

# A CLASSIFICATION OF INTERNATIONAL BUSINESS STRATEGIES IN THE CZECH REPUBLIC: A LONGITUDINAL ANALYSIS OF SELECTED FIRMS

James D. GOODNOW,\* Pavel VOPAŘIL\*\*

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## Abstract:

This study is focused on relationship between external and internal impact on decision-making influencing international business strategies in transitional economy. Drawing from secondary and primary interview data on international business activities of 18 startups and 20 enterprises operating in the Czech Republic (including firms controlled by both domestic and foreign investors), respectively, the authors propose five strategies. In general, the findings suggest that strategies developed by domestically owned niche-focused or recent startups and those carefully guided by inbound foreign direct investors are more successful. Moreover, the more successful (*i.e.*, those experiencing significant domestic and international sales growth) are those who develop unique marketing strategies. Uncontrollable externalities do not appear to have an impact on firms' success or failure. The regionally oriented exporting tends to be the dominant strategy. Globally oriented export activities are relatively modest whereas outbound direct investment strategies are very minor compared with inbound foreign direct investment activities.

**Keywords:** international bussiness strategies, transitional economy, foreign direct investors

**JEL Classification:** G31, L1, P2, P31

## 1. Introduction

Enterprises based in Central and Eastern European nations have been undergoing a complex transformation process for nearly one and one half decades. On the surface, the key change has focused on changing the locus of their decisions from state agencies to private decision making groups. But on closer examination, one finds a host of economic, political and cultural influences that when taken col-

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\*) Bradley University, 1501 West Bradley Avenue, Peoria, IL 61625, USA (e-mail: goodnow@bradley.edu).

\*\*) Sanford Corporation, 2707 Butterfield Road, Lombard, IL 60523, USA (e-mail: pavel.voparil@sanfordcorp.com).

lectively provide an enhanced understanding of reasons why enterprises have developed alternative international business strategies during this transition. Much has been written about the transformation process in both the popular press as well as in academic circles. However, those who have observed and written about the process tend to focus on the macro picture rather than on adaptations in strategies (and associated internal and external forces) at the level of the enterprise or the industry (see Barrell, Holland, 2000; Casson, 1994; Djankov, Hoekman, 2000; Gupta, Ham, Švejnár, 2001; Harper, 2001; Kosova, 2003; Myant, 2003 and Pomery, 1998.) A few researchers have examined the recent performance of specific firms in the Czech Republic (e.g. Estrin, Richet, Brada, 2000; Fogel, 1994; Nellis, 2000; Newman, 1997; Newman, Nollen, 1997, 1998a) and other Central European countries (e.g. Marinova, Marinov, Yaprak, 2000.)

The purpose of this study is to examine the ways how a variety of external and internal influences have impacted international business strategies of selected enterprises in the Czech Republic since the Velvet Revolution of 1989. Because the study focuses largely only on nineteen Czech manufacturing and service companies (in addition to nineteen startup companies) and not on a large representative sample of enterprises, its results are not statistically significant. With the exception of the startups, the firms in the study were all state owned prior to 1989. Since that time, all except two have been privatized. Some are owned by Czechs alone while others are partly or wholly owned by inbound foreign direct investors. The purpose of the study is to provide a classification that could be incorporated into hypotheses which could be tested more systematically by other researchers using larger statistically significant databases.

One of the authors made informal observations on the transitional activities of Czech firms when he visited selected companies during short visits to the Czech Republic (as a participant in professional development programmes in 1992 and 1994). He started his formal data collection in 1995 while serving as a visiting professor at the University of Economics (VŠE) in Prague. At that time, Czech colleagues suggested that managers of recently privatized enterprises might not be willing to respond to mail or telephone surveys concerning their international business strategies. Hence, the author decided to gather data from a relatively small convenience sample of enterprises selected largely on the basis of family or friendship connections of his Czech students. In 2003, while again serving as a visiting professor at VŠE, the author with the assistance of another set of Czech and international students resurveyed the same set of enterprises along with some additional ones. In sum, these results should be viewed as a set of longitudinal case studies that included an assessment of external and internal environmental influences in order to discover their association with various observed strategic and tactical behaviour patterns. In order to add generalizations to their propositions, the authors also used secondary data source statistics on overall trends in the Czech Republic's international trade and investment stocks and flows (e.g. CzechInvest 2003; Czech Statistical Office 2003; UNCTAD, 2002a, b). The second author gathered complementary data on eighteen Czech based startup companies. These companies were chosen by the Czech newspaper MF DNES as representatives of successful Czech startup companies. Relevant information about this sample of companies was published on the electronic portal of MF DNES – [www.idnes.cz](http://www.idnes.cz). The second author added two startup companies that supplement the MF DNES sample. In addition, the second author gathered data from the companies' websites. In this article, the authors suggest that these observed patterns could be organized as a five-category taxonomy that might serve as a useful instrument for more rigorous statistical testing and analysis by later researchers.

### *Success Indicators*

In a free enterprise economy, profitability of incremental business activity serves as the ultimate measure of success in a firm's strategy. However, comparative profitability data stemming from incremental international business activity were not available from most of the firms in the authors' sample. Therefore, as proxies for successful in international trade strategies, the authors examined (1) the growth in overall sales volume over the past decade, (2) export sales as a per cent of total sales, and (3) export sales to global (*i.e.* non European) markets as a per cent of total export sales. With respect to successful direct investment inbound or outbound strategies, they looked at (4) the nature and longevity of relationships with current and potential inbound foreign direct investors and (5) the level and nature of outbound foreign direct investment activity.

Items 2 through 5 in the list are obvious indicators of positive or negative changes in international business activity. However, the authors have used change in overall sales volume (*i.e.* organizational growth to which international activity contributes) as the primary success indicator in success *versus* failure subcategories noted in the discussion of two of the main categories of the taxonomy.

### *Externalities Impacting Successful Strategies*

The international business literature including research focused on Central and Eastern Europe has suggested several forces beyond the control of individual enterprises that have impacted the environment facing managers making strategic choices in transitional economies (see Bevan, Estrin, 2000; Buckley, Guari, 1999; Dunning, 1980; Johanson, and Vahlne, 1997 and Nollen, 2003). These include (1) market opportunity, (2) regional and global industry concentration ratios, (3) *optimum* output scale required in various industries, (4) the evolution of national government policy and regulation, and (5) relative production costs including relative productivity. The applicability and relevance of each of these indicators varies among the strategy taxonomy categories discussed below.

### *Internal Influences on Successful Strategies*

Previous researchers (those cited in the preceding paragraph as well as Soulsby, Clark 1996) have also suggested a variety of forces over which firms might have direct control and that could influence the nature of strategic choices. These include (1) international market connections, (2) industry specific factor supply advantages, (3) financial and technical strength, (4) cost controls including restructuring, (5) the impact of culture on productivity (e.g. a strong work ethic as well as lingering corruption) and (6) learning about creating competitive positioning strategies (for interesting insights relative to the impact of Czech culture on productivity, see Nollen, 2001). The implementation of quality control standards could be added as a seventh item. The majority of the firms in the sample have implemented ISO 9000 and/or 14000 standards during the past decade. Hence, that measure does not appear to be a measure that helps to explain the differences between the successful and less successful strategies. The six remaining influences vary in importance and applicability among the taxonomy categories.

## *Czech International Business Strategy Taxonomy*

As shown in Table 1, the authors suggest that firms in their selected sample (as well as other examples discussed in secondary sources) could be classified according to the following five-category taxonomy. The top of the table shows the company names as well as the strategy category and subcategory (positive *versus* negative growth, success *versus* failure.) The rows show the trend with respect to each of the success as well as external and influence factors listed previously. (In order to protect confidentiality, the actual company names have been disguised by using Greek letter names.)

### **2. Czech-Owned Regional Exporters**

Given the relatively small size of the domestic market, most Czech firms export a portion of their outputs in order to survive. With the end to the guaranteed Comecon markets in Eastern and Central Europe came a shift in the Czech Republic's overall exports towards the larger nations of Western Europe. According to government statistics (Czech Statistical Office, 2003), approximately 95 per cent of Czech exports today are sent to markets in Europe – especially the larger markets like Germany, the United Kingdom, France and Italy as well as neighbouring countries like Slovakia, Austria, and Poland. On the import side, the Czech Republic receives 85 per cent of its inbound goods from European sources. Most of the remaining imports come from the USA as well as the Far East. Therefore, it is not surprising that a subset of firms whose strategies are examined in the study *focus* their international efforts almost entirely on Europe.

#### *A. Successful Czech-Owned Regional Exporters with Growing Sales*

Three of the companies in the sample whose exports are almost entirely aimed at European markets have experienced significant growth in its overall sales volume. Company Alpha is a large producer of ready-to-wear clothing. Czech investors privately own it. During the past decade, its sales have nearly doubled while its work force has declined modestly. It exports most of its output to other European countries. While it faces price pressures in the market from low cost Asian producers, it has learned to adapt its management and marketing styles. The company uses team-based management principles and has changed its brand names including the overall corporate name to include French and English words so as to appeal to international customers. The firm also does contract manufacturing for internationally known name-brand apparel companies. Company Beta, a manufacturer of industrial tools, has had a modest level of sales growth over the past decade along with a significant decline in its work force due to competitive restructuring. Its exports, destined largely to European markets, have increased from less than 10 to over 40 per cent of its sales volume. It has opened sales branches in Poland and Italy. Yet sales to global markets are quite small. Nevertheless, it has opened relationships with dealers in South Africa, Taiwan and Turkey. The company was recently bought by a German-Japanese joint venture.

Company Gamma is a very unique case. It is a micro brewery whose brand name has been based on the location of its production facility. The formulation of its brew is considerably different from that of the beer of the same name bottled by a foreign company. Since the Velvet Revolution, company Gamma and its foreign competitor have engaged in many trademark disputes in courts throughout Europe and el-

TABLE 1.A CHARACTERISTICS ASSOCIATED WITH CZECH FIRMS' INTERNATIONAL STRATEGIES

TAXONOMY CATEGORIES	Czech-owned Regional Exporters										Czech-owned Global Exporters										
	WITH GROWING SALES					WITH DECLINING SALES					Theta	Iota	Kappa	Lambda							
	Alpha	Beta	Gamma	Delta	Epsilon	Zeta	Eta														
<b>Success Indicators</b>																					
Sales growth	+	+	+	-	-	+	+	+	+	+	+	+	+	+	+	+	+	+	+	+	+
Export sales / total sales (in %)	+	+	+/-	+	+	+/-	+	+	+	+	+	+	+	+	+	+	+	+	+	+	+
Global export sales / total sales (in %)	-	+/-	+	+/-	-	+	+	+	+	+	+	+	+	+	+	+	+	+	+	+	+
Relationships with current and potential IFDI*	+	+	+/-	+	-	+	+	+	+	+	+	+	+	+	+	+	+	+	+	+	+
Outbound foreign direct investment activity	+/-	+	+	-	-	+	+	+	+	+	+	+	+	+	+	+	+	+	+	+	+
<b>Externalities Impacting Successful Strategies</b>																					
Regional and global industry concentration ratios	↓	↓	↑	↓	↑	↑	↓	↓	↑	↑	↓	↓	↓	↓	↓	↓	↓	↓	↓	↓	↓
Optimum output scale required	↔	↓	↑	↓	↑	↑	↓	↓	↑	↑	↔	↓	↓	↓	↓	↓	↓	↓	↓	↓	↓
Evolution of national government policy and regulation	+/-	+/-	+	-	+	+	-	+	+	+	-	+	+	+	+	+	+	+	+	+	+
Relative production costs and relative productivity	+	+	+	+/-	-	+	+/-	+	+	+	+/-	+	+	+	+	+	+	+	+	+	+
<b>Internal Influences on Successful Strategies</b>																					
International market connections	+	+	+	-	-	+	-	-	-	+	+/-	+	+	+	+	+	+	+	+	+	+
Industry specific factor supply advantages	-	-	+	-	-	+	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Financial and technical strength	-	+	+	-	-	+	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Cost controls including restructuring	+/-	+	+	-	-	+	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Impact of culture on productivity	+	+	+	-	-	+	-	-	+/-	+	-	+	+	+	+	+	+	+	+	+	+
Creation of competitive positioning strategies	+	+	+	-	-	+	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

Legend:

"↑" positive impact

"↓" negative impact

"↔" ambiguous impact

"ds." domestic strategy, i.e. not export-oriented

"↓" low concentration or low optimum output scale

"↑" high concentration or high optimum output scale

"↔" Inbound Foreign Direct Investors

sewhere. In order to support these disputes impacting company Gamma and its recipe (both of which are considered national treasures), the Czech government has continued own the brewery. German speaking countries have traditions that beers have brand names that represent their local breweries. Hence, there was little problem in establishing company C's brand name as the only true one in Germany and Austria. Courts elsewhere in Europe have not been uniformly generous to company Gamma. Some (e.g. Italy) have ruled in favour of the foreign competitor while others (e.g. Lithuania and Spain) have favoured company Gamma. It sells about 40 per cent of its output elsewhere in Europe and is just beginning to introduce its brew in the USA and Canada under a slightly different trade name. Company Gamma has distribution subsidiaries in Croatia, Germany and the United Kingdom.

### *B. Czech-Owned Regional Exporters with Declining Sales*

Four companies in the case study sample (aircraft parts manufacturer company Delta, two chemical manufacturers companies Epsilon and Zeta plus apparel producer company Eta) fall in this category. Each of them has had a decline of overall sales ranging from 11 to 23 per cent over the past decade. Meanwhile, each of their work forces has been downsized roughly between one-third and two-thirds. Yet these companies have been aggressively exporting between 40 and 70 per cent of their output to European countries. Yet, none of them has exported more than a token amount outside Europe. Company Epsilon is part of a state – owned petrol group. The Czech government aims to privatize the petrol group in the near future. Its likely buyer is a Polish enterprise. A unit of the state property fund owns company Zeta's assets. Czechs privately own the other two companies. Despite the relatively low labour cost in the Czech Republic, each of these companies has been impacted by global price competition. Despite modest attempts to differentiate some items in their product mixes, each of them is considered to be a commodity producer. Company Delta faced diminished demand for the parts it makes because of declines in production of a Czech-made aircraft manufacturer as well as special machinery company discussed later. Nevertheless, it was able to shore up its revenues modestly by establishing relationships with a U.S. based multinational as well as other industrial goods manufacturers. Its overall export volume exceeds forty per cent of its gross sales including a small fraction sent to markets outside Europe. The company's situation may change in the near future given its recent product mix diversification to include other kinds of small parts. It may also benefit from the recent acquisition of the special machinery company by a Slovak firm (discussed below.)

Companies Epsilon and Zeta face competition from large multinational chemical producers based in Germany, Switzerland and the USA plus a large Czech-based petrochemical group. Their budgets for research and development are small compared with German, Swiss and U.S. based multinational chemical giants. Their output levels may not be sufficient to achieve the lowest possible costs. Chemical production requires large output levels to achieve economies of scale. Moreover, transportation costs are high. Therefore, shipping chemicals to countries outside Europe is noteconomic. Nevertheless, company Zeta has strategic alliances in Norway and Sweden as well as licensees in Taiwan and Thailand. Company Epsilon is a commodity generalist and lacks niche focuses. Meanwhile, company Zeta's product mix includes niches in synthetic sapphires and specialized epoxies. Company Eta, a traditional producer of both ready to wear clothing as well as professional and military uniforms has not yet developed globally oriented brand names or styles. It faces growing pressure for higher wages in the domestic market along with price

competition from producers in Eastern Europe and Far East. Nevertheless, it sells about four per cent of its output to purchasers on American continent.

### *C. Czech-Owned Globally – Oriented Niche Exporters*

Although most Czech-owned firms in the sample focused their outbound sales almost entirely on European markets, four companies provide products and services for which significant demand exists both within and outside Europe. Czech decorative glassware is globally respected along with other brands such as Waterford, Baccarat, and Orrefors. Company Theta's glassware is frequently used as gifts for visiting dignitaries and royalty. Likewise, company Iota positions its glassware output quality well above average on a global basis. While these two specialized companies have had slight sales declines in the past decade, their export volumes constitute more than half of their total outputs. Moreover, more than a third of their exports are sent to markets outside Europe – especially to the United States and Japan. For example, more than a third of company Theta's sales in the USA go to two prestigious retailers. Company Theta is now considering expansion to China, Taiwan, Australia, Russia and selected Caribbean countries. In order to expedite its export activity, company Theta has recently established a strategic marketing alliance with prestigious porcelain manufacturers from Germany and Hungary. Unlike company Theta, company Iota does not have a strong global brand name. Nevertheless, it employs very capable artisans and produces a wide assortment of products that are sold to tourists from all over the world in the Czech Republic. Given this dependence on the tourist trade, company Iota suffered from the downturn in that trade after September 11 coupled with the global economic downturn and the Czech floods of 2002. (For interesting insights into the early evolution of the Czech decorative glass industry in the immediate post Velvet Revolution era, see Foulds, 1993).

Artists and engineers throughout the world use mechanical pencils produced by company Kappa. Over the past decade, its sales have tripled. Eighty per cent of its products go to international markets. The company has sales subsidiaries in Poland and Slovakia as well as links with agents and/or distributors globally. It is currently considering outsourcing production to the Far East. Company Lambda is in a specialized service business operating in Prague. Its annual revenues have nearly doubled in the past decade. It does about half of its business with foreign based users and associates. About a fourth of its business over the past decade has been with production companies based in the USA. (More recently, that ratio has been closer to one-half.) Its competitive advantages include the availability of a complete production facility including buildings, equipment (and related servicing), support staff, supplies and inexpensive construction labour as well as specialized amenities of the greater Prague region. Company Lambda offers an especially attractive package cost wise for partners and associates who require extensive temporary construction to be completed as part of company Lambda's overall service package. Czechs privately own all four of these companies. A specialized Czech-owned conglomerate in the decorative glass and porcelain business now owns most of company Iota. A Czech-based steel company owns most of the capital stock in company Lambda.



### 3. Inbound Investors

#### A. Successful Domestic (and Regional) Market Opportunists

Shortly after the Velvet Revolution, managers of several North American and European-based multinational companies perceived opportunities to fill pent up demand (in then Czechoslovakia) for current consumer products as well as business services. This was especially important with respect to food and other essentials. Hence, companies like McDonalds, Coca-Cola, Procter & Gamble, and KFC entered the market with local subsidiaries largely oriented towards serving the domestic market (which became the Czech and Slovak Republics in 1993.) Nestle formed a joint venture with Danone from France and the former Čokoládovny, a state-owned confectionery monopoly. Likewise, international companies in legal, accounting and consulting professions saw immediate opportunities to assist in the upgrading of business services. A few firms in the industrial sector (e.g. Johnson Controls, ABB, and Siemens) realized that the parts they supplied might complement existing Czech capabilities in engineering related enterprises. In general, these firms were able to invest without major concerns about the number of domestic competitors or about requirements for large output levels to achieve economies of scale. Moreover, they were able to profit from relatively low labour costs without worrying about competition from producers in other countries.

An interesting case example is a major multinational tobacco company Mu that set up a joint venture in the early 1990s with a former state-owned tobacco monopoly. Over time, the multinational bought more shares in the enterprise so that today the company is now a wholly owned subsidiary. It has dropped its previous company name and replaced it with the globally known multinational's name. While the company downsized its employment by about a fourth, sales of the Czech operation have increased more than 250 per cent over the decade. Yet its market focus has remained solely the Czech and Slovak Republics rather than other nations in Europe. Reasons for its success include the multinational's ability to draw on its global supply sources, logistics technologies as well as its abundant financial base while adding its most success global brand to an assortment that retains other brand names that existed during the state-owned period. Moreover, the Czech government did not impose health-warning requirements on cigarette packages until recently.

#### B. Failed First Wave Inbound Investors

A few of the multinationals that had attempted to establish strategic alliances with or acquisitions of Czech enterprises decided to back out of their relationships. Included in this subset there are a British-based brewery that bought brewery company Nu, a U.S. based multinational that had a strategic alliance with special machinery company Omicron, a group of former American executives who attempted to manage truck producer company Pi, and a U.S. retail giant that acquired a department store in downtown Prague. Reasons for these failures vary among these companies. The British brewery as well as the American manager/investors in company Pi likely failed in part because they gave limited managerial attention to the day-to-day operations of the companies they owned. The U.S. retail giant's failure was probably related in part to that company's global competitive problems especially as it faced the enormous growth of even larger retail giants. It sold its store in Prague to a British-based company in the late 1990s.

The U.S. based multinational initially developed its strategic alliance with company Omicron with the goal of the latter acting as a low-cost contract manufacturer



TABLE 1B CHARACTERISTICS ASSOCIATED WITH CZECH FIRMS' INTERNATIONAL STRATEGIES

TAXONOMY CATEGORIES	Inbound Investors		Inbound Investors in Historically Czech-Owned Firms: Twenty First Century Repositioners				Startup Companies
	SUCCESS	FAILURE	Rho	Sigma	CLOSE TO BANKRUPTCY		
SUBCATEGORY	Mu	Omicron	Nu	Upsilon	Tau	Pi	Phi
<b>Success Indicators</b>							
Sales growth	+	-	+	-	-	+/-	+
Export sales / total sales (in %)	ds.	+	+	+	+	+	+
Global export sales / total sales (in %)	ds.	-	+/-	+	+	+/-	+
Relationships with current and potential IFDI*	+	-	+	+	+	-	+
Outbound foreign direct investment activity	ds.	-	+	+	-	+/-	+
<b>Externalities Impacting Successful Strategies</b>							
Regional and global industry concentration ratios	↑	↑	↑	↓	↓	↑	↑
Optimum output scale required	↑	↑	↑	↓	↓	↑	↑
Evolution of national government policy and regulation	+	-	+	-	+/-	-	+
Relative production costs and relative productivity	+	+/-	+	+	+/-	+/-	+/-
<b>Internal Influences on Successful Strategies</b>							
International market connections	+	+/-	+	+/-	+/-	+/-	+
Industry specific factor supply advantages	-	+	+	+	-	+	-
Financial and technical strength	+	-	+	+/-	+	+/-	+
Cost controls including restructuring	+	-	+	+	-	-	+/-
Impact of culture on productivity	+	-	+/-	+	+/-	-	+
Creation of competitive positioning strategies	+	-	+	+	+/-	-	+

Legend:

"+" positive impact

"- " negative impact

"+/-" ambiguous impact

"ds." domestic strategy, i.e. not export-oriented

"↓" low concentration or low optimum output scale

"↑" high concentration or high optimum output scale

"\*\*\*" Inbound Foreign Direct Investors

of small specialized machines carrying the multinational's colours and brand name that could be sold to customers in Latin America. The multinational's management team that represented its U.S. partner was able to influence changes in company Omicron's top management personnel. However, the internal company Omicron culture was slow to change from ways that it had acquired under communism. Productivity and related restructuring did not advance as rapidly as top management at the multinational's U.S. headquarters had wished. Probably the major reason underlying the collapse of the multinational's strategic alliance with company Omicron was that the latter's employees were worried that the multinational might move its production elsewhere. Hence, the multinational's management team was recalled to the USA. For the next few years, company Omicron sought a major investment partner. A possibility was a former state trading monopoly whose product mix included special machinery. While that trading company assisted in selling company Omicron products, it was not able to come up with a sufficient long-term financing package during a period in the late 1990s when it held more than half of company Omicron's outstanding capital stock shares.

Each of these Czech companies now has a new investor. These new investors and their experiments with repositioning strategies are discussed below.

### *C. Second Wave Inbound Investors – Responders to Incentives*

In the late 1990s, the Czech government approved a variety of measures (including tax incentives as well as a new set of bankruptcy laws). The Czech economy demonstrated a relatively high level of economic stability (low to moderate inflation, low unemployment and a positive rate of economic growth) during the mid 1990s. The country has a well-educated labour force as well as a well-developed infrastructure. Moreover, the European Union (as well as the Czech electorate) approved accession to the EU in May 2004. In addition, the outlook for labour relations looks positive. Not only did Czech wage rates continue to be below Western European norms, the Czech government approved a labour relations system that could lead to better overall economic results than has been the case in Germany where a similar system of codetermination exists. Both nations have laws that require *medium* and large size firms to have both management and supervisory boards. However, unlike Germany that requires half the votes on the supervisory board to come from organized labour, Czech law requires only a third to come from labour's representatives. Hence, the owners of Czech firms could have greater flexibility in implementing strategies compared with their German counterparts. (For an elaboration of the Czech codetermination regulations and their evolution, see Schutte, 2000).

Concurrent with the implementation or announcement of these measures, there was a significant increase in the inbound investment activities of multinational firms in the Czech Republic in the late 1990s. (The information that follows in this paragraph comes from CzechInvest, 2003). Annual foreign direct investment inflows nearly doubled in 1998 over the average inflows for the preceding five years. Those inflows peaked in 1999 but continued at high levels through 2002. These include consumer goods companies (e.g. Gillette and Matsushita) as well as industrial parts manufacturers (e.g. Flextronics and Honeywell). Boeing developed a relationship to prop up an ailing Czech based enterprise. Other companies (e.g. Robert Bosch, Continental Tires and glass producer Saint Gobain) invested in the market as they saw opportunities to provide their inputs to the expanding automotive industry. (In fact, more than half of the current *FDI* stock in the Czech Republic is related to the automobile industry.) The companies listed in this category undoubtedly also saw the benefit of entering the Czech Republic as a relatively low cost production base

for exporting to the European Union. The study's small sample of case studies does not include an example of any of these companies.

#### 4. Inbound Investors In Historically Czech-Owned Firms: Twenty First Century Repositioners

This strategy category in the taxonomy includes seven historically Czech-owned companies that inbound international direct investors have acquired very recently. All of these enterprises are developing new regional and/or global positioning strategies. With two exceptions, all of these enterprises were close to bankruptcy prior to being acquired.

The first exception is a former state-owned automobile production (company Rho) firm that became a joint venture with a German firm in the early 1990s and that firm's wholly owned subsidiary in the late 1990s. It is now the country's largest and most respected enterprise. While its work force has practically doubled in the past decade, its sales have grown more than four-fold. Although company Rho has more than half of the domestic market, more than 80 per cent of its output is exported (up from about half of its output about seven years ago). In fact, company Rho and its suppliers now account for about 10 per cent of the country's overall export activity. Although currently less than five per cent of its exports go to countries outside Europe, this percentage is increasing.

The German direct investor has repositioned company Rho's brand name (by means of significant quality and design improvements) so that it no longer carries the low quality image it had a decade ago. The new parent company has also added very significant assistance with financing, technology and distribution know-how. Yet, the company Rho division of the German firm is going to face growing national and regional competition in the near future. The German firm itself has another assembly operation in Slovakia where significant enlargement plans have been announced. A joint venture of a Japanese and French companies is building a new production and assembly plant in the Czech Republic that will be turning out vehicles competitive with the low end of the company Rho product mix within the next two or three years. A French company is planning to open another assembly operation in Slovakia that should be in operation by 2007. Likewise, another French company is building a new plant in Romania with the goal of selling its low cost model throughout central Europe. Within the coming decade, a Korean firm plans to open a plant in Slovakia. Although these new plants will produce cars for the Central European markets, they will also manufacture vehicles for export to other nations in Europe as well as to global market destinations.

The second exception is company Sigma, a large beer brewery that is now owned by a multinational based in South Africa. Company Sigma retains a significant majority of the important internal market in the country – especially with its lower priced brand. (Czechs consume more beer *per capita* than any other nation on earth). It has traditionally considered its corporate branded beer to be a *premium* brew in both domestic and international markets. The new South African parent has decided to position it as a global flagship brand to compete against well respected Dutch, American, Belgian, and Danish brands. To that end, it has set aside funds for international advertising. (Note that its major global competitor spends nearly 25 times as much on domestic and international advertising compared with the allocation for the new company Sigma campaign). The campaign has started in selected cities in the USA. Company Sigma exports currently account for about 20 per cent of the brewery's overall sales volume. It is also brewed in a Polish plant. The parent firm is

considering licensing the company Sigma formulation and brand name in other European and global markets.

Company Nu (that came close to bankruptcy while it was owned by a United Kingdom based brewery) became an acquisition of a Belgian based multinational in the late 1990s. Since that time, its sales have nearly doubled thanks largely to a domestic advertising and promotion campaign. Unlike the South African parent's vision for company Sigma, the Belgian executives envision that company Nu will continue to capture bigger share of the domestic market from company Sigma's best selling domestic brand. Nevertheless, the company Nu brand will probably continue to be exported as a niche *premium* brand to European and global markets. While its top markets are Germany, Slovakia and the United Kingdom, company Nu has recently decided to expand its distribution of its corporate name brand beer to the American continent and other countries. Company Nu also produces a few niche beers sold mostly in the domestic market. Company Tau, a manufacturer of capital equipment for the cement industry, came close to bankruptcy in 1999 and remained in that situation until 2003. A German manufacturer of complementary equipment became a strategic partner and has agreed to acquire company Tau's assets. As a result, the combined German-Czech alliance will be able to supply a complete range of machinery and equipment used in cement production. Previous to the agreement, company Tau's sales had declined by nearly half in less than a decade while its work force downsized by about 80 per cent. Nevertheless, its exports accounted for about 80 per cent of its business. About one fifth of those export sales were sent to markets outside Europe (e.g. to emerging market countries like Brazil and Iran).

During the years of socialism, company Pi had been an important supplier of automobiles and trucks to eastern bloc countries. However, when global markets opened in the early 1990s, the company faced major competition in both the domestic and international markets from well-known German and Swedish companies. Although a group of American businessmen attempted to take over the company in the mid 1990s and to manage it largely *in absentia*, the fortunes of the enterprise dwindled. Sales (mostly aimed at export markets) and employment have dropped substantially while expenses remained high. Therefore, the company attempted to operate in the red. It withdrew from the production of automobiles in 1997 and decided to focus mostly on off-highway trucks. Financial salvation for the company came in 2003 when an American-based corporation purchased most of its outstanding capital stock shares. The new owner has replaced the old management board with new members. To date, the only hints about new strategy for the company are that the American corporations is considering company Pi as part of the former's military programme. Moreover, the American company intends to utilize the company Pi distribution chain to push its own big vehicles.

After a three-year experiment, company Omicron ended its strategic alliance relationship with the American multinational. Although a Czech-based former foreign trade organization partner owned the majority of shares in company Omicron between 1997 and 2000, the company came close to bankruptcy while it and the Czech government searched for a permanent partner. In less than a decade, it lost nearly half of its sales volume and released a large majority of its work force. Its domestic market share of new tractor sales fell below ten per cent. Therefore, most of its sales were aimed at export markets (including Croatia, Ireland, Poland and the United Kingdom as well as the USA.) While the overall quality of its competitively priced tractors improved, the company does not provide auxiliary equipment needed by customers who purchase company N's major line of specialized machinery. Its multinational competitors sell such equipment along with their specialized machines. Company Omicron closed plants in Slovakia and Iraq and withdrew from a

joint venture in Poland. However, it maintained the Czech based former state owned trading company as well as a U.S. based company regional and global distributors. A Slovak based, holding company purchased company Omicron for a very low price. Company Omicron now accounts for about half of of the Slovak firm's holdings. The new investor hopes to speed up deliveries of spare replacement parts to regional and global company Omicron special machinery owners and is considering future outbound foreign direct investment in selected Asian countries. However, company Omicron's recent financial performance continues to be unspectacular. Its new owner, which has very limited experience in the tractor industry, defaulted on its most recent expected financial contribution.

The final example in this category is company Upsilon, a holding company that oversees its 18 divisions' production of a wide range of machine tools, power engineering and transportation equipment. In the late 1990s, UNCTAD considered company Upsilon to be the largest multinational based in the Czech Republic. This was during the period when its then CEO had a vision of creating a global "empire" led by the holding company. Two-thirds of the organization's sales came from export markets. Half of its export sales were made to markets outside Europe. The enterprise acquired a subsidiary in China (which has since been closed) and set up a joint venture in the USA. However, the organization faced three fundamental problems. First, it did not have a vision for well-known world class niches. Second, it did not have sufficient economies of scale in some of its divisions to be cost and price competitive with other global firms in its various industrial sectors. However, some of company Upsilon's divisions have strategic advantages of making custom equipment to order. Third, the former CEO was accused of "tunneling" (asset stripping). The Czech court subsequently exonerated him of this charge because the company still was able to employ a large work force composed of Czech nationals. Company Upsilon's overall sales dropped modestly over the past decade. In the same period, expenses rose more rapidly resulting in the firm's coming close to bankruptcy. In the early 2000s, a U.S. based holding company specializing in the energy sector, acquired company Upsilon and its divisions. It subsequently appointed a new five-member management board composed of young leaders ranging in age from their low thirties to their upper forties. Under the new management and ownership team, the holding company has been profitable. While new strategies and niche focuses were being formulated, the new owner helped to establish a strategic tie for the group with a Canadian multinational in the transportation equipment sector. The enterprise is also considering a joint venture with a prospective Russian partner. Under its new ownership and management, the company has been able to focus more on internal issues, such as new product development, selling off some of its less profitable subsidiaries and improvements in labour productivity. The company currently focuses on the manufacture of equipment used in the transportation and energy production sectors.

## **5. Successful Post Velvet Revolution Czech-Owned Startups**

The final category includes a number of Czech-owned companies began operations in decade of the 1990s. Some of these (notably those in high tech computer software) have begun to develop globally oriented export strategies. This study's sample includes company Phi, one of the most successful of these startup enterprises. Company Phi began in 1993. Its operations grew from acquisitions of small-

ler firms in the agricultural chemicals and animal feed industry. By 2000, it had become one of the top five Czech firms (ranked by total revenues). One investor controls more than half of its capital shares. A US/Swiss global agribusiness trading and holding company controls most of the remaining shares. Company Phi has established trading company affiliates in six European countries and has developed trading relationships in the United States and China. About a fourth of the company's business takes place internationally. Besides company Phi, there is a set of startup Czech companies that are not as large. Nonetheless, they are market leaders (or one of them) on their respective markets. In addition, these companies have significant domestic and international sales growth.

The following set of success factors is common for most of the companies in the group:

- previous international experience and contacts;
- perceived domestic shortage of a product or service and subsequent import;
- reliance on traditional strengths of Czech industries;
- internationally acceptable brand name with growing recognition;
- strong position on the domestic market and subsequent export orientation.

The first three factors are those that drove Czech entrepreneurs to establish their own businesses. At the same time, these factors appear to be fundamental determinants of success. The first factor is the entrepreneur's previous international experience and contacts. Founders of several companies worked in one of the former state-owned international trading companies. Moreover, several of them travelled internationally as tourists or on business immediately after 1989. International experience revealed the differences between Czech and western life styles. It opened their eyes and provided guidelines for how Czech life style could be changed in the future. In addition, the former foreign trading company employees knew the right people beyond the nation's borders and were able to maintain distribution channels used by their previous employers. For instance, the founder of a new bicycle production company was responsible for imports of bicycles from Ukraine and Poland in a former state owned trading company. He knew the bicycle market and the ropes of international business. Consequently, he started to import a variety of products. Later on, he switched to the bicycle industry, the field of his expertise.

The second factor is a perceived shortage of a product or service on the domestic market. It is closely related to the first factor. The communist market strictly planned production but failed to plan consumption. It resulted in the proverbial queues and under-the-counter trading. The Velvet Revolution changed this literally overnight. It offered an unprecedented chance to anybody to make a quick profit. The magic recipe was "to give people what they want and nobody else offers". This sounds like reinventing the wheel. However, it was easy for some entrepreneurs to do it, given the market realities at the beginning of the nineties. First of all, it was relatively easy to come up with a product for which there was demand. People were hungry for new, innovative goods. In addition, domestic customers had low expectations and typically perceived no comparisons with Western standards. Perhaps the only obstacle was the shortage of financial means. However, a relatively naive banking sector loaned capital for practically any business plan.

Nonetheless, a Czech national problem at that point was a significant lack of entrepreneurial spirit. Fortunately, there were some individuals whose behaviour countered this trend. An easy way to satisfy people's needs was to import successful products from other countries. A kitchen utensils manufacturer was founded by the group of musicians. They travelled abroad right after 1989 and saw the business opportunity in products that were on the Czech market. Import of these products



was just a logical result of this perceived opportunity. Today, the company is an important player on the European kitchen goods market.

The third factor suggests emphasizing traditional competitive strengths of Czech industries. As the Velvet Revolution brought opportunities for some people, it resulted in problems for others. Rigid and bloated state-owned establishments suddenly faced competitive forces and lost some of the “guaranteed” markets (especially the former Soviet Union). Furthermore, the *quasi*-autarkic economy was replaced by a market economy. This resulted in a spate of strong international companies entering the domestic economy. This resulted in declines of many traditional Czech industries such as textiles, engineering, and electronics. However, not all managers (or their employees) in the state-owned companies saw only dim prospects for their industries. Some people sensed opportunities in them. These individuals perceived ways to “harness” the potential in their companies that had just been released from struggling state juggernauts. They believed in craftsmanship and potential of Czech engineers. They added necessary entrepreneurial aspect to the technical expertise. For example, a manufacturer of security systems, started its business within a former giant state-owned enterprise. Even though it was only a tiny part of the larger entity, it paradoxically capitalized on the larger firms’ struggles. With help of former large enterprise employees, the startup built the worldwide known firm in its field. Today the startup exports to over 50 countries on all continents. It has a subsidiary in Slovakia and authorized offices in Taiwan and China.

In short, the foregoing three factors are strongly associated with successful startups. But starting successfully does not guarantee long-term growth. The examination of the eighteen company sample revealed two other fundamental success factors.

First, brand name recognition plays a key role. These companies implemented long-term strategies focused on adding perceived value through brand equity opposed to short-term strategies focused on immediate profits. Some firms own valuable brands that have broad awareness particularly on the domestic market. There are examples in the bicycle, eating utensil, apparel, and soft drink industries. An interesting approach was taken by a soft drink company that revived old brands from the previous regime, re-positioned them, and successfully offered as an alternative to global brands. Its local brand is the second most popular dark soft drink after Coca-Cola. There is an additional aspect of brand equity – the right choice of product’s or company’s name. Because almost all of the eighteen examined startup companies extensively trade on international markets, their brand names must be easily memorable and language neutral. Brand names should contain no region or language specific letters or sounds.

Second, all of the analyzed companies have developed strong domestic market shares in their respective industries. Their successful domestic revenues serve as the foundation for broader export-oriented strategies. Almost all companies in the sample realize a significant portion of their sales from export activities. For instance, one startup Czech-based company has become one of the top 5 manufacturers of fireplaces in Europe. It started in the former state enterprise producing laundry machines. Starting with imitating of a German product, the startup grew to an important player on the European market with almost 70 per cent of its sales coming from exports. In general, these startup companies do not limit themselves geographically. They are aware of their products’ or services’ qualities that are valuable to European and/or global customers. They looked forward to EU accession as an opportunity rather than a threat. They proactively worked toward these opportunities, e.g. by acquiring necessary certifications or permissions, designing products in accord with the EU norms, *etc.* One of the startups discussed previously is ahead of



its competition because it proactively acted upon the perceived opportunity. Its wireless home security system is not unique on its own. What makes it stand out from its competitors is that its products are the first of their kind that meet stringent EU regulations. While its international competitors waited for the relevant guidelines to be passed, the security system company's executives anticipated them in advance in the redesign of their products.

A few of the eighteen startup companies have elected to extend their value chain efforts beyond their Czech Republic home. Some have moved a portion of their activities to countries or regions where such moves make more economic sense with respect to production cost, investment flexibility and/or quality. For instance, a textile producer entirely outsourced its production to China because of its low labour cost. Market realities forced the company to act this way when its competitors became more price-competitive. The bicycle manufacturer quickly learned that the heart of the bicycle world is in Asia. Local facilities there are able to produce at a slightly lower cost. More importantly, the Asian product quality proved to be the bicycle company's key competitive advantage. Its Asian outsourcing has allowed it to satisfy upward swings in domestic and export market demand more rapidly. As another example, the kitchen utensil manufacturer outsources from supplier/partners in ten countries, mostly in Asia. These three example companies internally retain some parts of their value chains – typically R&D activities, marketing and sales.

## 6. Conclusions: Indicators of Successful Growth

While this paper's observations are limited to a selected convenience sample of firms, an examination of impacts of internal and external factors on success classifications shown in Table 1 suggests the following tendencies that might serve as possible hypotheses for future research.

First, there appears to be no consistent relationship between externalities and successes (as measured by growth in both domestic and international sales.) For example, wage rates in the Czech Republic are still relatively low compared with many of the larger European Union countries. However, wages in the Czech Republic are high relative to other emerging economies in Eastern Europe and Asia. These wage differentials impact firms across the board. Firms in industries with high competitive concentration ratios (e.g., chemicals, automobiles and brewing) might perceive significant barriers to entry to global markets. Yet the inputs of ideas and funding from foreign direct investors helped some of companies (e.g., companies Nu, Rho and Sigma, and more recently company Upsilon) in the sample finesse these constraints.

Second, there appears to be a strong association between successful domestic and international sales growth and internal factors such as international market connections (in some cases brought about by foreign direct investors) and the application of competitive positioning. All of the successful firms started by building strong shares in the domestic market. With respect to their international customers, there is little difference between those whose sales are largely in Europe *versus* those seeking global markets. The more successful firms have apparently identified unique niches for their offerings. This reorientation in favour of more emphasis on differentiation is a significant paradigm switch from the cost leadership competitive strategy approach followed by Czech firms in the early to middle 1990s. Given the small size of the domestic market and the relatively small scale of most Czech companies compared with multinationals, this strategy appears to be appropriate in light of growing exposure to global and regional competition including greater openness of the Czech domestic market stemming from the country's recent accession to the

European Union. Moreover, the successful firms have gone through restructuring and have good cost-control structures in place. Multinational investors' financial and technological strengths complement high technical educational standards in the Czech work force as well as historic strengths of the Czech economy in such industries as metal working and fabrication, glass production, and brewing.

Third, failures on the part of some foreign direct investors appear to be associated with their inability to implement meaningful niches and international logistic connections for their Czech operations within the overall mosaic of their global activities. For example, contrast the early failures of companies Nu and Omicron with successes of company Rho (for which the German parent identified a domestic and global niche) and company Mu (whose U.S. based parent company developed a largely domestic market strategy.) Moreover, some investors (e.g. the previous owners of companies Nu and Pi) did not give sufficient attention to day to day management of their Czech strategic partners. Although the foregoing taxonomy suggests five different strategy types, six observations characterize current as well as future indicators of strategic international business success for non-financial enterprises operating in the Czech Republic.

First, the role of inbound foreign direct investment has been critical in many of the examples above. By the year 2000, the stock of foreign direct investment as a per cent of the Czech Republic's gross domestic product exceeded forty per cent (UNCTAD, 2002a). Not only did investors bring much needed venture capital and world class technology, they also brought their management and marketing know-how to a country that had lost sight of such skills for many decades under socialism. This is especially important in light of the limited number of Czech-based institutions of higher education in management and the even more limited number of faculty in those institutions who have expertise in marketing and human resources management skills.

Second, with the exception of those Czech-owned companies that focus on relatively narrow market niches (e.g. decorative glass, specialized communication services and rebranded ready to wear clothing), solely Czech-owned enterprises did not demonstrate growing international sales. Their overarching strategic international business focus was clearly on export to European countries – especially to next-door neighbours.

Third, the accession of the Czech Republic to the European Union brought more intense competition that encouraged Czech firms to develop positioning strategies that go beyond price advantages stemming from relatively low cost labour.

Fourth, outbound foreign direct investment activities are extremely small. According to UNCTAD, the value of inbound *FDI* stock was close to USD 27 billion while the value of outbound *FDI* stock was barely USD 1 billion. Moreover, most of the outbound stock and annual flows of *FDI* was aimed primarily at the tertiary sector with prime emphasis on markets in Central and Eastern Europe (UNCTAD, 2002b). Given the small size of the Czech economy and its paucity of internally generated investment funds, this is not surprising.

Fifth, the automotive sector has had the fastest growth and increase in overall national economic importance to date. Yet regional and global competitive strategies of the dominant Czech-based firm in that industry (company Rho) will likely change as inbound *FDI* increases in Central Europe during the coming half decade.

Sixth and finally, perhaps the most interesting company types to observe in the future will be those in the fourth and fifth classification categories. It will be interesting to observe how managers of startup enterprises as well as those employed by new investor/owners in firms that were nearing bankruptcy will encourage and guide their respective companies to experiment with new regional and global strategies.

It would also be appropriate for future researchers to compare the taxonomy discussed above with a similar taxonomy that might be developed for other transitional market countries. Based on the author's informal conversations with United States Department of Commerce commercial officers serving in Slovakia and Hungary, the Czech situation probably has much in common with those nations. UNCTAD data also indicate that as of 2000, the ratio of inbound to outbound foreign direct investment stock was more than 100 to 1 in every country in the region with the exception of Hungary where the ratio was about 30 to 1 (UNCTAD, 2002b). However, the taxonomy could be somewhat different if one were to examine the evolution of international business strategies in emerging transitional countries in East Asia, the Middle East, Africa and Latin America.

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