilateral framework for increased economic contacts. Western European business, led by the West Germans, is increasingly looking eastward to augment its own saturated markets. Now that Poland's government has announced free elections, even the US has announced measures to conditionally increase economic ties. Except for technologies with military applications, almost anything goes in East–West trade.

In the world context, there is no exact analog to the CMEA, which accounts for only about 8 percent of world trade (*The World in Figures*, 1987). Economic strength is increasingly the measuring stick of countries, and the EC, US and Japan are far ahead of the CMEA's best. Poland is aware of this and thinks that joint ventures are one way it can help fill the gap between itself and the rest of the world.

7.1 Poland's Economy: Current Situation

Poland's economy is going through a difficult time. The country owes the West an amount approaching US$40 billion. If it were able, it would have to use two to three times its hard-currency export surplus yearly to pay off interest and principal on this debt. To raise foreign exchange, many exportable goods are shipped out. As a result, just about everything in Poland is scarce. Goods are hoarded. Producers, forced by workers and suppliers to pay more, are shooting prices up at their discretion (prices are no longer centrally controlled). The price structure does not help; prices do not reflect opportunity costs.

The government has tried to alleviate these problems through reform since 1981. Despite six years of recovery after the stagnation of 1979–1982 when the national income fell by 25 percent and investment by 50 percent, the economy still does not produce as much as in 1978–1979 (*Rocznik Statystyczny*, 1988). Poland's leaders have realized that they cannot solve their problems alone. They need debt-alleviation help from the West and new investment funds from either creditors or, as is the current trend, joint venture partners.

From 1985 to 1987, Poland's gross debt grew from US$29.3 billion to US$39.2 billion (self-reported NMP was US$44.4 billion); this growth was not a result of new loans, but mainly because of Poland's inability to pay interest on the existing debt.[1] At present, Poland cannot afford to pay the approximately US$3 billion needed yearly for interest and maturing principal payments. The year 1984 was the only time Poland's trade surplus exceeded US$1.5 billion.

In 1986, Poland officially rejoined the international banking system with membership in the World Bank and the IMF. Membership will make it easier for Poland to borrow foreign exchange. Many private and government creditors practically insist on it before lending. Further, the World Bank had already announced about US$250 million in project lending that could increase to US$1 billion if Poland's reform steps are successful. The IMF has also announced US$300 million in new credit for Poland. These organizations can also be important for joint ventures. For example, the IFC, a World Bank affiliate that lends to the private sectors, was willing to consider funding a large joint venture between Asahi of Japan and the Polish glass works in Sandomierz. The significance of funding from these international financial institutions should not be underestimated. The amounts are massive when compared to the approximately US$50 million of capital in the 113 firms with permits under Poland's Foreign Investment Law.

Creative ideas are needed to solve the problems of the world's big debtors. This is also true in Poland. Something like the 20 percent debt relief for the LDCs and Yugoslavia as foreseen by the Brady Plan could be possible. Polish and Western leaders have also talked about exchanging debt for equity in Polish enterprises (Weinraub, 1989; Radwan, 1988).

Business Infrastructure

Poland does not meet Western standards for infrastructure needed in the daily operations of Western firms. There are shortages ranging

[1]The fluctuations of the dollar's worth also played a role in the size of this dollar denominated debt.

from personnel, equipment, and raw materials to simple office space. What is available often sells only for foreign exchange. Telephone density is low and quality even lower. There are approximately 109 telephones per thousand people. This does not look bad in comparison with the USSR, which registers 98, or even Hungary, the GDR, and Czechoslovakia with 140, 212, and 226 respectively. The figure fails, however, in comparison with world-leader Sweden with 890 telephones per thousand people or the USA with 760 (*Die Presse*, 1989).

Many businesses in Poland hesitate to rely on the postal system because of slow deliveries. Only relatively expensive courier services can guarantee delivery within a reasonable time. The road system is fairly highly developed, but there are few highways except in the western parts of the country. Management and other consultancy services are not sufficiently developed. Computer networks are relatively unknown.

Polish Foreign Trade

Under the new legislation, any firm with export capability in Poland can export freely. Foreign trade has been greatly decentralized, which often causes difficulties. The number of trading bodies expanded from 60 in 1981 to 700 at the end of 1988.

Poland's most important trading partners are still the CMEA countries which account for 51 percent of trade turnover. The Soviet Union makes up over half of that total. The industrialized West accounts for another 41 percent of the trade; developing countries make up the remainder (*Figure 7.1*).

7.2 Poland's Economy: Reform Attempts

Poland has found that central planning and state monopoly of industries were producing unsatisfactory results, and is introducing a new economic order. The intent of recent legislation is clear. The decision-making power of the state in the economy is being broken. A real market is in its prenatal stages and not just in consumer goods and services. To make it grow, the Poles realize that they need capital, cash, and a labor market at the same time. As long as distortions

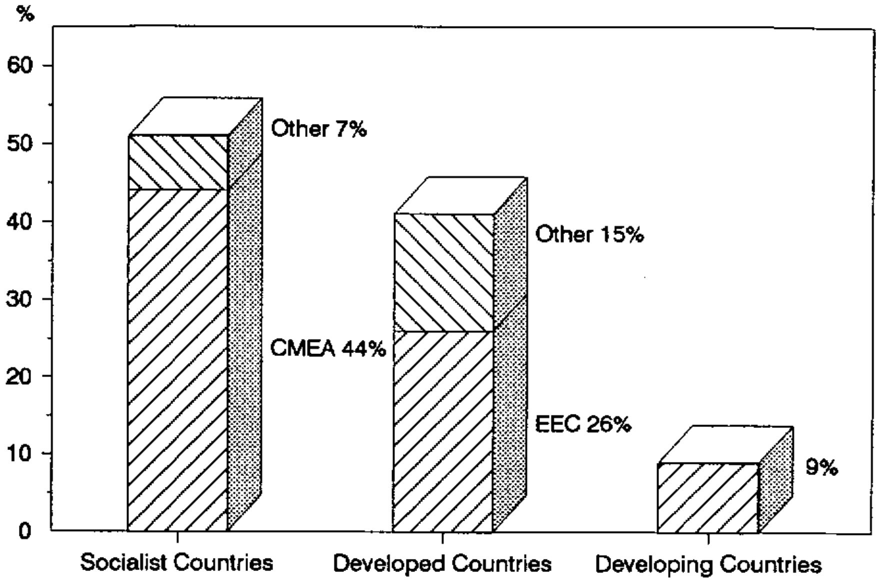

Figure 7.1. Polish trading partners. (Source: *Rocznik Statystyczny*, 1988, p. 356.)

exist in one of these sectors, the economy will be dependent on central authorities and the chance that a market can be born is hindered.

Currency Reform

As of June 1, 1988, the state-owned PKO savings bank began trading dollar-denominated coupons (*bons*) at free market rates (Bobinski, 1989). A new foreign currency law, passed on March 15, 1989 (Tekielski, 1989), further opened the areas of possible transactions. Now everyone in Poland can trade their foreign currency for zloty at market rates. Previously, currency exchanges among individuals were common, but illegal. At Pewex Premium Exchange windows, the going rate was about 3,700 zloty to US$1 compared to just over 620 zloty at official rates at the end of April. Polish officials have taken steps to make the Polish currency at least internally convertible and hope that the gap between the two rates will eventually merge to a rate twice the current rate.[2] Then, in about three to five years, external convertibility also can be attempted (Montagnon, 1989).

Firms are less likely now to get their hard-currency allotments at the previous low rate. In 1988, US$120,000 was auctioned at near market rates; in 1989, the amount auctioned was estimated to be US$3–3.5 billion (US$2.5 billion of this was previously allocated at the low rate; *The Economist*, 1989). This at least should make Polish firms more careful about how they spend their scarce hard currency. At the same time, however, it will also fuel inflation as firms pay more for input costs with price hikes.

For joint ventures, these convertibility issues are of vital importance. The problem is not selling in Poland but rather how to get profits out. Joint ventures can now sell foreign currencies at auctions in Poland but cannot buy them. Inconvertibility will limit growth and potential for foreign investment in the Polish market.

Private Sector

Previously, the government viewed firms in the order of importance: state, cooperative, and then finally private firms, but now all firms are legally equal. Of course, this is only the written law at present and it may never be totally true in practice. The law of December 23, 1988, on Economic Activity allows private business in almost all economic branches. At present, at least one and a half million Poles work in 630,000 private enterprises and the number is growing rapidly. Before the number of workers allowed by these firms was limited, but today private companies in Poland can hire as many workers as they can afford. Like joint venture enterprises, however, these businesses will face the same problems with regard to the supply of workers, raw materials, machines, and plant.

7.3 Foreign Investment in Poland

Significance of Polonia Firms

Over 700 Polonia foreign firms have been formed in Poland since this was legalized in 1976. The name "Polonia" fits since 55 percent

[2]New measures were taken on August 1, 1989; the two rates were merged to a stable rate of 9,500 zloty to US$1, as of January 1, 1990.

of the firms are owned by Polish expatriates or foreigners of Polish background. Most of these firms are small and involved in the limited fields of craft, domestic trade, restaurants, hotels, and other services. Five, however, have more than 500 employees. Polonia firms account for 1.5 percent of Polish industrial production. They concentrate on the domestic market, and together had exports worth only US$35 million in 1986 (about 5 percent of their production; World Bank Country Study, 1987). Almost all are owned 100 percent by foreigners. New Polonia firms are regulated by the Foreign Investment Law of January 1, 1989.

There are several lessons to be learned from the experiences of the Polonia firms in Poland. They were initially looked upon with great favor and were given generous tax and business incentives. Over time, however, local authorities (*voivodships*) began to complain that the owners of the Polonia firms were halting operations by the end of the three-year tax holiday and were concerned only with short-term profiteering.

The profit tax was raised from 50 percent in 1982 to 80 percent in 1985. Also, new legislation in 1985 established minimum levels of investment. These new limitations had an inhibiting effect on the number of new Polonia enterprises, as shown in *Figure 7.2*. Only 50 new permits to operate were issued in 1985, and only 10 in 1986, compared with an average of 188 in the years 1982 to 1984.

Role of Joint Ventures

Western businessmen invest in Poland for the following reasons:

- Poland is a large market, centrally located between Western Europe and an even larger untapped market, the Soviet Union. Those who are first in and get to know the system are likely to be those who will profit most in the future if market-type reforms, especially convertibility, materialize. In many cases, the joint venture may not be an end in itself but rather a means of increasing related import sales.
- Poland offers a relatively cheap and highly educated labor force. In 1978, the records showed over one million scientists and engineers. As with supplies in Poland, however, one has to be sure that low price also does not mean low performance.

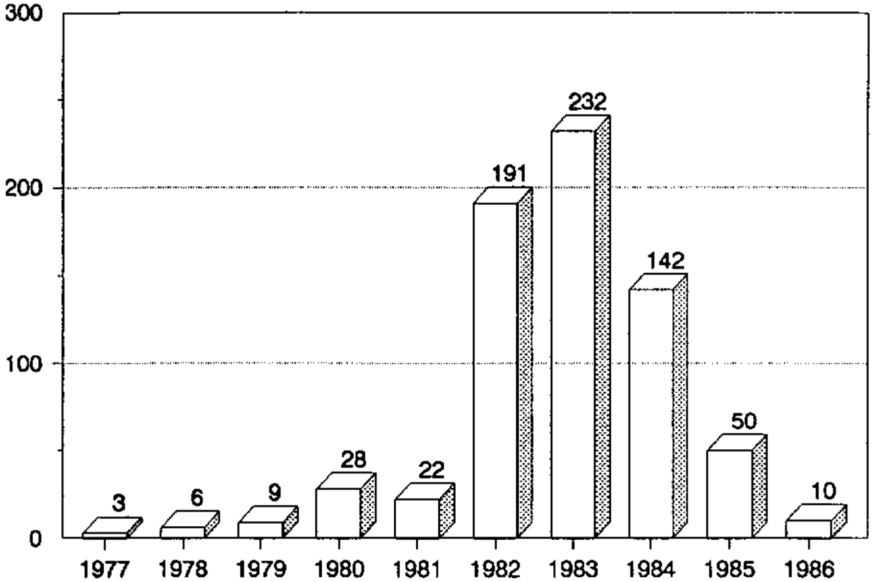

Figure 7.2. Polonia firms – new permits issued. (Source: World Bank Country Study, 1987.)

- The bottom line is not in all businessmen's calculations; what can best be described as sentimentality also plays a role. Ten million people of Polish heritage live abroad. Hundreds have already invested in Polonia firms. These people generally enjoy a higher than average standard of living in Poland.

For Poland, joint ventures and other foreign investments are a means to help economic growth. Thus, some main driving forces are:

- To combat the lack of hard currency. Given Poland's debt, this is probably the most important factor from Poland's point of view. The tax schedule set up for investments encourages exports that would help Poland's current account. Foreign investors always bring in foreign capital. Through import substitution, Poland can produce goods locally that were previously imported. Finally, the credit rating of Western partners can help bring new credits to Poland.
- To introduce modern technology and management techniques. Many of the firms have brought their own advanced equipment to

ventures in Poland. This can help Poland change its export structure from raw materials to high-quality value-added products. Western management techniques are usually brought at least to the venture itself. When the foreigners have money invested in Poland, they also have an interest in keeping the technologies efficient and up to date.
- To supply the local market. Given chronic excess demand in Poland for many things, the government hopes that firms will be able to supply goods and services not only for exports, but also for the local market.

Options for Joint Ventures

What some investors seem to forget is that there are many options for joint ventures that are not complicated and that have been successfully used in the past. In many cases, these forms of cooperation (e.g., switch and barter deals, licensing, franchising, and industrial cooperation agreements) are economically more important than joint ventures.

An International Chamber of Commerce study of industrial cooperation agreements noted that these agreements often lead to expanded cooperation between partners in cases where the agreements were implemented to the satisfaction of both parties (*East–West Industrial Cooperation Agreements*, n.d.). The main example listed in Poland involved International Harvester (Navistar) in a relationship with its Polish partner that grew over the years. To be successful in a joint venture, this type of long-term cooperation with the partner can be vital, if only to build mutual trust and understanding.

Some Statistics and Overview

The following figures are almost outdated as soon as they are published. Nevertheless, they give some indication of trends in foreign capital investment in Poland. *Table 7.1* shows that 52 firms were granted permits in the first two years that joint ventures were allowed to operate. In less than four months under the new law, 61 firms received permits. Clearly the formation of such firms has become very dynamic. The Foreign Investment Agency (FIA) was processing more

Table 7.1. Permits issued and corresponding equity capital.[a]

	Permits issued	Total planned equity capital
Old law[b]	52	9.79 billion zloty ($\simeq$ 30 million)[c]
New law[d]	61	9.98 billion zloty ($\simeq$ 20 million)
Total	113	19.77 billion zloty ($\simeq$ 50 million)

[a]From Ministry of Foreign Economic Cooperation (1988) and the list of permits granted for joint venture operation from January 16 to April 20, 1989 put together by the FIA.
[b]From November 12, 1986 to December 24, 1988.
[c]The exchange rate applicable for firms allowed under the old law ranges from 240 to 500 zloty/US$, the majority of those allowed under the new law had an exchange rate of 500 to 600 zloty/US$.
[d]From January 16 to April 20, 1989.

Table 7.2. Total equity capital (all 113 firms with permits).

	Old law	New law	Total
Up to 50 million zloty	12	31	43
From 51 to 100 million zloty	10	17	27
From 101 to 300 million zloty	17	6	23
From 301 to 1,500 million zloty	11	3	14
Over 1,500 million zloty	2	2	4
Total	52	61	113
Unknown	0	2	2

than two hundred additional permit applications in 1989, and many were expected to come through during the year.

We see that the investment in these firms has also grown. Now almost 20 billion zloty (US$50 million) is invested in firms with foreign capital.

Tables 7.2 and *7.3* show, however, that most of the firms can be best classified as small or medium in size. *Table 7.2* shows the distribution of the total equity capital of these firms. Over 60 percent have total capital investment amounting to less than 100 million zloty (approximately US$200,000). It should be noted that the trend recently has been toward smaller firms. Over 80 percent of the firms allowed under the new law include investments of less than 100 million zloty. Under the old law (through the end of 1988), this figure was 40 percent. Of course, the devaluation of the zloty plays some part in this change.

Table 7.3. Foreign capital contribution (under the new law).

Million zloty	US$ (approximate)	Firms
$\leq$ 25	$\simeq$ 50,000	13
25–50	$\simeq$ 50,000 – 100,000	31
50–100	$\simeq$ 100,000 – 200,000	8
100–500	$\simeq$ 200,000 – 1,000,000	4
500–1,000	$\simeq$ 1,000,000 – 2,000,000	2
$\geq$ 1,000	$\simeq$ 2,000,000	1
Total		61
Unknown		2

Table 7.4. Geographical pattern of foreign partners.

Country	Old law	New law	Total
FRG (without West Berlin)[a]	17	34	51
West Berlin	3	4	7
USA	7	7	14
Sweden	3	8	11
Austria	5	5	10
UK	5	3	8
Netherlands	5	2	7
USSR	5	1	6
Switzerland	4	1	5
Italy	0	3	3
Canada	0	2	2
Finland	2	0	2
France	2	0	2
Yugoslavia	2	0	2
Liechtenstein	2	0	2
Belgium, Denmark, United Arab Emirates, Thailand, Tunisia, Lebanon	(1 each)		6
Total			138[b]
Unknown			2

[a]Poland separates figures for the FRG and West Berlin.
[b]Many firms have more than one foreign partner from a single country. These 138 partners participate in 111 ventures.

Table 7.5. Value of foreign investments in Poland in 1989.[a]

Country	Joint ventures	Partners	Foreign capital (US$)[b]	Foreign capital zloty (million)
USA	5	7	4,010,000	2,005.2
FRG	33	38	3,690,000	1,847.4
UK	2	3	1,300,000	649.4
Sweden	5	8	390,000	195.1
Austria	4	5	373,000	202.0
Netherlands	2	2	124,000	72.0
Lebanon	1	1	120,000	62.0
Italy	1	3	107,000[c]	57.0
Canada	2	2	103,000	54.5
Switzerland	1	1	55,000	29.2
Thailand	1	1	52,400	25.2
Tunisia	1	1	50,000	25.0
USSR	1	1	50,000	25.0
Total	59		10,424,400	5,249.0
Unknown	2			

[a]For the firms that received permits from January 16 to April 20, 1989 according to the FIA.

[b]Approximate, with adjustments for fluctuations in exchange rates.

[c]US$50,000 + 28.5 million zloty.

Table 7.3 gives some idea of the size of foreign investment in the firms that received permits recently. The foreign investors added US$100,000 or less in 44 of 50 ventures. The largest investment among them and the largest foreign investment to date in Poland is by Barbara Piasecka-Johnson, the Johnson & Johnson heiress, who invested US$3 million to start the firm Tricotex in 1989.

Table 7.4 lists in detail the origin of the foreign partners of firms in Poland. The Federal Republic of Germany (FRG), including West Berlin, accounts for over 40 percent of the partners or 58 in total to date. Far behind are the United States, Sweden, and Austria. *Table 7.5* summarizes the value of foreign investments in Poland in 1989. We see that although the USA has only five joint ventures, it leads in new investments. It is followed closely by the FRG and the UK.

Figure 7.3 shows Poland's top Western trading partners. It is useful to compare this figure with *Tables 7.4* and *7.5*. The Federal Republic of Germany is at the top of the list. The USA, UK, Austria, Sweden, and Switzerland also are high. France and Italy, which are

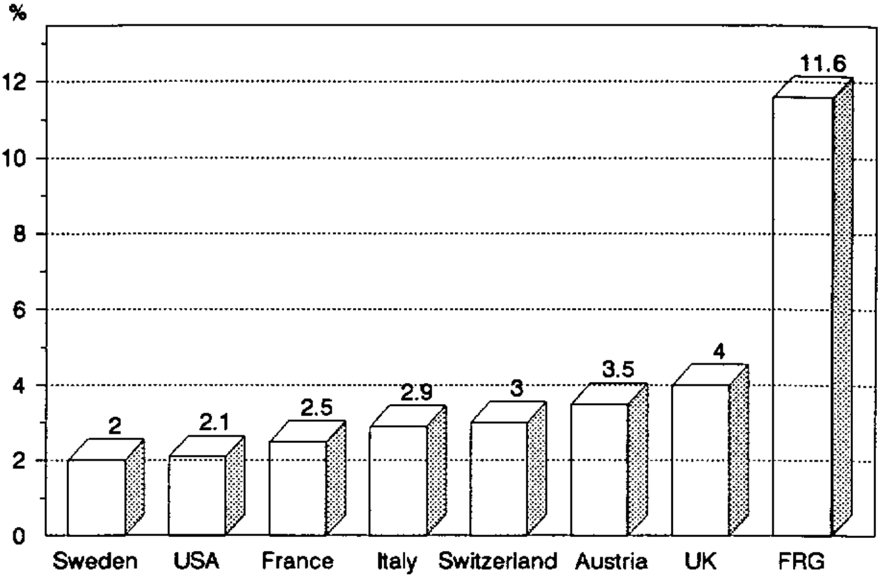

Figure 7.3. Poland's top western trading partners. (Source: *Rocznik Statystyczny*, 1988.)

among Poland's six trading partners, have fielded only one venture each. It is here especially that we see the importance of joint ventures with respect to other forms of economic cooperation. Italy has only one relatively small joint venture, but the participation of the Italian firm, Fiat, in the Polish auto industry is arguably more important than all the joint ventures allowed to date, and it is not organized as a joint venture.

Sales in 1988

Fourteen joint firms recorded sales and exports in 1988, according to the Polish monitoring authorities. These firms registered almost 32 million zloty in sales and US$17.5 million in exports to hard-currency areas. *Tables 7.6* and *7.7* show the comparison between these firms and the Polish Polonia firms.

Table 7.6. Sales of firms operational in 1988.[a]

Firms	Total sales (zloty)	Exports (US$)	Exports (rubles)	Employed
14	31,778 million	1.7 million	10.73 million	5,669

[a]From Table No. 2 – The Performance in 1988 of the Largest JV Established in Poland, Polish Embassy, FRG.

Table 7.7. Polonia firm sales in 1987.[a]

Firms	Total sales (zloty)	Exports (US$)	Employed
≃ 700	154,768 million	≃ 35 million	61,562

[a]From *InterPolcom*, 1988.

7.4 Doing Business in Poland: Problem Analysis[3]

Foreign firms have had capital investments in Poland for the past 13 years. Since the start, the laws regulating capital investment have been modified several times to broaden the areas open to investment. The momentum for these changes has come from the 700 foreign companies in operation and from over 100 joint ventures that have been set up since they were first allowed in 1986. This law allowed companies with foreign capital participation (joint ventures) without constraints on the size of the company or branches of industry. On December 23, 1988, the Polish Sejm approved the Foreign Investment Law,[4] liberalizing the laws for companies with foreign capital even further.

7.4.1 Problems in initial steps

Each joint venture starts with an application submitted to the newly formed FIA for a permit to operate. A decision is made within two months of submission. Proposals that affect state security and economic interests or that are environmentally dangerous will be rejected. Rejected proposals can be appealed to the President of the

[3]This introduction and the comments to the law that follow are by Burzynski, 1989. Several of the comments come from the experiences of various businessmen in Poland.

[4]"The Law on Economic Activity with the Participation of Foreign Parties – the Polish Foreign Investment Law," Warsaw, December 23, 1989.

Agency. If the company engages in activities contrary to those outlined in the permit, the FIA can request that these activities be curtailed. If necessary, the FIA will restrict or withdraw the permit.

The items required for a permit application include a feasibility study. Such studies usually are done using UNIDO guidelines (UNIDO, 1986). In the past, the Polish consulting company, Investexport, had a virtual monopoly on doing these studies. Since then, other consulting companies and bodies have sprung up to do this work. These studies weed out unjustified ventures and help joint venture partners see their options more clearly. On the other hand, they add cost (some have paid US$5,000) and time (up to three months) to the joint venture process (*Business Eastern Europe*, 1988). Western partners often have not been impressed by feasibility study work. The studies often are done using theoretical models and not such methods as "cruel accounting" (worst-case scenarios). Sometimes they simplify reality by using planned results as actual ones.

The share of the foreign participants ranges from 20 percent to 100 percent of capital stock, to be determined in consultation with the FIA. Investment should not be less than 25 million zloty, adjusted in exchange rate changes.

The foreign share[5] of the firm must be at least 20 percent to avoid arrangements where Polish firms joined with a foreign investor just to reap tax benefits. Until the new law was passed, foreign partners could have more than a 49 percent share of capital only in special cases.

The foreign partner shares in joint ventures that already have permits are summarized in *Table 7.8*. It is clear that many firms have taken advantage of the liberalization of restrictions on the extent of foreign ownership. Under the new law, only 19 of 59 firms had half ownership or less. Before the law changed, the figure was 50 out of 52. Significantly, 12 of the new firms have 100 percent foreign capital. These results are made somewhat less significant by the fact that Polonia firms, which previously also were allowed up to full foreign ownership, are now included under the new foreign investment law.

[5]Foreign firms that have 100 percent of the capital stock cannot be called joint ventures by definition. Thus, we cannot group this legislature in the category of the joint venture law.

Table 7.8. Percentage of capital equity of the foreign firms.[a]

Percentage	Old law[b]	New law[c]	Total
0–49%	47	11	58
50%	3	8	11
51–59%	1	7	8
60–69%	1	8	9
70–79%	0	5	5
80–99%	0	8	8
100%	0	12	12
Total	52	61	113
Unknown	0	2	2

[a]From Ministry of Foreign Economic Cooperation (1988) and the list of permits granted for joint venture operation from January 16 to April 20, 1989 put together by the FIA, and also from permits kept at the FIA.

[b]Firms registered under Poland's 1986 Foreign Investment Law for the period November 12, 1986 to December 24, 1988.

[c]Firms registered under Poland's New Foreign Investment Law for the period January 16 to April 20, 1989.

Investments can be made in cash or in kind. Zloty investments must have accompanying official exchange forms. The value of the in-kind investments (buildings, equipment, licenses, trademarks, patents, etc.) should be specified in the contract of establishment. The value of the in-kind contributions can be subject to verification by independent authorities at the request of the FIA.

Valuing cash investments is not difficult once an exchange rate is agreed upon. Valuing in-kind investments, however, can be a serious hurdle. While Western inputs usually have a well-defined value based on their price on Western markets, Eastern European inputs often do not have such a clear valuation. Eastern European goods sold on foreign markets, for example, often have entirely different prices than they do at home.

7.4.2 Problems within the financial framework

Accounting principles are provided by the Minister of Finance in compliance with the Commercial Code of 1934.

Polish and foreign accounting standards often are very different. While firms have found officials flexible in the application of accounting standards, and many find Eastern European accounting practices easy to get used to, they are not accustomed to many of the systems' features. Special care must be taken with such items as depreciation methods and safeguards against theft or misappropriation of funds. One Western businessman described Polish accounting and taxation rules as a minefield. In his example, all foreign investors are forced to tread through this minefield blindfolded. To get through without being "blown up," the foreign investor needs a guide. Though technically allowed, authorization to employ an outside auditor is not given. At least one firm was not allowed to work with its choice of auditor.

Fifteen percent of the hard-currency earnings from export must be sold to a Polish foreign exchange bank. The President of the FIA can reduce this rate in economically justified cases. Selling hard currency to the Polish bank means that the joint venture has less for purchases and distribution to the partners. This resale also has an effect similar to a tax. All currency is sold at the official rate, which, at the end of April 1989, was just over 600 zloty to a dollar. The premium exchange rate was about 3,800 zloty to a dollar. To make matters worse, resale is based on gross earnings not on net. Still, enterprises with foreign investment have a relatively good situation. Polish enterprises on average sell 82 percent of their export proceeds to the foreign exchange banks (Burzynski, 1989).

The company keeps accounts at a Polish exchange bank of its choice. This bank can guarantee the company's obligations. Credits can be obtained from that bank or from abroad. Accounts can be opened with foreign banks once the company has a foreign exchange permit. To help the insufficient banking system, new banks recently have been established to join the big three: Bank Handlowy, Bank PKO, and Bank Pekao. Most of these will have a regional customer basis.

The foreign partner can receive a guarantee from the Finance Minister promising compensation for losses due to expropriation or nationalization. It should be noted that this guarantee does not help those who make foolish business decisions or suffer from bad market conditions. Furthermore, many firms, especially small- and medium-sized ones, are not satisfied with this guarantee alone. Many are said to be waiting until their government and Poland have signed a bilateral investment protection agreement before investing. Among other things, such an agreement means that the state takes over the

Table 7.9. Scope of business activities of the first 52 firms under the old law.

Branch	No. of joint ventures
Agricultural processing	13
Computers (hardware and software)	5
Engineering and tools	5
Hotels	5
Construction and production of building materials	4
Metallurgy	4
Textiles	4
Electronics	3
Chemicals	3
Films and publishing	3
Wood and furniture	2
Others	4
Total	55[a]

[a]Some firms were active in more than one industry.

rights and claims of investors in certain situations. The agreements also specify that foreign investors are not to be treated worse than local investors. Agreements are in force with the UK and China; agreements with Belgium, Luxembourg, and Austria are signed but not yet ratified. Negotiations are under way with other countries (Maciejko, 1988; Burzynski, 1989; Bacynski, 1988).

7.4.3 Problems during operation

The preferred businesses for joint ventures include:

- Introduction of modern technologies or management techniques.
- Provision of goods or services for export.
- Improvement of domestic supply with modern high-quality goods or services.
- Introduction of environmental protection equipment.

Table 7.9 lists the industries in which the first 52 firms were engaged.

Not only will engaging in preferred businesses increase the chances of getting a permit, but it also will help in obtaining the government's support in such important issues as obtaining supplies. With the approval of the President of the FIA, the companies' tax holiday can be extended from three to six years if the firms are active in such a preferred business. The Polish government has issued a specific list of businesses in which foreign investment is encouraged. This list also provides information as to which Polish businesses are insufficiently developed and could possibly make for profitable investments.

No licenses are necessary for foreign trade except for a few limited commodities (Burzynski, 1989). Even in that case, if firms have to wait for some office to approve a new foreign trade license each time they change the conditions slightly, they will in the long run most likely fail.

Joint companies will operate under the same regulations as Polish enterprises with regard to supplies in Poland. State enterprises can transfer fixed assets and limited rights into the company. Joint ventures can purchase necessary goods or services in Poland for foreign currencies or import them. For anyone trying to do business in Poland, getting high-quality supplies delivered on time is a major issue as is quality that meets Western standards. Often supplies cannot be found in Poland and must be imported. This, of course, is a hard-currency expense. When firms with foreign investment find the supplies they need in Poland, they often have to pay more for them than state enterprises despite the new laws. Because of their need for hard currency and because they see joint ventures as relatively rich firms in this respect, the suppliers often demand that the joint ventures pay at least partly in foreign currency. If a state enterprise cannot meet its planned targets because it could not get supplies that went instead to a company with foreign participation, the officials responsible for the firm's performance will have problems and will put pressure on the supplier. Some suppliers simply do not want to risk this.

The centrally distributed raw materials in 1989 were coal, coke, diesel oil, heating oil, copper, tin, aluminum, and silver (Burzynski, 1989). Under this law, firms obtain these items under the same rules that govern state enterprises.

The Polish partner can contribute rights to use state-owned real estate according to the provisions of the Utilization of State-Owned Land for perpetual use or lease. Companies can also acquire and lease real estate not owned by the state. If the foreign partner is a majority owner of the firm, any purchase must be verified by the

Ministry of Internal Affairs. Purchases from the foreign shareholder's profit require a separate foreign exchange permit.

7.4.4 Taxation

Taxation is a major issue for joint ventures in Poland. Although the corporate income tax was lowered to a moderate 10 percent with the new law, the tax burden is higher including some charges not detailed in the law. For example, 1.5 percent of total capital must be paid to the notary and a further 2.5 percent as a treasury fee.[6] For many firms, these charges are unbearably high. Since March 15, 1989, firms must also pay 200,000 zloty to have their application considered by the FIA. This fee replaces the previously levied stamp duty of about 1,500 zloty (information from the FIA). Firms now operating in Poland are still enjoying the tax holiday and have not yet paid corporate income tax.

The corporate income tax is 40 percent of taxable income minus 0.4 percent for each percentage point of sales export (thus the minimum is 10 percent). Taxable income is calculated using depreciation applicable to state-owned enterprises. The corporate income tax has been reduced from 50 percent to 40 percent as specified in the 1986 Foreign Investment Law. The reduction in tax as exports increase shows Poland's emphasis on export. Taxes are at a minimum when exports reach 75 percent of sales. Poland's government does not reduce taxes more for firms that export more than 75 percent because it would like to have at least some production for the local market.

No corporate income tax is charged for the first three years after the establishment of the firm (i.e., from the date of the first invoice). The tax holiday can be extended up to three years with the approval of the President of the FIA if the companies are active in a preferred business area (see *Table 7.9*). If the company is dissolved within six years of its establishment, income taxes have to paid retroactively for the entire activity period. The foreign partner's income is subject to a 30 percent tax unless international agreements provide otherwise.

[6] Also turnover tax, corporate income tax, agricultural tax, wage tax, real estate tax, local taxes, stamp duty, and community and city fees.

Poland has signed double taxation agreements with 21 countries.[7] Firms from these countries pay from 5 percent to 15 percent tax.

7.4.5 Management and employment

Management

In keeping with Poland's commercial code rules on joint-stock and limited liability firms, the shareholders decide on the composition and powers of the management. This is a change from the law of 1986 wherein the companies' top manager had to be a Polish citizen and a permanent resident of Poland. In comparison with conventional firms, joint ventures have fewer management personnel. One firm explained that the previous organization was 60 percent administration, the comparable figure for a joint venture was only 10 percent.

Finding qualified skilled employees, such as executives and engineers, may be the biggest challenge for a joint venture. The employees have to be flexible and work in a combination of two economic systems. Many firms look to the younger generation for this flexibility. The Furnel Joint Venture, for instance, has recruited people from the Foreign Trade Department of Warsaw's Central School of Planning and Statistics. Finding people with the appropriate language skills as well as a business knowledge of West and East is difficult. Until now, Poland's expatriate community or second generation Poles born abroad has been one source of foreign employees in Western representative offices, but not for joint ventures.

Employment

The first 52 joint venture firms that received permits in Poland planned to employ 7,079 people. The structure of employment for these firms is listed in *Table 7.10*.

Foreign citizens can be employed by the company with the permission of regional authorities. Wage specifications are to be defined in the contract of establishment or by management. While cash payments are generally in zloty, at least a certain percentage of payments is usually made in foreign exchange.

[7] Austria, Belgium, Czechoslovakia, Denmark, Finland, France, Spain, Netherlands, Japan, Yugoslavia, Malaysia, FRG, Norway, Pakistan, USA, Sweden, Sri Lanka, Thailand, Hungary, UK, and Italy (Burzynski, 1989).

Table 7.10. Structure of employment.[a]

No. of employees	No. of joint ventures
Up to 50	21
51 to 100	11
101 to 200	10
201 to 500	6
501 to 1,000	3
Over 1,000	1 (Furnel)
Total	52

[a]According to data included in the feasibility studies submitted by the first 52 firms.

Previously, foreign employees could draw only 50 percent of their salary in hard currency. The permission of regional authorities is not needed for employees of the foreign participant, but this does not apply to the joint venture. Significantly, there are very few foreigners working in joint venture management in Poland. Compared with Polish management, they are expensive.

Polish employees are paid in zloty and are taxed according to the tax applicable to employees of non-socialized entities. The tax on the Polish employees can be rather high. One joint venture reported that the Polish workers' salaries are subject to a 75 percent "equalization tax." Some companies report that joint venture wages for Polish employees are from 20 percent to 100 percent higher than for conventional workers. The Polish government wants to avoid worsening Poland's disastrous wage-price spiral and applies at least some pressure to keep wages reasonable.[8]

Often the joint ventures demand more productivity and more hours from the workers. Most of the joint firms offer the employees only a higher salary, but not necessarily benefits that are normal in Polish state enterprises. Further, one company that has foreign and Polish workers together reported that the Poles are 50 percent less productive. Another manager reported that Polish workers were four times less productive than Western workers for the same job (Gotbaum interview). One company noted that the Polish laborers must be motivated to do good work; those working abroad are often excellent workers. Companies working with some kind of incentive

[8]Many of the observations on employment were recorded by Noah Gotbaum of IIASA in interviews with joint venture managers in the summer of 1988.

scheme, such as piecework, reported better success with the Polish employees.

7.5 Conclusions

In Poland, the number of investments is small but growing. The 20 billion zloty ($\simeq$ US$50 million) in foreign investments announced since joint ventures were first allowed in 1986 is equal to less than 1 percent of Polish investments during the period.

Joint ventures in the CMEA are not always easy. It can take a long time to conclude negotiations and start operations. Positive returns cannot be expected for several years in many cases. In Poland, Western joint venture partners have to realize that the joint ventures are seen as a means of increasing exports to the West; they must decide whether they can afford possible further competition in these markets. If they want to sell in the local market, they must find a way to export profits. Barter trade is the main solution until convertibility becomes a reality.

Some firms are looking into the possibilities of joint ventures with Eastern European companies without considering other options. In many cases, it seems that joint ventures are not the best way to make a quick entry into Eastern European markets. It may make more sense to build up cooperation with Eastern European partners slowly, and learn how business in the Eastern European country works before pursuing a joint venture. The same goes for the Polish firms. They must remember that joint ventures are but one of their options, although an attractive one at present for various reasons (e.g., taxation).

Polish leadership is trying to address economic issues. Most foreign businessmen applaud the liberalizing moves, but some complain that changes come too fast and the situation is too unstable. The extent of foreign capital in Poland will not be sufficient unless there is a good business environment.

It is a dilemma. Poland needs foreign investors if reform is to be successful, but foreign investors will hesitate to invest unless the conditions foreseen by reform exist. Poland's economy is still too unpredictable to guess its future, but we can at least look at two possibilities.

First, hesitant reform moves have been rewarded by mediocre economic performance. Popular resistance to changes that bring certain short-term pain and only perhaps long-term gain slows down reformers. Inflation, price increases, and corresponding labor disputes distract decision-makers from major moves. Legal changes are made, but are not realized in practice. The level of foreign investments will stagnate. After a period of initial interest, only a slow growth in foreign investment can be expected. Multinationals wary of the economic risk generally stay out.

Second, reform could be a major success. Decision-making is practical. Justified investment is being made to improve the infrastructure including transport, communications, and office space. Temporary unemployment, with retraining if necessary, is becoming acceptable. Profit orientation that does not harm social welfare is encouraged to spread and is flourishing. The currency is steadily being made convertible, and prices are being adjusted carefully to reflect opportunity costs. Foreign investment is growing especially among small- and medium-sized firms as foreigners feel comfortable working in Poland.

Members of the 13-million-strong international emigrant community have set up 55 percent of the 700 Polonia firms established in Poland. While these firms are small in scale, they are at least a start in increasing cooperation between Poland and the West. The Poles abroad can be one of Poland's most valuable assets in raising its levels of exports and in injecting life into the moribund economy. Other Eastern European countries do not share the advantage of such a large foreign population.

Training managers to work in a two-system environment will be a particular challenge. The Soviet Union already has sent some of its brightest foreign trade specialists to the West for intensive training and on-the-job experience in cooperation with Western governments, and Poland must do the same. The West provides opportunities not only to create such exchange programs but also to negotiate an international legal framework for investors, including investment protection agreements. Such agreements can be important to guarantee foreign investment capital from expropriation and to make sure that external forces such as boycotts will not affect business security in times of political tension.

Attracting big multinationals to invest in Poland will be difficult. They are not likely to send top management to check out conditions in Poland and therefore have difficulty estimating the risks. An exception was ICL, which had an experienced executive working for several years in the country. The management of smaller and medium-sized firms, however, does often have an opportunity to understand their chances in Poland. They are closer to the action and can often make quicker investment decisions. The longer the companies have experience in Poland the more likely they are to be able to estimate the possibilities for joint ventures. Furthermore, mutual trust built up over these years can be the basis for joint venture cooperation. Firms want to be in the CMEA if economic reform succeeds and big opportunities come. Many want to get to know the system, to make the contacts, and to learn from initial mistakes.

Western investors have many options outside Poland and outside Eastern Europe. Poland has to continue stressing its economic strengths such as its central location and skilled labor pool. The UNIDO conference in 1987 and the accompanying project identification were a good start. Given the list of industry branches in which foreign investors get special tax treatment, it is clear which branches are being stressed. Poland must convincingly show the advantages to foreign firms of doing business in those branches. In the process, it must make sure its laws provide a framework for doing business that awards profit and performance and removes obstacles.

But while flexible legislation may grease the turbine of joint venture formation, it cannot fuel the engine. No laws can possibly cover all aspects of operations. Practice in Poland does not resemble the legal framework in which it operates. Much more important is the willingness on the part of the joint venture participants and their home governments to make economic cooperation work. The real problems will not be legal; they will be practical, such as how to get supplies and the right personnel.

Chapter 8

Experiences and Future Outlook of East–West Joint Ventures in the Soviet Union

V. Ranenko and A. Soloviev

The economy of the USSR is an extremely vast national complex, uniting production, distribution, and consumption of material resources, goods, and services. This complex comprises more than 300 sectors and subsectors operating in the territory of 15 Soviet Socialist Republics. The management of the economy is based on the use of sectoral and territorial principles.

The development and activity of the national economic complex has at its foundation a system of state planning and control, edited centrally on the basis of united national plans.

There are more than 46,000 production organizations and enterprises in this complex that are legal entities, nearly 50,000 *kolkhozes* and *sovhozes*, and more than 32,000 different inter-economic construction and installation organizations.

Table 8.1. Rate of economic growth in the USSR from 1980–1988.

Indicator (1970 = 1)	1980	1985	1986	1987	1988
GNP	1.65	1.98	2.07	2.12	2.21
National income	1.61	1.92	2.01	2.09	2.26
Production assets	2.14	2.90	3.09	3.28	3.37
Capital investments	1.63	1.94	2.10	2.16	2.23
Industrial output					
Group "A" (capital goods)	1.82	2.18	2.30	2.38	2.44
Group "B" (consumer goods)	1.67	2.02	2.10	2.20	2.24
Agricultural gross output	1.12	1.24	1.31	1.34	1.38
Labor productivity	1.47	1.72	1.77	1.86	1.93

The fixed assets of the national economy are 2.5 billion rubles. The production assets are 1.7 billion rubles, 49 percent of which are made up of industrial assets, 21 percent of agricultural assets, and 20 percent of transport and communications assets.

More than 131 million people (or 45 percent of the population) are engaged in the national economy of the USSR, 73 percent of whom work in the various sectors of industrial and agricultural production and 27 percent in service sectors. Nearly 25 percent of all people working in the national economy have graduated from universities and have specialized professional education. The state enterprises of the USSR currently produce 97.8 percent of the gross industrial product, and cooperatives 2.2 percent.

The Gross National Product of the USSR in 1987 was 2,120 billion rubles. The national income of the USSR used for consumption and accumulation averaged 576.0 billion rubles in 1986; this is a 30 percent increase over 1980. The development of the national economy is based on large-scale state investments. Their total value exceeded 194.4 billion rubles in 1986, or more than 1.3 times the amount for 1980. The main figures of the rate of economic growth in USSR are shown in *Table 8.1*.

In the 1970s, there were a number of negative aspects in the Soviet economy, such as the diminished volume of economic growth, which were connected with the extensive development of the national economy. These tendencies were not overcome during the period 1981–1985.

A program to intensify production and increase labor productivity from 2.3 to 2.5 times by the year 2000 was approved in the 27th Party Congress.[1] This program should be realized through:

- Accelerating innovation processes.
- Intensifying R&D activities.
- Democratizing economic management.
- Using the advantages derived from the wide participation of the USSR in international economic relations.
- Strengthening the social dimensions of national economic development.

8.1 Foreign Economic Relations in the Period of *Perestroika*

One of the key problems of economic reform in the USSR is believed to be implementing and strengthening the new economic mechanism. It should combine centralized management with the development of different forms of business activities, encouraging initiatives from the prime producers of goods and services. This problem is resolved now on the basis of:

- Differentiation of various forms of property, development of cooperative enterprises, wide use of leasing, development of individual business activities.
- Endorsement of the independence of the main economic entities in the planning process, the use of profits and goods produced.
- Enlargement of trade including means of production and development of market relations within the national economy.
- Strengthening of sectoral and territorial profit-and-loss accounting and self-financing.

A package of legislative acts such as the Law on the State Enterprise, the Law on Cooperatives, the Law on Property, the Law on Leases, the Law on Stockholding Companies, and the Law on the

[1]Some of the negative tendencies in the USSR economy developed further in 1989. At the same time, some obvious changes took place, directed at restructuring the economy and social orientation. The growth rates for 1989 GNP and National Income are 3 percent and 24 percent, respectively. (Editors' note.)

Use of Soil, which strengthen the legal basis of economic reform in the country, were adopted during the past years. These laws were considerably improved by a recent session of the USSR Supreme Soviet.

Economic reform is supported by the democratization of the country's political system. *Glasnost* and broader participation of the people in State management are some of the main features of the democratization process. The results of the political and economic reforms, however, cannot be seen immediately due to the complex character of the problems to be solved as well as to the slow pace of implementation and the bureaucratic hindrances to their realization.

Food shortages are still a major problem in the country. The State budget deficit has increased to 100 billion rubles, inflation processes are more widespread, and the country's foreign debts have not been reduced.

A vast scientific and technological potential is available to the country. In 1986, there were 5,070 scientific establishments including universities in the USSR. Of that number, 20 are academies with 21 branches, scientific centers and laboratories; 3,200 are scientific research institutes (including their branches); 412 are scientific research laboratories, scientific and applied-experimental centers; and 15 are observatories. About 15 million people work in these establishments, of whom over 518 thousand people have a scientific degree. In 1986, Soviet scientists made up one-quarter of the total number of the scientists in the world.

During the period 1971–1985, a total of 306.1 billion rubles were drawn from the state budget for the development of science. These expenditures represented 4 percent of national income in 1970 and 5 percent in 1986. By the year 2000, a goal has been set "to guarantee the fulfillment of key political and economic tasks to accelerate technical progress, to raise the role of science and technology in the decisive transformation of productive forces, to transfer the economy in the direction of intensive development, and to raise production efficiency." The R&D potential of the country will play a major role.

Soviet foreign economic relations with capitalist countries are regulated by long-term intergovernmental agreements and programs of trade, economic, industrial, and scientific technical cooperation. The necessity to develop economic relations between countries with different social-economic systems has a direct influence on the development of Soviet foreign trade with these countries.

Table 8.2. Volume of exports and imports from 1970–1988 (in million rubles).

(In million rubles)	1970	1980	1985	1986	1987	1988
Turnover	4,694	31,583	37,875	28,989	32,861	30,987
Exports	2,154	15,862	18,581	13,136	14,830	14,666
Imports	2,540	15,721	19,294	15,853	18,031	16,321

The volume of USSR trade with the capitalist countries in 1985 was nine times higher than in 1970. The volume of Soviet exports and imports increased accordingly (*Table 8.2*). The country's production and R&D capacity is also increasing with the conversion of defense industries to civil production.

Nevertheless, in 1986–1988, there was a reduction in the volume of trade with this group of countries, due in part to the fall of world price levels for raw materials and power goods (80 percent of Soviet exports to capitalist countries). Prices for agricultural goods and food, the main articles of Soviet imports also fell. Shortages in foreign currency derived from exports appear to be the main reason for the decline in Soviet imports.

At the same time, the trade policies of the capitalist countries (embargoes and licenses) may be regarded as a main restrictive factor. These policies and the overall price deterioration on the world market led to stagnated trade relations between the USSR and these countries.

All of this reduced the volume of mutual trade during 1984–1986 by 11,939.3 million rubles (exports by 8,213.4 million rubles and imports by 3,725.9 million rubles), which resulted in reducing the volume of foreign trade in 1986 to 22.2 percent of the total Soviet exports.

The dynamics of turnover with different Western nations varies from country to country and is closely related to the achieved levels of mutual trade, economic, scientific, and technological relations as well as to the specifics of economic development, and overall directions of government policy of these countries toward the USSR.

The leading partners in USSR trade with Western countries are the Federal Republic of Germany (FRG), Finland, Japan, Italy, France, UK, USA, and Austria.

In 1986, USSR foreign trade with these countries was 78.2 percent of total USSR trade turnover with Western countries (about 11.0 billion rubles or 82 percent in Soviet exports and 12.5 million rubles or 80 percent in imports).

Soviet exports to the industrialized Western countries are made up mainly of fuel and electric power including crude oil and oil products, other types of fuel, natural gas, chemical products, round wood, machines, equipment, and vehicles. Soviet imports from the industrialized Western countries consist basically of machines and equipment, chemical products, and grain. In addition, paper and cardboard, cellulose, wool, clothes, footwear, and food also were imported during this period.

Beginning in the 1970s, new forms of economic relations between the USSR and Western countries came into practice. During the period 1976–1986, more than 100 industrial projects with compensation agreements were constructed in the USSR. Some are in the chemical and oil industry (49) and the production of fertilizers (31); other projects are in gas, coal, and the wood processing industry.

A recent phenomenon in the development of trade and economic relations between the USSR and the Western countries is the signing of mutual long-term trade, economic, industrial, and scientific and technical cooperation programs. The first of these programs was signed between the USSR and Finland in 1977, and was based on the issues of the Final Act of the Meeting on Security and Cooperation in Europe.

Production cooperation, which includes the supply of components and complete Soviet-made sets of equipment for the manufacture of products imported to the USSR or components for future Soviet export, became widespread. Simultaneously, more sophisticated forms of cooperation such as coordination on the volume and types of components as well as conditions for final deliveries were developed and put into practice. Industrial cooperation based on component exchange and technological specialization is very common. The main partners of the USSR in this form of cooperation are firms from Finland, FRG, Italy, and France.

The construction of big industrial projects also may be regarded as an important form of long-term cooperation among countries. This form combines conventional commercial deals (for the delivery of equipment and materials) with bilateral and multilateral contracts to carry out research and development activities, as well as technical help including feasibility studies, training of personnel, and other forms of cooperation. Examples include the construction of a major car manufacturing plant in the USSR with the assistance of the Italian company Fiat, and the construction of a nuclear power station, *Lovisa*, in Finland with Soviet assistance.

During the five-year period of 1981–1985, USSR export of machinery increased by 26 percent (7.8 billion rubles in 1980; 10.1 billion rubles in 1985). But the average rate of growth per year was 4.7 percent and the volume of export of these goods was reduced to 0.5 percent per year. During 1986 and 1987, the USSR export of machines and equipment increased to only 4.5 percent, while the volume of exported machinery and equipment during this period was reduced to 1 percent. As a result, the share of machines and equipment in USSR exports was reduced from 15.8 percent in 1980 to 15.5 percent in 1987. In currency, the share of these goods in the total volume of USSR exports in 1987 was only 12.5 percent as compared to a share of the same type of machinery on the international market of over 30 percent.

The existing production structure is regarded by Soviet economists as a considerable obstacle, preventing the growth of USSR machinery and equipment exports. In 1987, six groups (out of a total of 63) made up 53 percent of the entire range of the machine-building industry. These six groups include energy and metallurgical equipment, tractors, garage equipment, cars, aviation engineering, motorcycles, and scooters.

During that period, the volume of exports increased 4.8 times. This rate of growth was higher than the total growth of USSR exports of machines and equipment. At the same time, four groups of goods – cars, energy equipment, railway trains, laboratory instruments and equipment – made up 70 percent of USSR exports to the industrialized Western countries.

Perestroika in economic management and dramatic changes in managerial and planning methods are leading to greater autonomy for enterprises. The greater independence also calls for changes in the management of foreign economic relations.

Taking all of this into consideration, the decision *On Measures for Improvement of the Management of Foreign Economic Relations*, adopted by the Party Central Committee and the Council of Ministers of the USSR, provides more responsibility and greater interest of branch ministers, associations, and enterprises to enhance production of high quality export goods that will be competitive in the world market.

By this decision, more than 20 ministries and government departments and about 80 major manufacturing associations and enterprises were granted the right to direct transactions. These ministries now have incorporated the self-supporting associations whose primary aim is to assist parent ministries in foreign trade. Science and industry pools and industrial associations also have foreign trade firms of their own. The number of organizations involved directly in trade is increasing continuously.

Additional regional foreign trade associations were established under the Councils of Ministers of the Union Republics. These associations will be in charge of dealing on external markets with commodities manufactured in the Union Republics.

The above-mentioned measures in no way undermine the state monopoly on foreign trade since the central state bodies exercise general guidance over foreign trade activities, planning and utilization of hard-currency funds. These measures, however, change the monopolistic trade relations in the USSR to a certain extent.

With the adoption by the Decision of the Central Committee of the Communist Party of the Soviet Union (CPSU) and the Council of Ministers of the USSR of *Additional Measures to Improve Economic Activity Under New Economic Conditions* in September 1987, broader rights in external economic relations including the use of hard-currency funds received from the export of produced goods were granted to enterprises.

To boost business initiative and strengthen self-sufficiency, Soviet producers are entitled to pool their funds to implement joint projects, transfer funds to other producers and associations under mutually beneficial conditions, and invest abroad. The most important feature of the 1987 decisions is the opening for new and effective forms of external economic relations by permitting joint ventures with foreign firms to be established on Soviet territory.

New opportunities for trade, economic, and industrial cooperation between the USSR and foreign partners were provided by Decision No. 1405 of the Council of Ministers on December 2, 1988, which in fact granted the right of direct external transactions to all Soviet producers of goods and services, while regulating state auditing and control mechanisms. Along with the formation and development of new elements of organizational infrastructure in external economic relations, the process of restructuring the steering bodies of foreign trade was initiated.

To ensure general guidance of the entire complex of foreign economic relations, a State Foreign Economic Commission was established under the USSR Council of Ministers. A primary aim was to elaborate relevant legal and economic measures aimed at the most efficient use of external economic activities to accelerate the development of the national economy. This commission is responsible for mapping out and implementing the country's external economic policy and supervising its fulfillment, and for coordinating the activity of Soviet ministries, government departments, and organizations on foreign markets. The commission's major functions are to provide for the development of the Soviet export basis, to assist producers in obtaining information, and to arrange for the training of personnel and other aspects of adjusting the new mechanism of foreign economic activity including implementation of export/import quotas within the whole complex.

At the same time, further steps have been undertaken towards increasing the role of the Ministry of Foreign Economic Relations as the key state instrument in maintaining control over the level and quality of commercial operations. In this connection, the USSR Council of Ministers granted the right to arrange for the recording of all participants involved in foreign economic activities.

8.2 Legislation for Foreign Investment in the USSR: Dynamics and Development

In the process of Soviet economic reform, substantial efforts have been made through legislation to encourage new forms of foreign economic activities. The legislation is aimed at creating favorable conditions for gradually developing relations in foreign economic activities to achieve the following goals:

- Enhance USSR participation in international business relations by developing new forms of industrial cooperation together with conventional trade relations.

- Broaden the involvement of Soviet enterprises in foreign economic relations.

Joint ventures in Soviet territory are the principal new form of foreign economic relations between Soviet organizations and foreign companies. All questions regulating creation, activities, and operations of such joint companies are stipulated in the complex set of legislative documents.

A decree on related issues such as the establishment of joint ventures, international associations and organizations in the USSR is considered a major step among the complex set of legislative documents issued so far in the country. The decree defined the legal procedures for establishing joint ventures as well as the conditions for the use of natural resources in the USSR and the taxation structure. A procedure for arbitration was also considered. The stipulations have been further developed by several decisions of the USSR government and governmental agencies.

On January 13, 1987, Decree No. 49 on the *Establishment and Activities of Joint Companies on the Territory of the USSR with Participation of Soviet Organizations and Companies from Capitalist and Developing Countries* was adopted by the USSR Ministry Council. This decree defined the status of joint companies as juridical persons according to Soviet legislation and set the following goals:

- Satisfaction of demand for certain industrial goods, raw materials, and services.
- Technological and managerial know-how transfer in the USSR and attraction of material and financial resources.
- Development of export possibilities for Soviet industry.
- Changed structure and increased efficiency of Soviet imports.

The decree initiated the process of establishing joint ventures in the USSR and granted them the following rights:

- Joint ventures have the right to be fully independent in their business activities as well as in making decisions without the approval of the governmental agencies managing the USSR economy.
- The share of the foreign partners should not exceed 49 percent and the general director of the joint venture as well as the chairman of the board should be Soviet citizens.

- The joint ventures have the right to independent export and import operations necessary for their business activities.
- On the domestic market, sales and supplies in rubles can be done on a contractual basis, but the right to operate was not given to the joint venture directly; this can be done through State trade organizations.
- Joint ventures are obliged to cover their requirements for convertible currencies including those for profit distribution among partners only from their own income in convertible currencies, but loans are also possible.
- After the first two years of operations, the joint companies are obliged every year to pay a profit tax of 30 percent. The reserve fund and funds for production development and R&D are to be allocated before taxation.
- The Ministry of Finance reserves the right to grant taxation holidays depending on the importance of the joint venture business activities to the economy of the USSR. Exemption of the profit tax is also possible. The regulations for taxing joint ventures, one of the most important elements of foreign investment legislation, were formulated in a way that stimulates reinvestment in the joint venture. Furthermore, the State economic agencies and ministries are empowered to regulate the process of establishing joint ventures in national priority areas.

Decree No. 49 established import and export guarantees for the foreign partners' share of the authorized fund. As long as other arrangements have not been stipulated by bilateral agreements between the USSR and the respective foreign countries, repatriated profit is taxed at the rate of 20 percent. It is important to note that in this decree the Ministry Council declared that labor conditions and payments of foreign citizens working in joint ventures will be based on concluded individual contracts. Soviet labor legislation applies with respect to Soviet citizens.

Experience gained while establishing the first joint ventures in 1987 demonstrated, according to Soviet and foreign specialists, that the stipulations and provisions needed revision to overcome barriers to joint entrepreneurship. On September 17, 1987, the Central Committee of the Communist Party of the USSR together with the Ministry Council adopted Decree No. 1074 on *The Further Development* *of Foreign Economic Activities in New Business Conditions.* The changes thereby introduced in Soviet joint venture legislation were substantial. Its basis revealed new opportunities for developing joint ventures. It should be noted that the right to sell and buy within the USSR in convertible currency as well as in rubles was granted to joint ventures. This should be regarded as a step towards solving some of the problems connected with joint companies in the Soviet Union and has attracted the attention of Western companies. At the end of 1987, a total of 23 joint ventures had been registered. In the first half of 1988, the list gained 80 new companies.

This process became the subject of serious analysis by both scientists and practitioners in the Soviet Union and abroad; here we attempt to analyze the initial problems.

On December 2, 1988, the Ministry Council of the USSR adopted a decree *On the Development of Foreign Economic Activities of State, Cooperative and Other Public Enterprises, Associations and Organizations*, which continued the process of legislation development in the country. The 49 percent limit on the foreign partners' share in the authorized fund of the joint venture was removed. Foreign citizens were allowed to serve as general directors and chairmen of the board. This important step is closely related to the following circumstances:

- The foreign partners' share in the authorized fund of the first 150 joint ventures registered in the country averaged about 37 percent. But almost 20 percent of all joint ventures, especially those created with partners from the FRG, Japan and Finland, have shares equal to 49 percent.
- On the other hand, the minority share of a foreign partner in the authorized fund decreased its role in the decision-making process. According to our observations, Soviet representatives on joint venture management boards have generally respected the positions of Western partners, but differences in opinions have been raised. In such cases, the minority share of the foreign partner formally appears to be a barrier to achieving one of the main goals of joint ventures in the USSR, transfer of managerial know-how. Together with the Decree No. 1405, practical observations have established that key decisions should be taken by consensus, not based on the percent share in the authorized fund.

The decree granted all rights for personnel recruitment, salaries, and employment conditions of Soviet citizens to the joint ventures. The changes aim to equalize business activities and conditions between State, cooperative, and joint enterprises. According to the law of State enterprises and the law of cooperatives in the USSR, all juridical restrictions for salaries and wages of Soviet citizens were removed. At the same time, all problems concerning labor conditions and personnel were to be coordinated with the trade union. Decree No. 1405 contains other provisions that further simplified the establishment and activities of joint ventures in the USSR (see Chapter 2).

In March 1989, the Council of Ministries of the USSR adopted Decree No. 203 on *State Regulations of Foreign Economic Activities*. This decree is aimed at creating a complex system of accounting, auditing, and regulating foreign economic relations of the Soviet state and cooperative enterprises regarding conditions of independent export and import operations. Decree No. 203 restricted the export operations of joint ventures only in volume and structure of their own production. Imports are restricted to the goods and services necessary for the joint venture production activities. During 1988, tendencies to increase the joint venture profits based on trade with Soviet raw materials and Western goods on the Soviet market were observed. The new Law on Foreign Investment is now being elaborated and considers various forms of foreign investment in the USSR not only for joint ventures.

8.3 The Formation and Activities of the Soviet East–West Joint Ventures

The first joint venture in the USSR was registered on May 12, 1987; this was a Soviet-Hungarian enterprise, "Littara-Valanpac."

Figure 8.1 illustrates the dynamics of growth of joint ventures established in the USSR. There are now nearly 1,000 joint ventures in the USSR; 70–80 joint ventures are being registered monthly, by the end of the second quarter of 1990, 1,800 had been registered.

Of joint ventures registered in the USSR as of September 1, 1989, the total volume of the authorized fund was 2,412 million rubles; Soviet enterprises and organizations have contributed 57.7 percent, Socialist countries 6.9 percent, Western countries 34.1 percent, and

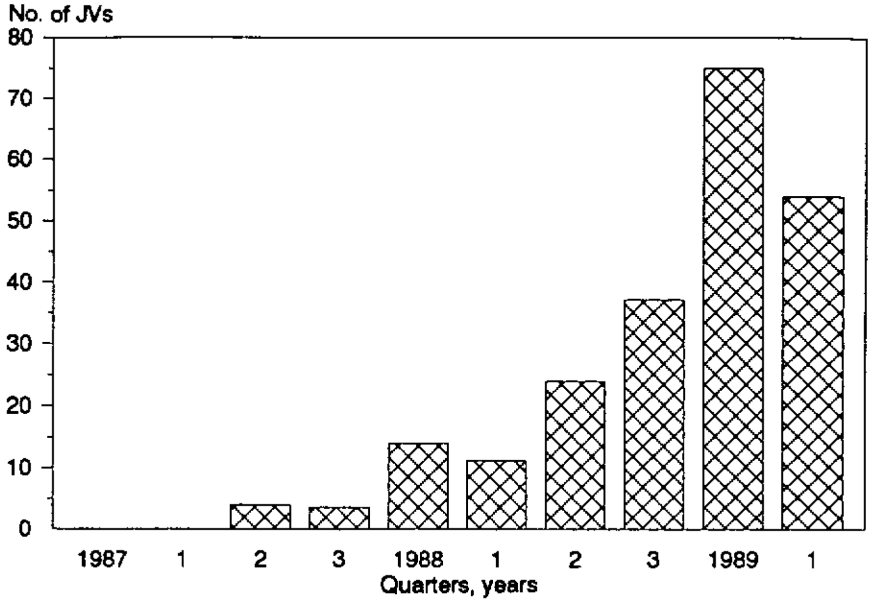

Figure 8.1. East-West joint venture process in the USSR.

developing countries 1.3 percent. On the whole, approximately 57.2 percent of the joint ventures established in the USSR have authorized funds of less than one million rubles, and approximately 6.6 percent have more than five million rubles.

About one-third of the registered joint ventures operate in the industrial sphere (including transport and construction), 32.5 percent are established in the social sphere (production of consumer goods, health services, public food services, tourism, etc.), 31 percent in science and research services (engineering, consulting, brokering, training personnel). Concerted investments (the sum of the authorized funds and credits) in joint ventures are less than 1 percent of the yearly investments in the Soviet national economy.

Figure 8.2 illustrates the dynamics of joint venture formation in the USSR with partners from capitalist countries. The first of such enterprises is a firm from Finland, registered in the USSR on July 22, 1987.

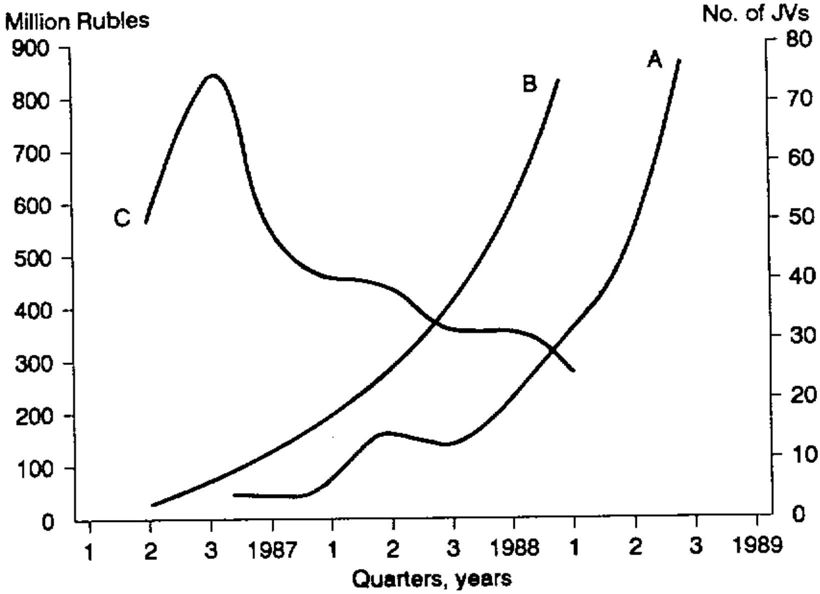

Figure 8.2. Dynamics of East–West joint ventures in the USSR.

On September 1, 1989, the number of East–West joint ventures registered in the USSR totaled 747. More than 300 Soviet State enterprises, cooperative associations, and organizations and their partners representing more than 700 firms from 23 countries had contributed a total amount of 1,939 million rubles (US$1,286 million) to the authorized funds. Western partners contributed 34 percent of the total sum of these investments.

Joint ventures with Western partners show rapid and intensive growth (*Figure 8.2*, curve A); the total volume of Soviet and foreign investments in these enterprises increases more slowly (curve B); and the value of the average authorized funds of individual joint ventures decreases (curve C). This is due to a large number of joint ventures recently created in the spheres of engineering, consulting, brokering and other services, where large investments are not required.

Most joint ventures are in the fields of consumer goods, health services, tourism, services, hotels, restaurants, and also in engineering, consulting, brokering, and information services. These enterprises promote the welfare of the population, create the infrastructure required for developing the national economy, and promote management development and the use of modern management methods.

In 1988, several joint ventures began to produce consumer goods, e.g., Lenwest (Leningrad) and Belwest (Vitebsk), whose foreign partner is Salamander (West Germany), and Sovplastital (Tashkent) established with the participation of Alma Rose (Italy).

A number of joint ventures have started activities in consulting and engineering, e.g., the Soviet-Finnish Vneshkonsult (Moscow). Demand for engineering services is much higher than the supply in the Soviet market. This may be explained by a restructuring of the economic mechanism in the USSR and the higher independence of enterprises, particularly in the field of foreign economic relations. Since April 1, 1989, Soviet manufacturers are responsible for their export-import operations, and they badly need to improve their decision-making system to deal with this new function. Soviet producers also have the right to participate in joint venture projects.

A number of joint ventures have been created in the USSR to produce personal computers and software, for which there is great demand. During the first stage of their activities, such enterprises arrange for the delivery of personal computers manufactured abroad or assemble personal computers from imported components. Under these circumstances, local prices (in rubles) may be 10–20 times more than prices abroad.

In this field, joint ventures also have an opportunity to use the comparatively low labor costs of Soviet programmers, who are usually engaged on a contractual basis. Therefore, the profitability of such enterprises is very high. Two joint ventures that are now successfully being developed to produce personal computers are Dialog (Soviet-American) and Interquadro (Soviet-French-Italian).

About 45 joint ventures have been established in the chemical sector. Some of them will be ready to start operation in the near future: Petrokam (Soviet-West German) in Nieschnekamsk for the production of ethylene-glycol, PRIS (Soviet-American) in Moscow for engineering activities in the petrochemical industry, and others. As of September 1, 1989, a total of 36 joint ventures had been established in different branches of machine building (excluding computers).

These enterprises have wide product ranges (metalworking tools and centers, machine tools for light industry, engineering services

Table 8.3. Western countries' contribution to USSR joint ventures.

Country	Number of joint ventures	Total[a] funds[b] A	Average[a] funds[b]	Foreign partner's total invest-ments[b] B	Share of foreign invest-ments B/A	Share in the total amount of foreign invest-ments
FRG	55	192.0	3.49	60.0	31.3%	16.6%
Finland	51	96.3	1.89	38.7	40.2%	10.7%
Italy	30	183.7	6.12	51.5	28.0%	14.3%
USA	30	41.7	1.39	21.4	51.3%	5.9%
UK	27	32.5	1.20	12.1	37.2%	3.4%
Austria	24	64.6	2.69	21.0	32.5%	5.8%
France	16	135.5	8.46	51.3	37.9%	14.3%
Switzerland	14	97.3	3.38	21.0	21.6%	6.0%
Japan	10	39.5	3.95	18.7	47.3%	5.2%

[a]These are authorized funds.
[b]In million rubles.

in machine building, etc.). In many instances, the partners in these joint ventures had been cooperating in R&D and technology development long before the joint venture was established. Joint ventures in the machine-building industry have much higher levels of authorized funds than joint ventures in other branches.

At present, some joint ventures in machine building have started production: Homatec (see Case Study H in the Appendix) in Moscow, Tirpa (Tiraspal City) established with the participation of Italian companies, KRANLDD with the participation of the Swiss company Libherr, and the Soviet-West German MSZ Vendt (Moscow) in machine tools.

Joint ventures engaged in machine-building faced many sophisticated problems, specifically with the supply of raw materials and components within the domestic wholesale system, training of personnel, cooperation with state-owned enterprises, ruble nonconvertibility, and interrelated issues.

The distribution of joint ventures in terms of partnership and the contribution of various Western countries (as of April 1, 1989) can be illustrated by the data given in *Table 8.3*.

Table 8.3 shows that the FRG ranks first in terms of the total amount of invested capital. Almost 22 percent of FRG investments belong mostly to the machine-building field. Moreover, many of these joint ventures were established on the basis of previous long-term cooperation between the partners, e.g.: Homatec (Moscow) – machine tools and manufacturing centers; MSZ-Vendt (Moscow) – polishing machine tools; and Sedin-Shiss (Krasnodar) – carousel machine tools.

In the field of consumer goods and other social services, a total of 11 joint ventures have been established. Joint ventures in Leningrad and Vitebsk started producing shoes with the participation of the West German Salamander company.

Finnish companies participate mainly in the fields of consumer goods (29 percent), engineering services (31 percent), and building and construction. More than half of the Soviet-Finnish joint ventures have individual authorized funds amounting to less than one million rubles. Among the joint ventures in operation are: Vneshkonsult (Moscow) and Consofin (Leningrad) for consulting services. Not far from completion is the joint venture Infa Hotel in Moscow.

Italian companies participate in 30 joint ventures in fields such as social services (40 percent of the total), machine building (17 percent), and engineering (27 percent). In total, more than 180 billion rubles were invested in these ventures, and their average authorized funds amount to more than 6 million rubles. Italian investments make up only 28.1 percent of all capital invested in Soviet-Italian joint ventures. Some of the largest joint ventures in the USSR are Soviet-Italian joint ventures, such as Sorplastital (Tashkent), plastics and consumer goods; Sovitalrpodmask (Volgsk), refrigerating equipment; Sorbutital (Western Siberia), gas polymers. About 44 percent of the Soviet-Italian joint ventures have authorized funds exceeding five million rubles.

US companies participate in 30 joint ventures of which 67 percent have authorized funds amounting to no more than one million rubles and only 18 percent have authorized funds exceeding five million rubles. In total, US investments make up 35 percent of all invested capital in Soviet-US joint ventures and amount to 21.4 million rubles. About 50 percent of the US joint ventures are established in technological, consulting, and engineering services and 33 percent in the social complex. US companies have not yet participated in the heavy machine-building industry.

Investigations are now under way within the framework of Soviet and American consortiums. Among the joint ventures presently in operation, the joint venture Dialog in developing personal computers and software ought to be mentioned (see Case Study G in the Appendix). The Soviet-American joint venture PRIS, which collaborates in applied electronic control systems in the petroleum industry, is ready to start production.

Almost all of the 27 Soviet-British joint ventures are small and operate in the technological field (41 percent), social complex (33.3 percent), or computer production (10.5 percent).

Austrian companies are engaged in consultancy services (37.5 percent) and in computer software (25 percent). Almost all of them (80 percent) have authorized funds below one million rubles.

French partners have invested in rather large-sized joint ventures. They have the largest average authorized fund (8.46 million rubles) and only 25 percent of them have authorized funds below one million rubles. The French companies possess more than 38 percent of the financial funds in their USSR joint ventures, which can be broken down into the following sectors: engineering services (37.5 percent), social (31.3 percent), and the chemical industry (12.5 percent).

Joint ventures established with the participation of Swiss companies have a rather broad activity spectrum: consumer goods and engineering (both 16.7 percent), tourist services, machine-building, chemical industry including pharmaceuticals, agro-industry, and others. Some 44 percent of all the Soviet-Swiss joint ventures have authorized funds below one million rubles. At the same time, the total Swiss contribution amounts to 21.6 million rubles and is even higher than that of the US companies.

The Japanese contribution to Soviet-Japan joint venture is not yet very large, only about 6 percent of total Western investments. The Soviet-Japanese joint ventures fall within the following fields: agro-industry or fisheries (40 percent), forestry, and tourist services. One of the prominent Soviet-Japanese joint ventures Igizma-Tairiku (Siberia, Irkutsk) is now producing approximately 90,000 cubic meters of high-quality saw timber articles, more than 60 percent of which is being exported.

At the first stage, the joint venture leaders in the USSR are the companies and countries with highly developed trade and economies and with some tradition in Soviet relations (FRG, Finland, Italy). Improved international relations serves as a good basis for the further development of US and British joint ventures. Practical experience gained in this rather new form of multilateral cooperation and improvements in the level of foreign investment legislation in the USSR will facilitate the further development of joint ventures in the USSR.

8.4 Practical Experience and Problem Analysis

To obtain sufficient current data on joint ventures with Western companies, the most prominent joint ventures with the longest histories were selected for examination: Dialog (Soviet-US); Homatec (Soviet-FRG); and Technicord (Soviet-French) – all were registered in the USSR in 1987. The carefully described process of their formation reveals differences in motivation, level of previous cooperation, negotiations, and concluded agreements.

The West German company Heinemann Maschinen und Anlagenbau and the Production Organization (P/O) Ordzonikidze machine-tools plant had begun cooperation in the period 1986–1987, which led to the establishment of Homatec. On the other hand, the establishment of the Dialog resulted from occasional meetings of representatives from MPI and P/O KAMAZ at the American trade exhibition in Moscow.

The scope and mode of activities with foreign partners from the USA, FRG, and France differ, and the results of their activities can be measured from different points of reference. There is no doubt, however, that they possess certain common features, in particular:

- Relevant foreign technology is broadly used in the production process.
- Foreign-made components and parts delivered by principal companies normally provide the basis of the main production cycle.
- Soviet licenses and/or know-how are very often used in the production process.
- Foreign managerial expertise is implemented in practice.

An analysis of establishing a joint venture in the USSR with partners from Western countries was made by the authors in 1988.[2]

[2]Part of the results can be found in the IIASA Working Paper entitled *"Joint Ventures with Foreign Capital Participation in the Soviet Union: Experiences and Future Outlook"*, Ranenko & Soloviev, WP-89-03, January 1989.

The analysis generalizes the most typical problems that were explicitly described in interviews and questionnaires. The main groups of problems are the following:

First Group: Problems provoked by differences between the status and rights given to joint ventures and the character of internal management in the USSR.

Second Group: Problems provoked by the nonconvertibility of rubles.

Third Group: Problems arising from insufficient knowledge and lack of experience of Soviet managers and specialists in the fields of economics, organizational development, and management of international operations.

When analyzing the first group, it is important to note that the legislative framework for operating joint ventures in the USSR has improved business economic mechanisms and produced economic reforms in the country. Joint ventures have been empowered to perform business activities that their Soviet partners should also be allowed to perform in the domestic market. The majority of goods are produced by State enterprises under State orders or based on contracts that are concluded in advance by higher authorities. The scale of supply is not more than 15 percent to 20 percent of the total turnover of goods in the country. Therefore, joint ventures face difficulties in obtaining supplies of raw materials, components and parts from the centralized distribution system.

Currently, the USSR lacks business and management infrastructure, specifically engineering, consultancy, information, and other scientific services. This is also due to the previous economic mechanism in the USSR, and was a source of problems for joint ventures in market relations and daily market orientation. Joint ventures have been created in the field of business and management infrastructures, however, and these should help solve the problems mentioned above.

The second group of problems is connected with the nonconvertibility of rubles. Currently, there is no doubt that in the course of instituting radical economic reforms, it is necessary to achieve a balance between monetary funds and goods within the economy in order to solve this problem. The main difficulty of joint ventures related to nonconvertibility is the necessity to self-finance activities involving hard currency. The case studies show some practical solutions to this problem, both in exports and in domestic market activities. The nonconvertibility of rubles, however, is not the most significant problem during the initial stage.

Some additional opportunities provided by the right to independent export and import operations for State and cooperative enterprises should also be considered. The amount of convertible currency earned thereby may be used by these enterprises to buy goods and services from joint ventures. It is also possible for joint ventures to participate in currency auctions, which will be organized by the Vnesch Economic Bank of the USSR in the near future.

The third group of problems is related to the insufficient experience of Soviet managers and specialists in the field of foreign economic relations. This appears to be a problem not only for joint venture activities but also for practical foreign economic activities of Soviet enterprises.

The practical experience and knowledge of Western partners are very often much greater than their Soviet colleagues can offer. Possibilities for more intensive use of management methods and practical experience, which as a rule are well known to the Western companies, have seen a remarkable increase. Options are greater now that representatives of the foreign partners can be appointed general directors and chairmen of joint ventures. These decisions have gradually changed the attitude of Soviet managers to the realities of the new business environment.

The solution of the problems mentioned above lies in management development. Many activities at different levels and in various organizations are being organized to create new management programs and schools. Universities are taking part and so are institutes for management development, joint ventures specialized in the field, and consultancy companies. Publications on management and new methods and techniques are rapidly increasing. Seminars and conferences for Soviet managers, including the participation of Western experts, are being organized in increasing numbers every day.

Chapter 9

Current Issues and Challenges in East–West Joint Ventures: An American Perspective

J. Morton

9.1 A Brief History of Change

In the late 1960s and early 1970s, it became increasingly evident that the economic systems within the so-called "Socialist" countries were not able to create the level of goods, food, shelter or technological progress that were evident in the industrialized, free-market economies of the West. These increasingly apparent shortcomings were exacerbated by an acceleration of technological achievement in the West that not only threatened to diminish the relative global economic, political, and military capabilities of the Socialist states, but also threatened to undermine their very social and cultural structures.

In the late 1970s, the prospect that these Socialist economies and societies might virtually collapse became imaginable – not only because the Eastern economies were actually in a state of accelerating decline, but also because technological changes involving the instantaneous transmission of data, images, printed materials, and voice were facilitating enhanced global communications at a level never before possible; it became increasingly difficult for governments to obstruct the flow of economic bad news to their own populations. Accordingly, Socialist countries confronted with a decline in their economic, technological, and political structures, and increasingly unable to control the flow of information within their own territory (information which principally increased the expectations and heightened the frustrations of their own people) were forced to permit change or confront disaster.

For many reasons, some obvious and some less so, the People's Republic of China was among the first communist countries to adopt a joint venture law. China, therefore, became something of an economic "laboratory" within which systems were designed, modified, supplemented, repealed, and redefined over a period of more than a decade, culminating in a system that, prior to the Tiananmen Square incident in the Spring of 1989, was producing considerable wealth, foreign investment, consumer goods, export items, and technology exchanges within the territory of the People's Republic of China. On the dark side of the Chinese "experiment," however, were increased corruption, escalating inflation, widely disparate shortages, local grass-roots resentment toward an emerging entrepreneurial class, and a growing discontent in urban centers relating to repressive laws and practices restricting individual freedom. Despite these problems, the Chinese experiment produced many demonstrable economic benefits within China, giving rise in Eastern Europe to fears that the Chinese might have hit upon a formula that could accelerate the decline and isolation of the Warsaw Pact Nations.

The relative success of the Chinese experiment was predicated on, among other things:

(1) The concentration of economic development (and infrastructural development) within certain special economic zones.

(2) The willingness of the Chinese to permit the operation of wholly owned and majority-owned foreign subsidiaries on Chinese territory.
(3) The creation of special regulations permitting the purchase and sale or transfer of foreign exchange among East–West joint ventures situated in China.
(4) The willingness of a large number of Chinese to accept the new entrepreneurialism and the new entrepreneurs in a cultural and social context (although this acceptance was not universal, nor was it without specific and sometimes violent local consequences).
(5) The creation of a "total-cost" system (taking into account the aggregate real costs of capital, labor, taxes, duties, transporting raw materials and the like) which permitted Western-style businesses to set up quality-oriented, efficient, profit-oriented manufacturing facilities able to produce cost-competitive, world-quality products for the global marketplace.
(6) The creation of mechanisms for ameliorating (if not resolving) problems of sourcing and pricing raw materials, parts, space and labor, as well as mechanisms to ameliorate problems relating to management and capital accumulation, and to the distribution, transportation, sales, and marketing of goods and products of the China-based venture.

Despite all of the continuing political and social problems in China, billions of dollars of foreign investment poured into the People's Republic of China during the first nine years of the 1980s. The technological and production infrastructure within China was substantially enhanced. One of the most obvious and most serious consequences of the enormous economic changes that swept the People's Republic of China during this period was an increasing discontent among the Chinese population, particularly in urban centers. This discontent derived, in part, from frustrated consumer expectations and, in part, from a growing dissatisfaction with the increase in corruption at every level of Chinese society and with the burdensome encumbrances on personal liberty and political freedom imposed by the government.

This discontent led to a series of demonstrations that ended on June 4, 1989 with the Chinese military intervention in Beijing's

Tiananmen Square. The events that led to the Tiananmen uprising and to the infamous suppression of the Tiananmen demonstration were closely observed by both Easterners and Westerners with concern and consternation. The immediate reaction of the Western business community was to review existing Chinese business relationships and to postpone new or proposed business relationships. East–West business projects in China were substantially retarded following the Tiananmen incident and they have not fully recovered from the negative consequences of that event.

While it is difficult to understand fully all of the factors that led to the Tiananmen incident, perhaps the most obvious conclusion to be drawn from those events is simply that one of the inevitable consequences of rapid and substantial change in any society is widespread discontent, demographic restructuring, and an increased level of social disorder, all of which are exacerbated when a program of economic reform is launched in the absence of political and social reforms.

With this concern clearly in mind, the Soviet Union in 1987 embarked on a concurrent program of political reform (*perestroika*), cultural and social change (*glasnost*) and economic reform (the USSR Joint Enterprises Decree of January 13, 1987). These reforms have progressed simultaneously and have produced profound changes not only in the Soviet Union, but also in those Eastern European nations that have been within the Soviet Union's sphere of influence since the late 1940s. The changes wrought by these reforms have been so dramatic and so fundamental that it is both astonishing and gratifying (and perhaps a tribute to Soviet leadership) that they have not been accompanied by violence and revolution on a broad scale.

9.2 Lessons Learned From Recent Changes

As in the case of China, the lessons learned from the experiences in the USSR and in Eastern Europe over the past several years depend, in large measure, upon the personal perspective of the beholder. From my perspective, several conclusions seem justified:

(1) No nation – however vast and however rich in human and natural resources – can survive unless it establishes and maintains an economic system that can produce a surplus of goods and services

that are available and attractive, both to its own population and to the external world market. Otherwise, such a nation has nothing of value to trade for those essential goods and services that it cannot produce at home.

(2) To be successful, the mechanisms for creating a surplus of goods and services must be predicated upon some system that provides incentives for individuals to express their creativeness, industriousness, and enterprise. Otherwise, experience demonstrates that individuals have no incentive to work hard to produce quality, cost-competitive goods.

(3) Individual creativity, industriousness, and enterprise in business and industry must be encouraged in a political and cultural environment that values and rewards (rather than represses) personal liberty and that does not impose long-term unpopular choices on indigenous populations. Otherwise, plant managers and entrepreneurs, who are expected to be bold, creative and innovative, will find themselves instead, timid, unpopular, suspect, and intimidated.

(4) To encourage and reward individual initiatives within its political and economic system, a nation must place significant value upon the role of the individual (as well as upon the value of the group) within both its cultural and economic systems. The inevitable consequence will be that individuals will press for increased personal liberties well beyond the economic sphere. In short, the inevitable result of encouraging individual initiatives in the business and economic spheres is to create irrepressible popular demands for increased personal liberties in the political and cultural spheres. In the case of the Chinese, the inevitable demands for increased personal liberties were forcibly repressed, at least in the short term. In the case of the USSR, these demands have been anticipated, encouraged, directed, and – at least up to now – accommodated.

All of this, of course, is relevant to an examination of East–West economic ventures situated in the Socialist countries because the long-term stability of the political, cultural, and economic conditions within any prospective host country is a necessary precondition to the long-term success of a business venture there. While insurance may be available to protect Western businesses from certain foreign losses arising from specifically defined political risks, such policies do not compensate the Western investor for the loss of the enormous "soft costs" of unsuccessful foreign activities. Such soft costs include the time, energy, and lost opportunity that are consumed in the negotiation, creation, operation, and eventual failure of a foreign venture. National stability is also important to Westerners, who do not want to become economically involved with a country that provides unhappy – even bitter – employees, or that is the subject of angry protests, embargoes, or boycotts back in the West. Such problems have occurred in the United States with respect to China and South Africa because of widely perceived repressive policies in these countries toward their own people. All things considered, therefore, a rational program for national economic reform must include provisions for political, cultural, and social changes, all of which are designed to increase the level of individual initiatives, participation, and prerogatives within the changing society.

9.3 Significant Infrastructural Issues Confronting East–West Joint Ventures

At conferences, seminars, round-table discussions, and strategy meetings throughout the world, lawyers, policy makers, accountants, and business people spend a great deal of time talking about legal structures, tax laws and tax treaties, accounting principles, and economic strategies that will position East–West joint ventures for success within their host countries. These discussions are certainly vital to the success of any joint venture but, in my view, the issues that most likely will affect the ultimate success or failure of a joint venture cannot be found in legal papers, accounting rules, or economic strategies.

It is useful to conceptualize the productive aspect of any manufacturing business as a lock in a river-based transportation system through which all ship traffic must pass. In building the lock, a great deal of attention must be given to the size, configuration, cost, pricing (if tolls are to be charged for passage through the lock), taxes (if taxes are to be paid by the lock), business structure, and capital structure affecting the construction, operation, and maintenance of the lock. Certainly, the construction and operation of the lock should not be undertaken on a for-profit basis unless its physical construction and function are permitted by both the laws of man and nature, or unless there is some demonstrable need for its services, or unless there is a permitted form of business structure that accommodates the needs of all of the business participants, or unless the entire project is economically feasible by some external standard. On the other hand, in planning the *business* of establishing and operating the lock on a for-profit basis, considerable attention must also be paid to the *feeder* and *receiving* systems, which supply necessary materials to the lock and which receive those materials after the lock has performed its function. In short, the lock is not an independent, free-standing entity that, if managed efficiently and effectively, will succeed without regard to a multitude of external forces that affect it. It is, instead, one essential piece of a continuum of pieces, events, and conditions, all of which are necessary for the proper function of the lock and the larger transportation system of which it is just one component. The best designed lock will not be commercially viable if the river runs dry or if there are no ships to use its services.

The degree to which one must consider these external pieces in planning a business varies both with the nature of the proposed business and with the nature of the particular input and outflow networks within which the proposed business is to be embedded. For example, computer manufacturers, food processors, or clothing manufacturers are critically dependent upon the accessibility to inflow channels that feed into the business a large number of necessary materials, parts, components, supplies, utilities, equipment, machinery, and other items. Such businesses are heavily dependent upon the accessibility of critical outflow channels that receive and dispose of finished goods. These outflow channels include facilities for transportation, distribution, sales, service, market information, and the like.

It is helpful to imagine that a modern production business, like the hypothetical lock itself, must have a relatively secure inflow of supplies and services to sustain its core business and must be able to transfer its products into a distribution system that is prepared to accept, transport, display, demonstrate, sell, and service those products in an efficient, market-oriented, cost effective manner. It has been the downfall of many ingeniously conceived, cleverly structured, carefully planned and generously financed East–West joint ventures that they have inadequately assured the supply of necessary inputs and/or failed to pay adequate attention to the mechanisms and channels of product outflow.

East–West ventures in China and in the USSR are particularly vulnerable to inflow and outflow deficiencies because the Western business people who are involved in the design of these ventures have not had to pay such careful attention to these aspects of their businesses in the West as they must in the East. In most Socialist economies neither the inflow ("sourcing") nor the outflow ("distribution") channels are as clearly defined as they are in most Western countries. In fact, in most Eastern countries neither channel may actually exist in any form relevant to a market-driven economic system.

9.4 The Sourcing Channel in Socialist Countries

As stated above, sourcing channels in Socialist countries are, at best, undefined and, at worst, nonexistent. The response to (or perhaps the cause of) sourcing problems in most of the Soviet Union's major domestic industries has been vertical integration. To assure a source of supply for essential raw materials, parts, and supplies, local Soviet industries almost universally have developed in-house capacity to manufacture or supply their own needs without regard to cost or efficiency.

The tendency to integrate vertically is evident in virtually all of the Soviet industries that I have toured. Because Soviet industries tend to develop dedicated, in-house manufacturing capability for all of their required parts and components, it is not uncommon for ancillary manufacturing and fabrication centers within Soviet umbrella industries to operate at efficiencies of 30 percent or lower. This inefficient vertical integration is the inevitable consequence of an incentive system that has rewarded Soviet managers not for quality or productivity but for meeting centrally mandated production quotas without regard to cost, quality, or efficiency. Soviet managers whose career paths have depended upon meeting such quotas have gone to great lengths to assure that the materials and supplies necessary to meet those quotas will be available to them when they are needed, notwithstanding – in fact, without regard to – the enormous costs associated with unnecessary and inefficient vertical integration.

Even the current trend in the Soviet Union to hold managers accountable for profitability does not adequately address the cost consequences of unnecessary vertical integration. Soviet accounting rules do not yet adequately account for the capital costs of running a business and not enough attention is being paid to encouraging a broad network of specialized support industries to meet the diverse and changing needs of major production facilities.

In planning an Eastern Europe-based manufacturing enterprise, very little should be assumed in the area of sourcing. In the West, office furniture, telephones, and other routine office supplies and equipment are available from a large number of competing suppliers at competitive prices. These suppliers are keenly aware of the need to meet or beat the pricing, quality, and service policies of their respective competitors, and they are willing to work hard to assure that their customers are well served and satisfied. Similarly, in the West, there are a large number of competitive sources available to most businesses for raw materials and production machinery.

In the East, however, the supply of raw materials, machinery, equipment, and other necessary items has been constrained historically by political rivalries between the central planning agency and end-users over the allocation of the available (and insufficient) supply of necessary resources. While the control of central planning agencies is diminishing rapidly in the East, the allocation of essential raw materials remains essentially the prerogative of Central or Regional authorities. It is rarely possible for the local partner of any East–West joint venture (or, for that matter, any Eastern contract manufacturer) to assure with any degree of certainty the availability of essential materials. It is therefore advisable for Western partners to examine the sourcing channels in the host country for essential raw materials and to involve in the negotiations leading to the joint venture or manufacturing agreement any additional ministries, authorities, or business entities that are essential to the sourcing issue.

9.5 The Disposition Channel in Socialist Countries

For the past several decades, most businesses in Eastern Europe (particularly in the Soviet Union) have had a single customer: the Central government or entities *assigned* by the Central Planning Authority of the Central government. In this assigned customer context, marketing and sales efforts by Soviet manufacturers have not been required, and customer satisfaction has not been a major factor in the success or failure of any particular business entity.

Again, on the theory that a system becomes what it rewards (and does not become that which it fails to reward or that which it actively discourages), it is not surprising that an efficient distribution system has failed to develop in most Eastern European nations. Most Eastern European manufacturers have no reason to be concerned about advertising, transporting, distributing, displaying, or servicing their products. Instead, their responsibility has been to produce certain specified products and deliver them to their loading docks for pickup by a customer whom they may never have seen and whom they may not even know by name.

While Eastern sourcing deficiencies impose formidable obstacles to operating an East–West venture, the outflow or distribution side of any such business may be a more serious impediment to success. Because the customers of an Eastern business have traditionally been assigned by a central planning authority, notions of competitive sales and marketing or product innovation have not been relevant to Eastern managers. Furthermore, because most Eastern products are not manufactured until they are *sold* or *assigned* to the ultimate customer, there has been no need to develop a wholesale distribution network for most products. Finally, because the ultimate customer has been *assigned* to the supplier and because the supplier has been *assigned* to the customer, there has been no perceived need in Eastern economies for market information, service or warranty agreements, or for competitive transportation alternatives. The result is that there has developed within Eastern countries a network of distinct and noncompeting *dedicated* distribution, transportation, and warehousing systems that relate to long established and centrally-dictated relationships between specific producers and specific customers. Although these networks may be operating at substantially less than full capacity, it is extremely difficult (if not impossible) for unrelated third parties (such as new East–West businesses) to break into the systems and use their excess capacities. Even if a Western company could penetrate one of these dedicated distribution networks, furthermore, the resulting market access would be limited to those few end-users around whom the distribution network has developed.

Problems on the distribution side may begin very early in the manufacturing cycle. During my recent tour of Soviet manufacturing facilities along the Volga and Don Rivers, e.g., we were frequently told that certain existing businesses had excess capacity that they would like to dedicate to an East–West joint venture involving an appropriate Western partner. In attempting to work out the mechanics of assuring the dedication and availability of this alleged excess capacity, it became clear that the alleged excess capacity was only available to the extent not required, from time to time, by the preexisting customer base and, further, that this excess capacity was available to the Western partner fully burdened with the myriad of problems affecting the preexisting underlying production base. Even if all other problems could have been overcome, the critical problem remaining for the proposed East–West joint venture wishing to use this excess capacity was to identify or develop mechanisms for sourcing raw materials marketing, transporting, displaying, servicing, and selling within the USSR all or some portion of the goods produced by the proposed joint venture.

9.6 Top-Down Versus Bottom-Up Economies

It is fashionable for Western observers to characterize the Eastern economies as top-down (centrally planned) rather than bottom-up (market driven) systems. From a producer's point of view, a top-down system is more predictable and more comfortable because producers in a top-down system do not have to worry about the shifting desires of consumers and can attend, instead, to meeting their assigned production quotas for standard, specifically designated products. In a top-down system, however, consumers and end-users inevitably fall victim to the ineptness of central planners and, even worse, to the corruption and shortages that centrally planned economies tend to spawn.

Producers in a bottom-up economy operate in a much less secure environment. Bottom-up producers tend to be highly specialized, intensely competitive, highly innovative, and very cost, quality, and service oriented. In a bottom-up system consumers tend to be the group that actually controls the entire production system through their responses to market surveys and through their purchases of (or refusals to purchase) the wide variety of products available to them.

The differences between top-down and bottom-up systems extend far beyond the matter of who decides what is produced and what is consumed. The two systems require, and inevitably produce, a very different infrastructure of support mechanisms on both the sourcing and distribution sides.

As previously noted, in a top-down economy, distribution mechanisms most often take the form of very specific and exclusive arrangements between a single designated producer and a single designated end-user and involve a single product or a single family of products. In such systems raw materials are either locally manufactured or are assigned by the central planning authority. Accordingly, generalized sourcing and wholesale distribution mechanisms are not required and do not develop in top-down or centrally planned economies.

In a bottom-up economy, on the other hand, extensive product differentiation is required by the sheer volume of market segments identified by consumers. The result is that bottom-up market segments and products become so diverse that only a generalized sourcing and warehouse-based wholesale distribution system can serve the marketplace.

The lack or presence of a generalized wholesale distribution system is not the only infrastructural difference between those distribution-side systems that are available in the East and those that are available in the West. Of equal importance is the lack in the East of any established market feedback mechanisms that are so vital to the long-term success of Western consumer goods manufacturers.

Central planners, however capable and well-intentioned they might be, are simply not capable of determining (much less reacting to) sudden changes in true market needs because of the sheer magnitude of the task with which they are confronted. To do a thorough and accurate job of understanding consumer needs, they would have to consider tens of thousands of products and hundreds of regional, ethnic, or religious variations affecting local preferences. Even if they had access to all of the necessary market data (and they assuredly do not), it would not be possible to process it all in a meaningful fashion and come to useful conclusions within the time allocated to the planning process.

During my recent trips through the Soviet Union, I have had lengthy and candid discussions with shopkeepers in a variety of state-run retail stores. They unanimously stated that they had little or no control over the products that were assigned to their stores by the central planners and that they felt it futile to attempt to request specific products from their government supplier because such requests went unheard and unfulfilled.

In a bottom-up economy, on the other hand, systems for determining market needs are grossly decentralized and because they are so critical to business success, they are highly developed. These market survey systems utilize the most sophisticated psychological and statistical data available. In addition, bottom-up economies typically generate whole industries devoted specifically to understanding and influencing consumer preferences to produce goods that respond to market needs and to incline existing market demands toward a particular manufacturer's products. These market analysis industries rarely exist in Eastern economies.

9.7 Conclusions

Over the past several years, I have written a multitude of papers analyzing the legal, accounting, and tax implications of doing business in Socialist countries, such as the USSR and the People's Republic of China. My focus has been on an analysis of the legal mechanisms available in these countries to accommodate East–West economic transactions and on the difficulties that may arise because of deficiencies or ambiguities in the existing legal structures.

I remain convinced that a careful analysis of existing legal structures within any target country is a necessary prerequisite to planning a business venture in such a country. On the other hand, it is becoming clear to me that the Socialist countries are rapidly developing legal systems that permit rather traditional business structures, joint ventures, contract manufacturing agreements, and the like within their territories, and that the substantive legal work relating to most East–West ventures actually can be reduced to assuring that the final documents fairly reflect the intentions of the parties, do not run afoul of any particular local idiosyncrasy, and are properly authorized, signed and recorded with appropriate authorities.

In addition, it has become clear to me that in most of the Eastern countries at this stage in their development virtually everything is negotiable, including tax rates, tax holidays, rights to use and dispose of land and buildings, import duty rates, export permits, access to raw materials, costs of raw materials, internal financing arrangements, and the like. Almost all of these matters reduce, ultimately, to a determination of the true cost of doing business within the Eastern country. In this regard, Eastern countries have made a commitment to make themselves attractive to foreign investors and are willing to make substantial cost concessions to achieve that objective. While these cost factors are extremely important and must be dealt with, they will ultimately be fairly (if not favorably) resolved – with patience and perseverance – because both sides understand that a transaction must be competitively priced if it is to proceed.

After all of these very important matters are taken into account, the principal remaining issues upon which the ultimate success or failure of the East–West business venture will depend involve the adequacy of the inflow (sourcing) and outflow (distribution) systems within which the proposed East–West venture is to be embedded. I can think of no other factors that will so profoundly affect the ultimate outcome of the proposed venture as these.

Until local sourcing and distribution mechanisms are developed within the Eastern countries, it will quite likely be necessary even for East–West manufacturing ventures to integrate vertically to a much greater extent than their counterparts in the West have found necessary. It may be attractive for several Western manufacturers to pool their resources to create certain vital sourcing and distribution infrastructural mechanisms that might not otherwise be available to East–West ventures. This linking of primary manufacturing investments with secondary and smaller infrastructural investments on both the sourcing and distribution sides of the primary manufacturing facility may not only produce substantial ancillary profit centers within the host country but also may ultimately assure the success of the primary investment.

Chapter 10

Joint Ventures Beyond Statistics: Current Practices and Problems

E. Razvigorova and J. Djarova

International joint ventures had become a focus of world business attention and were considered strategic alliances[1] even before the recent developments in East–West economic relations. But so far researchers and managers have come up with only a few limited theories and empirical observations in this regard. International joint ventures link two or more partners with different economic, organizational, and managerial features to fulfill common and previously agreed upon goals. The East–West type of joint venture presents the most serious challenge to the scientific community and greatest motivation for business people in finding answers to many questions of great importance to the future of both East and West.

[1] Joint ventures have been described as options to avoid mergers or long-range strategic alliances (*1972 Business International*).

The beginning of the 1980s was marked by a new form of relations between the two economic systems, equity joint ventures. The number of joint ventures escalated and in less than two years increased ten times. It is obvious and understandable that this short period of existence does not permit strong final conclusions. But the current tendencies and main problems can be elaborated.

To appreciate the risks and opportunities inherent in joint ventures, partners must begin to develop a viable joint organization. Combining the property, technology skills, and know-how of two or more parties and making them profitable is neither an easy nor a quick job. Doing this in a turbulent economy with often changing rules is even more complicated. Local traditions, rules, and administrative practices influence the process of developing joint enterprises and change the scope of their activities, affecting the success of the joint companies. Organizations can survive only with a supportive environment that cannot be created without an understanding of the business conditions in the host country.

The results reported in this chapter are based on national analyses and are supplemented by questionnaires and interviews conducted jointly by IIASA staff members and national experts connected with 50 different joint ventures. Twenty-five Western partner organizations, 20 of which are from Austria were also interviewed.[2]

The new legislation introduced in all CMEA countries at the beginning of 1989 triggered a rapid growth in the number of joint ventures. For example, in Poland, 61 joint ventures were registered in four months; in Czechoslovakia, 25 in three months; in USSR, 600 by the end of August 1989; in Bulgaria, 25 through the end of June; and in Hungary, nearly 500.

The type of business conducted by joint ventures varies by country and industrial sector according to the partners' priorities, it became more diversified after the new legislation was adopted. The majority

[2]At the time the study was conducted, three joint ventures were in operation in Czechoslovakia and another nine were in the process of being established. A total of 282 had signed contracts in Hungary, significantly fewer were in operation, of which 10 percent were "sleeping" and 25 percent just recently established; Bulgaria had 16, of which 13 were in operation; USSR had 15–20 in operation; and Poland had 12. That produced a sample of about 160 joint ventures in operation. Statistical data for the total sample of registered joint ventures were analyzed.

of joint ventures are still in the chemical, machine-building, transport equipment, and light industries. The service sector is rapidly attracting investments in Hungary and in the USSR and, to a lesser degree, in Czechoslovakia and Poland. Generally, East–West joint ventures located in the CMEA countries concentrate their activities in industry, but 26 percent of the joint ventures studied in Hungary are in service sectors. Czechoslovakia is oriented towards hotels and tourism and already has numerous spas organized as joint ventures. Engineering, consultancy, and training organizations have been established in Hungary and the USSR and, to a lesser extent, in Bulgaria and Poland. Joint ventures in R&D are very rare; R&D activities are usually related to the needs of the joint venture's production, which with few exceptions is on a large scale.

One most important factor for the establishment of joint ventures and their development concerns the many changes involved in restructuring the economic organization in general and foreign trade in particular. Greater freedom of action is being accorded to individual enterprises in all CMEA countries with regard to foreign trade operations. The state monopoly in industry and economic management is being removed. Administrative procedures are being simplified. All of these changes improve the environment of joint ventures.

Many similarities are found in joint venture legislation, particularly with regard to foreign participation in equity joint ventures, repatriating earnings in convertible currency, and the nationality of managers. There is, however, an appreciable diversity of tax rates on profit earned and repatriated and a variable scope for negotiations of local salaries and access to domestic markets. The experience accumulated over the past years has obviously shown the importance of making legal conditions to establish and operate joint ventures clearer and easier for the partners involved.

All countries are trying to encourage joint ventures in different branches of industries. Countries have introduced incentives on taxation for defined priority areas. Different reductions and even exemptions from the profit tax are possible. For example, if the company carries on an activity of special importance to the Hungarian and Polish economies different deductions for a tax holiday are granted. Bulgaria decides this on a case-by-case basis, which make the situation more uncertain. The USSR and Czechoslovakia allow exemption from taxes to all joint ventures for the first two years. The only country that has incentives on regional basis is the USSR, with the Far East.

10.1 Joint Venture Description

The study equally represents joint ventures from industrial and service sectors. The contract duration varies from country to country. According to the study, the majority are open-ended or long-term (30-year) contracts.

Some of the joint ventures (especially those in the service sector) have a large range of activities. As a rule, a joint venture begins business with a few activities and gradually develops others. This is typical for a number of Bulgarian joint ventures and some Hungarian ones. Trade joint ventures are very widespread in all countries, which can be explained by the lower costs of trade activities through a joint venture, compared to the cost through trade representatives in some CMEA countries. Another reason is the previous relations between the partners, which tend to be transferred to the new joint company. Next in the sample of studied service joint ventures (in order of prevalence) are hotel, tourism, restaurant, and spa activities. Management consultancy and software development together with system engineering services rank third. The industrial joint ventures studied are mainly in the chemical and machine-building industries.

In all CMEA countries, contributions to the joint venture's authorized fund are permitted in capital stock and in kind. The studied sample showed that the partners' participation in a majority of cases is in capital stock (50 percent of the Western and 51 percent of the Eastern partners). The Western companies contributed machine tools, and the Eastern companies, buildings and offices. The latter is due to legislative provisions on the use of real estate in CMEA countries. In only about 36 percent of the cases, the Western partner participates with technological know-how; in only one case is technology made available by the Eastern partner.

Before establishing a joint venture, the partners in the majority of cases have had traditional trade relations. Less often are joint ventures previously unknown partners; this happens most frequently in the CSSR. Previous relations through licensing and conventional trade are typical for Hungarian joint ventures. Relations through delivery are most typical for the USSR. The Western partner tends to be smaller both in terms of turnover and personnel. The tendency to concentrate vertically prevailed in all CMEA countries that permitted large companies.

10.2 The Partners' Motivations

The main motives for entering into a joint venture differ between partners. Eastern partners are motivated mainly by undertaking large-scale production of complex products previously imported or by developing new products and sectors of industry while obtaining hard currency. Western partners are motivated by enlarging the scope of their markets and encompassing new market and marketing channels. To a lesser extent, the motives of obtaining a cheaper labor force or new sources for product supply or expanding production capacity come into play.

The only common motives for both partners are in marketing and realizing the effects of synergy. To access market opportunities in the West is more important for the Eastern partner, while the main target for Western companies is the huge CMEA market. These opportunities and the fact that 57 percent of the joint ventures studied are selling their products to host markets, 25 percent to home ones and only 8 percent to new markets show the difficulties joint ventures have in attaining the objectives of both partners in their first years of business activity. The sales volume of joint ventures on the Western market is relatively much smaller than sales in other markets. This increases the gap in fulfilling the objectives.

It should also be stressed that the products and technologies introduced by the Western partner are predominantly in the saturation phase in the Western market. In the Eastern market, the products and technologies are mainly in the introductory phase. This demonstrates the difficulties in realizing one of the most important objectives of the Eastern countries – technology transfer and increased product quality. It also decreases the competitiveness of the joint ventures in the Western markets.

10.3 Negotiation

The joint venture is an agreement, the results of which are uncertain and highly risky. Part of the uncertainty can be removed during the process of negotiation. Negotiation demands strategy, skills, and information, and should aim to coordinate goals, activities, and shared interests. Negligence and lack of attention, external difficulties, and heavy administrative procedures can make the negotiation process unnecessarily long, unproductive, and unsuccessful despite the signed agreement.

The spirit of collaboration and creative partnership should be established during negotiations and realized in the operation stage. Because of this, it is very important that the future joint venture management team participate in the negotiations. In many cases, the process of negotiation has been enhanced by consulting governmental agencies, banks, or consultancy organizations. Fifty percent of the joint enterprises studied have had special consultancy help of some kind.

Despite recent attempts to decentralize management in CMEA countries, partners and negotiators from the host country are usually ministries of various types and/or planning authorities. The Western partners are represented in the first place by a board of directors and in the second place by bank representatives and middle management. As a rule, no third parties are involved in the negotiation process.

According to the study, the initiative to start negotiations for a joint venture has come from either side. In many cases, despite the rights legislatively granted to Socialist companies, the initiative for joint undertakings of this type comes from higher governmental levels.

The study proved that market research and product selection are highly important elements for successful negotiations, followed by availability and content of internal policy decisions. The quality of the feasibility study, agreement, and other document preparations rank third. The main criterion for selecting a partner is the credibility of the company.[3] This criterion ranks nearly equally with the project's

[3] Both Eastern and Western partners are reporting difficulties in obtaining data for assessing credibility.

Table 10.1. Duration of stages in setting up a joint venture.

Stages	Months
Pre-negotiation research	10.0
Partner selection	5.5
Feasibility study	4.0
Signing agreement and registration	5.5
Begin production	10.5
First earned profit	27.0
Total	62.5 $\simeq$ over 5 years

Source: IIASA MTC data base.

importance and the capacity for international development of the local labor force.

The availability of natural resources or raw materials and the existence of contracts with the administration or government supporting the joint venture's activities are considered less important. Technology, availability of financial resources and management as well as marketing capacity, on the other hand, are considered of highest importance. Intermediate priorities concern the partners' knowledge of the business environment, the company's image, price structure, local supply channels, and qualifications of labor force.

Interestingly enough, the number of firms ranking the price structure as being of high importance equals the number ranking price structure as being of medium importance. Local supply and qualification of labor are considered as medium importance.

Long procedures and bureaucratic difficulties have been shown in many cases to be one of the main problems in the process of negotiating and establishing joint ventures. The average duration of the different stages of the process is shown in *Table 10.1*.

The table shows that the time that elapses from the moment a company reaches a decision to look for joint venture opportunities in East Europe until the first profit is earned is, on average, over five years. This should not be considered an excessively long time. Delays can occur in stages where the external environment has a greater impact (signing the agreement and registration, production start-up, etc.). Differences among countries in the duration of these stages also have been registered. The prenegotiation stage on average takes two months longer in the CSSR and two months less in Hungary. Partner selection is again two months shorter in Hungary, but three months longer in the CSSR. Hungary also has a shorter production start-up (by five months) and Hungarian joint ventures earned their first profit, on average, a year earlier. In the CSSR, the first profit usually comes one year later than the average, and the production start-up is also three months longer than the average. The latter applied to USSR joint ventures as well.

10.4 Operation

To become a viable organization, each joint venture needs to develop an effective and creative partnership and cooperation. High flexibility and the ability to innovate have to be promoted from both inside and outside the enterprise. A company's good image, organizational culture, and social and communicative competence are highly important in reaching viability. Some of these matters were highlighted as a result of the study.

10.4.1 Objectives of the joint venture

The study has shown that no joint venture has fully attained the partners' objectives. Seventy percent of the joint ventures studied (including the Austrian study) declared that the partners' objectives had been partially fulfilled. It can be assumed that, according to the partner's motives, the operational objectives of each joint venture will be set in the following main areas:

(a) In production:
Rank 1: Increasing scale of production (71 percent).
Rank 2: Earning profit and maintaining production capacity (24 percent).
(b) In technology development:
Rank 1: Transferring technology (57 percent).
Rank 2: Developing own new technologies.
(c) In marketing:
Rank 1: Maintaining existing markets (62 percent).
Rank 2: Penetrating new markets.

Among the production objectives, "increasing scale of production" is ranked first. In technological development, more preference is given to technology transfer. The opposite is true in Hungary where a majority of the joint ventures are aiming at technologies to develop within their own company. The most common objective in the market field (with the exception of the CSSR) is to maintain the existing market.

According to the responses, the current success of joint venture activities is mostly connected with manufacturing (well-organized production activities), secondly with product selection, and thirdly with technology or marketing (both are equally ranked).

10.4.2 Supply, procurement, and marketing

Local supply in terms of delivery time, availability, quality, and standards appears to be the main problem in joint venture operations. It is reported to bring a high level of environmental uncertainty. This is partly due to the lack of some goods and raw materials in host markets, to the monopoly still existing in the CMEA countries, and to quality problems.

The main barrier to joint enterprises in marketing their products is the lack of market information. In most cases, this information has been obtained by the joint venture itself, a process that is reported to be rather difficult. The absence of a developed infrastructure in most of the CMEA countries (consulting companies, market research institutes, etc.) also has contributed to the problem.

Foreign sales are a great difficulty for joint ventures. Reaching the markets of other CMEA countries is prevented by existing trade quotas. Lack of competitiveness and absence of distribution channels are the two main reasons for not selling to the Western markets. The products manufactured by the joint enterprises usually hold major shares in their home markets.

10.4.3 Finance and pricing

No difficulties in obtaining loans from banks in host and home countries are reported. About 22 percent of the Western partners interviewed told of difficulties in obtaining a loan because of a lack of guarantee facilities and high interest rates in CMEA markets. Seventy percent of the joint ventures studied set prices for products independently on a contractual basis. Pricing is the second operational area in which more than 80 percent of the joint ventures have not reported difficulties.

The vast differences in accounting and bookkeeping between Eastern and Western partners have been reported as a problem by the majority of joint ventures. In their opinion, training soon could help to overcome the problem. Closely related are problems stemming from differences in economic development indicators.

Problems in the areas of investment and planning also could soon be overcome. No difficulties concerning salaries and profit repatriation have been reported. Bearing in mind the nonconvertibility of local currencies, this is very surprising.

10.4.4 Personnel and labor issues

Controversial opinions about labor qualifications and personnel motivation have been published. The study has shown that the host country's specialists and workers, in most cases, can be defined as very good or good. Only in five cases are qualifications reported to be bad.[4]

Most of the Western partners tend to consider travel abroad and high salaries to be the main motivation factors for the local labor force. The study has shown that professional prestige, self-realization and larger possibilities for professional contacts are the main motives (at least in Hungary and Bulgaria).[5]

10.4.5 Management and organization

Difficulties in the area of management are mainly related to establishing appropriate management style and methods and organizational structures, and less to the decision-making process. Modern methods and techniques of management are used in many joint ventures. Mixed management styles and systems dominate, not only because of the environmental conditions of the host countries, but also because the new organizations need new forms of management, neither Eastern nor Western. The organizational structures are simple, mainly

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[4] Razvigorova *et al.* (1989).

[5] A study based on special methodology investigated the motivation structure of Hungarian and Bulgarian joint ventures. The study was first reported in the Bulgarian journal *Management and Self-Management*, May 1990 (in Bulgarian).

Table 10.2. Level of environmental uncertainty involved in joint ventures.

Market and customer preferences	High
Supplier competence	High
Competitor's actions	Medium
Governmental actions	Medium
Relevant partner resources and skills	Medium
Local society	Low
Regional authority	Low

due to the small scale of business activities. In general, both partners decide upon company strategy, investment and reinvestment policy, and, in some cases, bookkeeping and accounting. Daily operating decisions are made by the joint venture. The decisions made separately by one of the partners are insignificant in number. The organizational innovations most in demand are the implementation of EDP and telecommunications, reduced bureaucracy, and better training.

Only two joint ventures have foreign partner representatives on their staff. This small number means limited progress in the transfer of managerial know-how. According to the Western partners, additional incentives should be given to personnel of the home country to work in the joint ventures (see Chapter 4).

The short but very dynamic experience of the joint ventures under study is summarized in their appraisal of the environmental uncertainty involved in their operations (*Table 10.2*). Customers and markets present a high level of uncertainty. As noted above, supply is another uncertainty for joint ventures. With very few exceptions, local regional factors are rarely considered as high in uncertainty.

The joint ventures have different rates of operating success and cite a diverse number of contributing factors. In fact, all factors mentioned in the questionnaire are reported to have a strong influence on success, specifically:

- Strategic fit of joint venture and achievement of partners' goals (over 60 percent of studied companies).
- Control of key aspects of the joint venture agreement.
- Start-up and learning.
- Quality.
- Technical capability and technical standards.

Table 10.3. Advantages of joint ventures.

Advantages ($\geq$ 50%)		Possible disadvantages $\simeq$ or less 30%	
1	Management skills (100%)	1	Western partner re-payment
2	Marketing	2	Joint venture duration
3	Market expansion	3	Risk sharing
	Ownership		
	Joint venture control		
4	Updating of transferred technology		
5	Quality control		
6	Joint venture capital		
7	Return on investment		*Note*: The areas are ranked
8	Risk sharing and pricing		according to the results of the
9	Research and development (44%)		questionnaires (% of answers)

Less influential are the following factors:

- Synergies of combining the partners' contributions.
- Resolution of managerial and functional conflicts.
- Complementary contribution by partners.
- Supplementary agreements; licensing management contracts, etc.

The strategic fit of the joint company and the achievement of both partners' goals are seen as high risk areas. Nearly all success factors also involve risk, as do joint management responsibilities and decisions on product pricing.

The escalating number of joint ventures can be seen as a sign of euphoria in East–West economic relations. In terms of goals and scope of activities, some of the contracts could be easily performed through other forms of industrial cooperation. Joint ventures, however, allow better control of operations by both partners, options to overcome nonconvertibility of local currency, etc. The advantages of joint ventures are listed in *Table 10.3*.

Finally, the study looked at the main attitude of joint venture management (*Table 10.4*). The table shows the percentage of all responses. The answers have been distributed among different degrees of agreement/rejection. Thirty percent of all answers are decisive agreements and 23 percent are decisive disagreements. In the absence of a unified opinion, it is difficult to draw conclusions.

Table 10.4. Attitudes of joint venture managers.

	DA	AR	CC	RR	DR
Partner has a pronounced interest in improving his technical level	28		28		
Partner's management operates less effectively than one's own	37	29	25		
Partner's interest in cooperation is greater than that of superior responsible organizations, authorities and ministries	67		22		
The cooperation has a decisive influence on the following areas of the partner company:					
(a) internal organization		24	24		24
(b) product range		in common opinion			
(c) quality of production					45
(d) technical standard of resources for means of production	36				27
(e) work force qualifications		26			38
(f) export share of production	29	33			25
(g) foreign currency earnings	38	24	20		
The cooperation ensures the sales of goods already at the saturation stage and eases pressure to look for new products and processes	32		24	44	

DA = Decisive agreement.
AR = Agreement with reservations.
CC = Depends on concrete circumstances.
RR = Rejection with reservations.
DR = Decisive rejection.

10.5 Conclusions

Joint ventures are slowly taking their place in CMEA economies. Despite an escalating increase in their number, there is a tendency for the average capitalization fund and the average foreign capital share to decrease in all countries. This can be explained partly by the Western company's strategy to enter the CMEA market with long-term perspectives. Profit is not an immediate goal of the Western partner in many cases. Most of the joint ventures began to realize profits during the third year of their operation, but their total contribution to the country's national economy remains insignificant.

Repatriation of profit and convertibility issues are not the main problems of any joint venture. This is partly due to the small profits and capital availability. Problems in this area are overcome through different options provided by the joint companies themselves. With the accumulation of profit and capital in the future, these issues will urgently call for solutions. The increased number of East–West joint ventures will aid the process of attaining full convertibility, but in the near future nonconvertibility will increasingly have an inhibiting effect on joint undertakings.

Local supply appears to be the main current problem of joint ventures. Hard currency supplies to replace unreliable deliveries and unavailable materials are only a short-term solution to the problem.

Difficulties in creating the company's image are due to the fact that joint ventures are still new organizational entities in the CMEA business environment. Joint ventures are an excellent means for transferring managerial know-how, but this is not happening extensively in practice. Managerial problems and the need to create a unified management system and an appropriate management style require training, consultancy, and greater emphasis, even during negotiations and the signing of the contract.

Joint venture managers have been praised for their achievements and this has motivated them to work harder. A misunderstanding of the motivation structure could lead to conflicts and lower productivity.

Although similar to multinationals in many ways, joint ventures will raise other issues in the future such as environmental protection, harmonized economic indicators, labor, safety, and unemployment.

Chapter 11

Executive Summary: Policy Recommendations

E. Razvigorova and F. Schmidt-Bleek

A new industrial revolution has begun to influence the world economy. The increasing pace of technological transformation led by the microelectronic sectors calls for worldwide institutional changes, in both centrally planned and market economies. For CMEA countries where economic difficulties necessitate urgent attempts to reform management systems, measures envisioned include moving away from overcentralization and state monopolies, promoting market forces, and partially privatizing the economy. These changes also may call for the adaptation of political and institutional structures. Considerable movements along these lines already are apparent in most European Socialist countries. For Western Europe and North America, the rise of Japan to international economic leadership and the aspiration of newly industrialized countries pose serious challenges that will undoubtedly spawn institutional adjustments.

The rapprochement in economic theory and practice has special significance for the development of international cooperation.

Changes in the economic policies of Socialist countries and their approaches to international relations already have profoundly influenced the climate of East–West relations and collaboration. These new and exciting opportunities for developing improved economic relations far exceed what seemed possible only a short while ago. Even so, differences in social, economic, and cultural traditions will continue to have strong influences on national and regional socioeconomic choices as well as on technology trajectories.

During the last decade, a new institution helped to push East–West economic relations onto a new stage: East–West equity joint ventures in Socialist countries. Under the umbrella of *perestroika*, state authorities promulgated guidelines under which joint ventures could be established and operated, leaving negotiation and partner selection to individuals and companies. Governments also have supported the process by granting advantages to some sectors and national areas through special economic laws, tax holidays, and other relief. Some very important changes in the laws of almost all CMEA countries during the last two years, and especially since early 1989, have profoundly influenced the joint venture process. These changes have been followed by a rapid increase in the number of established joint companies. Countries such as Bulgaria, Czechoslovakia, Hungary, Poland, and the USSR no longer have any restrictions on the Western partner's share nor on his participation in management or as employee. The state supports its efforts by giving enterprises opportunities to decide upon the main questions of joint venture negotiation, establishment and operation: type of company, scope of activity, partners' shares, management systems and methods, etc.

While considerable legislative efforts are evident in Eastern European countries, foreign investment in them still is made in an environment that is often unpredictable. Rapid changes, both economical and political, still are occurring and will likely continue for some time. The more Western companies can be certain of the environment in which they are considering an investment, the more likely they are to invest. The risks still evident have fostered a "foot-in-the-door" approach to CMEA markets by making small investments in joint ventures. Of course, the opportunity to penetrate a market of nearly 400 million (together with China over 1.7 billion) consumers is appealing. The trend appears to be toward decreasing average funds per joint venture and toward lowering foreign capital shares; this is happening despite the fact that most barriers against majority foreign shares have now been removed.

Even though some of the difficulties originating from legislative provisions are sometimes exaggerated by Western partners, much remains to be done to improve the situation. Procedures to appeal against denied requests should be put in place. Authoritative written commentaries and interpretations of laws, regulations, and administrative procedures should be issued to help foreign and domestic investors. Interpretations should include such issues as tax statutes and profit repatriation. Frequently, the situation is sufficiently unclear to prevent boards of Western companies from deciding to invest in joint ventures in CMEA countries.

Economic information, both on the macro and micro level, could increase the clarity and certainty of the investment environment. Respected Western accounting and consulting firms should be encouraged to open branch offices in Eastern European countries and to analyze the available economic information and the accounts of potential Eastern partner companies. Joint venture accounting companies also should be established.

Meetings and investigations have shown that foreign investors are not sufficiently informed about the opportunities available in CMEA countries. Setting clear priority areas for investment in all Eastern countries will attract investors and help the process of negotiation and partner identification. Countries willing to attract foreign capital should make determined efforts to disseminate appropriate information among potential investors, work out new channels beyond traditional options, and possibly enter into joint ventures with Western advertising firms.

IIASA's empirical comparative international study has shown that joint ventures are a big challenge in East–West economic relations. Despite their growing number, they still are newcomers in the economic environment of the host country. The findings show that:

- The process of legislative improvements will likely continue in the future in the direction of simplifying and clarifying provisions and procedures as well as equalizing conditions for joint ventures with those of national companies.
- Despite their growing number, joint ventures so far have had very little impact on the macroeconomic situation of those countries,

as their total contribution is still very small. They may, however, have an important catalytic effect. East–West joint ventures are the playing field upon which new ideas and approaches are tried out, where new skills are acquired.

- Advantageous to governments and business people, joint ventures still are strangers in the business environment of CMEA countries. In many cases they do not compete well with purely Western companies simply because they are joint ventures.
- Lack of sufficient infrastructures to support joint ventures contributes to the problems they face and has considerably delayed the achievement of initial profits in some countries.
- Even joint ventures that are facing difficulties provide channels for the transfer of managerial know-how. This partly fulfills one of the goals of CMEA countries to enrich and adapt Western management methods and techniques. Surprisingly, this issue is neglected by partners in most cases. It is advisable that more attention be paid to management development during the process of negotiating joint venture contracts.
- Concentrating on such important matters as convertibility, financial and investment issues in the initial stage of the joint venture often causes partners to pay too little attention to the human side of the joint undertaking; the human side has frequently proven to be very important for joint success.
- Matching two economic systems in everyday operations proves to be a difficult and long-term process. Major difficulties are encountered in bookkeeping and accounting, both of which are completely different in the two systems. Calculation of profits, profitability, and efficiency are difficult; thus controls and comparisons are complicated.
- Auditing control is inefficient in all Socialist countries (and in some cases not even established).
- The convertibility issue has impacts on profit repatriation, supply, and marketing.

The history of East–West joint ventures is too short a period to permit definite conclusions in all areas of their operation. The fact that most of them earn their first profit in their fifth year means that more than two-thirds are still in their initial phase. Therefore, participants in the study and several workshops on the subject, have suggested that an appropriate organization (possibly IIASA) should further monitor the development of joint ventures with regard to:

- Changing conditions for investments.
- Reasons why firms invest.
- Managerial aspects.
- Business experiences (documentation) beyond legal administrative provisions.
- Failures.

Future attention should focus on the human factors involved in establishing and running joint ventures, intellectual property protection, and differences among Socialist countries with regard to joint ventures, particularly the convertibility of currencies in Socialist countries.

Policy makers, governmental agencies, and other responsible groups should consider the lack of information in the following areas, and make serious efforts to improve the situation:

- The actual experiences and contractual arrangements (beyond legal provisions) of joint ventures and special economic zones should be documented.
- The disclosure of reasons for official approvals and disapprovals should become a routine matter.
- The provision and updating of practical information for potential investors are essential.
- Governments of Eastern European countries, Chambers of Commerce, etc., should actively advertise advantages, conditions, and other pertinent information concerning joint ventures and special economic zones, domestically and abroad. The availability of this information could also lead to a better understanding by the Western partners of the interests of the host country.
- CMEA countries should make more economic information available to potential investors, banks, and consulting firms so they can better assess the chances of success for joint ventures.
- Information on the role and opportunities of small and medium-sized companies should be collected and made available.
- Multilateral tax agreements need to be established to avoid uncertainties about potential or double taxation.

- Tax holidays for joint ventures should begin when the first profits are earned and made clearly and definitely known to the potential investors.
- Patent rights, property know-how, and software must have better legal protection in CMEA countries.

Western governments should support the creation of joint ventures in CMEA countries by offering special credit lines and extending the privileges of most-favored trading status. Some Eastern experts insist that trade barriers exist, preventing access to Western markets and thus lowering the chances of hard-currency earnings for joint ventures. Eastern countries should give preferred treatment to those joint ventures that make special efforts to protect the safety of their workers and the environment.

Conclusions

Political and economic reforms in Socialist countries will further increase the opportunity for joint ventures to develop and prosper. Market orientation of the economy and other improvements in incentive systems will help accelerate the reorientation process. The focal issue of the reforms will be currency convertibility, which should be solved by a carefully planned, step-by-step approach to avoid unnecessary economic risks. Full convertibility can hardly be reached in less than ten years. Improved efficiency in manufacturing and higher quality and broader spectrum of goods and services are necessary conditions of the process. Effective devices should be adopted to permit access to hard currencies as an interim step to convertibility; these include permits to convert soft to hard currencies at negotiated exchange rates where joint ventures replace quality products previously imported for hard currency.

Further decentralization of management in CMEA countries and reduced central control of industrial projects and enterprises are necessary. This should be accompanied by a sharp reduction of the vertical structure of industries. The creation of wholesale distribution capabilities that are not confined within specific industrial groups, ministries, or special areas should help develop market connections further. The encouragement of private sector initiatives in establishing small manufacturing and service-oriented infrastructure to support and complement the operations of large companies and multinational joint ventures is essential. A rapid move away from centrally controlled to market-price structures also is necessary. Beyond this, nations should adopt income tax systems that, beyond raising revenues, could also be the principal vehicle for the redistribution of wealth, especially during the early stage of market pricing, and provide the mechanism to detect and control the illegal accumulation of wealth.

Benefits now given to joint ventures should be extended to other forms of East–West economic relations such as license agreements, contracts, manufacturing, and buy-sell agreements. Special attention should be paid by both East and West to develop new styles for cooperative management and creative partnerships in a world of growing interdependence. This also calls for the careful collection and analysis of case studies, the development of teaching materials, and the creation of appropriate international arrangements to make courses on East–West economic relations available to business people. Among the most critical issues facing economic reform in Eastern European countries and worldwide integration are the following: creation of labor and capital markets, privatization, monetary policy and state budgets, prices and taxation, indexation, currency convertibility, inflation control, and construction and housing. These and other issues are the subjects of a new research project at the International Institute for Applied Systems Analysis.

Part III

Chapter 12

International Cooperation Management and the Success of Joint Undertakings

G. Wolf-Laudon

> ***In turbulent times, the first task of management is to make sure of the institution's capacity for survival, to make sure of its structural strength and soundness, of its capacity to survive a blow, to adapt to sudden change, and to avail itself of new opportunities.***
>
> Drucker, P., 1985

Siemens was the first Western company to take advantage of the 1974 joint venture legislation in Hungary. The joint company called SICONTACT KFT was founded that same year, with 51 percent of the shares owned by Hungary and contributed by Intercooperation AG for the development of trade, and 49 percent contributed by Siemens AG. The Headquarters of the joint venture are in Budapest.

With each subsequent liberalization of the law, Siemens has further developed its joint venture activities, becoming a resounding success and a respected elder to 2,500 (December 1990) newer joint ventures in Hungary. Drawing from this experience, the enterprise has developed a basic philosophy and strategic concept useful for other firms when considering joint ventures with East-European partners. The success of strategic alliances in general and of East–West joint ventures in particular lies in the creation of joint responsibility.

Business contacts between Hungary and Siemens began in 1894. Two years later, Siemens and Halske Vienna planned the underground railway in Budapest, the first on the Continent, and provided the electric installations and systems. Within 14 years after the joint venture SICONTACT was established, more than 25 production cooperations with about 20 Hungarian companies had been realized. Siemens played a significant part in the transfer of modern techniques and technologies, especially in the field of mosaic techniques and current redressers. The latter contributed the modern outlay and finish of the underground in Budapest and also of the Hungarian aluminium industry. Hungarian participation and input were also very important. Similar cooperation followed with a number of other techniques, such as power engineering, communications, and measurement and control.

In the 1980s, two more partners, the Hungarian companies REMIX and EMO, joined the venture. As a result, there was a remarkable increase in the authorized fund, while maintaining the initial proportion of 51/49. Siemens transferred the license for producing passive electronic components and also brought in a leasing contract. This contract enabled REMIX to start production of modern condensers for the Hungarian market and also for export. Other areas of cooperation include numeric control systems for portal cranes. It is obvious now that cooperation contracts (e.g., mutual supply or existing business contacts) have a positive effect on business activities.

In 1986, the authorized fund was raised once more when PSZ, a fourth Hungarian partner, entered the venture. Presently, the company's fund is 15 times higher than originally. Since its establishment, SICONTACT has shown consistently positive results.

12.1 East–West Joint Venture Challenge Begins with New Thinking

Even before considering such factors as product or service or production targets, five key basic elements must be available if an East–West joint venture is to succeed. Each of these elements involves people:

(1) Special discipline.
(2) International joint venture contract negotiations.
(3) Cooperation management.
(4) Customer orientation.
(5) Innovation management.

12.1.1 Special discipline

This is demanded by both those who will negotiate and those who will subsequently manage the joint venture. Both assignments require a synthesis of cooperation and competition that is difficult to achieve but essential for the success of the joint undertaking. Experience shows that 70 percent of failures in joint undertakings can be attributed to behavioral problems among those assigned to negotiate and manage the venture (*Figure 12.1*). New ways of international thinking, new kinds of managers, and an effective management style are required. While the Western partner must bring something that the East European partner needs, a "one-way street" cannot lead to success over the longer term.

Thesis 1:

Fundamental to the success of a particular venture for each parent organization is achieving a high degree of correlation between the intensity with which the joint venture pursues the parent's strategy and the degree of strategic control that the parent retains over its resources, such as funds, proprietary technology, and critical human resources. When the parent enters into a cooperative venture in which the overall strategy is crucial to success, it must retain the necessary degree of discretionary control over its strategic resources.

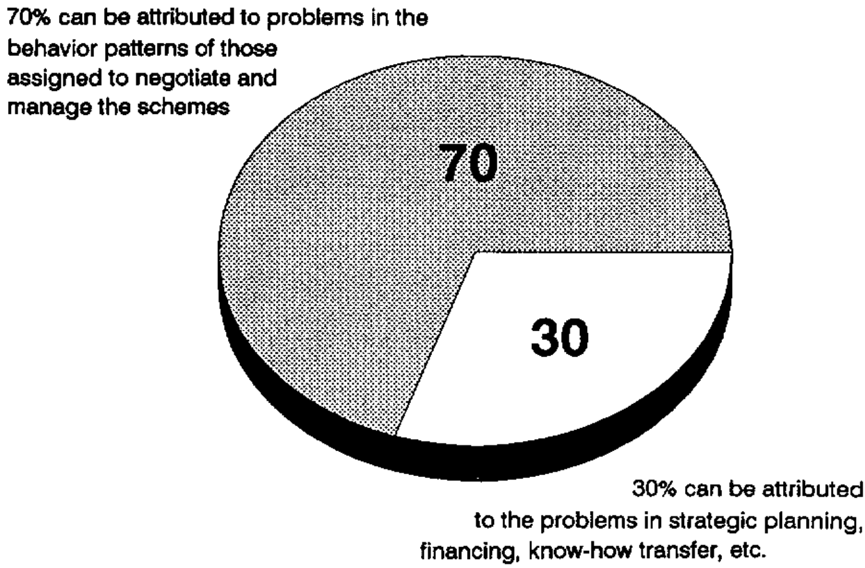


Figure 12.1. Failures of joint undertakings.

Thesis 2:

The role of "cooperation" management is not to spot and solve problems. Rather, it is to create an organization that can spot and solve its own problems. First of all, it is management focused on human resources management and seeks to:

- Be effective, i.e., to do the right thing in an efficient and appropriate way.
- Be innovative, i.e., to increase constantly its capacity for self-criticism and renewal by knowing more, being capable of more, wanting more, and having more courage of its own convictions.
- Challenge the mental abilities and talents of its leaders.
- Concentrate its own motivation and that of all joint venture employees on strategic concerns and specific demands of the new joint venture market and competition.

As we have pointed out, joint ventures demand a cooperative, moral consciousness and behavior, i.e., putting a high ethical value on the undertaking. Joint ventures also demand reciprocal understanding and recognition of the partner's logic in thinking as well as the development of a joint logic in thinking.

Thesis 3:

Human beings respond in similar ways when presented with the same situation, but each culture presents its people with vastly different situations. So, although the same principles of behavior may be preserved across cultures, the social structures and patterns of behavior that evolve because of local conditions may vary greatly.

Managers in a joint East–West corporation need to learn, first of all, how to manage a very new social system and how to manage themselves. Joint management practices have to be focused on joint effectiveness. Effectiveness is not a quality a manager from the East or West brings to a joint situation. Effectiveness is best seen as something joint management produces as a common task or goal. Effectiveness represents output, not input. An effective common management practice must:

First of all:	*Later:*
– do the right things	– do things right
– produce creative alternatives	– solve problems
– optimize resource utilization	– safeguard resources
– obtain results	– follow duties
– increase profit	– lower costs
– strategic thinking: Know why, know what	– tactical thinking and operation: Know how

Thesis 4:

Basic political and philosophical statements clarify the organization's values in such areas as customer relations, growth, strategic mission, social responsibility and community, and – most importantly – managerial style.

12.1.2 International joint venture contract negotiations

Joint ventures, a form of partnership, are as old as commercial relationships. Precedents can be found in Roman law and in English common law, but such customs also can be found in earlier societies.

Thesis 5:

Technology, techniques, and innovative ways of thinking move across national boundaries more readily than ways of perceiving, believing, and behaving.

We may define a joint venture as a productive partnership agreement, the result of which is uncertain because there is risk of loss or failure as well as the chance of gain or success. Special problems have to be managed when a joint venture is negotiated and initiated, e.g., in a country that may have different laws, customs, commercial practices, and political and social institutions. Besides acknowledging the problems, the parties must deem them worth solving.

Negotiation is a process in which the parties (larger social systems, individuals, groups, organizations) exchange and communicate knowledge, skills, motivation, resources, and information in order to make goal-oriented decisions – e.g., the joint venture. Decision making and negotiating are not identical, but there is a considerable overlap. Negotiations for joint ventures are a flexible activity in which elements of interpersonal and interorganizational contacts are amalgamated according to patterns that differ from situation to situation. No elements should be neglected.

Certain aspects of negotiations for joint ventures attract more attention:

- Negotiating style (individual, group, organization, larger social system, national governments).
- Substantive long-term and short-term aspects (political, operational, strategic, tactical, methodological objectives).
- Complexity of negotiation situations (political, technological, economic, and social changes, problems, decisions, potential problems).

It is important to negotiate different issues for joint ventures only on the levels listed in *Figure 12.2.*

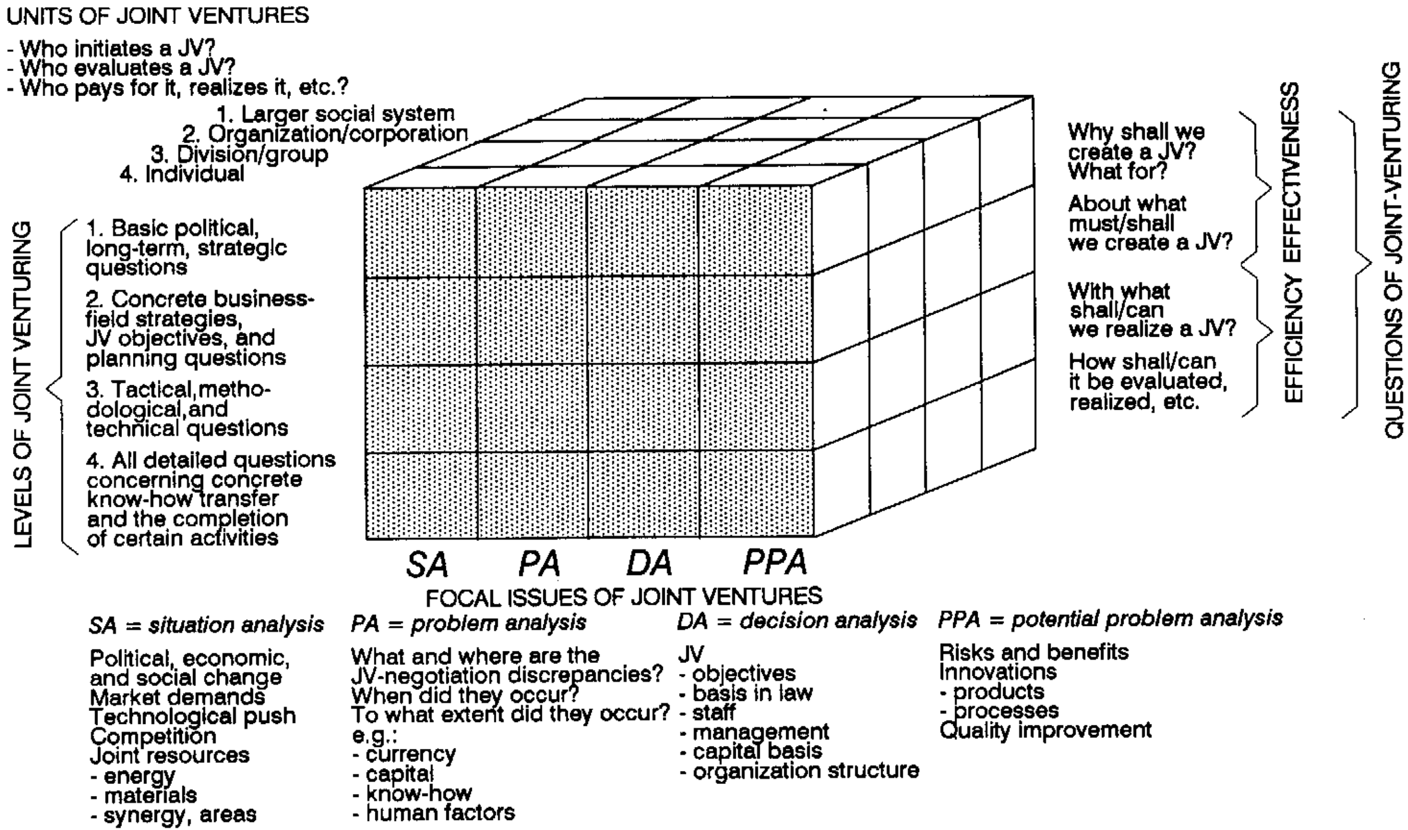


Figure 12.2. Framework for joint venture negotiation.

In negotiations with politicians or top management, basic political and long-term strategic questions should be discussed. Details should be delegated, as these are the business of middle management. Concrete business strategies, objectives, and planning questions should be discussed with the responsible division management. The results should be passed on to top management as information.

Tactical, methodological, and technical questions should be discussed with those responsible or with representatives of all departments affected by the decision. All detailed questions or questions concerning know-how and the completion of certain activities should be discussed with those who will carry them out.

Thesis 6:

Typically, cooperative ventures are poor at addressing conflict issues, allowing such issues to linger for too long, with weakening and demoralizing results. It is necessary to have a planning and control process that counteracts problems in this area, resolving conflicts early and ensuring that a relatively low amount of organizational energy is lost to friction within the cooperative network.

A favorable new joint venture environment (strategy, culture, structure) places great emphasis on compromise and consensus, avoiding unnecessary disputes. Differences of opinion between partners are rarely fought out legally; a consensus is usually sought. It is important to collect and analyze information and data. Preparation for the talks is therefore just as important as careful preparation for the decision.

Thesis 7:

Organizations in general and especially strategic alliances need to develop an ability to deal with changes in complexity of products, services, cultures, technologies and environments. Organizations that are proficient in information technology will be in a better position to cope with these changes than those that are not. Productivity is heavily influenced by information technology, which can provide ways to reduce the number of hierarchical levels from entry to chief executive, expand the span of control of managers, effectively link individual units into a whole, and refine the relationship of line to staff.

Advanced information systems can radically change the dynamics of an organization.

Social hierarchy and courtesy: Effective negotiations for East–West joint ventures should have a highly developed social hierarchy and system of courtesy in mind. They should not only be outwardly polite at contract negotiations, but should also bear in mind that the person leading the discussion is not necessarily the highest ranking member of the group; his position as leader might be determined by linguistic ability or technical knowledge.

Language: Negotiators from both sides should speak slowly, in short sentences, and use simple words. All picturesque expressions and uncommon idioms should be avoided. Effective negotiators hear and think selectively; they are masters of ignoring what seems to be superficial.

Translation and interpretation: Negotiators for joint ventures should take an experienced interpreter with them. It is not useful to rely on the other side's interpreter for the entire negotiation. Apart from the fact that interpreting is difficult and exhausting, one's own interpreter should better know and interpret one's own position, which requires thorough preparation.

Behavior: A calm and relaxed attitude indicates seriousness to the negotiating partners. Hyperactive, partly aggressive behavior and impatience can be interpreted as a lack of discipline or untrustworthiness. Negotiators do not often take notes during negotiation; if one side does not, it is often better not to do so at all.

12.1.3 Cooperation management

Thesis 8:

A joint venture is not a "zero sum" exercise where the gains of one partner offset the losses of the other. A better result for all partners is obtained by uniting forces, i.e., benefiting from synergy rather than acting just for oneself or even against one another. Joint management in a real sense will lead to creativity, innovation, and joint effectiveness.

What does cooperation management mean in a joint venture? Above all it means focusing on people. Everything that is done in a company as well as in a joint undertaking should aim at solving problems related to products, systems, and services for other people.

Thesis 9:

Today a company's competitive situation depends on the quality of the alliances it is able to form. In the future, most companies will be members of teams that compete against other teams. Companies that try to go it alone will find themselves on the bottom of an emerging two-tier system.

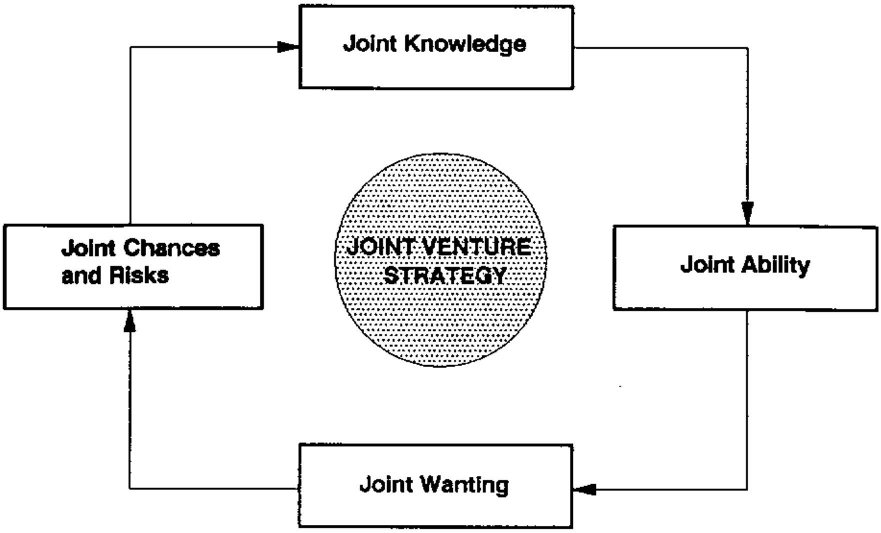
The joint venture company is shaped by the way that its management and employees think, decide, and act. Their ability to offer special advantages to customers – thereby distinguishing themselves from their competitors – can only happen as a result of human individuality, i.e., the company is set apart only by its people as the material products become more and more alike. Even a perfect organization can never compensate for or replace the human qualities necessary for successful cooperation.

Thesis 10:

In contrast to a high-volume, standardized enterprise organized into a pyramid of hierarchical tiers, a flexible joint venture company should have a flat structure. It should be organized as a set of relatively stable project teams that informally compete with one another for resources, recognition, and projects.

Job satisfaction and the all-out effort needed to accomplish many tasks flourish only when certain qualities and ways of behavior are a matter of course. On one side is professional talent and expertise; on the other side, character and willingness to cooperate. Both are important for the smooth running of an organization (*Figure 12.3*).

The following barriers to effective cooperation can be observed usually at the beginning of a joint undertaking:



JOINT VENTURE GUIDELINES

JV-leadership spells responsibility – for JV-projects and for JV-people – and the demands of this role are greater today than in the past

PERFORMANCE AND COOPERATIVE EFFORT

- establishing clear JV-objectives
- participation in decision making
- delegating responsibility
- discussing performance
- activating cooperation
- information exchange

ASSIGNING AND PROMOTING EMPLOYEES

- task assignments – custom-made
- frankness in assessment
- training does not end at thirty
- promotion through new tasks
- salary geared to performance

SOCIAL AND POLICY RESPONSIBILITIES

The JV-company has a social responsibility to its employees. It is imperative that this be reflected in the dealings of the management with the staff.

Figure 12.3. Main criteria for effective joint venture management.

Knowing?
- Lack of knowledge about the tasks of others (30%)
- Insufficient market and customer orientation (45%)
- Lack of input of instruments and methods (15%)

Being Able?
- Insufficient ability to cooperate (20%)
- Separation of function areas (20%)
- Communication barriers caused by different education/tasks (10%)
- Differing values (30%)

Wanting?
- Joint venture partner and/or department egoism (50%)
- Insufficient recognition of cooperation (30%)
- Unequal recognition of results (10%)

Being Allowed?
- Conflict of goals (area goals – overall goals) (45%)
- Superiors often a poor example (20%) (Motivation is what managers allow subordinates to do themselves)

Thesis 11:

If it were possible to unite people in a joint undertaking with a spirit of teamwork and exercise to the fullest extent their technological abilities, such an organization would offer untold satisfaction and benefits.

An effective joint venture manager must have the ability to listen and observe, to understand a person from another group, organization, a different culture and mentality. Effective joint venture management should be based on a consensus-oriented style that emphasizes the following:

The will and ability to cooperate: In general, the joint venture philosophy demands that all those working on a joint project or within a joint corporation cooperate intensively. An open interchange of ideas, which includes taking the trouble to appreciate the way the other side is thinking, is a basic requirement.

The balance between adaptation and innovation: One should strive to behave in a way appropriate to the situation while endeavoring to improve and use human capabilities. Joint venture groups are an expression of a culture geared to adaptation and innovation through cooperation.

The ability to participate: Full participation in decision making and implementation by working together are characteristics of effective joint venture management.

High motivation through target-setting by consensus: The strategy, culture, and structure of joint ventures have to be defined. Synergy can be achieved through negotiations in which all partners contribute. When there is agreement on targets, motivation of the participants is high.

Capability to cooperate and integrate: Harmonizing demands and expectations through strategic thinking based on consensus is crucial. Effective joint venture managers must think in terms of performance and not personality. What the joint venture manager does is less important that what he and his colleagues achieve together. Effectiveness should be measured by the extent to which the joint venture management achieves the output requirements – synergy effects – of their joint position.

Thesis 12:

In strategic thinking, one first seeks a clear understanding of each element in a situation and then makes full use of human brainpower to restructure the elements in the most advantageous way. Phenomena and events in the real world – especially in an East–West joint venture – do not always fit a linear model. The best solution can come only from a combination of rational analysis and imaginative reintegration of different items into a new pattern.

The above-mentioned bases of a joint enterprise give strategic venture management the chance to:

- Solve country-specific tasks and diverse problems more expeditiously due to a common legal basis.
- Achieve joint intent, target, and strategic planning as well as a methodical employment of all resources.
- Appraise and calculate more realistically the possibilities and risks of new areas of cooperation.
- Achieve more satisfactory solutions of large and complex technical and economic problems more quickly.

- Extend the application of cooperation to synergy areas of advanced technology.
- Choose, train, and further educate suitable staff in a target-oriented way.
- Communicate continuously and hold coordination meetings that will enable conflicts of interests to be discussed daily.

Joint ventures that are oriented toward their customers' needs and future market demands require creativity, motivation, and optimism, and thereby also increase their ability to use joint synergy effects.

Thesis 13:

Only people can recognize and solve novel problems; machines can merely repeat solutions already programmed within them. Industries of the future will not depend on hardware which can be duplicated anywhere, but on the software to which human brainpower can continue to give a new technological edge. Financial capital formation is becoming less important than human capital formation. Productivity and effectiveness can be increased by improving performance with human resources from joint venture partners. A mechanism for achieving a strategic long-term increase in joint productivity and effectiveness is shown in *Figure 12.4*.

12.1.4 Customer orientation

Thesis 14:

A cooperation manager with a long-term view of customer relations sees a sale as the beginning, not the end, of the marketing process. An effective joint venture management should answer the question: "Who are our customers and what do they need today and in the future; what will be their problems that we can help to solve?" After all, with no customers, there is no business and no income.

Thesis 15:

Analysis shows that the long-term strategies of successful and foresighted entrepreneurs can almost always be characterized in a very simple and natural way. This should not be surprising, for strategy is

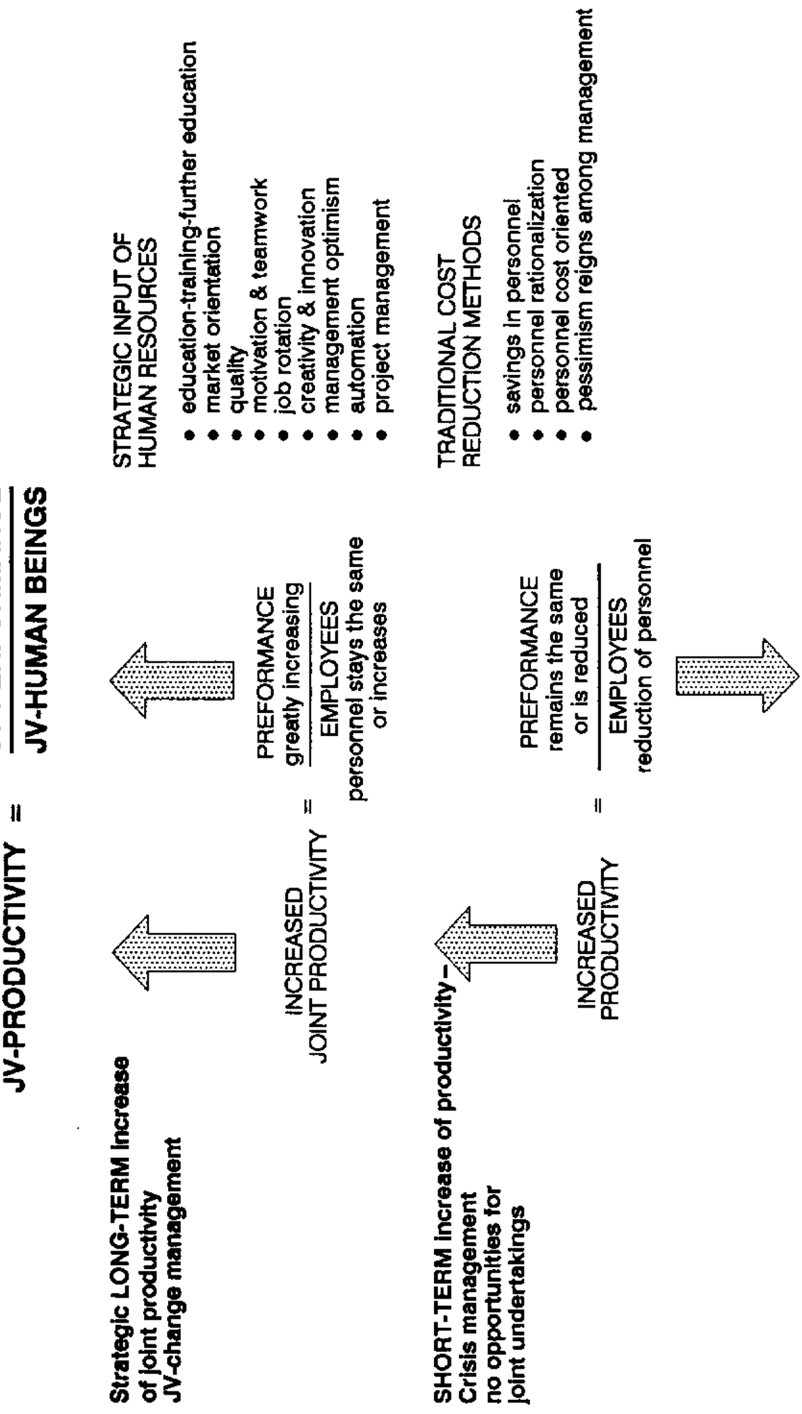


Figure 12.4. Strategic long-term increase of joint productivity and effectiveness.

really no more than a plan of action for maximizing one's strengths against the forces at work in the business environment.

In SICONTACT KFT, we began with a customer-oriented marketing concept: "To solve customer problems and to create a joint organization to meet joint strategic goals," following these guidelines:

- Joint venture philosophy: to understand our customers' needs and benefits.
- Joint venture strategy: to create, innovate, and produce the best possible solutions to the problems of our customers.
- Joint venture management style: to intensify and deepen a new way of joint venture thinking and acting.

Customer orientation is not a function. It must be digested like a vitamin by all those responsible for each function in the joint venture. That means thinking and acting for the benefit of the customer. In other words, he who understands the customer problem better and solves it, profits.

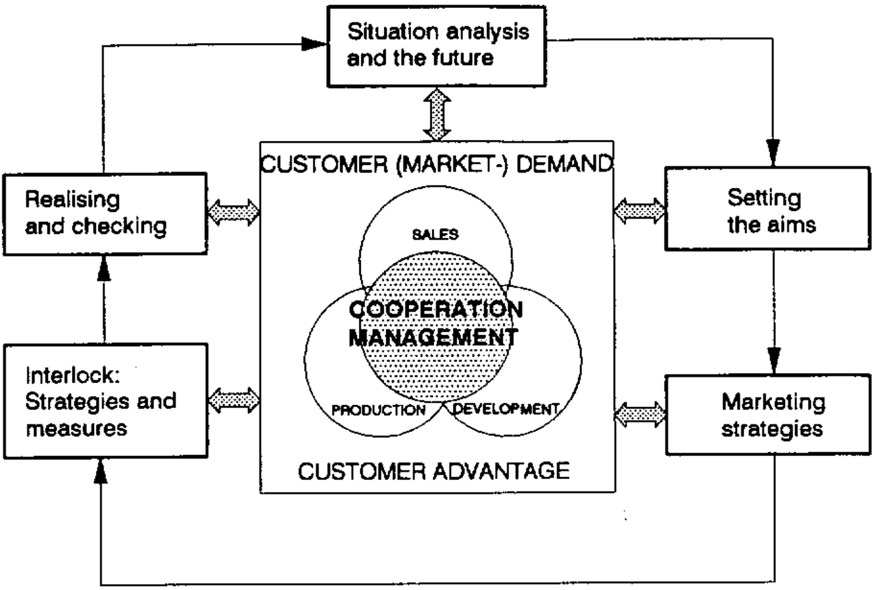
The selection and segmentation of the market into crucial service areas is of vital importance in the development of joint venture strategies. Since strategic shaping of the future means mental preparation for the future, it becomes a central demand on all management, especially in East–West cooperation management. It is the customer who determines the success of a joint venture through his buying and repeated buying. He must, therefore, be brought into the center of the thoughts and actions of all managers and employees. The better the cooperation between all partners and functions of a joint undertaking, the greater the success (see *Figure 12.5*).

12.1.5 Innovation management

Thesis 16:

Innovation does not necessarily mean research, for research is only an innovation tool. Innovation means, first, the systematic sloughing off of yesterday. It means, next, the systematic research for innovative opportunities in the vulnerabilities of a technology, a process, a market; in the lead-time of new knowledge; in the needs and wants of the market.

Through effective management of innovation, corporations can foster business development and harness the entrepreneurial energy



EFFECTIVENESS OF JV-MANAGEMENT

GOOD
- work input
- doing things right
- solving given problems
- activities
- reducing costs

BETTER
- achieving the joint goals
- doing the right things
- finding creative alternatives
- results
- increasing profits

It is not that JV-efficiency is bad, but that JV-effectiveness is more important

Figure 12.5. Cooperation – acting together in a market-oriented way and customer advantage.

of their employees to the mutual benefit of employees, the enterprise, the joint venture partners, and the surrounding community.

The managerial policy that best encourages viable new internal or external ventures is based on human qualities and on technology. Management of innovation requires a special viewpoint, from which human beings are seen as unique partners in the production process.

Thesis 17:

One should recognize and manage innovation as a tumultuous, somewhat random, interactive learning process, linking a worldwide network of knowledge sources to unpredictable customers and uses.

Innovation management can be seen mainly as a socio-technical process. The innovation manager is not a conventional project manager but rather a combination of employee and independent entrepreneur. Consequently, his position within the organization is somewhat paradoxical – he is an employee but also independent and free to pursue new ideas. The innovation manager has a special organizational role, does not engage in routine operations, and follows rules differently from those governing the established activities in the enterprise. Within a large corporation, the innovation manager has a well-defined "space" in which he acts to enhance the creative production of ideas and programs.

12.2 Example: Conclusions From SICONTACT KFT

The obligations and rights of the executive branch of a joint East–West enterprise are characterized by the following: joint basis in law, joint staff, joint management, joint capital basis, joint management organization, and shared risks and benefits. This organizational innovation shows the synergistic effects of successful cooperation and co-venturing (see *Figure 12.6*). The synergism comes especially from:

- Joint management and highly qualified full-time joint staff continuously present and available for services and problem-solving.
- A normative basis for systematic, non-bureaucratic cooperation formed in all agreed-upon areas of cooperation.

- An information and communication center in daily use where marketing and other production-related activities can be conducted.
- The creaton of a pool of knowledge, the potential of which multiplies through long-term joint activities and internal innovations.

Thesis 18:

The circumstances of the ever-changing market and ever-changing products are capable of breaking any business organization if that organization is unprepared for change. A joint venture organization has to be kept lean and muscular, capable of taking strain, but capable also of moving fast and availing itself of opportunities. Unless challenged, every organization tends to become slack, easy-going, diffuse. It tends to allocate resources by inertia and tradition rather than by results. Above all, every organization tends to avoid unpleasantness.

The synergistic effects of cooperation have resulted in:

- The establishment and extension of lasting partnerships in scientific, technical, economic, organizational, and legal areas of activity.
- The development of new areas of cooperation between those enterprises having a share in the joint company and the other economic organizations and associated companies connected with those enterprises, thus forming part of a worldwide business network.
- The more realistic appraisal and calculation of the possibilities and risks in new areas of cooperation.
- The achievement of faster and more satisfactory solutions to large and complex technical-economic problems.
- The extended application of cooperation to areas of advanced technology.
- The selection, training, and further education of suitable staff in a target-oriented way.

Joint capitalization extends the partner's freedom of movement for which business practices can be selected effectively and quickly, and transacted efficiently. A better knowledge and understanding of the business environment is created by the continuous presence of the partners in the joint organization. By developing quality promotion measures, both management and staff are continuously being developed. The innovation potential can be increased rapidly through the

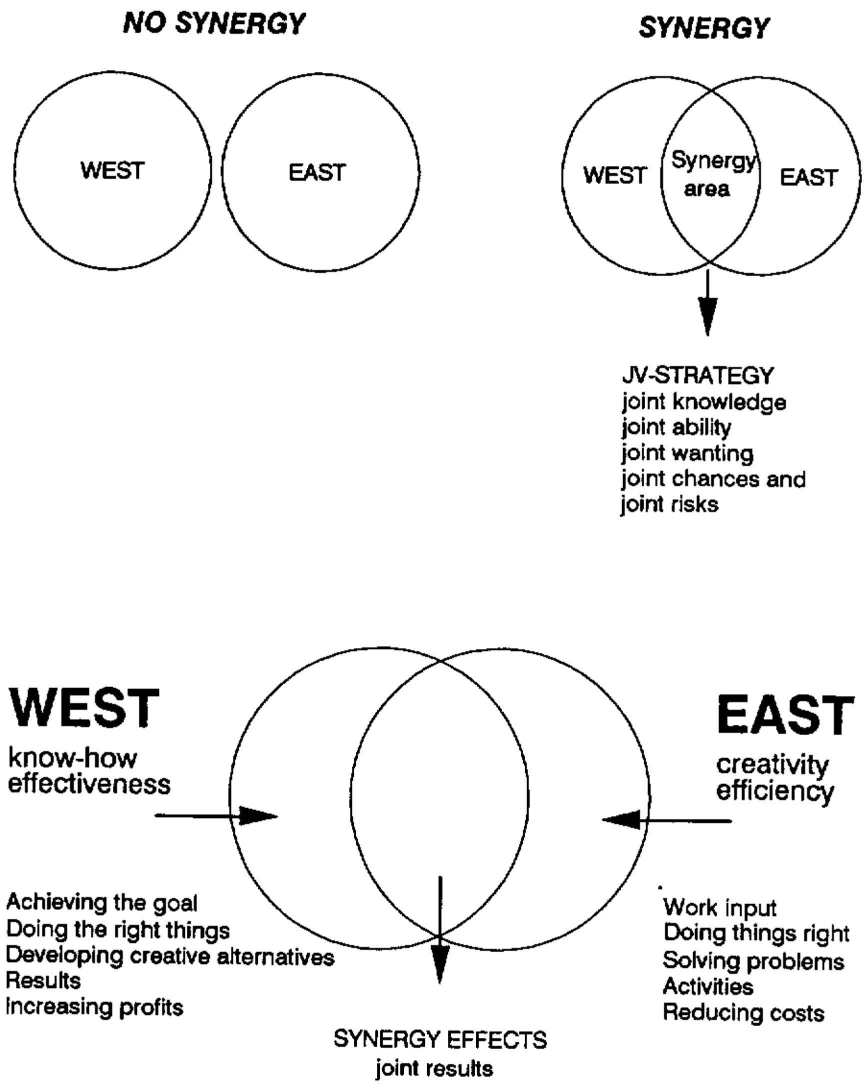


Figure 12.6. Creating a favorable negotiating environment through synergy effects.

pooling effect of a joint organization in which joint resources can be optimally employed, opportunities maximized, and risks minimized. Finally, the time needed for preparing and executing different programs can be shortened substantially while reducing costs (travel allowances, visas, etc.).

12.3 Merger of Interests

The chances of success for an East–West joint venture are determined well before the joint venture is set up. I conclude that it is possible to have a successful commercial relationship in the form of a joint venture in another country if certain conditions are met, including knowledge of that country's legal system, cultural norms, political and social institutions, and business practices. It is always much more than just a matter of understanding commercial practices alone.

We are familiar with Thomas Alva Edison's recipe for inventive genius: "1 percent inspiration, 99 percent perspiration." The same ratio holds true for creativity in any endeavor, including the development of a joint venture strategy.

In considering a joint venture, first of all, the partners must find the areas of synergy – those areas where mutual interests in technology, organization, production, sales, and legal aspects coincide. Then success is based on excellent negotiating by both partners. Both sides must be willing and able to analyze, to seek synergy, and to create and manage a favorable new environment until the joint venture objectives are realized. Working from these points of understanding, the joint venture negotiators first and the joint venture cooperation managers later must innovate to overcome inevitable differences.

The difficult part is finding and training effective cooperation managers with the skills to reduce the gap between "is" and "should be" (*Figure 12.7*). Here, joint venture leaders are needed who are willing to listen and observe as well as to change their attitudes and adapt to the thinking processes of the other joint venture partners. "How should joint venture managers today be trained to guarantee the success of a joint undertaking?" To give a useful reply to this question one must look carefully at the criteria of joint venture goals (see *Figure 12.8*).

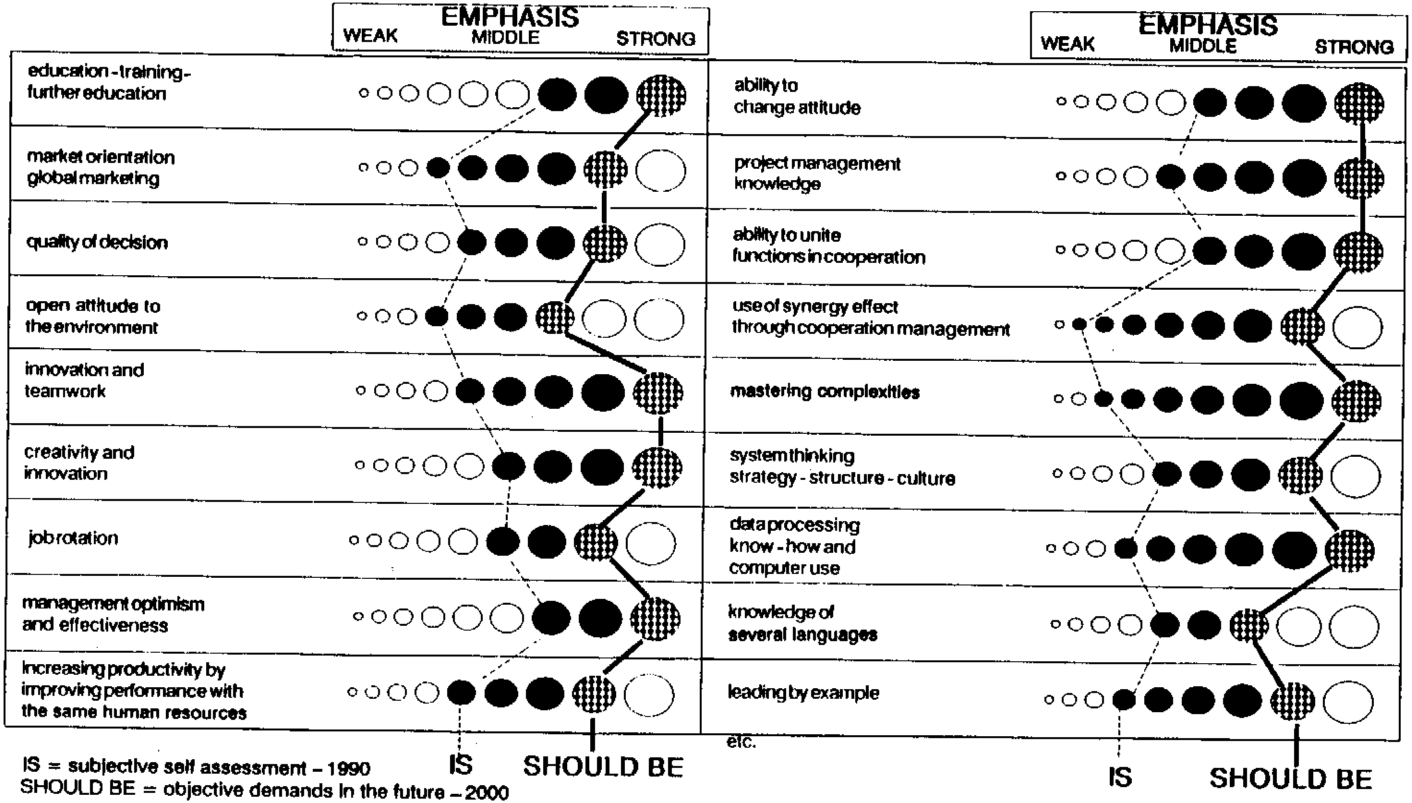


Figure 12.7. Striving for security and success as a strategic goal: An example of a general management profile.

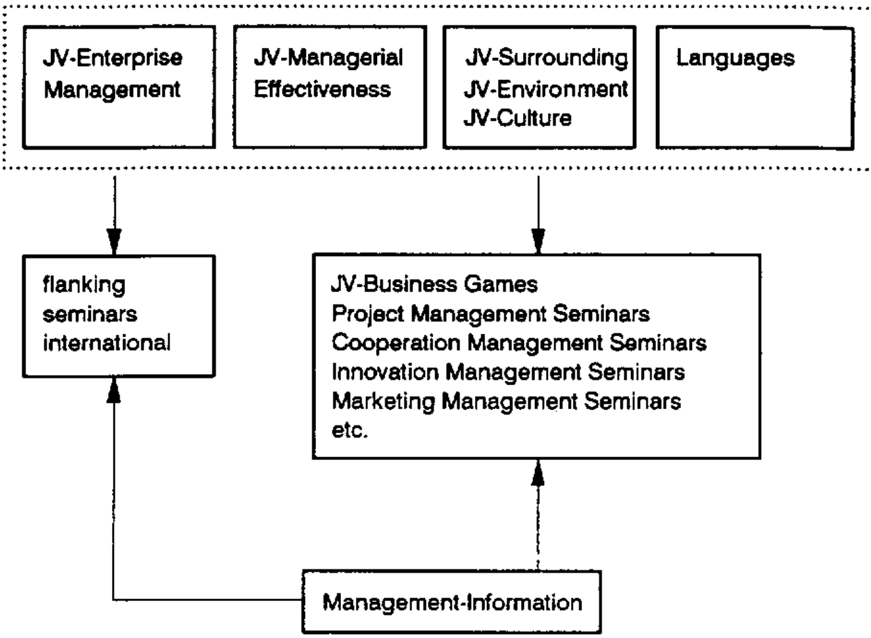


Figure 12.8. Every person, organization, and country strives for security and success.

The common joint venture management profile of the next decade will be branch-specific and oriented to such facts as continuous globalization and strategically planned international innovation and business competition. This requires more than just talented managers; it also requires the efforts and persistence of all employees. In addition, market and innovation power must be present, i.e., the ability to do something unexpected, to surprise the competitors. It is necessary to apply the available resources and concentrate them on certain target markets and customers at the right time, thereby forming strategic reserves for the future and creating permanent surplus values.

Parallel to competitive thinking, i.e., the "zero sum game thinking" where somebody's profit always means someone else's loss, it is of great importance to understand the value of cooperation, and it is necessary to create a favorable new joint venture environment while managing in an unfavorable one.

The mobilization of human resources and their mental potential for successful joint ventures should be given greater emphasis in the future. The driving forces in the structural economic and social changes in the industrial countries of both East and West and also in the developing nations, especially those of the Pacific, will be directed into new channels by increasing:

- Internationalization and globalization (market demand and technology push).
- Information and communication (know-how transfer).
- Humanization in the sense of a balance between human nature and automation (office, network, and factory of the future).
- Flexibility and mobility (synergy effects, creativity, innovation, etc.).
- Freedom in the sense of an ethic of responsibility (the ability to do more than we are asked to do).

At the same time, there is a new holistic consciousness that is developing and can be observed worldwide. This way of considering matters as a whole characterizes the behavior of many politicians and managers, especially in internationally oriented institutions and enterprises, of which the International Institute for Applied Systems Analysis is a prime example.

Chapter 13

East–West Joint Ventures: A Tool for Technology Transfer

J. Hentze and R. Wiechers

Close business relations between individual enterprises involved in the export of technological know-how have become very common within Western organizations such as the European Community.

Due to peculiarities and diverging frameworks set out by two different political and economic systems, cooperation between Western private enterprises and CMEA organizations, however, is still considered exceptional, despite the growing number of contracts. As an outcome of political developments in East–West relations during the early 1970s, business activities between the two sides have increased despite differences in scale due to specific national demands. Notably, the recent past has shown that the CMEA countries have made enormous efforts to modernize their industries by applying Western technology.

The new industrial revolution under way in the world today calls for methodological and institutional changes in both economic systems. Accelerating technological advancement and bridging the technological gaps in some branches of industry are a top priority in CMEA countries. Technology transfer is one of the main goals promoted by the economic reforms and legislative changes taking place in almost all these countries.

Technology transfer itself originates from cooperation. One can distinguish the various business instruments, e.g., acquisition of plant or individual technological items or large-scale cooperation between two or more business organizations. The concept underlying the term *cooperation* comprises various meanings and consequently manifold understandings. To avoid confusion, it is necessary to first give a general outline of the term leaving out its role in the field of technology transfer. This chapter will present *joint ventures* as a special form of cooperation and will also give details about the meaning of *technology*. The framework of international technology management, the life-cycle approach, methods of strategic technology planning, and also the practical application of technology management theories through joint ventures will also be discussed.

13.1 Transfer of Technology as a Part of East–West Economic Relations

A number of different mechanisms are at work in the relations between two or more business partners in the field of technology transfer, and the main difference lies in the diverging planned intensity and duration of business links. Some widely used mechanisms are:

(1) Delivery of plant for immediate use (export).
(2) Sale of licenses.
(3) Joint ventures.
(4) Direct investment.
(5) Exchange of technical personnel.
(6) Instruction in advanced technologies.
(7) International cooperation in the field of research and development networks.

13.2 The Concept of Technology and Cooperation

Technology as a concept can be used with two different meanings. One needs to distinguish between production technology, on the one hand, and information technology, on the other. *Production technology* is defined as the methods actually applied in the production process. *Information technology* also has a two-fold connotation: firstly, the methods actually applied to data processing, and secondly, the scope of knowledge about such methods. This chapter focuses on the term *technology* in its strict sense of production methods.

Generally, the term *cooperation* is associated with the idea of long-term business relations between two or more partners. In CMEA countries, cooperation is mainly seen as a certain kind of trade link usually referred to as a compensation trading deal: technical equipment delivered by the Western partner is exchanged for goods of Eastern production. Such procedures are favored because they help to make up for the scarcity of hard currencies.

The major characteristic of cooperation is that it is meant to be a long-term partnership. There is a free choice of goals for either of the participating parties. The cooperation contract should be formulated to secure mutual benefits. Such cooperation may also entail changed perspectives concerning the individual business organizations. Again it is the contract that must secure successful results. Adjusting organizational activities to the given new conditions can help the individual enterprise work out its strong points and advantages. Productive resources can be more effectively used because doing business on an international scale implies a higher quantity of products ordered for a new larger market (economy of scale).

The cooperation of two or more partners in one economic field or segment will inevitably lead to a division of tasks. Basically, Eastern and Western enterprises have diverging reasons for embarking on a cooperative business partnership. Cooperation, however, presupposes common points of interest. The different CMEA countries are characterized by different stages of economic development. Consequently, the goals of cooperation vary a great deal. Due mainly to a lack of competition and motivation, innovation activities in CMEA organizations are low. Permanent deficiencies in the supply of production materials, obstacles caused by vast bureaucracies, and the lack of capital account for delayed innovative processes. To compensate for these deficiencies, at least in part, the CMEA countries have been trying to enhance business contacts with Western enterprises. Western companies, in most cases, venture into cooperations with Eastern partners in their constant search for new markets. Moreover, they consider it more profitable to transfer part of their production facilities to the East.

Low product quality is often considered the main obstacle to a successful business operation, especially on the part of the supplier. Unlike simple trade links, close and intensive cooperation intensifies the often slow and low-level exchange of information. By cooperating with a domestic Eastern business organization, the Western partner earns a reputation and gains an advantage when considering new contracts. Cooperation can also help an enterprise to secure long-term access to market segments to which competitors have little access.

13.3 Cooperation Through Joint Ventures

Joint ventures are business cooperations of two or more independent organizations that result in the foundation of a third enterprise and are marked by the capital investments of at least two founding partners. In contrast to mergers, creating a joint venture is more like stepping into unknown territory. One aim is to secure access to government-controlled markets. Since joint ventures are long-term partnerships, entering into such a cooperation is a risky endeavor. Consequently, choosing the right partner is crucial. Companies, however, do not always proceed with sufficient care. It is important to follow certain steps in choosing a partner for a joint venture type of cooperation: strategy development, partner evaluation and selection, implementation, and controlling.

Successful joint ventures are based on a particular strategy. The term *strategy* comprises the fundamental and conceptual means of determining, pursuing, and putting into effect fixed corporate objectives. *Strategy* consequently implies the determination of an objective and the necessary steps to achieve it. Pursuing a strategy presupposes that a certain objective should be achieved by following a series of decisions made when the basic direction is affirmed. The strategy can later be adapted to consequent developments, if necessary. It becomes obvious that no strategy can exist without objectives. An individual strategy is necessary for planning activities because it comprises acting instructions suited to a certain point in time relevant to the decision-making process. Of course, the amount of resources available to meet the corporate objectives needs to be determined. There are several important principles to keep in mind when conceiving a strategy:

- *Centralizing coordination of potential*: This means that there is a need to select carefully how to allocate a given enterprise's performance potential in financial and human resources and in other productive means. It is advantageous to spend most of the productive means in fields where competition is weak. Such knowledge presupposes profound analyses of given competitors.
- *Emphasizing strong points and avoiding weaknesses*: This principle always requires a strategy to be built on the strong branches of an enterprise.
- *Taking advantage of positive environmental and economic developments*: An enterprise needs to take advantage of given opportunities; possible dangers must be avoided.
- *Innovation processes*: Within a strategy, major attention should be given to the innovative element. Innovative activities may cover a variety of fields such as new products, new modes of service, new markets, new production methods, or new forms of corporate structure.
- *Using synergetic potential*: As a rule, the strategies that are most likely to prove successful are those that are profitably drawn from existing business facilities.
- *Harmonizing objectives and instruments*: Objectives and instruments are carefully chosen to complement a given successful strategy. Being overly ambitious may cause the whole strategy to collapse completely by overestimating the given resources. Very modest objectives, on the other hand, are not likely to provide sufficient challenge, which is of utmost importance for long-term business activities.

- *Creating a meaningful and manageable corporate structure*: This principle is vital for the successful implementation of a given strategy.
- *Balancing the portfolio*: Following a given strategy always implies certain risks. A wise businessman will always avoid risk except in cases of emergency. It is common to choose a moderate and balanced approach, including an appropriate amount of available resources.
- *Developing a back-up strategy*: The given strategy needs a back-up, both with a clear-cut and easily understandable outline.
- *Persistence*: Firm decisions are always challenged by more short-term considerations, while business efforts are meant to provide long-term profits. It requires some amount of persistence to put a strategy successfully into effect. This means that once a strategy has been established, it should be adapted to consequent circumstances only for fundamental changes.

The development of a strategy is often understood as a simple act of planning. What people fail to notice is that integrating a given strategy into the already existing business structures may cause a serious gap that can be bridged only through project-related planning.

Search, Evaluation, and Choice of the Appropriate Partner

In searching for a business partner there are basically two alternatives from which to choose, either the offensive or defensive approach. Operating defensively means waiting for the right opportunity. It is an inexpensive approach, but may not prove successful. Proceeding offensively requires a strategy. A list of potential business partners is made and later classified according to preference criteria such as cooperation and production potential. To avoid unnecessary waste of time through negative reactions, more than one enterprise at a time should be approached. Professional consultants may contribute valuable advice. The offensive approach is more likely to find an appropriate business partner. Moreover, there is a chance to compare potential partners and make a choice. Experience acquired during the searching phase may contribute to a more successful partnership. The offensive partner may also determine the rules according to which business is done. In evaluating potential business partners, the following criteria must be kept in mind:

- *Complementary partners*: A joint-venture type of partnership requires that partners complement each other. Thorough analysis at the initial stage should provide information about the weaknesses and strengths of a potential partner. Only synergetic potentials can be useful along these lines.
- *Compatible partners*: Successful partnership also presupposes that both partners develop a corporate philosophy and mutual understanding.
- *Confidence in a partner*: Within a joint venture, confidence in a partner, as well as openness about the motives for entering the partnership and plans for proceeding need to be worked out to guarantee positive results.

Once the cooperation contract is signed, the choice of a partner is completed. A carefully designed contract needs to provide a firm outline according to which the business should be carried out. At the same time, it also needs to guarantee flexibility. Major attention should be paid to the following:

- The objectives, purpose, and strategy of the joint venture should be clearly defined.
- The modes for integrating potential new partners have to be developed.
- To avoid lawsuits arising from business conflicts, the contract should provide modes of mediation.
- "Divorce" procedures or the right to separate from the partnership, if necessary, should be stated and the price clearly fixed.

Implementing the joint venture implies: the *waiting phase*, the *construction phase*, and the actual *operation phase*. Technology transfer is an issue mainly in the last two phases.

13.4 Framework for the Successful Management of Technology Transfer

13.4.1 Acquisition of background information

Before going more deeply into the subject of technology transfer, attention must be paid to the particulars of new markets in which the joint venture is supposed to profit. Entering a foreign market resembles the exploration of a new land; it requires firsthand preknowledge and perfectly reliable information about the language and the cultural and political background. Profound background knowledge helps in finding marketing strategies that are perfectly tailored to the market in question. The following questions can serve as a useful guideline.

- What kind of information is actually needed and relevant in connection with the particular project?
- Who or what institutions can provide such information?
- Are these sources reliable?

From the information gathered, a general pattern reflecting the current economic, technological, and political situations of a given market should be revealed. It is only by this general pattern that a business organization is in a position to make valid predictions about future developments and launch promising strategies.

Gathering useful information of the type described may sometimes turn out to be a difficult undertaking for various reasons. In the past, government authorities were often very uncooperative when asked for relevant information. Recently, their attitude has started to change. The joint venture partners should focus on the education level of the country (important for recruiting employees), the overall legal situation with emphasis on the granting of patents, and the existence of standards and technological resources such as research facilities and plants. There are various reasons for an enterprise to start doing business in Eastern countries on a joint venture basis. Impulses may go back either to internal or external sources (*Figure 13.1*). After completing the primary checking phase, business trips should be undertaken to include practical experience in the decision-making process. At this point, information from outside sources is taken into account. Strategic decisions are usually influenced by information from secondary sources whereas results from primary analyses are applied to operative decisions. *Figure 13.2* summarizes the relevant details of country analysis.

The peculiarities prevailing in the host country should be considered thoroughly. It is equally important to check the domestic, legal, and political situations. Problems also may arise when cooperating with managers from different political, cultural, and economic backgrounds. Government regulations for technology transfer

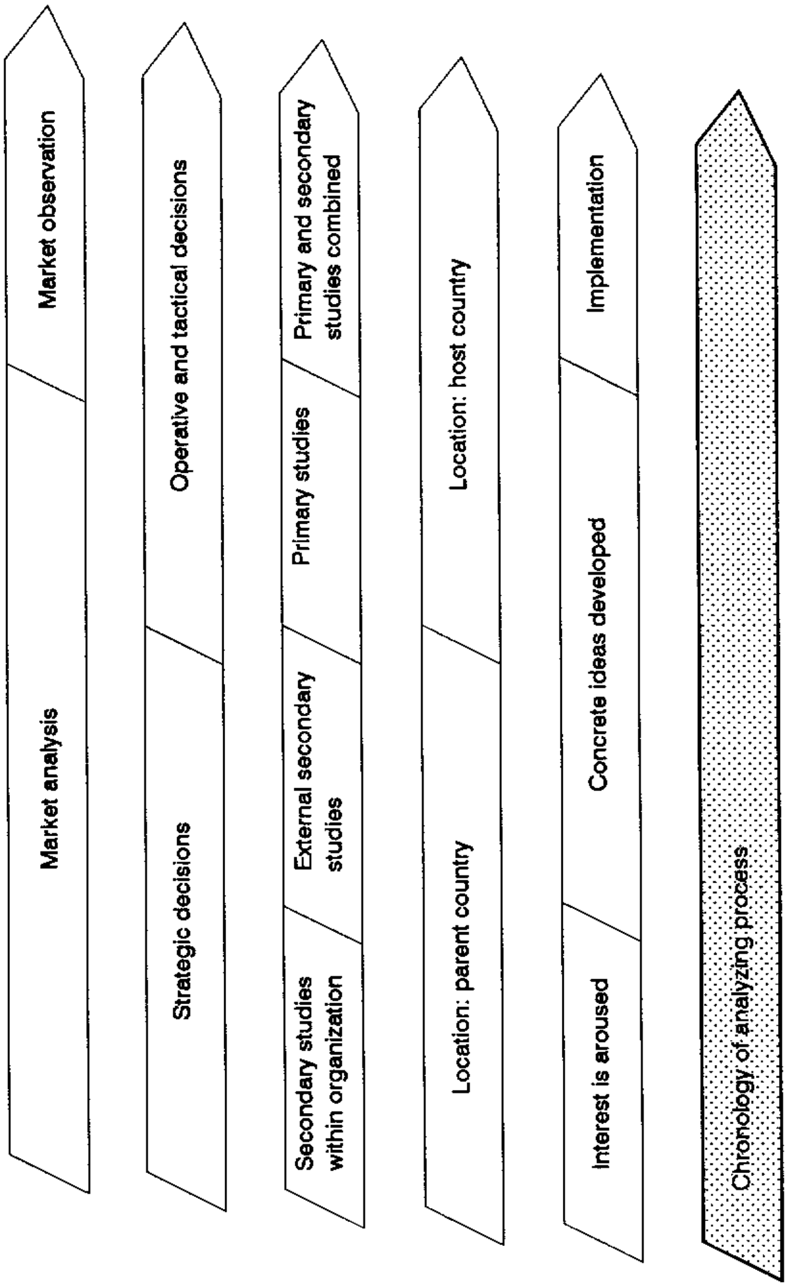


Figure 13.1. Chronology of foreign market analysis.

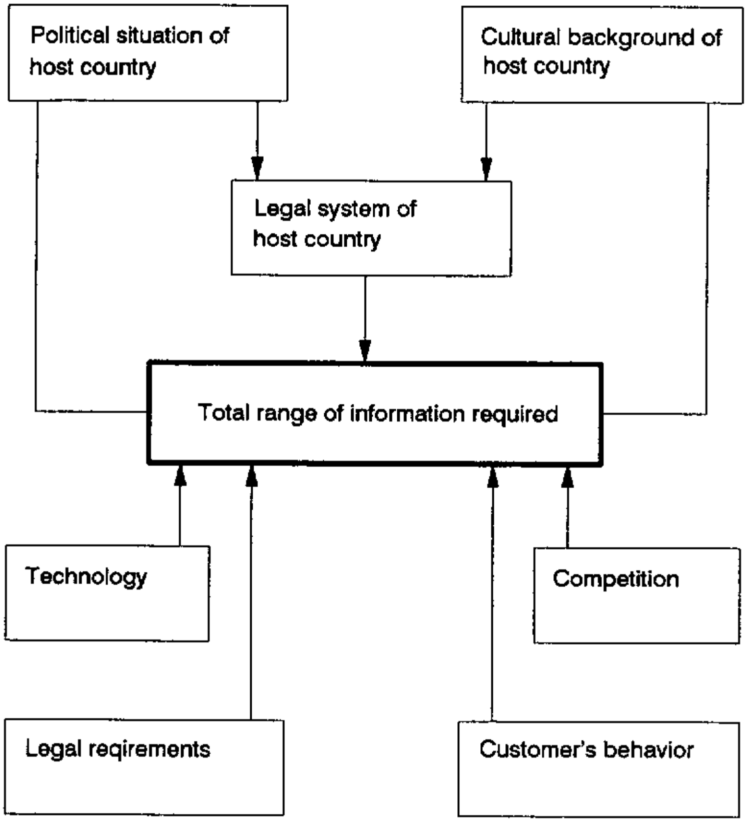


Figure 13.2. Scope of information for successful analysis of the potential partner country.

through joint ventures sometimes result in economic strains: production on domestic territory to augment the gross national product and government-determined and fixed prices.

The availability of the necessary technological resources plays an important role in technology transfer. An underdeveloped infrastructure may force a new business to provide its own technological resources. Technical standards are also significant. If not available, it is necessary to introduce foreign norms that may enforce the position of the Western enterprise. The major risks of a joint venture are

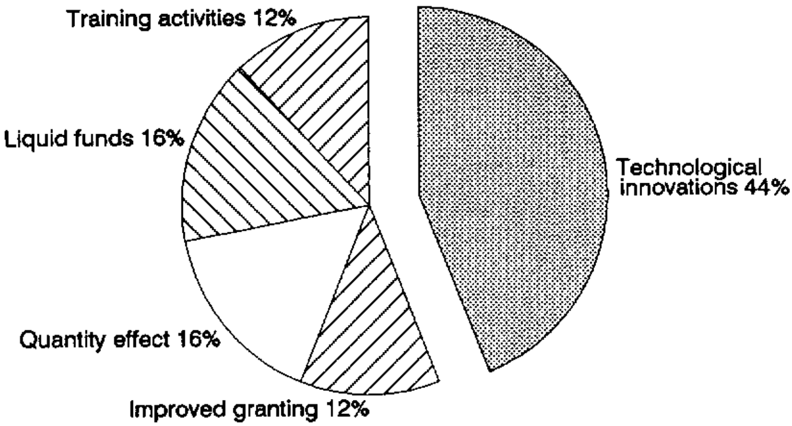


Figure 13.3. Rate of gain in productivity. (Source: Bothe, 1985.)

commercial and political in nature. Minimizing these risks is of utmost importance (see outline for cooperation contracts). Particular parameters may provide the necessary assistance.

13.4.2 The life-cycle model

The greater portion of increased production can be traced back to the innovative process (*Figure 13.3*). Like individual products, technologies and industries are subject to what is referred to as a *life cycle*. This cycle can be divided into five phases; four of which are considered very important: emergence, growth/expansion, maturity, and decline.

As shown in *Figure 13.4*, there is a chance for technologies to drop out of the regular cycle prematurely if they do not reach their maximum competitive value. The most significant criteria for classifying different phases are also given in this figure. It is during the expansion phase that the most positive effects of the cost-production ratio are noticeable. The life-cycle model is not valid in all instances, however. Due to the rather vague criteria, the lines separating the various phases tend to blur. Consequently, the succession of the phases may vary under the influence of various factors. In analyzing the

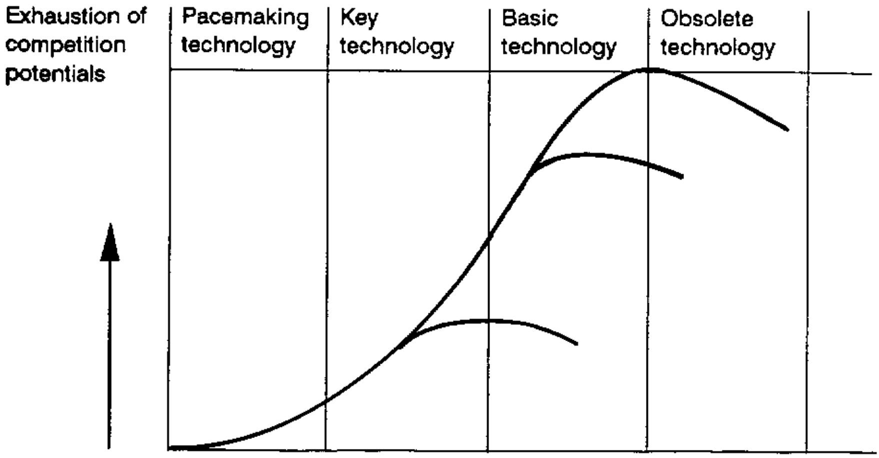


Figure 13.4. Technological life cycles in relation to exhaustion of competition potentials. (Source: Schneider, 1984.)

life cycle, it is necessary to clarify which factor is being referred to. The more general a factor is, the more plausible the model appears. The life-cycle model, moreover, is counted among the integral parts of strategic planning as there are no scientific methods to predict exactly the durability of a certain technology. Neither is there a way to determine precisely the current position of a technology within the life cycle.

13.4.3 Development of new technologies

Figure 13.5 shows a close, two-fold correlation between technology and an individual product. The combination of different technologies may contribute to the creation of an individual product. On the other hand, an individual technology may contribute to a whole variety of products.

Innovative processes can involve high costs. In *Figure 13.6*, the costs for research and development are contrasted with the total sales of a product. Research and development costs cannot be charged to one product only; certain technologies may have contributed to the production of various different products.

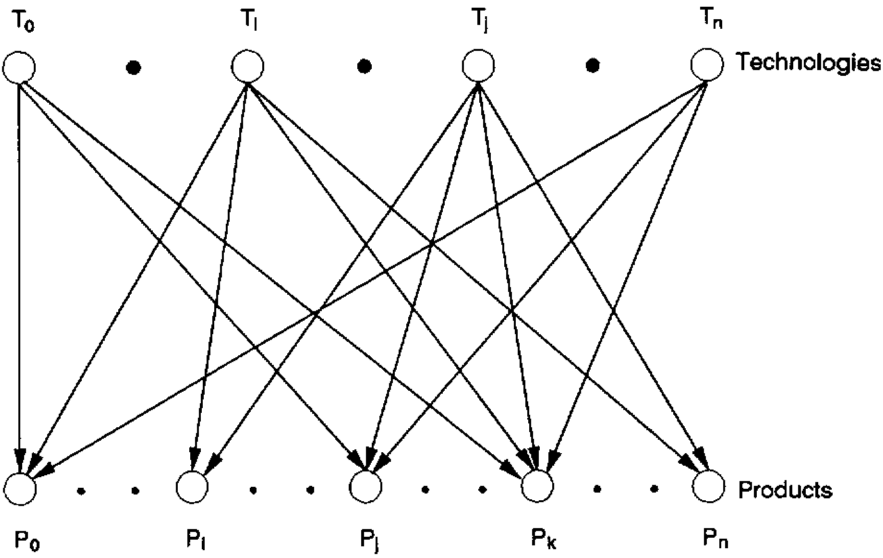


Figure 13.5. Relation between products and technologies.

13.4.4 The life cycle of technologies on an international scale

To be valid also on an international scale, the life-cycle model as presented above needs to be enlarged. Depending on the country in question, technologies can already be obsolete or just expanding (*Figure 13.7*). This state of affairs entails both opportunities and risks. The internationalization of markets, on the one hand, may help to prolong the life cycle of a product or technology. On the other hand, it can stimulate international innovative competition by making the re-import of technologies into the home country possible. *Figure 13.8* shows how the diffusion process works:

- A new technology is employed in a domestic enterprise.
- Domestic markets face complete saturation, and export activities are undertaken.
- The exported technology is taken over, and production starts to supply the domestic markets and secure hard currency.
- Competition in foreign markets becomes keener; the domestic market increasingly faces pressure from imported products. Low wages call for lower product prices, which can only be reduced

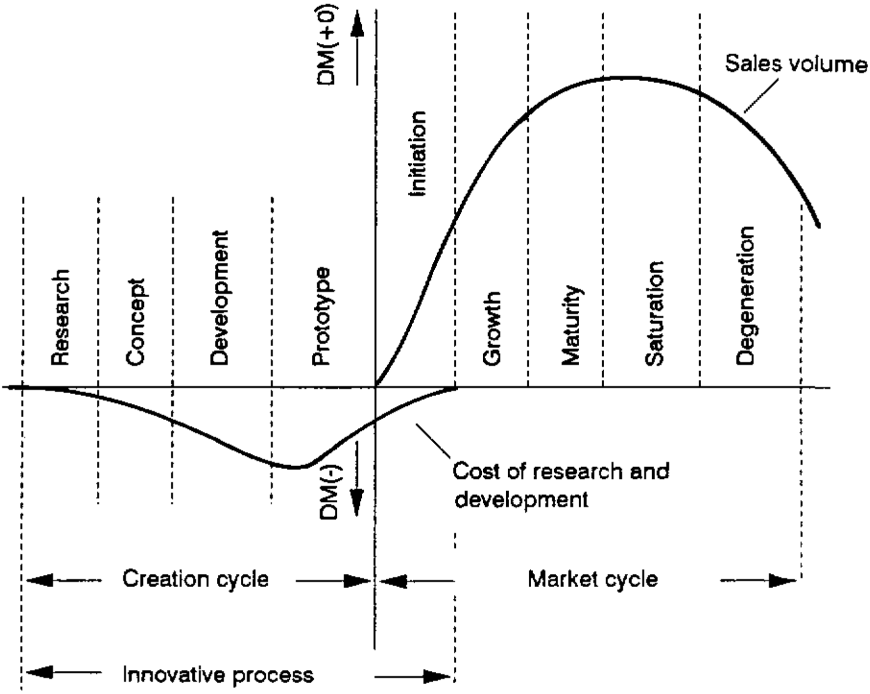


Figure 13.6. Costs for research and development in the course of a particular product's life cycle. (Source: Beckurts, 1983.)

by implementing new advanced technologies. According to the above decision, the following phases emerge: innovation, exportation, imitation, and importation.

Differentiation between the so-called high-tech and low-tech countries results in a varied pattern of technological diffusion. In high-tech countries, diffusion is faster whereas in low-tech countries, the necessary resources need to be provided first. One can easily notice the striking differences traceable to political, cultural, or other influences. Positioning within the life cycle varies as well (see *Figure 13.8*). A given technology may have already become obsolete in one of the high-tech countries, while still expanding in one of the low-tech countries. If a technology faces slow diffusion in one country while simultaneously being superseded in others, its life cycle has been longer in the country where it was first applied. Low-tech countries may possibly spend a great amount of money creating an

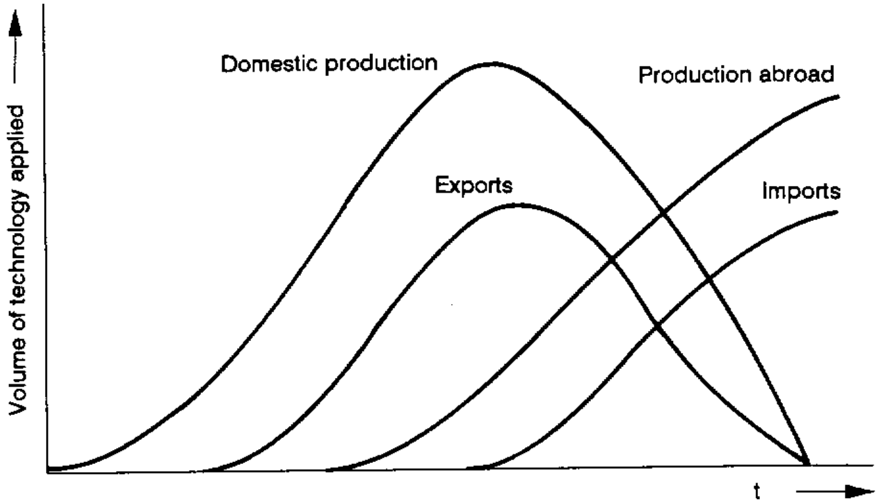


Figure 13.7. International technological life cycle in relation to production input, both domestic and foreign.

adequate infrastructure without being able to take advantage of the imported technologies. High-tech countries, however, gain quicker access to various markets and can thus keep prices up for at least a certain period of time. The majority of technology transfer cases through East–West joint ventures fall into the above description (see also Chapter 10).

13.5 Implementation of International Technology Management

The transition of business corporation activities from a national to an international scale presupposes the application of special methods in strategic planning, e.g., the strategic alliance. The joint venture is among such alliances. They help in minimizing corporate risks by collaborating on the use of resources. Front-ranking international organizations in research and development face the following phases: organization of local development and application of systems in significant markets, establishment of information retrieval systems in important high-tech countries, and completion of domestic research

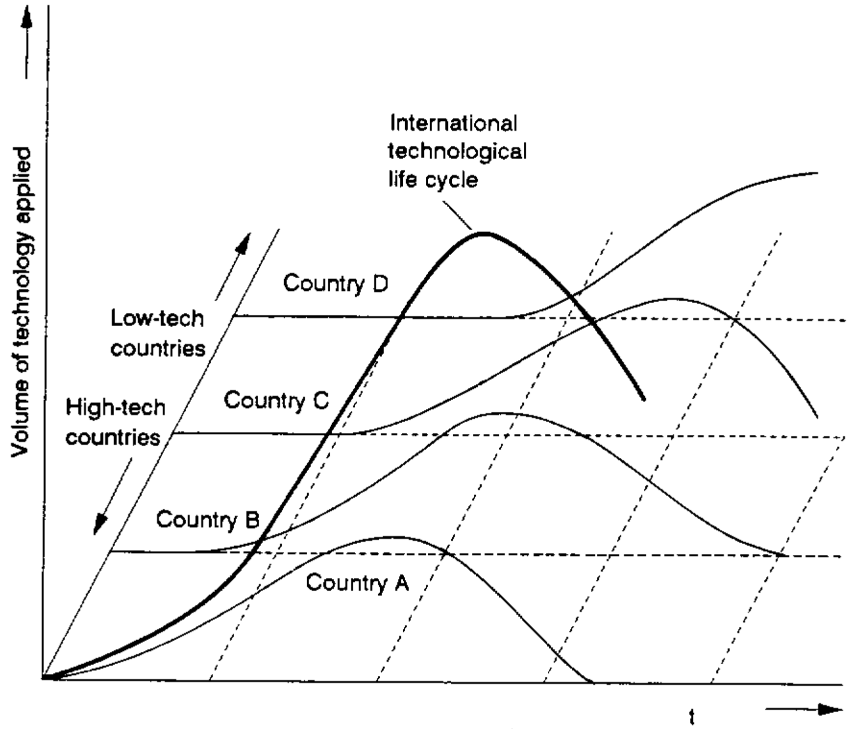


Figure 13.8. International technological life cycle.

activities through a network of decentralized research and development units.

International research and development activities focus on the objectives of marketing, technology, and innovation. Decentralized research and development networks aim at the following:

- Better access to new markets to solve user problems.
- Representation in significant high-tech regions.
- Creation of connections between the positive effects of internationalization and the innovative potential of decentralized research and development units.

Economic steps are often taken at random instead of purposely applying strategic planning and internationalizing the research and development fields. Solving short-term problems often prevents long-term planning.

13.6 Problems Likely to Arise from Joint Ventures

Apart from problems such as the nonconvertibility of currencies and diverging objectives of joint venture partners, there are some additional problems related to the process of technology transfer. The Western partner typically keeps entire control over the technologies in order not to stir competition in its own market, a position that is completely contrary to that of the Eastern partner. Very often only a segment of certain technologies is available, and some joint ventures are completely dependent on Western supply. To keep competition from increasing, the Western partner is likely to bar his markets. Technology transfer is more a concession from the Western point of view because of cost reduction, easy access to large new markets, and the realization of economies of scale. CMEA countries may find the integration of new technologies into the current structures difficult.

Chapter 14

Joint Ventures: Bridge Between East and West

R. Pry and I. Faminsky

14.1 Western Point of View[1]

In Western countries, joint ventures were once a common form of cooperation in cases where complementary assets were identified or where it was possible to capitalize on economies of scale. More recently, the size of some projects has surpassed the potential of a particular company and even that of an individual country. This has led to the creation of joint bilateral or even multilateral ventures. Examples are the Siemens-Philips megachip project and similar ones in South Korea and Japan, where several companies are combining their complementary assets.

The way in which these organizational structures are created and phased out is an important component of present-day free-enterprise economy. It is therefore a subject of economic research.

[1]This section was written by R. Pry.

Particular problems emerge when individual economic agents engaged in joint venture activities operate in dissimilar economic environments. This is the essence of the East–West joint venture problem. Because of the rapid political, economic, and social changes in most of the CMEA countries, the study of joint ventures in an East–West context sometimes seems to be like "shooting at a moving target."

14.1.1 Development of East–West cooperation

Before World War II, several Western companies (Siemens, Philips, Tungsram, etc.) had subsidiaries in places that now belong to East European countries. These subsidiaries were usually dependent technologically on the parent company. After World War II, these subsidiaries were nationalized and obliged to develop independently of their Western mother companies. With relations between East and West interrupted, the subsidiaries had to build their own R&D base.

During the Cold War, only very limited economic contracts between Eastern and Western companies were maintained, mostly in the form of the direct purchase of strategically insignificant goods. With the emerging *détente* at the beginning of the sixties, mutual relations improved and economic contacts developed further, not only in the trading of goods, but also in license sales and mainly turnkey capital purchases. The most representative of these activities are the production of Fiat cars under Italian license in the USSR and Poland, the license for the British float glass process arranged with Czechoslovakia, the license from Control Data (USA) for the production of 50 megabyte disk storage for computers in Rumania, and petrochemical facilities supplied by British, Japanese, and West German corporations to most CMEA countries. Western capital investment in the East represented more than 50 percent of all investments in the chemical industry in some CMEA countries for a number of years.

With the advent of *perestroika* and economic reform, which has done away with the autarkical tendency of Socialist economies, room for a more advanced form of cooperation, including joint ventures, was created. This new challenge evoked many hopes and expectations that are not easy to meet, as the relatively brief history of East–West joint ventures has shown. The sweeping changes that have taken place in the past few months have brought with them political preconditions for still further development in the economic environment. In time, these changes may lead to a situation similar to that in the Western countries. In other words, the legal, economic, and institutional differences between, West and East European countries may be no more significant in the future than the present differences between individual West European countries. Then the topic of East–West joint ventures will lose its peculiarity.

14.1.2 The present situation

The number of meetings devoted to East–West joint ventures has been steadily increasing over the past few years, but very few of these events have stressed the relationship between this fashionable form of entrepreneurship and the priorities of the national economic or industrial policy of a particular Socialist country. When we look at the problems that Hungary, Bulgaria, Poland, Czechoslovakia, and the USSR face at the present time, we see that they are trying to bridge the gap between the past, centrally administered, system and the more market-oriented, free-enterprise system. This brings with it the necessity to change the structure of the national economy as well as of industrial production within certain sectors, and to carry out corresponding shifts in employment. It is important to comprehend the positive role that joint ventures can play in the efforts to accomplish this immense task.

Over the past few years, the number of regulations and decrees related to joint ventures formulated in CMEA countries has been rapidly increasing, as have the changes that have subsequently been made in them. This development seems to have led to a certain homogenization of the regulations in those CMEA countries taking part in joint ventures.

In fact, in 1988, at a meeting organized by IIASA and the Hungarian Chamber of Commerce,[2] the opinion was voiced that this volatile legal and business situation might have a negative effect on joint ventures by delaying the decisions of Western companies. It also may have resulted in certain drawbacks for early joint venture agreements, which were unable to capitalize on the benefits introduced later on.

[2]Meeting on Managing East–West Joint Ventures: Practical Experiences, Budapest, October 30–November 2, 1988.

Sooner or later the process of change in the business environment will become more regular than it is now. When the legislation for creating and operating joint ventures finally has been firmly established, the possibility of making them more attractive by creating still more agreeable conditions will end. In fact, it already may be easier to start a joint venture in some CMEA countries than in Western ones.

It stands to reason that the governments, which put a great deal of effort into creating a favorable environment for joint ventures, will want to see results. A few months ago at a meeting organized by IIASA and the Bulgarian Ministry of Foreign Economic Relations, a Soviet reporter characterized the joint venture situation as follows: "The time of euphoria has come to an end, and the time of hard reality now prevails."

In spite of the growing number of registered joint ventures in many CMEA countries, their economic significance, measured by the volume of production or share of the GNP, remains small. The Soviet Union currently has over 800 joint ventures registered with an integrated investment of about US$1 billion. (To put this in perspective, US$1 billion is somewhat less than SONY of Japan offered in the second half of 1989 for Columbia Pictures in the United States.) This does not mean, however, that in some branches or national markets the share of a particular commodity produced through a joint venture is not substantial.

One of the appropriate ways of changing the situation might be to make joint venture activities more consistent with the national economy of a particular country. This presupposes a knowledge of the national economic policy, assuming that such a policy exists at all.

The process of designing an economic policy is not simple. It must include the identification of realistic and compelling goals and ways to achieve them. On the volatile domestic and foreign markets, a "top-down" approach, as used by the CMEA countries for many decades, may not work. One also has to devise a strong "bottom-up" component. One has to analyze what assets a particular country, economy, industry, and branch have, whether these are material endowments, skills, accumulated capital, infrastructure, etc., and where the comparative advantages, leading to competitive advantages on the world market, can be developed. Even if a comprehensive economic policy does not exist, the priorities of individual countries, stemming from their present situation and needs, should be known.

What are the common needs of the CMEA countries? The Eastern European countries (with the exception of the Soviet Union) can be described as small, more or less open economies, that in the past pursued more inward-oriented policies than foreign-trade ones. Now this orientation has shifted to more open policies, which is why such importance is attributed to joint ventures.

A consequence of the autarkical orientation is a more vertically integrated production organization, usually leading to the establishment of large enterprises that are less adaptive to change because of their vested interests. This problem has been accentuated by the lack of small and medium-size enterprises in most of the CMEA countries. The result is a major hindrance to the functioning of the market mechanism that these countries are trying to introduce.

All the European CMEA countries (except for the Soviet Union) are deficient in raw materials and fuel. Previously, because of a controlled price structure and pricing of exports to other CMEA countries, oil and gas energy was cheap – favoring heavy-equipment industries and high-energy consumption activities. As one approaches a more international market with convertible currency, world energy prices will prevail. The emphasis should be shifted thereafter to a more intensive type of development (resource-saving, high value-added production). A radical structural change in products (light instead of heavy manufacturing) and processes (resource-saving instead of traditional ones) must take place. Here one would expect joint ventures and other forms of cooperation to have a more significant positive effect than they have had up to now. Shifts in employment are an inevitable byproduct of structural changes of the macroeconomic proportions mentioned above. These shifts may be the most difficult problem to solve in the course of restructuring, because the countries involved have little operating space in which to provide a solution. They cannot relocate a large amount of manpower fast enough. This means they will be obliged to find ways to requalify people and create new jobs, whereby investments in retraining the work force should be considered as part of capital assets and not as an added cost. Joint ventures in the service industries can play a useful role here.

In the strict sense, a joint venture is legally, financially, organizationally, and even culturally, the most complicated form of cooperation. If one wants to penetrate the foreign market, and that is indeed what CMEA countries want to do, there are simpler ways to do so. It is instructive to observe how the Japanese entered the steel and electronics market in the United States. They supplied unsophisticated, low-profit products that created little defensive action on the part of companies already present in the US market.

Because of their past priorities, all Eastern European countries have less well developed service industries than Western countries. This includes services for the public at large and also services for industry such as communication, distribution, and financial services. Although in most Socialist countries some form of joint ventures has been started in the services sector – predominantly in tourism – joint ventures still remain extremely limited in this sector.

Many opportunities are open for industry in services. Out sourcing and even global sourcing, which are part of the strategy of many Western companies, are embryonic in the CMEA countries. There are many explanations for this situation, the most common being the lack of convertible currency and of logistic support and services. Closer scrutiny, however, reveals that a possibly even larger barrier is the lack of managerial skills to find a viable business and respond quickly to market needs, a lack of market knowledge and, of course, the vertical integration of most enterprises in the CMEA countries. Above all, the will and determination to get things done in spite of organizational obstacles is largely missing. International marketing of a concept or a product is not achieved merely by opening one's door and installing a phone. Because of their organizational complexity, joint ventures preclude fast success. Simple production cooperation may have a better chance. An exchange of components avoids the problem of nonconvertible currency. More emphasis needs to be placed upon becoming reliable high-quality component suppliers to foreign specifications through close cooperation agreements for supply at low cost. Again, many examples can be found in Japan 20 years ago and in the newly industrialized countries of the Pacific Basin now.

Another problem common to all industrialized countries is environmental pollution. Some Socialist countries (notably Czechoslovakia) have doubled the investment designated to combat pollution in each five-year plan. One can, in fact, speak of an emerging environment industry in both East and West. This creates a natural basis for joint manufacturing or joint ventures. Several agreements have been signed between Western companies and companies in Socialist countries in the area of environmental protection, with more certain to come. Some CMEA countries have transferred part of the manpower that has become available through the reduction of the armed forces to this emerging industry.

During the meeting that IIASA organized on this topic in 1988 in Budapest, one participant, who earns his daily bread by organizing joint ventures, said that he had more than 100 proposals for joint ventures, half of which were from agriculture. The statistics of successful joint ventures so far, however, do not confirm the preponderance of agriculture. Furthermore, agriculture in some CMEA countries leaves much to be desired. In September 1989, IIASA organized a small workshop on "Low-Energy Agriculture" in České Budějovice (Budweis) together with the Czechoslovak Academy of Sciences. On this occasion, it was pointed out that agriculture today may be at a crossroad because the energy-intensive way of farming practiced up to now is reaching its technical, economic and, above all, environmental limits. Several alternatives – referred to as "sustainable," "soft," "chemical-free," "natural" or "biological" agriculture – are being explored. Many new processes are being developed and tested within Socialist countries for biological pest control, plant protection, humus production, etc. These would constitute a basis for future joint ventures or other business forms. Because agricultural complexes in CMEA countries tend to be much more vertically integrated than in the West, opportunities are more easily developed for providing a full service for pest and plant disease control rather than just a particular product. This development could be used to establish and franchise service companies in the West, offering the control products manufactured in the East.

At the same time, public awareness of the overuse of chemicals in food is increasing. This has led to the growing popularity of health foods. Such foods also would offer a potential opportunity for joint ventures. Eastern European authorities, even the political ones, are very active in their efforts to assist this desirable development.

14.1.3 Integration trends in Europe and joint ventures

The deficiencies of small national economies are one of several reasons why economic and political measures supporting integration have become a major trend, specially in Europe. The best-known result of this endeavor is the year 1992, when the unified European Community market is due to come into being.

The CMEA countries also have passed several decrees and resolutions on the integration of both production and markets. Substantial differences between these two economic systems, however, have led to different results on the way to integration. The main differences, as identified at a CMEA-EC Meeting held in Moscow on October 14–15, 1989, are summarized below:

EC	CMEA
Supranational	Nonsupranational
Coordinating authority	Coordination through 5-year plan
Multilateral	Bilateral
Convertible currency	Nonconvertible currency
Transnational corporations	Transnational corporations
Active	Nonactive
Integrating	Disintegrating
Booming	Crisis-ridden
Structurally more balanced	Structurally unbalanced

It is apparent that the situations in these two economic systems are diametrically opposed to each other in some areas. Most of the terms are self-explanatory. The term *structural balance* refers to the fact that while the EC has several large economies of similar size, the USSR is about an order of magnitude larger than any other CMEA country. The private sector of Western European countries has responded with various activities such as:

(1) Preemptive European mergers and activities.
(2) A profusion of consultancy offices for corporate strategies for 1992.
(3) The attracting of capital for 1992 portfolio strategies.
(4) The establishing of corporate headquarters and offices in Brussels.

The increase in the number of mergers by the largest 1,000 EC firms provides an illustration of this development: 1982–1983 – 117; 1984–1985 – 208; 1986–1987 – 303.

It is interesting to note the reasons behind these mergers. EC sources indicate that these were: rationalization and restructuring – 30%; expansion – 22%; synergies – 12%; reinforcement of market position – 12%. This also could be an additional incentive for launching joint ventures.

Individual industries have developed various types of strategies for 1992. Thus, e.g., traditional industries are rationalizing their production lines and locations. The most prominent merger to date is that of ASEA and Brown Boveri. High-tech industries try to reduce their large R&D costs so as to enhance their competitive position. To achieve this, companies competing in an end-product market may join forces to develop an important component. One such case is that of Siemens and Philips, who have agreed to collaborate on the development of megachips.

A different approach is taken by the producers of consumer goods, specially in the food and beverages sector. Here marketing operations are usually integrated, and the market presence throughout the entire EC is considered. Some companies have changed management structures to assure "European" rather than national marketing strategies (e.g., Colgate-Palmolive and 3M).

Several banks have announced mergers, and others have agreed to share the control of subsidiaries.

Multinational firms, and particularly the investments effected by them, have a significant impact on the economic situation in the EC. As a result, the 1989 private capital formation rate was raised and presently is estimated at 7 percent (the average for 1982–1987 was 1.5 percent).

The situation in the CMEA countries is different, but this does not mean that the development in the EC region are irrelevant to them. Several Socialist countries have established missions in Brussels and, in December 1989, the Soviet Union signed a special cooperation agreement with the EC. This will certainly create a still more favorable economic environment for joint ventures.

14.1.4 Opportunities brought about by new technologies

Sooner or later the impact of all "megatrends," which already is being felt in more developed Western economies, also will be felt in East European countries and will lead to the creation of a new economic and technological environment. Joint ventures could facilitate the adaptation of enterprises to this new environment. To illustrate this point, let us examine briefly what it means to say that the world is adding intelligence and speed through telecommunications, information processing, transportation and logistic networks to existing strengths of energy, power, and control.

Until recently, although we had the energy and power literally to move mountains and travel faster than a speeding bullet, we nonetheless had to rely on inventories at all stages of our economy to make up for a lack of information and communication. We not only had to rely upon inventories of goods but also on inventories of services, called "readiness to serve," and on inventories of money "in transit" between investments.

We now are entering a period that, within the next few decades, will make an immediate response practicable in the provision of goods and services. Inventories or excess capacities will then be minimal, as shown by the following examples:

- "Custom orders" by customers through computers or teleorders.
- Immediate availability of goods.
- Shorter delivery times.
- Automated financing and accounting.

How does this affect the focus and direction of an enterprise? First, if telecommunications are cheap, fast, and accurate and if logistics are rapid, reliable, and low-cost, materials and components can be sourced worldwide, depending upon lowest materials, capital, and labor costs.

If manufacturing is automated and flexible, one can make a variety of high-quality, customized products cheaply; "economy of scope" will replace "economy of scale." Regional plants of broad scope (producing a small quantity of each product) with world sources for components will replace large, high-volume, single-product, vertically integrated plants.

If one has flexible, automated manufacturing plants with well-defined manufacturing process rules and controlled quality, customer orders, custom design, and customer delivery and service can be separated from manufacturing.

If finance and accounting transactions are immediate and low cost and if financial information handling and storage are cheap and immediately available anywhere in the world, finance can be separated from either manufacturing or engineering/sales or connected to either, depending upon coupling of sales and financing as a package. Logistics and telecommunications already are mostly separated but will become increasingly separated and privatized.

If the above comes to pass, and I believe it will, then the trend will be toward marketing/engineering companies, toward manufacturing companies, toward distribution companies, and toward financial companies. This implies that industrial companies would restructure along *horizontal* lines of integration versus the present *vertical* lines of integration.

If this occurs, sales/marketing firms, manufacturing firms, financial companies, logistics and information/telecommunication companies will find, in fact are already finding, additional economies of scale by internationalization.

One should note that each of the above steps demands increased management concentration upon the relationship between internal units and between firms within the total systems to obtain the needed costs and efficiencies. That requires that the systems aspects and the services and quality improvement aspect of management will dominate in the future. If the evolution to horizontal integration and internationalization occurs, and this is very likely, the objectives of the enterprise and the objectives of the nation-state become less and less congruent.

What are the consequences of all this? A growing divergence of nations and enterprise objectives is created:

(1) Nation (tied to geography, including resources, labor, capital infrastructure).
(2) Enterprise (when internationalized *and* horizontally integrated – not tied to any land area, labor market or, unique capital infrastructure).

With the assumption that this evolution proceeds inevitably forward, no nation will be able to pursue a protectionist or commercial isolation policy without inevitably destroying its standard of living. Any nation pursuing such a policy does not compete with each other country; it must compete with the best and cheapest of all countries together, simultaneously, since all, or almost all, will be linked by a set of universal enterprise systems.

14.1.5 Conclusions

The economic development of nations will inevitably lead to increased possibilities for cooperation including joint ventures, that can play a significant role. As the practice of joint ventures becomes more widespread, the problem of devising methods and tools for launching and operating East–West joint ventures will diminish and leave room for the skill of discerning branches and enterprises where opportunities for combining assets exist. Then the long awaited positive-sum game situation will prevail.

14.2 Eastern Point of View[3]

An analysis of the status and development of joint ventures in East European countries shows that this new form of international economic relations has become widespread, in a comparatively short period of time, and assumed great significance in East–West economic relations.

This may be explained, first of all, by the fact that the economic strategies of most of these countries are connected with programs of radical economic reforms, based on a deep democratization of management. Producers are being granted more and more independence, including the possibility of direct cooperation with different foreign partners. The management of trade and industrial cooperation thus becomes one main element of the general economic mechanism and is exempted from excessive dictates of the state administration. Cooperation is accelerated, and the process of harmonizing goals, interests and possibilities of the cooperating partners becomes more active, increasing the efficiency of joint activities.

[3]This section was written by I. Faminsky

New political thinking is now being introduced into the field of international relations. A main component is the formation of open economies in certain countries, including countries with different social-political systems. Joint ventures in the CMEA countries, established with the participation of Western partners, are a striking example and form a firm basis for the further mutual development of economic potentials between East and West.

Administrative methods of management are gradually being replaced in the USSR and other Eastern countries by economic methods, ensuring a decentralization of management and of the main economic elements, the development of horizontal integration, and the formation of internal markets. It is undoubtedly recognized in economic circles of the USSR and most East European countries that the radical economic changes require highly developed technological and managerial units, such as joint ventures, which have the ability to be competitive in the international market.

In the USSR in particular, the successful economic activities of joint ventures are ensured by the decisive implementation of the following main principles:

- Legally recognizing different forms of property.
- Granting producers the right to operate independently on a self-supporting basis according to market requirements.
- Establishing free contract relations with different producers of goods and services.
- Implementing a new effective taxation system to promote flexible differentiation of tax relations with state budget authorities.
- Establishing a market environment of competition and promoting a sharp increase in business activities.

In Soviet and other economic circles before 1980, it was believed that the presence of foreign investments in the country would contradict the very nature of a centrally planned economy. At the end of the 1960s, however, some East European countries, first Hungary and Rumania, introduced legislation to allow joint ventures with the participation of Western firms in their territory.

The most active process of establishing joint ventures in East European countries took place in the 1980s. Active state support to establish joint ventures in the USSR is now a part of the country's economic policy. This is seen as one solution to the problems of restructuring the economy and of more completely integrating it into the international market.

The successful move towards the main principles of a market economy and the development of these principles in certain Eastern countries will promote joint venture cooperation under conditions required by the world market. The organizational and managerial principles used in Western countries and applied in joint ventures will facilitate the Eastern countries' adaptation to conditions of a market economy.

The presence of foreign capital in a joint venture promotes an effective interaction with the financial environment of the world market. The activity of the joint venture in its host country also promotes an adaptation to conditions of the world economy among the numerous local suppliers and consumers and develops their contacts with external markets. Such contact provides the local enterprises with more information about technical standards and prices on the world markets and also exposes them to new elements of technological and managerial know-how. The experience of international large-scale production and scientific-production cooperation shows that including local enterprises in the division of labor on the microeconomic level is the determinant condition for expanding the country's participation in the international division of labor. East–West joint ventures permit increased opportunities for foreign economic relations and also encourage integration into the world economy.

It is quite obvious that joint ventures have certain advantages compared to other traditional forms of cooperation, specifically production cooperation and deals on a compensation basis. Joint ventures provide access to advanced technology and managerial experience as well as the possibility to use loan capital, currency resources, and a large-scale network. It is clear, e.g., that Western firms that have agreements on production cooperation with organizations in Socialist countries tend to grant their East European partners only second-rate technology. The agreements themselves sometimes exclude access to Western markets. This can be explained by the fact that Western partners are not as committed by joint property as they are in joint ventures. Therefore, they are not interested in maintaining technological standards that are competitive in world markets. In contrast, joint ventures imply that the partners from both systems own common property and run common commercial risks. The

Western firms, therefore, have a vested interest in maintaining a competitive technical level in the international market.

East–West joint ventures are a new phenomenon and represent a different stage of economic cooperation, possibly because of the new economic mentality recently introduced in East–West international relations. The obvious advantages for both sides are clear. In this connection, it is important to examine the legitimacy of a Western thesis that joint ventures are one of the few remaining means for the CMEA countries to address problems in the current economic situation. In the author's view, this thesis is not in full accordance with the facts. The specified goals of joint ventures in Eastern countries are essential, recognized by the Socialist countries themselves, and interpreted in all official publications. But the assertion that joint ventures are the only means to solve their economic problems is far from reality.

Joint ventures as well as other traditional forms of economic relations are efficient ways to effect technology transfer and capital investment. But to consider joint ventures as a panacea for all the economic troubles of the CMEA countries or as the only means to advance to a higher economic level would be certainly wrong. This fact is demonstrated by the other forms of East–West economic relations that were introduced at the beginning of the 1960s.

It is equally untrue to assert that the Socialist countries derive more benefits from joint ventures than do their Western partners. Most Western businessmen clearly realize that this new form of economic relations brings them some unique important advantages such as:

- Immediate participation in the manufacturing process, which allows them to control quality and technology standards.
- More flexible regulation of pricing and marketing, which allows a higher level of profitability on capital investments.
- Access to a comparatively cheap, highly skilled workforce and engineering services.
- Possibility of using material resources of the host country as working capital on a long-term basis.
- Additional possibilities to market their products (machinery, equipment, basic technology and services, etc.).

- Broadening their own production and financial basis by increasing sales for export on the local domestic markets.
- Stable sources of components and semifinished products, both for their own production and for local markets.
- Exclusive position in the local market and in some cases in other Eastern European markets as well.

The above factors make East–West joint ventures the most attractive option for rapidly developing Western firms whose economic strategy relies on an effective, long-term production cycle.

The study conducted at IIASA revealed the factors that can slow down the development of this new, mutually beneficial form of East–West economic cooperation. This study presented first of all a full picture of joint venture legislative developments in many CMEA countries and clarified the reasons behind the updated legislation. This allows a more in-depth understanding of the changes in the basic regulations in the various countries, the essence of which is improving the investment climate for joint venture activities.

The problem of the nonconvertibility of Socialist currencies has emerged as one of the main barriers to cooperation and currently is the most difficult to overcome. For instance, the joint venture partners can agree (usually during negotiations) to include in their agreement a special clause concerning the Western partner's obligation to sell a part of the joint venture's products on the world market for hard currency. This option is particularly acceptable for Western partners, especially when the joint venture is dealing with materials or semifinished production. In some CMEA countries, there are special conditions that allow delivery to the Western partners of goods not produced by a joint venture, but considered as a payment for profits that the Western partners are to receive in hard currency. Production subsidiaries of the joint ventures founded in countries with convertible currency also could play an important role as an additional source of hard currency. In the USSR, e.g., the sale of joint venture products to Soviet enterprises is widespread to ensure the required earnings as well as to purchase hard currency at auction.

The results of the IIASA study have shown that this new effective form of joint East–West activity is gaining popularity among businessmen, in both East and West European countries, including those CMEA countries where the process is being introduced rather slowly. The obvious advantages of joint ventures for Europe, as well as the possibilities for overcoming existing trade barriers, present new possibilities for future multilateral activities.

The most attractive possibility would be to develop a broad program under the auspices of IIASA to study the problems of East–West joint ventures, taking into account the specific nature of this international forum. Such a program could investigate East–West joint venture activities on a systematic basis as an important component of the European global economies and could analyze the conditions of joint venture activities as a large economic system functioning as a new element in a market economy. Such a project prepared by IIASA could significantly supplement some prospective research projects that are being implemented under the auspices of various European Community institutions.

Appendix: Case Studies

The following case studies have been prepared based on information presented by the respective companies or elaborated by the authors themselves through research. The case studies have been chosen by the national groups with the agreement of the joint companies.

We think they can be a good lesson for managers and future investors in the field. Difficulties and problems are shared together with achievements. Failures and unsuccessful stories also would be good lessons, but companies as well as individuals are less willing to share unpleasant experiences. Moreover, joint venture history is very short, and clear cases of unsuccessful joint ventures have been very few. A number of joint ventures have not been profitable in their first few years or have been "sleeping" during those years, but these are not necessarily unsuccessful cases.

A. Polish Case Study by *R. Maciejko*

Furnel International Ltd: Institutionalized Barter Trade

A.1 Background

The name Furnel is an acronym created by merging the first few letters of two main activities of the firm, "Furn" for furniture and "el" for electronics. The firm also has plans in the tourism industry. To date, Furnel is by far the biggest production joint venture established in Poland. It accounted for 75 percent of all Polish joint venture sales in 1988, and exported five times as much as the second largest joint venture. It employed by far the greatest number of employees (4,500), all of whom are Polish nationals.

Furnel became possible after Poland passed its first joint venture law in 1986. The current president of Furnel, Jan Bandurski, was then an executive of PAGED, the Polish Foreign Trade Organization that handles furniture exports. He organized a consortium of six firms and government bodies in wood, wood processing, and furniture production. This group accounts for about 10 percent of Poland's wood and furniture industry. They have the advantage of being vertically integrated and being up to 80 percent self-sufficient in raw materials, something vital in Poland where unreliable supply lines are a chronic problem. This by no means guarantees cheap and abundant inputs, but it at least increases the chances of adequate supply on time.

This group had one major problem. They felt that furniture and wood product sales and exports could be increased dramatically only if they could afford a small hard-currency investment in quality-improving foreign technologies and such things as better dyes and varnishes. With the difficulty of obtaining government credits and the virtual nonexistence of new Western financing in Poland, the group decided to find a Western partner. One of the main advantages of having a foreign partner would be to bring in hard-currency capital and acquire a credit rating by which the Polish group could have better access to Western financing. Such a partner, therefore, would have to be large and established. According to Mr Bandurski, the partner's products also had to fit the demands of the Polish market. Finally, the partner's products had to compete in a different market, in which the Western partner would not try to lower the export prices of the Polish producers.

The company that had the courage to take the risks involved was International Computers Limited, ICL, part of Britain's Standard Telephones and Cables. ICL already had been based in Warsaw for 25 years and had the largest representative office of any Western electronics firm. It also had gained experience in producing and selling to the Polish market. Since the 1960s, ODRA computer systems had been built in Poland under ICL license and used by Polish banks and other institutions. In addition, ICL's general manager had worked in the Polish market for ten years and could estimate the risks and possible rewards of the venture. Mera-Elzab, an expanding computer company, and the electronics foreign trade organization Metronex joined ICL to develop the export market.

A.2 Plans and actions

The furniture firm contributed 49 percent of statutory capital, mainly in kind. This in-kind contribution included about 90 percent of the production capacity for some firms. The two Polish electronic industry firms, with a 16 percent share, and ICL, with a 35 percent share investment of approximately US$2 million, together make up the remainder of the company. STC-ICL's investments in Furnel are rather small when compared with the firm's sales of US$3 billion worldwide.

ICL's main aim in establishing the venture was to circumvent the single biggest problem of selling in Poland, the nonconvertibility of the zloty. ICL could then enjoy a competitive edge over its computer-selling rivals by selling to the Polish market for zloty instead of hard currency. It could provide software and consulting services on a similar basis. Its hard-currency profits would come from the sale of the joint venture's furniture abroad.

Using its equipment and know-how, ICL and Mera-Elzab began manufacturing in Poland. In the early phase, the production used ICL's licensed technology and imported components and subassemblies. In the future, Furnel hopes to develop and produce more of the products in Poland, first for the domestic market and, secondly, for export within the CMEA.

The joint venture officially started operation on February 23, 1988. For 1988, its sales were almost 24 billion zloty (approximately US$47 million at official rates). According to Furnel sources, its hard-currency exports amounted to more than US$12 million. According to President Bandurski, furniture exports were up 80 percent from levels before the joint venture began. In the future, he predicted, these exports would rise by 400 percent with a production increase of from 50 percent to 100 percent.

A.3 Impressions and conclusions

Furnel owes its success to the use of advanced management techniques, some of which were part of ICL's in-kind capital contribution. The over 400,000 workers split earnings from finished products on a piecework basis. Together with a commission system, this is said to have improved quality and reduced absenteeism by 50 percent. The company tries to keep the wages of joint venture workers 30 percent above wages earned by those outside the venture, but because of Poland's wage-price inflation it is difficult to maintain this. For the added wages, the employees are expected in many cases to be more productive.

Mr Dolczewski, executive director of Furnel, emphasizes, however, that quality must be stressed over quantity to compete in tough Western markets. In the future, Furnel wants to implement more Western management techniques and hopes to start a Furnel International Business School using ICL's experience in business training. Although Furnel's management admittedly has been creative in several aspects, the joint venture basically was created to make business work despite unavailable credits and nonconvertible currency. It can better be described as an institutionalized barter trade in which Polish wood and furniture are exchanged for British electronics. If the Polish wood and furniture conglomerate had been able to obtain hard-currency financing from some other sources to fund improvements, there would not have been the need for a joint venture. Likewise, if the zloty had been convertible, ICL would not have had to join with the furniture companies to have exportable profits.

B. Czechoslovakian Case Study by *O. Bečvář*

AGROTOP Joint Stock Company

B.1 Background

Czechoslovakia has traditionally exported about 3 million cubic meters of roundwood per year. Essentially it is an export of raw materials. Human labor is limited to cutting, manipulation, and transport. All other operations, such as sawing, drying, and planing, are done abroad. The initiators of the established Agrotop joint-stock company are specialists in lumber processing and suggested that wood processing be brought back to Czechoslovakia. They carried out all the necessary calculations and studies, discussed the proposition extensively, with the appropriate official bodies, and finally achieved the establishment of a specialized joint company.

The successful operation of this joint venture was assumed based on the following facts:

- The Czechoslovak partner had a secure supply of raw materials.
- The Austrian partner was well established in the wood market, and a continuing demand had been verified by its marketing activities.
- The production (with the small exception of substandard output that is sold locally) would be destined exclusively for export against hard currency.
- In the sawn-wood trade, long-term credits were not customary; collection of payments would take place continuously.
- The energy and manpower were available in Czechoslovakia.
- The transport route was very short, with a view to the proximity of both the works and the frontier for export.
- Capacity could be easily extended.
- The product would not be subject to frequent changes and price fluctuation would very slight.

The benefits gained by the foreign partner consisted of obtaining sale stock. The final purchasers also would be satisfied, as they could profit from a larger offer on the market. Finally, the treasury of the importing country could gain by imposing a higher rate of import duties. The latter fact was taken into account, of course, in the supply-chain calculations.

B.2 Plans and actions

In principle, the seat of the enterprise could be located near the material resources, or near the most important forest plants, or near the customers. The second variant was chosen, and the enterprise is being built near Strážnice, 70 km from the Austrian border. This choice shortened the transport route, which is paid for in foreign currency.

The plant is being built under Czechoslovak conditions and construction should be completed in one year. Lightweight halls are envisaged, in which only the staff workrooms will be heated. Completing the construction work within the indicated time was made possible by giving the order to the Pozimos joint venture, and by partial payment in freely exchangeable currency.

The raw material, designated as industrial coniferous logs, is a centrally budgeted item in the present planning system. The situation is complicated somewhat because the Czechoslovak partner is subordinated to another branch involved in different activities. Therefore, the centrally allotted supply and the planned sawn-wood export function must be transferred to the branch to which Agrotop is subordinated. Under the present planning system, wood supply is ensured by the central authorities and, at the same time, an export obligation is imposed. The arrangement is an exception to the principle that no state plan obligations are to be assigned to joint ventures with foreign ownership participation. It also is a precedent for handling similar cases in the future.

The possibility of processing imported raw materials also was considered. The decision was postponed, however, and will be reexamined after the plant reaches full operation. The up-to-date technology for wood processing – an automatic line for sawing, planing, and milling – will be provided by lease from a Swedish supplier. The payments will be spread over six years with the first installment due six months after delivery. The plant also will be equipped with modern electronic facilities for fast communications.

The number of employees has been limited to a functional minimum, markedly smaller than usual for that branch in the country. The administrative staff also will be kept to a minimum (only 13 percent of the total). The employees are expected to show extraordinary efficiency and self-reliance in unplanned situations and in executing routine orders. This will require successive selection of high-quality manpower and will entail a higher initial personnel turnover.

For greater efforts, including work outside of regular hours, higher wages than the normal level are planned. For the variable wage component, only one criterion is to be decisive: fulfilling export orders. The number of employees is planned for one shift; a second shift is possible if additional sources of roundwood are found. As far as price relations are concerned, the actual wholesale price will permit effective exports. To obtain complementary roundwood resources, it will be possible to accept a contractual price (if permitted by official methods at the given time) or to increase the delivery of raw materials by stimulating the interest of the supplier through offering to share foreign currency income, i.e., making partial payment in hard currencies.

The increase of foreign currency income from sawn-wood exports as compared with roundwood is 30 percent. In the calculations, prices registered at the *Holzbörse* (wood exchange) and published in the *Holzkurier* journal have been used.

For economic considerations, the new joint venture broke away from standard practice in the CSSR. The economic analysis of the Agrotop Co. proved that their application to establish a joint venture with foreign ownership participation should be approved. This is further evidenced by the efficiency and effectiveness of the project in making installment leasing payments.

B.3 Management

Some specific data of general interest, taken from the foundation documents of the Agrotop Company, follow:

- The foreign trade company Transakta (see below) is included not as a founder, but as a participant in negotiations; its function is to realize exports and imports.
- Ten percent of the nominal value of shares taken over is to be paid within one month, the rest according to regulation.
- The amount of basic capital of Kčs 20 million is distributed between the founders: Agropodnik (Czechoslovakia) – Kčs 12 million, and Topham (Austria) – Kčs 8 million.
- The range of products and their specifications will be decided by a two-thirds majority.

The statutes of the company stipulate that:

- Any increase in capital requires the approval of two-thirds of the subscribed capital votes.
- The shareholders will obtain at least 50 percent of the net profit after deducting taxes and appropriations stipulated by law.
- The members of the board of directors can only represent the company collectively, unless individually authorized in writing.

It should be noted that the majority shareholder owns three-fifths of the subscribed capital, which is less than the two-thirds specified above. This means that fundamental decisions that are to be approved by a two-thirds majority require a larger number of votes than those held by the majority shareholder.

Foreign trade activities were entrusted to the very experienced foreign trade company, Transakta. It will charge a mark-up for its services, i.e., for exports of sawn wood and boards as well as for imports of technology.

This joint venture represents only a small production plant exerting a limited influence on the structure of total Czechoslovak exports. It will be possible, however, to apply the experience gained from its operation to other territories and branches of industry.

C. Bulgarian Case Study

by *W. van Campenhout*

Atlas Consult: Finding its Own Way to the Market

C.1 Background

In December 1986, three enthusiastic and experienced managers with a great deal of training background founded Atlas Consult, a company specializing in integrated organizational development projects: Total Quality Control, Human Resources Management, Sales, Marketing, and Export Management. After a year, in November 1987, four more partners were incorporated, all of whom are experts in their own field. In March 1988, Atlas Pharma NV, a distribution and marketing company for pharmaceutical products was established. To allow for faster growth, Atlas Organization Development Consult was split off in May 1988, and the Sales Training Department remained under the parent organization. Atlas Organization Development Consult determines its own activities and outlines its overall and long-term strategy. In August 1988, Atlas Pharma BV, a 100 percent subsidiary aimed at the Dutch market, was set up. A branch company in the USA (North Carolina) began operating in July 1989.

C.2 Mission and overall strategy

The objectives of the company are:

- To fulfill the existing needs of large and medium-sized companies for Total Quality Control within their white collar environment.
- To comply with growing demands for professional support and training for International or Export Management.

Atlas Consult highly values its commitment to the results of implementing its methodology. It believes it offers a unique approach to the transfer of its know-how to the personnel of client companies. The rapid development of the company can be explained by the interest of its multinational customers, who pass on the successful programs and formulas to their subsidiaries.

C.3 Actions

The company decided that any commitment should be focused on establishing a long-term relationship. Believing that the Eastern European economy could catch up easily with the more advanced West, an action plan was worked out in the beginning of 1988.

An office base is essential for the services that Atlas Consult offers its customers and requires:

- Efficient communication facilities (telephone, telefax, secretary).
- Address.
- Meeting rooms.
- Reception facilities.
- Training equipment (flip charts, overhead projectors, etc.).

To operate effectively, it needs:

- Ability to hire/dismiss local employees.
- Ability to invoice the client.
- Use of working capital.

In short, a legal entity was essentially needed to enter the market. To meet the requirements, a theoretical plan was developed, describing the following actions:

- Search for preliminary contacts.
- Organize product presentations (with the help of local organizations, if possible).
- Find the right local assistance.
- Investigate possible "legal frame" solutions.
- Prospect customers.
- Train local consultants at the Belgian headquarters.
- Choose the right legal entity and apply for settlement.
- Establish office base.

- Start delivery to customers.
- Improve the organization, depending on local response of authorities, customers, and personnel, etc.

C.4 Reality and practice

The channels existing in Belgium proved to be unreliable, and the company's plans were regarded with disbelief. Through a young enthusiastic diplomat of the Belgian Embassy in Sofia, initial contact with the Institute for Social Management (ISM) in Bulgaria was made during the first visit of one of the partners in May 1988. Efficient help from ISM enabled the company's top management to present their products only three months later to the right people in Bulgaria: top management of companies and relevant authorities. The Director of the Institute appointed his principal lecturer as the coordinator between Atlas Consult and ISM. Without this decision, Atlas Consult would not have been able to accomplish so much on such short notice.

Due to the preliminary visits of a skilled local consultant, the productivity of each visit to Bulgaria was over 100 percent. During the third trip, in November 1988, contact with the first potential clients were made on a business level. At the same time, different possibilities to establish a legal framework for the activities planned jointly with the Institute for Social Management were discussed.

Due to Decree No. 56, the establishment of the joint venture was postponed until more information on the new legislation was available. The application procedure finally started on April 3, 1989.

C.5 Impressions

The first visit to Sofia in November 1988 was a revelation. During meetings with the different contacts, the Atlas Consult representatives had a strong feeling of *déjà-vu*, which grew during discussion of the possibilities of establishing an organizational base and the necessary legal framework. Common factors in the respective systems became more apparent. This point was stressed during one of the first seminars held in Bulgaria: "Don't look too much at the differences, but focus on the common factors. People are people wherever they live. Systems established by people cannot differ too much since people think much in the same way."

Another very important concern was to show that Atlas Consult believes in what it intended to do. When a local company asked for guidance in upgrading the quality of its products and organizations, it was clear that a long-term commitment from Atlas Consult would be required. Atlas Consult clearly demonstrated its confidence in the proposal by accepting payment in local currency. Atlas Consult sees the European market as an entity, not as a compilation of different tax systems. As long as a country allows payment of the operating costs with the earned money and reinvestment of excess cash, it will make no difference in the long run which currency is used.

Atlas Consult believes that within five to ten years, the gravity point of economic activity will start moving from Western to Eastern Europe. The general education level and knowledge already are at hand. University degrees are more than sufficiently available in East Europe; they just must be directed to staff functions in the companies. Motivation and responsibility will create middle management in the new company structures. Once management becomes responsible for profits and future investments, they will soon become market-oriented.

The process of alteration is for the better and will prove irreversible. With the understanding that changes consist of adjusting the existing system and not copying Western ways, results will be successful in due course. Many "Western mistakes" can be avoided by steadiness and caution.

Decree No. 56 and the new legislation on leasing confirm the determination of the Bulgarian government. Still, much remains to be done to motivate people to think and act accordingly. The mobilization of entrepreneurship and inventiveness, on a daily basis, is an enormous task. To select a more market-oriented economy without sacrificing victims during the process is the government's responsibility and demands wisdom and caution.

C.6 The near future

Administrative regulations in the Eastern countries will become more flexible and will allow Atlas Consult to act independently as a company within the different countries. By the time this book is published the Atlas Consult office in Sofia will have been opened.

In February and March 1989, three Bulgarian consultants were trained in the Atlas Consult philosophy and its products. Total Quality Control (TQC) and Export Management Programs have been started at two companies in Tolbouchin, one in Sofia, and one in Silistra. Together with IKO in Sofia, Atlas Consult will make presentations during the training programs. Programs soon will begin in two other organizations – one in Sofia and one in Kazanlak. Residential training programs are being organized for two headquarters of large state firms and are being negotiated with another large company. Today, 15 full-time and four part-time specialized consultants are working to support the different programs throughout the company.

D. Hungarian Case Study by *P. Szolnoky*

Macon Ltd: Establishment of a Successful Joint Venture

D.1 Background

Macon Ltd is the first Finnish-Hungarian joint venture. Its name refers both to the founders and the activity and stands for MAnagement and CONsulting. The founders are the Institute for Building Economy and Organization (EGSZI), Budapest – 60 percent, and Oy MEC-Rastor AB, Espoo – 40 percent. The initial capital of the company is Ft 2.5 million. The capital increase in 1988 was Ft 0.5 million.

The main profile of the two founding companies is as follows:

- Institute for Building Economy and Organization:
  Research and development, organization development, building economy, housing and communal economy, computer services, assisting services, publications.
- Oy MEC-Rastor AB:
  Management consulting, business strategy and organization development, improvement of industrial productivity, project management, logistics, assisting central and local administrations.

The immediate precedent of the joint venture was a development project conducted by the two founders in Hungary. In this way, they became thoroughly acquainted with each other's activity; the foreign party also became acquainted with conditions and possibilities in Hungary and with possible opportunities for management consulting services. Evaluating this information and analyzing the Hungarian conditions and the experiments of the successful common project, the two parties decided to establish closer cooperation through a joint venture.

The founders believed that the success of the company would be based on a well-developed strategy. One year before establishment, they selected the future managing director, who was made responsible for the preparatory and strategic planning. The strategy outlined the areas and activities on which the new joint venture should concentrate to hit the common targets and interests of the two partners. The company's business philosophy is defined in the following three principles:

- High-standard, client-oriented consulting services for both domestic and foreign clients.
- Profit-oriented business from the start.
- Profit to be distributed among the founders and the consultants.

Based on these principles, the business strategy was determined for approximately a three-year period, in which the main objective was the introduction and stabilization of the company. The following main targets were defined:

- At the end of the third year, the sales revenues should reach approximately Ft 11 million; the ratio of the gross profit to revenues should range between 8 percent and 10 percent, and the ratio to the initial capital should reach 20 percent. The initial staff should have doubled (approximately 13 to 18 persons).
- Based on the building-industry customers, a continuous profile diversification was to be started. The target was set for the size of revenues from the building sector and from other sectors.
- The partners did not consider the payment of dividends as a primary target and would make decisions annually based on actual results.
- At least 10 percent of the revenues had to be realized in hard-currency exports, in order not to disturb either the company's activities abroad or its relations with the foreign partner.
- The assets and equipment necessary for operation had to be ensured continuously, partly through the partners' support and partly through the company's own sources.

- The income of the employees had to increase annually on an average of 10 percent to 15 percent.

The business strategy also determined that in 1989, with full knowledge of the results of the first three years' development, a new business strategy should be defined for the next three to four years, aiming at the dynamic development of Macon Ltd. The targets of the business strategy indicated a difficult challenge for the company, but it was clear that the possibility for both asset investment and increased income would result from profitable activities.

D.2 Events and action

The following events are the main milestones in establishing the joint venture:

- Common development project in Hungary (EGSZI-MEC Rastor), December 1983 to July 1986.
- Started negotiations to establish the joint venture, April 1985.
- Established procedure (based on the framework valid before 1986); obtained preliminary approval of the Professional Inter-departmental Committee, July 1985 to November 1985; previous announcement of the intention to establish and its approval, December 1985 to February 1986; signature of the Association Agreement, May 1986; request for approval of the establishment, June 1986.
- Approval of the joint venture's establishment, Bank of Finland, Hungarian Ministry of Finance, July to August 1986.
- Statutory general meeting, September 3, 1986.
- Registration of the company with various authorities and with the Court of Registration, September to December 1986.

These events show a very slow process but took place within the legislative framework valid before 1986. New regulations were then introduced and the establishment procedure began again in January 1986. Within one year, the joint venture was established and registered. In our opinion, this duration is fully acceptable compared with the previous procedure. The activities of the Ministry of Finance and the Inter-departmental Committee were similar in both procedures.

Registration was the slowest part of the procedure and needed to be done with various authorities: register book office, tax office, statistical bureau, court of registration, without any coordination. This process is extremely bureaucratic. It could be shortened with suitable cooperation among the different authorities. In the case of Macon Ltd, the registration took up much time so the association agreement was checked with the different authorities before it was signed.

D.3 Scope and essence of Macon Ltd's activity

Macon Ltd performs and offers its services in the following fields:

- Business development
  - Strategic planning and analysis.
  - Problem-definition, diagnostic, transexamination.
  - Development of contracting activities.
  - Marketing and market research development of companies.
  - Development of planning systems.
- Organization development, managing system development
  - Implementation of organizational structure development.
  - Wage development, compensation, and motivation systems.
  - Development of planning and controlling systems.
  - Development of human resources.
- Information and management system development
  - Management systems.
  - Management information systems.
  - Project management systems.
  - Problem-oriented developments.
  - Increased operational efficiency.
- Foreign trade-type services
  - Consultation for the practice of company foreign trade rights.
  - Formalization of the apparatus necessary for the practice of foreign trade rights.
  - Improving the efficiency of a given working apparatus.
  - Market studies.
  - Preparation of contracts.
  - Searching for business partners.
  - Preparation of marketing and public relation plans.

- Assisting services
  - Assisting in common contracting, including establishing joint ventures.
  - Feasibility studies for joint venture organization.
  - World Bank development projects.
  - Implementation of professional seminars, conferences, study tours, etc.

The following table shows the main figures of the firm's activity to date.

Denomination	1986		1987		1988	
Net Income (Ft '000)	1.349	100%	6.319	100%	10.300	100%
From this						
Building trade	1.179	87	3.990	63	6.200	60
Export	–	–	1.040	16	1.300	13
Others	0.170	13	1.289	21	2.800	27
Gross profit (Ft '000)	0.207		641		717	
Number of customers	6	100	14	100	19	100
From this						
Building trade	4	67	6	43	4	21
Export	–	–	3	21	3	16
Others	2	33	5	36	12	63
Number of projects	10	100	25	100	28	100
From this						
Building trade	8	80	14	56	13	46
Export	–	–	3	12	3	11
Others	2	20	8	32	12	43
Number of staff	7		10		13	

The figures show that Macon Ltd reached its goals and, with continuous business development, shaped new strategies.

Macon Ltd is an economical partnership operating in the form of a limited liability company, and its activity is regulated by the act concerning joint ventures in Hungary. The common rules, the company's main document, do not contain any special provisions and give a correct orientation to every point mentioned in the act. A cooperation agreement was signed that contained the conditions of activity between the two founders and the joint venture in specified areas. This additional document has proved to be advisable and very useful. The organizational structure of the firm was formed according to the legal regulations.

The general meeting is the main instrument of the association. It is held annually, but can meet at any time upon the request of any member. The general meeting is headed by the chairman, who is one of the partner's representatives. The chairmanship changes every year (after the acceptance of the balance sheet from the previous year). In the first year of business, the chairman was a representative of the Finnish partner.

The general assembly decides whether to increase or decrease the basic funds of the association, to sell and purchase ownership, to modify the common rules, to accept a new association member, and to accept the annual balance sheet of the company. The general assembly nominates the managing director and decides on his annual salary. It also elects the members of the board of supervision and is empowered to meet and decide on all questions referred to it.

The board of supervision consists of three members, although this number is not obligatory. Its main duties are to control the managing director, take charge of revising the association's balance sheet, comment on the rules concerning the association's activity, and revise proposals made by the managing director.

The managing director is an employee of the company, and his duties and responsibilities are to ensure the company's successful activity.

D.4 Impressions and conclusions

To summarize the experiences gained so far, the joint venture is developing according to its preliminary strategy and plans. The external conditions are satisfactory. The foreign-trade activity (export-import) is being managed without significant problems. Problems have arisen in the specific areas of accounting for the settlement of cost categories (representations) where the accounting rules and competence of the partners had not been fully coordinated.

A serious problem is the available infrastructure (office, telecommunications, car, etc.) in a country where the partners cannot provide much help and central settlements are very difficult and expensive. The law concerning joint ventures (managing sectors or not) was poorly coordinated, which posed a problem until 1989.

The unstable economic environment is the main problem because it precludes the possibility of making correct forecasts. The joint venture is a foreign body in the Hungarian economy, which causes some problems in relations with other organizations.

Macon Ltd so far is a viable organization and there is great demand for its activity. The firm has been profitable from the beginning and, based on the clients coming from the building sector, has been able to access the market as planned. The consulting staff is capable of high-level work and speaks many different languages. The joint venture Macon Ltd can significantly contribute to developing Finnish-Hungarian economic relations.

E. Hungarian Case Study by *T. Benedek*[1]

KEMIPUR: Harmonizing Partners' Relations Over Time

E.1 Background

The KEMIPUR Polyurethane System Limited Liability Company was founded in 1985 with central premises in Solymár, a village near Budapest. The basic capital is Ft 1 million. The foreign founding partner was Elastogram Polyurethane GmbH, Federal Republic of Germany (FRG), with a share of 49 percent. The domestic partners are the Plastic Industry Company of Pest County (PEMÜ) with a share of 41 percent and the Chemolimpex Trading Company for Chemicals with a share of 10 percent.

The joint venture is engaged in the production and marketing of polyurethane foam systems. The aims of the Hungarian partner in establishing this company were to eliminate the import of products for hard currency and to increase exports against hard currency. Any joint venture whose aim is to reduce hard-currency imports and at the same time to promote exports has been encouraged by the new

[1]After the study by Dr Donát Bonifert from the Ipargazdasági Intézet (Institute for Industrial Economics), Budapest, 1989.

Hungarian legislation. The foreign partner was motivated to establish the company due to the positive attitude of the Hungarian market.

The Elastogram Polyurethane GmbH is a concern of the BASF works in the FRG, supplying in the past about two-thirds of the polyurethane on the Hungarian market. A further aim was to extend the deliveries of this new company to other CMEA markets as well.

The establishment of the company on behalf of the foreign partner was further motivated by the possibility of increasing profits due to the expected increase in turnover. The establishment of the joint venture was not easy. The requirements were well known and negotiations began in 1978. The filing at the Court of Registration was done in 1985 and production started in 1986. Thus the period of time between the first intention and final realization was about eight years. The various necessary approvals (an approval was needed even to start negotiations), the fact that this was the first joint venture to be established in Hungary, the practice of recording every discussion, and unexpected variations and uncertainties consumed much precious time.

How the Partners Found Each Other

The Elastogram Polyurethane GmbH was a supplier to PEMÜ. A proper and fair business relationship had already been established between these two companies. PEMÜ had a very large production profile, producing plastic foam basic materials and polyurethane systems for the footwear industry, insulation products for the vehicle industry, and other special materials, e.g., soft plastic foam for the furniture industry.

The basic raw materials for all the above products were imported by PEMÜ from Elastogram. The two companies, therefore, had developed a business relationship. By establishing this new joint venture their connection was drawn even closer.

Harmonization of the Partners' Interests

The parties had a common interest. The primary aim of the Hungarian partner to increase hard-currency exports revealed problems related to the customs duty charged on imported materials, double transport costs (the basic materials had to be imported and the finished products exported), and guarantees and service for customers outside the country. The aims of the parties finally were resolved and the foreign partner agreed to sell 20 percent of the yearly production through its own organization.

E.2 Management of the joint venture

The top management body of the company is the board of supervision (assisted by the general assembly). It decides on long-term strategic plans and profit distribution (whether profit should be reinvested into the company or withdrawn). The board of supervision consists of five members: one delegated by PEMÜ, and two each by Chemolimpex and by the German partner.

The management of the company's operation is performed by two managing directors, with different responsibilities. One director is Hungarian; the other is German. The Hungarian manager deals with commercial, economic, and labor questions; the foreign director oversees production and quality control. The two managing directors must consult with each other every week to coordinate actions that arise between the two different groups.

The foreign partner emphasizes strict quality control. The products must meet the highest requirements of foreign markets. This is absolutely necessary in order to protect the brand image, which is very important to both partners.

E.3 Production and staff data

The KEMIPUR staff consists of five physical workers, two truck drivers, one import-export executive, one sales manager (foreign employee), two administrators, one director of finance, one bookkeeper/wage accountant/social security account administrator, one storekeeper, and two managing directors. The technical staff includes one laboratory assistant (assigned to the technical director) and three application technicians (responsible for client contacts and periodic visits, problem-solving connected with supplying materials and repairing machines, and performing maintenance service tasks). Thus a considerable part of the staff maintains permanent relations with the clients. The company attaches high importance to the above tasks.

The company offers assistance for material processing and consultations if a new material has to be supplied. The company also produces and sells the machines used to mix two components to produce foam.

The total income of KEMIPUR in 1988 was Ft 1,150 million, which is equal to 8,000 tons of produced materials, satisfying the total needs of the Hungarian market. About 10 percent of the production, i.e., 800–850 tons, was exported for hard currency. The company's profit was moderate due to high investment costs during the first year. The basic aim was not only to obtain a high profit but also to retain customers. The considerable profit in 1987 was divided between risk and share funds (prior to taxation). Forming a risk fund of 10 percent to 20 percent of the investment capital is obligatory; the company's fund reached a level of 12 percent. In 1988, the profit was retained in order to extend the activities of the company.

E.4 Markets

The local supplies of KEMIPUR are minimal. Only auxiliary materials (tools, etc.) are required from local sources. The basic materials for production are supplied by the foreign partner.

KEMIPUR does not face local competition. Competitive imports would be possible in principle, but practically the chances are minimal for the following reasons:

- The local prices are lower than the prices of any possible imports.
- Imports from a new company could be difficult because of various obstacles (e.g., covering deposits for imports); local supply within the joint venture agreement is considerably faster.
- Service facilities are more favorable and quicker with the local joint venture than with a company operating in the FRG.
- Delivery time for local materials is shorter (maximum two weeks) than for imported materials.
- Other delivery terms also favor local supply when compared with imports (even if imports would be practically possible).

The quality of KEMIPUR products, following the strict quality control and image requirements of the well-known brand, make the company almost unbeatable on the local market. Starting in 1990, however, the BVK (Chemical Works of Borsod) will produce the polyurethane component "B" as well. It might be possible that ordering this material locally would be more favorable than importing it from the foreign partner. Contacts could be developed with the BVK as a partner or even as a competitor.

E.5 Environmental protection

As is usually the case with all chemical firms, the question of possible environmental pollution could be raised with regard to KEMIPUR. The company has drastically reduced the likelihood of such problems, however, by organizing the entire production into a fully enclosed process in complete compliance with the very strict FRG regulations for environmental protection.

E.6 Contact with local organizations

The premises of KEMIPUR are in the vicinity of the Hungarian partner PEMÜ, and the operation between the two works is undisturbed. The people from the village Solymár, the district of the work site, however, are not very friendly towards the new KEMIPUR works, according to local rumors. A possible reason might be that the KEMIPUR works are different from other local works, salaries are higher, and the managers are foreigners. No actual consequences, however, have been ascertained regarding this matter.

E.7 Wage politics

Within KEMIPUR, tasks are more complex as each worker performs different activities. Because of that, the aim is to pay higher wages than the average local companies. Higher wages are further indicated by the higher requirements and performance standards at KEMIPUR.

The cost level and cost-bearing capacity of the company, which in this case does not limit wage levels, are the main criteria in establishing salary levels. The gross income of the company (Ft 1,200 million) has been achieved with a staff of only 20. Thus with KEMIPUR, the profit/capita ratio greatly exceeded that of the average local companies.

The general assembly annually raises salaries, adapting them if necessary to the rate of inflation, and always observing increases in the connected costs. After the changes in 1988 (personal income tax to be included in wages), the labor costs for KEMIPUR no longer can be considered low.

The development of costs in this new phase requires a more detailed study by the company. Prices of the local suppliers are going up faster. Prices converted in hard currency had previously increased annually by only 1 percent to 2 percent; now the rate is 5 percent. At the same time, the possibility of increasing the price of the finished products on the local market is limited. The products of KEMIPUR belong to the first-grade import price level category, and this limits price changes locally. Up to the present, the KEMIPUR prices are 10 percent to 15 percent lower than the price of similar imported materials, but this might increase by 20 percent to 25 percent.

There is a considerable difference between the wages of the two managing directors. The wages of the local managers were determined in comparison to the wages of similar local managers. The case of the foreign manager was quite different. His salary was based on the wages of similar managers in his country. This discrepancy was resolved in such a way that the basic wages of the two managers were fixed at an identical level, but a special bonus was given to the foreign manager. Some further problems, however, had to be faced in this respect as well. The question of whether the foreign manager would have to pay social security contributions in Hungary had to be clarified. This could be eliminated, but the question of income tax still posed a problem. Finally, with a special application, it was agreed that the foreign manager would pay an income tax equal to the actual valid taxation in the FRG.

E.8 Taxation system from the point of view of joint ventures

For joint ventures, taxation is less burdensome than it is for the domestic companies. This does not mean, however, that there are no problems, especially after the modifications that went into force in 1989. Companies with foreign participation have had considerable advantages in the system up to the present, and the profit taxation of such companies ensures some of these advantages even today. Some changes of the regulations introduced in 1989, however, have made the situation less favorable.

With the introduction of the New Company Law, the concept of economic partnership has been determined. Up to the present, the different statutes of the Cabinet and the Ministry of Finance, which determines profit regulation, did not apply to companies with foreign participation. The exceptions for joint ventures have been automatically canceled, and the applicable profit regulations (except for specifically exempted joint ventures) are now identical with the regulations valid for local companies. As a result, many hundreds of regulations are now automatically valid for joint companies as well, with consequences that could not even be estimated at the time of publication.

Special concern was caused by the statute of the Cabinet that went into effect on December 31, 1988 (issued however some weeks later), concerning the tax abstractions due to special natural and other conditions. This statute applies to various products based upon the general item classification.

The KEMIPUR products belong to an item classification that is subject to this tax abstraction. According to this statute, the company also will have to pay a separate tax. This statute in its actual form contradicts the investment protection law, which states that joint companies with foreign participation will not be charged any tax in addition to the profit tax (or tax paid on the company's profits). This special tax abstraction, however, could be interpreted in such a way that it would be paid as expenses before calculating the company's net profit. With this new taxation system, it is possible that foreign investments will be less profitable. It is also alarming that new provisions for companies are issued every year, some of which are contradictory. Legal documents are sometimes made effective retroactively, which causes unusual difficulties for the foreign partner.

Problems arise with regard to accounting. Procedures for entering reports into the book of accounts have not been clarified. As foreigners cannot possess real estate, a building (in this case the property of PEMÜ) could not be entered into the accounts, and a special solution had to be created in the form of a "capitalized rental right."

Starting in 1987, special bookkeeping instructions were edited and sent to the individual joint companies; these instructions, however, were never published. They state that the capitalized rental right can be handled as an immaterial asset. According to the general regulation, depreciations may be entered into accounting only upon special approval from the Ministry of Finance. Therefore, the value of PEMÜ's share would not diminish over time, and consequently the capital share of the partners might be changed. Finally, a 4 percent depreciation was granted yearly upon special approval of the Ministry. The so-called "other payments for development purposes" could not be handled as expenses. This was changed, however, in 1988.

Beginning in 1989, the company will not be charged a separate company tax. At the same time, it will have to pay a "technical development contribution" despite the fact that the company does not make use of this.

The telecommunication infrastructure is not satisfactory; it is difficult to get telephone connections. The telefax line is often engaged and sometimes out of order. A special computerized telecommunication system was planned with the foreign partner, but was not possible to implement due to the lack of appropriate cables.

E.9 The future

By retaining the profit gained in 1988, KEMIPUR plans to extend its activities, which will require a considerable capital investment. Up to now, the company has produced only the component "A," while the component "B" has been supplied by the foreign partner. Now the company intends to produce the component "B" locally as well. For this a so-called "Station B" is foreseen. This fulfills part of the original joint venture contract.

Another expansion plan is to engage in the production of vehicle components. For this activity, the foreign partner is ready to hand over the production process of Cellasto springs and to supply the necessary materials as well. If this plan is to be implemented, new premises will be necessary, either through rental or purchase. Then the joint venture products could be used for the production of Skoda-Favorit and Lada-Samara cars within the frame of a special barter agreement.

F. Bulgarian Case Study by *O. Lumvef*

APV Bioinvest: Bulgarian-British Joint Venture

F.1 Background

APV Bioinvest Co. is a joint venture company established in July 1985 as a result of the partnership agreement between the Bulgarian company, Bioinvest Engineering, and APV plc, United Kingdom. The agreement was reached after a careful research and selection process done by the Bulgarian partner, as well as the active response and interest shown by the British company.

The motives of the Bulgarian party for entering into a joint venture were mainly to develop economic, industrial, scientific, production, and marketing cooperation in the field of biochemical and biotechnological machine-building. During the first stage, the parties agreed to work on a number of joint projects that mainly concerned specific items of food industry equipment.

The foreign party of the joint venture is APV, the largest company in the world specializing in supplying process equipment for food, beverage, and related industries. It is the only company that includes in its product portfolio the full spectrum of dry, liquid, frozen, fresh, and snack food industries. APV has a broad, evenly distributed product range, with no single segment of the food or beverage industry predominating. An international company with sales of approximately £1 billion, APV employs a staff of 14,000.

On the Bulgarian side, the partner is Bioinvest Engineering, the country's leading process-engineering company for food and beverages with annual sales of nearly US$800 million, and with over 750 people employed worldwide. As a multi-industry group, Bioinvest Engineering supplies expertise and equipment for the food, canning, and tobacco industry; refrigeration and air treatment; and the chemical, pharmaceutical, and biotechnological industries.

The equity shares were distributed with APV holding 55 percent and Bioinvest 45 percent. The hard-currency capital share has not been used for any kind of investment so far. The account in leva is used to cover most of the joint venture's expenses, because there is only negligible income available in hard currency. Upon mutual agreement, the shares of the partners could be increased, but that has not been done so far. It was agreed that the joint venture would have its headquarters in Sofia and its employees would be Bulgarian citizens only.

F.2 Activity and management

The scope of the joint venture's business activities, as mentioned above, is quite broad, and covers engineering activities and services in biotechnological, refrigeration, food industry, machine-building as well as consultancy activities, contracting, designing, and supply of equipment, construction and start-up of industrial installations, technical assistance, service and maintenance, and also foreign trade activities in Bulgaria as well as in third countries. Such a wide range of activities was to be expected in view of the structure and profile of the two parent companies.

The board of directors consists of five members who are appointed by the partners. According to the company statutes, the chairman must be of Bulgarian nationality. The board lays the overall policy and takes decisions on the basis of consensus. The staff is very small and includes:

- One managing director (engineering background).
- Three engineers (chemical and machine-building engineering).
- One secretary and two part-time consultants.

The current managing director was selected with some difficulty and after several personnel changes; trading experience was essential. Technical skill and expertise in the managing body appeared to be very important as do personal relations between joint venture staff and partner representatives. Because of the high demand profile, the managing director appears to be a key figure.

The demands on the staff are also higher than in local organizations. Staff members are expected to perform a broad range of activities due to the wide scope of the joint venture and the limited staff size. The careful selection of personnel, which was one of the difficulties at the beginning, became one of the main reasons for the joint venture's subsequent stabilization.

Initially there were no problems concerning registration and operation. This was due to the fact that no joint financing or contracts existed then. There also were no problems concerning property or office arrangements. Rather, problems were encountered due to the wide potential field of activities and the inability to follow the initial development program. This was the reason why APV-Bioinvest, needed – again through experience – to find its real image, which was possible after hiring staff with an engineering background. Problems and difficulties encountered by the joint venture were not connected with any legislative restrictions or other administrative formalities.

The weak point of the joint venture was the fact that it was not connected with any previously organized production system or individual product. This was one of the reasons it did not earn any substantial profit during the first years. There were no taxation problems or difficulties concerning the repatriation of profit to the partners simply because profit did not exist. There also were no practical problems concerning staff social insurance, salaries, or employing foreign citizens. The joint company is still regarded as a foreigner in the domestic market.

F.3 Impressions and conclusions

After overcoming the problems mentioned above, it is the opinion of both partners that the joint venture is starting to operate in a proper way and is gathering momentum. There is positive development in the engineering activities, and the representation of the British partner in the local market is also becoming more efficient and stable. This is opening the way for better prospects of future cooperation. One of the weak points before establishing the joint venture was that the British partner had no representative in the Bulgarian market, and the partners did not immediately realize the necessity for one big project to be used as a training base for the transfer of knowledge and expertise.

The issuance of new legislation has revealed new potentials and possibilities; there is still much to be done, but the knowledge and experience gained during the initial period provide a good starting point for successful future development.

G. Soviet Case Study by *V. Ranenko and A. Soloviev* (based on company materials)

Dialog – Personnel Management: Key to a Promising Start

G.1 Background

The participants of the Dialog joint venture had previously cooperated in developing electronic techniques as the production association KAMAZ. Contacts with the American partner came by chance during an exhibition of electronic equipment in the USSR. The president of the American firm, Joe Rightehe, was interested in organizing a joint venture in the USSR, taking advantage of *perestroika* in economic management and the range of social changes taking place. As he put it, the principles of *perestroika* (the acquaintance of the workers with production management, creation, and control of innovation) call for active labor. Democratization of production relations fully corresponds with his personal concept of managing a work collective. The unique understanding of this concept became obvious even during the initial contact with representatives of the future Soviet partners (e.g., the present director of the joint venture) and became the basis for the joint venture's operation.

For the Soviet partners, the advantage of a joint venture lies in the ability to engage in commercial and production activities without a departmental managerial system.

Dialog was registered on December 12, 1987. The authorized fund was distributed as follows:

- Production association KAMAZ, Ministry of the Automobile Industry of the USSR (32.6%).
- Production Organization (P/O) Vneshtechnika (9.8%).
- Institute of Space Research, Academy of Science of the USSR (7.2%).
- Central Economic Mathematical Institute, Academy of the Sciences of the USSR (13.0%).
- Moscow State University (13.0%).
- Major Exhibition-Information Center of Economic Achievements of the USSR (2.6%).
- Management Partnership International Inc. (MPI), USA (21.8%).

The main goal of the joint venture is the production and sale of personal computers and software in the USSR and abroad.

G.2 Activities of the joint venture

Dialog began operating in 1988, selling personal computers that the American partner had imported as its contribution to the authorized fund. Dialog also produced a number of software packages, mainly with the help of Soviet specialists. Computers sold in the USSR were supplied with a Russian text editor and a Russian text printer. Dialog provides service to clients who purchase the computers.

Payment was accepted in rubles as well as in hard currency, which made it possible to buy new computers abroad for resale and to pay for additional equipment. From the beginning, sales were high and software was created in the amount of 300,000 rubles. This was due to the conditions of sale that Dialog guaranteed to the Soviet customers, as follows:

- Accuracy and guaranteed delivery.
- Customer-oriented and tailor-made software.
- Maintenance.
- Option to pay by installment or in rubles.

During the first year, more than 3,000 personal computers were sold, and a number of programs were developed in which foreign customers were also interested. The partners agreed to reinvest all profit in the joint venture. At present, the joint venture has a workstation near Moscow (5,000 square meters of building units) where the personal computers are assembled with the use of Soviet assembly units. Special computer rooms for developing software are available at the Moscow State University and at Dialog's central building.

The joint venture has 15 branches in the USSR and a number of joint ventures in Czechoslovakia. Plans to expand activities by increasing the authorized funds are being developed. Further activities in producing electronic consumer goods and consultation and training of specialists also are planned.

G.3 Unique personnel management

The Dialog staff consists of 45 personnel located at headquarters (including ten staff programmers), and 400 employees in other branches of the joint venture. Recruitment and work assessment are directed by a collective work team using a concept based on inner unity and satisfaction for each employee. Consolidation based on a good psychological understanding and a healthy climate is the main goal of the joint venture. A special method of periodic assessment and testing of professional and personal characteristics was introduced by the American specialists.

Salaries at Dialog are lower than at the Soviet enterprise KAMAZ, but at the end of 1988, the employees got a bonus ranging from 1,500 to 5,000 rubles, according to the contribution of each staff member. In addition to this incentive, the director of the joint venture tries to stimulate labor productivity by democratizing relationships among employees, by showing respect for each individual, and by introducing a friendly atmosphere. A family spirit is therefore dominant at the company.

G.4 The near future

In general, Dialog may be regarded as a successful operation in the USSR, with a high level of entrepreneurial capabilities. Some future plans include activities to be performed in the following directions:

- Studying the Soviet market so as to build up a future strategy based on real market research.
- Building new production facilities and special purpose enterprises that will provide opportunities to enhance company activities.
- Reinvesting profit and overcoming issues concerning the nonconvertibility of the ruble.

H. Soviet Case Study

by *V. Ranenko and I. Soloviev*

Homatec

H.1 Background

Prior to organizing the joint venture, the partners had engaged in cooperative deals. Within the framework of this cooperation (1986–1987), the Soviet enterprise exported machine tools (mechanical parts) to the German company for future production and sale.

The joint venture was registered on July 16, 1987. The partners are the Production Organization (P/O) machine-tool building plant of S. Ordzonikidze (Moscow) and the company Heinemann Maschinen und Anlagenbau, FRG. The joint venture specializes in production and sales of machine tools, base-machine centers, and flexible models and systems. The authorized fund is 47.7 million rubles.

The share of the Soviet partner is 32.5 million rubles (68.0 percent) and includes the right to use a land area of approximately 25,000 square meters in the territory of the Soviet partner; buildings with an area of 11,200 square meters, various general purpose buildings (valued at 33 million rubles); and part of the fixed capital equipment, technical documentation, know-how (approximately 1.5 million rubles), and circulating assets (9.0 million rubles). The share of the foreign partner is 15.2 million rubles (32 percent) and includes fixed capital equipment, precision machine tools, measurement equipment (3.6 million rubles), a system of automated project and office equipment (1.4 million rubles), technical documentation and know-how (1.8 million rubles), and current assets in foreign currency (9.5 million rubles).

H.2 Operation and activity

The production activity of the joint venture takes place in an area of 800 square meters that is rented from the Soviet partner (a section of the machine-tools building, the design office, and the warehouse). The joint venture built the engineering education center for the students of the Moscow Technical University, and plans to construct its own production department and organize a branch office in Leningrad. The staff of the joint venture consists of 18 specialists (administrative and construction) who are hired on a contract basis from the Soviet partners for additional payment.

In 1988, the joint venture produced 14 machine tools for East Germany and Cuba, four manufacturing centers for the Soviet ship-repairing plant in Kandalaksha, and six centers for Western customers. Sales were carried out through Heinemann distribution channels. The profit was nearly 600,000 rubles, 200,000 of which were distributed among the partners.

In the period 1989–1990, the joint venture plans to produce 25 to 30 machine tools, 50 percent of which are to be exported for hard currency. In the future, when their own production facilities have begun operation, about 120 to 150 machine tools will be produced and some manufacturing centers as well.

H.3 The near future

In the future, the joint venture will supply Soviet consumers of machine tools with spare parts and other services. The joint venture also will organize a research and development unit for developing modern technologies. The R&D unit will be able to provide information, consultations, and engineering services to Soviet and foreign clients.

H.4 Impressions and problems

The main problems of the joint venture are:

- Material and technical supply is a very complicated procedure, and it is often necessary to import some materials against hard currency.
- The activity of the joint venture is not planned by the state bodies, so the material and technical supply is not guaranteed by the state plan.
- The joint venture would be ready to carry out the state orders if suppliers were guaranteed through the national plan.
- It is difficult to obtain hard currency from the Soviet market. Therefore, many Soviet managers are considering limiting the import of machine tools and instead using hard currency to buy the products of the joint venture.

I. Soviet Case Study by *V. Ranenko and I. Soloviev* (based on company documents)

Technikord

I.1 Background

Prior to organizing the joint venture, the partners engaged in scientific and technological cooperation in the field of gas-flame covers. The cooperative activities were a good basis for negotiating the joint venture.

The joint venture was registered on December 4, 1987. The partners are the State Institute of Mining Chemical Raw Material of the USSR (79 percent of the authorized funds), and the Societé Nouvelle de Métalisation Industrie of France (21 percent). The total authorized fund amounts to 4.1 million rubles. The joint venture declared its activity in the field of producing special cords from powders for the gas-flame cover of metal products. The share of the French partner includes know-how, factory equipment, quality control, instruments, and machineries. The share of the Soviet partner includes the right to use land area, buildings, and equipment.

The planned volume of production is about 250 tons/year. In 1989, the venture planned to produce 75 tons. Distribution of the product will be approximately 75 percent of production for the Soviet market, and about 25 percent for the Western European market.

I.2 Operations

The average annual profitability of the invested capital is planned to range from 10 percent to 12 percent. During the first years of the joint venture, the main portion of profits will be reinvested into production and the R&D fund of the joint venture.

The staff consists of 12 specialists. One foreign citizen (the commercial director) and three Soviet citizens serve on the board of directors. The administration consists of foreign employees.

Technikord is a small producer, but its product is in considerable demand on the Soviet market. The technology used by the joint venture is based on Soviet innovations as part of the Soviet partner's contribution to the authorized fund.

I.3 Problems

Among the problems needing resolution by the joint venture since the beginning of its operation are:

- Preparation of the joint venture's management staff.
- Development of an appropriate strategy planning system for the joint company.
- Development of a company image.
- Development of a market segment in the developing countries.

J. Soviet Case Study by *E. Razvigorova*[2]

Interfackel: World-level Quality in a Ukrainian Village

J.1 Background

December 30, 1987 marked the birth of a joint Soviet-Austrian enterprise under the name of Interfackel. The registration was preceded by 13 difficult meetings between the USSR partner, Fackel, and the Austrian company, Metallisierung-Technologie-Systeme Gesellschaft mbH (MTS) (Bad Vöslau). To match two economic systems that had developed in different ways turned out to be a hard job. The historical development of the companies and their countries had to be taken into consideration in the process.

The plant of the Soviet partner belongs to the All-Union Scientific Production Association for Recycling Machine Components (REMDETAL) and is situated in a village near Kiev. The plant was restructured in 1982, and is closely associated with a research institute, EO Paton.

The Austrian partner is the subsidiary of the Austrian firm Interweld Schweißmaterialhandelsgesellschaft mbH, situated in Bad Vöslau and specializing in the production of similar equipment.

The meeting between the two partners happened by chance during an exhibition in Moscow, where the two companies exhibited next to each other.

The authorized fund of the joint venture is only 256,000 rubles, 51 percent of which belongs to the Soviet partner. An understanding of the potential risks involved in joint undertakings has caused the two partners to minimize their investments. At the time when the feasibility study was performed, many loopholes existed in the relevant legislation. Some of the problems that the partners considered unsolvable at the time were the following:

- The formulation and content of the contracts.
- The price of raw materials, energy, equipment, and technological know-how and its assessment.
- The price of finished products.
- The salaries and other personnel issues.

[2]Based on paper presented by Mr Kozlenko, Chairman of the Soviet-Austrian joint venture Interfackel.

- Duty regulations and the preparation or the opening of a bank account.

Small technical problems, such as the preparation of the company's legal documents, registration of company cars, accommodation for foreigners working in the joint venture, and the payment for business trips within the USSR were encountered during the initial period. The two partners believed that these problems should be resolved actively. They started to work and during the initial period came to the conclusion that the legislative conditions are only one side of the story. Sometimes it is necessary to work within a completely different situation. Under these uncertain conditions, the joint venture has started its activity by building an enterprise in a 400 square meters area with the necessary equipment, communications, and money. This formed the share of the Soviet partner. The Austrian company contributed equipment, technological know-how, compressors, computers, copy and telefax machines, and money.

J.2 Operation and activity

Six months after registration, the first production was released. Despite that, the fiscal year of 1988 was concluded almost without profit. Profit, however, had not been the only goal of the joint venture. The most important goal during the first year was to consolidate the joint company, build up an organizational structure, and create joint international activities. Great importance also was attached to defining bottlenecks and finding possible solutions. The initial difficulties mentioned earlier appeared small compared to those encountered during operation.

To resolve the main bottleneck concerning supply, the joint company began a search for relevant Soviet innovations on which the future production of the joint company could be based. Part of the first year was used for business trips by both the Soviet general director and his technical deputy (an Austrian citizen). They visited many specialized exhibitions and fairs. More than 20 meetings with more than 12 companies were held. Specialists from six countries visited the joint enterprise. Negotiations have been carried out within Austria, the FRG, Italy, Czechoslovakia, and Hungary. All attempts to find relevant technology failed. To solve the problem, the joint venture selected the offer of the electro-welding institute EO Paton.

The first year of operation lessened the optimism. Selling against hard currency turned out to be very difficult due to world competition in the field. The newly emerging products of the joint venture are competing against well known and established companies. The hope that a low price based on low labor costs could be offered so as to obtain market share also proved unrealistic. A direct relationship between the level of payment and equipment productivity was found to exist.

The first year was a learning process in the direction of a market economy; knowledge of the market mechanism and prices was gained. Soviet employees in the joint venture realized that in the absence of state-planned orders, guarantees for wages and supplied materials do not exist. That created the necessity to be flexible in thinking and making decisions.

In spite of all these difficulties, the joint venture produced 600 pieces of equipment for special thermal covering during its first year, 156 of which were sold for hard currency, the rest to Soviet enterprises.

The most important achievement by the joint venture was the absence of any complaints from either Western or Soviet customers. This has a very important socioeconomic impact; in an ordinary Ukraine village, a so-called world-quality level had been achieved. This created a great deal of confidence among the people.

The joint venture established three cooperatives: Techkon-Fackel, Bulat-Fackel, and Austro-Fackel.

J.3 Impressions

The experience of Interfackel shows that the use of different legislative possibilities is important. For the time being, three sets of legislation exist in the USSR by which business activities can be organized: the law of enterprise, the law of cooperatives, and the decree of joint activities. All possibilities have been used by Interfackel. An efficient form of joint activity is the association, which should be organized based on mutual interest, e.g., Agropromservice. The joint enterprise can obtain a large range of services from the association, which provides members with necessary information and defines and discusses problems that can be solved by the responsible governmental agencies. The variety of forms already existing in the USSR give opportunities to enterprises to join their efforts on an international basis. Of course a common interest, flexibility, and entrepreneurship also are required.

K. Bulgarian Case Study by *V. Kotchev*

Systematics

K.1 Background

During the mid-1970s, the US company Honeywell Inc., already with some experience in selling their products in Bulgaria, set a new target for its European Trade Division to expand sales in that country. It was discovered that the target could be met in two ways: either to continue operations along the established path of traditional sales with its own sales force, or to look for new avenues to approach more effectively the growing Bulgarian market for control and automation products. Sending salesmen periodically to meet with Bulgarian customers and to promote products did not prove to be the most effective method of doing business. On the other hand, a local partner with sufficient technical knowledge and experience and good contacts with prospective customers in one or more branches of industry would provide local support to expand the market for Honeywell products, promote Honeywell's position in Bulgaria, and assist operations locally.

At the same time, the Bulgarian Ministry of Chemical Industry, which controlled the chemical, petrochemical, pharmaceutical, pulp and paper, and other divisions of the chemical industry, strongly felt the need to upgrade its production facilities with new high-tech control and automation systems. The feasibility study performed by Ministry experts on the existing manufacturers of control and automation systems worldwide showed that only three or four of the largest manufacturers were up to the requirements of the Ministry; among them was Honeywell.

The initiative came from both sides. A target project was selected for the start-up of the first distributed digital control system in Bulgaria to be installed at a large synthetic fiber plant in the town of Yambol. This involved a great number of technical consultations, engineering exchange, and support from Honeywell. It also required substantial training of local engineers.

The success of this project in 1980 led to the next step in the cooperation between the Ministry and Honeywell; the establishment of a common technical office to serve as a demonstration center, technical library, and training center for Bulgarian engineers.

The experience of Honeywell and the Ministry of Chemical Industry over the period 1979 to 1983, with legal support from the government, led to the idea of a joint-stock venture in Bulgaria. In September 1983, an agreement was signed creating a joint-venture company under the name SYSTEMATICS. The partners listed in the agreement are:

- Honeywell Inc., with headquarters in Minneapolis, USA, is an international company, the world leader in automation control systems and products. They participate in the joint venture through their affiliate Honeywell International Management in Milan,[3] operating in Southern Europe, the Middle East, the Mediterranean, and Africa.
- The Bulgarian Chemical Industry participates in the joint venture through the following three companies:
  - SYSTEMCHIM – a leading engineering company for data systems and computer applications for industrial control and management.
  - CHIMIMPORT – the largest Bulgarian foreign trade company operating in the chemical industry.
  - CHIMCOMPLECT – the major engineering and contract company in the Bulgarian Chemical Industry (joined the venture in 1985).

The statutory capital of the joint venture was US$264,000 to be contributed in cash and in kind, and the share contribution: Honeywell Inc. – 40 percent, SYSTEMCHIM – 40 percent, CHIMIMPORT – 10 percent, and CHIMCOMPLECT – 10 percent.

The joint venture was registered in March 1984, and this is the official date on which it started operation. The operation profile of the joint venture is to provide engineering and marketing services for

[3]In March 1990 Honeywell changed its partnership in the JV to its affiliate in Vienna – Honeywell Austria GmbH.

Honeywell automation and control systems and products used by industry in Bulgaria and other countries, and a multitude of other engineering hardware and software services to its wide range of customers. In practice, it was planned to become the backbone of automation for the chemical industry and a few other branches of industry in Bulgaria. To attain this objective, the joint venture relied on:

- The use of Honeywell high-tech equipment.
- The excellent practical knowledge and experience of its engineers in the field of microprocessor and computer-based systems applications.
- The fine technical and financial backing of the joint venture partners.

K.2 Capital structure

The initial capital of the joint venture, US$264,000, was split into 100 shares distributed among the parties. In 1985, when CHIMCOMPLECT was included in the joint venture, the shares were distributed to include 10 shares for the new partner. No further changes have since been made.

Honeywell contributed its share to the capital in kind, which meant submitting a certain amount of control and automation equipment; SYSTEMCHIM contributed its share in local currency (leva); and the two other partners, CHIMIMPORT and CHIMCOMPLECT, contributed their share in US dollars, which meant a contribution of US$26,400 each.

As the amount of the initial capital share was relatively small, the joint-venture agreement gave the partners the possibility of making temporary additional investments in support of the joint venture operations to be used for a certain period of time by the joint venture without any liability or interest. The transfer of shares also was made possible, but only in a limited number of cases such as reorganization, incorporation, or restructuring of the parties; in this case, the newly formed party would take over or transfer its shares to a third party succeeding its rights or interests.

K.3 Operational activities: management, administration, and personnel

A specific feature in the operation of the Board of Directors from the very beginning was that it would adopt decisions only by consensus. This created a special atmosphere, which meant that unanimity was the basis for the management, control, and direction of the joint venture operation.

At the start of its operations in 1984, the joint venture had only two employees as full-time staff, one director and one marketing expert. Slowly additional staff were appointed, so that today the number of employees totals 25. An additional 25 people work for SYSTEMATICS on a contract basis. These are mostly engineers from SYSTEMCHIM, a partner company. The full-time staff of SYSTEMATICS is split into two groups: the sales engineers group consisting of 10 people, and the other is the administration support group consisting of 15 people.

As time passed, an evolution took place in the national economy. The strongly centralized system of control began to relax. The end-user and foreign trade organizations started to be more and more involved in the decision-making process. At a certain moment in 1986, the ministries were replaced by associations. In practice, this meant that the production units of a certain sector were no longer obedient producers, executing centrally planned quotas of given products. They started to become equal partners with independent discretion for decision making. In the process of decentralization which started in Bulgaria, the previous policy of unification and dealing with one manufacturer and supplier shifted more and more towards a new policy of plurality; at the same time, more and more automation and control companies appeared on the market and competed with each other.

Actions also were taken by some local organizations to copy the SYSTEMATICS model and try to start up joint ventures with competing companies. This also influenced the end-user who, for the first time, was able to choose among bidders, manufacturers, and suppliers. This possibility was further strengthened in 1989, with the adoption of new legislation, specifically Decree No. 56 on economic activity and the relevant regulations for its application. The establishment of a new economic system of "firms" is certainly contributing to economic decentralization. This situation radically changed the market for industrial control systems and automation equipment by making it more fragmented and decentralized. Now decision power is split between the individual end-users, with almost no power left in the hands of the coordinating associations, consulting engineering organizations, or foreign trade organizations, to influence or direct their preferences and choices – starting from individual pieces of field equipment and ending with large distributed industrial control systems.

Another new phenomenon also took place. The state government fostered a new policy directed towards establishing joint ventures with a manufacturing profile. In this situation, SYSTEMATICS felt a strong pressure from its Bulgarian partners, mainly the association SYSTEMBIOCHIM, to organize joint manufacturing of control systems in Bulgaria. This was foreseen eventually to begin with the assembly and staging of such equipment and later slowly to go into the manufacture of separate components and subassemblies. Simultaneously, the idea for SYSTEMATICS to become a partner with other Bulgarian engineering organizations like SYSTEMBIOCHIM and CHIMCOMPLECT was promoted and entered international contracting.

SYSTEMATICS had to take some action in this new situation, and so a memorandum was signed between the Association of Biotechnology and Chemical Industry and Honeywell late in 1986, outlining the commitments of the two parties for the study and eventual implementation of projects for the manufacture of Honeywell products in Bulgaria and joint operations in international contracting. Now SYSTEMATICS has to face and adapt to a new market situation in Bulgaria.

Meanwhile, a steady evolution has taken place in SYSTEMATICS as well. Since 1986, its operations have expanded from a purely industrial field to three other areas:

- Building automation control systems.
- Information systems.
- Sales of spare parts, field instruments, components, and OEM products.

For many years, well-established manufacturing and trading companies have been operating in these markets, where SYSTEMATICS was relatively a newcomer. Its sole strategy was to make a breakthrough, and it looked for opportunities to do so. The close contacts established with various industries and their design and project organizations and the profound study of this market produced good results. Presently, SYSTEMATICS is operating successfully in all four of these markets.

K.4 Impressions

SYSTEMATICS has filled a very important niche in the national economy, that of a versatile engineering organization in the field of automation and control, combining a high level of engineering know-how with a capability for flexible operation. Thus it is able to offer a package solution to demands and fulfill its commitments effectively, on time, and with high quality. For good reasons, the logo of SYSTEMATICS is "Exceptional reliability and flexibility."

The national economy has benefited substantially from SYSTEMATICS' activities. Direct benefits include 25 highly sophisticated industrial control systems operating in Bulgaria's largest chemical, pharmaceutical, pulp and paper, and petrochemical plants. Many prestigious buildings in Bulgaria are equipped with Honeywell building automation systems. SYSTEMATICS has over 100 users of its information systems and software. Many also use Honeywell components, among them the major machine tool and electronics manufacturers.

In 1989 alone, SYSTEMATICS had 200 large and small projects in operation at various sites in Bulgaria and abroad. During the last five years, it has trained almost 250 engineers from Bulgaria and other countries in the use and application of Honeywell equipment and supplied the latest information to all of its customers. To date, SYSTEMATICS has sold over US$10 million of Honeywell equipment.

K.5 Future development and growth

The management of SYSTEMATICS considers that the first five years since its establishment comprise the first stage of its existence and operation. The joint venture took and continued to maintain a lead over its competitors. SYSTEMATICS has lost very few jobs to its competitors.

The future strategy of SYSTEMATICS is expected to be:

- To consolidate and strengthen its position in Bulgaria.
- To expand from engineering into manufacturing and assembly of Honeywell products in Bulgaria.
- To develop further its trading and credit capabilities.
- To expand its international operations and become a Honeywell engineering center in its region.
- To maintain continuous steady growth of its revenues and profit.
- To be ahead of its competitors.
- To diversify its operations at home and abroad.

In applying the above mentioned strategy, SYSTEMATICS would like to take advantage of promising trends in Bulgaria and abroad. Having developed a high competence and good experience in its field, it expects to make the best use of the growing markets in which it operates. It intends to extend its ties further with the USSR, which might lead to closer forms of cooperation. For the future, it would like to make better use of its geographic location and continue to work in the spirit of entrepreneurship and new leadership. Its practical goals are to increase its turnover at least three times and its profit five times over the next five years.

Overall, SYSTEMATICS is considered to be the most successful joint venture in Bulgaria. It has served as a model for other joint ventures in Bulgaria and also in other CMEA countries.

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Jacket design by Colin Robson
Printed in Great Britain

ISBN 0-631-18054-0

9 780631 180548

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