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EVOLVING SUBSIDIARY ROLES AND REGIONAL ECONOMIC INTEGRATION IN EUROPE

¹**Sergey Filippov**
Delft University of Technology
 Jaffalaan 5
 2628BX Delft
 The Netherlands
 Tel.: +31 15 2783565
 Fax: +31 15 2783177
 E-mail: s.filippov@tudelft.nl

²**Geert Duysters**
*Tilburg University &
 Eindhoven University of Technology*
 P.O. Box 513,
 5600 MB Eindhoven
 The Netherlands
 Tel.: + 31 40 2478993
 Tel.: +31 13 4662363
 Email: g.m.duysters@tue.nl

¹**Sergey Filippov**, PhD, is Assistant Professor of Innovation Management at the Delft University of Technology (Netherlands). He obtained his doctorate at the United Nations University (UNU-MERIT) in Maastricht. He holds Executive Master's degree in International and European Relations from the University of Amsterdam. His research interests encompass innovation, international business and emerging multinational companies.

²**Geert Duysters**, PhD, is Professor at Eindhoven University of Technology and Tilburg University (Netherlands). In 2010, he was awarded a distinguished Chutian Professorship at Wuhan University of Technology (China). His academic research mainly concerns international business strategies, innovation strategies and strategic alliances. He has published over 80 international refereed articles and book chapters.

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ABSTRACT. *The focus of this paper is on the impact of regional economic integration on changing roles and strategies of overseas subsidiaries. The literature has acknowledged the positive impact of regional economic integration on the investment attractiveness of member states participating in a regional bloc and hence new inflows of foreign direct investment. Yet, the interplay between regional economic integration and evolution of already established foreign subsidiaries remains under-researched, as these two phenomena are often studied in isolation from each other. The paper aims to examine this link in the context of new EU member states, using a proprietary data base. We find evolution of subsidiary roles, towards more advanced ones. Further, we analyse drivers of such evolution and their importance. The paper provides managerial and policy implications.*

KEYWORDS: subsidiary evolution, multinational corporations, transition, integration, Eastern Europe.

JEL classification: F15, F15, F23, O52.

Introduction

Regional economic integration has emerged as a pervasive force on all continents. Regional economic integration increases the interaction between the member states and creates new forms of supra-national organisation. Despite the variety of regional economic integration schemes, the European Union (EU), presently consisting of 27 member states, represents the most well known, fifty-year old and advanced attempt at regional integration. From a scholarly perspective, European integration studies and Europeanisation have emerged as distinctive academic disciplines (Exadaktylos and Radaelli, 2009).

Over the past decades, the EU as a whole has become the largest FDI recipient. A crucial role in this process has been played by an accelerating economic integration and progressive enlargement. Since its establishment in 1957, the European Economic Community has enlarged several times, and the single largest one was the 2004/2007 eastward enlargement. The Central and Eastern European countries (CEECs) have gone through a dramatic process of industrial restructuring prior to their accession to the EU, and they are showing structural convergence with the 'old' EU member states (Crespo and Fontoura, 2007).

One of the main tenets of the common market studies, and the International Business (IB) discipline with respect to regional economic integration is that participation in an economic bloc is beneficial for a country. It implies *de-facto* enlargement of its economy and hence improvement of investment attractiveness. The emphasis here is on new FDI flows. Much less research, however, has been devoted to the question of how already established overseas subsidiaries react to regional economic integration. In other words, what does regional economic integration entail to the FDI stock accumulated by host economies – members of a regional economic bloc? Answering this research question constitutes the main objective of this paper.

A number of CEE countries, new EU member states, represent a relevant setting for such research. In their transition to market economy, these countries relied heavily on FDI; and a high share of subsidiaries of foreign multinationals became their inherent characteristic. Since the moment of their establishment, many subsidiaries have altered their roles and strategies, reflecting the changes in their host economies.

By examining development of subsidiaries in the context of regional economic integration, the paper makes important contribution to the field of European studies and the IB discipline.

The paper uses a quantitative approach, based on a proprietary dataset. It is structured as follows. The *next section* provides theoretical insights. *Section 2* outlines an analytical framework. *Section 3* presents data and methodology, and the key results are described in *Section 4*. Finally, *Section 5* concludes this paper.

1. Theoretical Background

The paper draws upon insights from various disciplines, primarily from the vast literature on regional economic integration and the literature on subsidiary management. The challenge though is that these two academic domains have been developing in a relative isolation from each other, and hence the present study attempts to identify the points of contiguity between them.

1.1 Regional Economic Integration and Multinational Companies

Regional economic integration is a multifaceted process coming into a variety of forms. Nevertheless, the common idea is that a regional economic integration scheme involves the reduction and standardisation of government controls and policies over the flow of products and/or factors in a group of nations.

A country acceding to an economic bloc expects to benefit from two main sources. Firstly, the short-term benefits from an improved allocation of resources, as a response to the new markets and new competition, created by the economic bloc. The most effective use will be made of a nation's comparative advantages. The inefficient industries (protected before the regional integration) are expected to decline, and the efficient ones are expected to grow. Secondly, there are medium/long-term dynamic gains. In the longer term, the member states realize that the static comparative advantages are not sufficient, and they need to contribute to an improved industrial environment.

“The membership in a bloc may affect countries' locational advantages. Previously “outsider” economies become “insider” economies. They must reorient their economies to the supra-national norms established by the core countries” (Benito and Narula, 2007). Economic integration offers previous “outsider” economies more opportunities to be integrated into global economy and accede to the “economic core”, making it more attractive for multinationals.

Since economic integration represents the enlargement of the market, unsurprisingly, an interrelation between regional economic integration, trade and FDI has become an established area of research (Buckley *et al.*, 2001; Eden, 2002). In other words, the focus of the literature has tended to be on new FDI flows, i.e. on market-seeking FDI. In many instances the academic research has established a relationship between the advancement of the regional integration and the magnitude of FDI inflows (Dunning, 1997). In a similar vein, as Barrell and Pain (1997) note, the overall level of new investment projects has risen sharply in the then new EU member states since the middle of the 1980s, following the common deregulation of national capital and product markets. Various studies sought to establish the impact of accession of an individual country to an economic bloc on the amount of FDI inflows. For example, Bajo-Rubio and Sosvilla-Rivero's (1994) econometric analysis shows that inward FDI in Spain rose spectacularly since the entry into EU in 1986.

On the other hand, scholars also studied the impact of regional economic integration not only on new investments, but more so, on the adjustments in extant businesses, and specifically on the restructuring on multinational companies. First studies appeared in the 1960s, following the creation of the European Economic Community (e.g. Kindleberger, 1966). Every new step aimed at deepening the single market provided ground for new studies in this direction. For instance, signing of the European Single Act in 1987 has given ground to scholars (e.g. Dunning and Robson, 1988) to suggest that multinational companies may adjust their strategies in relation to formation of regional economic blocs, i.e. evolving from country-centred to supra-national (EU) strategies. This idea found its support in further studies (Chesnais *et al.*, 2000; Akbar, 2003), and complemented by empirical evidence, e.g. Yamawaki (1993) and Ford and Strange (1999) that investigated the responses of Japanese multinationals to the European integration. Likewise, Filippaios and Papanastassiou (2008) found that the US FDI pattern varies among different groups of countries in the EU, and that there was a restructuring in US multinationals' investment activity after the implementation of the single European market.

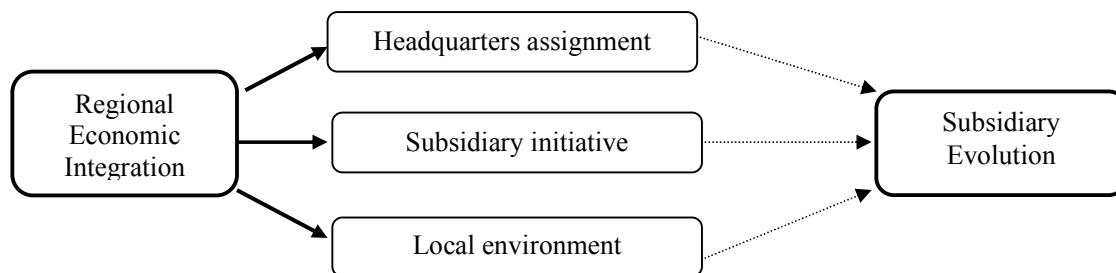
“Overall, the disappearance of borders among a group of countries implies for multinational companies that they can serve the whole economic bloc from only one subsidiary based in the bloc, instead of serving fragmented national markets separately” (Benito and Narula, 2007). Despite the increased interest to this topic, Pearce and Tavares (2000a) argue that several issues have been largely neglected and specifically, the role of subsidiaries. Many multinational companies have already well-established subsidiaries in many of the member states, and regional economic integration may eventually lead to downgrading of some subsidiaries and strategic evolution and growth of others.

1.2 European Economic Integration and Evolution of Subsidiaries

Earlier studies adopted the dominant traditional view on multinational companies as a centralised structure and hence the focus was placed on the decision-making process and motivations at the headquarters. However, advancements in the research area of subsidiaries in the 1990s have provided a major boost for empirical studies seeking to assess the impact of European integration on the performance of subsidiaries (e.g. Young *et al.*, 1991; Pearce and Papanastassiou, 1997; Pearce and Tavares, 2000b).

The seminal model by Birkinshaw and Hood (1998) identifies three driving forces of subsidiary evolution – HQ-level management, subsidiary management and local environmental dynamism. Relating to this model of subsidiary evolution, regional economic integration is a powerful force influencing the drivers of subsidiary evolution (*Figure 1*).

Firstly, regional economic integration impacts corporate strategies at the level of parent companies as these strategies are tailored according to the level of integration of specific countries into economic blocs. Secondly, regional economic integration impacts subsidiary management. An enlarged market opens up new possibilities for the development of subsidiary and subsidiary management may be keen to grasp them. Thirdly, regional economic integration impacts the local environment, i.e. the economic structure in member states such as factor markets.



Source: created by authors.

Figure 1. Indirect Impact of Regional Economic Integration on Subsidiary Evolution

The entry of a host country into an economic bloc is conceptualised as an exogenous shock on the activities of multinational companies and their subsidiaries. Introverted and truncated activities of subsidiaries may change in favour of export-oriented activities (Pearce and Tavares, 2000b). In its essence, accession of a host country to a regional economic bloc implies the enlargement of a national market, which can be crucial for the subsidiaries that focus on the market-seeking imperative. For the efficiency-seeking subsidiaries it may imply access to a larger pool of suppliers as well as easier access to labour and capital. Regional

economic integration increases the preference for multinational companies for local production within the bloc.

These theoretical considerations were corroborated by several empirical studies. Young *et al.* (1991) found changes in the profile of EU-based subsidiaries as they became responsible for the production of a good, service or component for the whole economic bloc. Pearce and Papanastassiou (1997) studied the role of foreign subsidiaries located in the UK in serving the common European market. Empirical evidence collected by Hogenbirk and van Kranenburg (2006) suggest that foreign subsidiaries located in a small economy (The Netherlands) use it as an export base to serve the entire European market, since the national market is too small. Tavares (2002) contrasted two peripheral EU economies – Ireland and Portugal – and examined the issue of subsidiary evolution in the EU context. Tavares and Young (2004) undertook the similar exercise with Portugal, Spain and Ireland.

Economic impact of the EU enlargement on subsidiaries is hard to establish due to the simultaneity of diverse causes. It is clear that changes in the subsidiary after the accession of its host country to a regional bloc cannot be attributed to economic integration alone. In other words, a major challenge for many of these studies is the lack of counterfactual aspects. It is less of a problem to study subsidiaries in Nordic countries: Benito *et al.* (2003) compared subsidiaries in the EU members Finland and Sweden to non-EU member Norway, and found a positive relationship between membership of the host country in the EU and subsidiary performance.

2.3 Regional Economic Integration and Subsidiary Typology

The body of research on subsidiary roles places an emphasis on the idea that subsidiaries assume different roles within a corporate network. The extant body of research on subsidiaries has employed several typologies of subsidiary roles and strategies.

A typology that is the most appropriate for the study of the connection between subsidiary evolution and regional economic integration is the one that distinguishes between subsidiaries in terms of product scope (product line extensions and new product areas), market scope (range of geographic markets available to the subsidiary) and value added scope (range of functions performed by the subsidiary – development, manufacturing, marketing). It stems from White and Poynter's (1984) pioneering study and it is the most appropriate classification for the purposes of this study since the regional economic integration might affect all the three categories – product, market and functions. Originally, five types of subsidiaries were pointed out – miniature replica, marketing satellite, rationalised manufacturer, product specialist and strategic independent.

The typology has been modified over time and widely used in studies on subsidiaries (Pearce, 1992, 1999, 2001; Papanastassiou, 1995, 1999; Hogenbirk and van Kranenburg, 2006; Taggart, 1996, 1999; Pearce and Papanastassiou, 1997). In its most common form the present typology determines three types of subsidiaries: truncated miniature replica (TMR), rationalised product subsidiary (RPS) and world/regional product mandates (WPM).

The TMR is the basic type of subsidiary pursuing a market-seeking strategy by supplying already well-established goods to a particular market. Establishment of TMR subsidiaries was a reaction to barriers to trade. Multinational companies had to establish production within the host economy since high trade tariffs made goods produced elsewhere and imported into host economy uncompetitive. By definition, this type of subsidiary pursues a market-seeking imperative; it aims to produce in the most cost-effective way the goods already well-established in a corporate network to a particular isolated national market. It

supplies a large product range (extensive product scope) to a limited market (narrow market scope). Some primitive R&D is necessary for adjusting the product for the local market. Nevertheless, it does not have a potential for substantial innovative activities.

The rationalised product subsidiary pursues an efficiency-seeking imperative; it assumes a specialised or complementary product responsibility. This type of subsidiary became possible due to the changing nature of global economy and considerable lowering of trade restraints, and in case of regional blocs even the complete removal of any barriers to trade. This subsidiary reaps the economies of scale and manufactures goods for a very wide market scope in a cost-effective way. The functional scope is even more restricted than in TMR and the need for R&D is limited since the products are exported and they match the necessary production techniques in other corporate locations. Since a product is delivered to a wide geographical market and not only to a host country market, local adaptation of a product is severely limited, almost non-existent.

The world product mandate (WPM) pursues a strategic asset-seeking imperative. This subsidiary is fully responsible for the creation, manufacturing, marketing, distribution and further development of a product. Undoubtedly, in order to receive this status, subsidiaries should possess distinctive competence, making it different from their peers. On top of that, these mandates to produce a certain good are normally earned in tough competition with other subsidiaries. The success factors include unique local technological competence, a local science base or human capital. These distinctive capabilities and competences are used as inputs into product development process. WPM subsidiaries have a wide geographical market scope; the product scope is narrow and the functional scope is very wide as the subsidiary possesses a full range of corporate functions. Emergence of WPM has been spurred by various factors, such as technological heterogeneity of individual countries and by the ability of multinationals to coordinate efficiently and effectively dispersed subsidiaries.

2. Analytical Framework

The literature review presented in Section 2 serves as a foundation for the revision of the dominant subsidiary typology, in order to accommodate for the particularities of the CEE markets.

2.1 Subsidiary Typology

The subsidiary typology presented in Section 2 reflected mainly the closed nature of many economies and existence of tariff protection. Presently, the global economy has undergone considerable changes, mainly liberalisation and free trade. As such, free trade heralded the demise of the miniature replica subsidiary in its classical understanding. However, this type has not fully disappeared, but rather transformed. Multinational companies responded to the changing economic environment and liberalised trade by closing the inefficient activities and retaining only those necessary to serve the local market.

Miniature replica subsidiaries may exist in order to produce goods tailored to the idiosyncrasies of the domestic market. They may also serve several neighbouring markets in addition to its host economy. Scholars sought to split the miniature replica in distinctively two types – the one serving local markets and another one – serving a wide single market. For example, in the study of UK subsidiaries, Pearce and Papanastassiou (1997) introduce two types of miniature replica – for the UK market only and for the EU market. In the present study we define the miniature replica as a Minimalist Subsidiary (Role 2), producing goods,

already produced elsewhere in the multinational company, for the host country and neighbouring ones.

The rationalised producer subsidiary is becoming more important in the global economy, but for the sake of clarity it can be split into two types. Firstly, a subsidiary can be an export platform (Role 3) meaning that it produces a certain set of existing final products for the multi-country or global market. The export platform may produce goods and products for the entire single market. This type of subsidiary is particularly typical for the specific industries: proximity-sensitive industries, in which physical distance to target markets is critical; industries that places premium on rapid responses to shifts in consumer market; export industries that emphasis heavy, bulky or fragile products. Secondly, it is a specialised subsidiary (Role 4), which produces a certain set of component parts and they are further processed by other parts of the corporate group. For example, this type of subsidiaries is abundantly present in the automotive industry.

The product mandate (Role 5) is almost the same as in the original typology, although the product mandate may not necessarily be global. Furthermore, a representative unit (Role 1) is added, as a subsidiary orienting mainly towards the local market and containing a set of functions supportive to manufacturing (sales and marketing, logistics, etc).

The overview of different roles is presented in the *Table 1*.

Table 1. Comparative analysis of subsidiary roles

Subsidiary role	FDI strategy	Market scope	Product scope	Functional scope
Role 1. Representation unit	Market-oriented	Narrow and isolated (a host country)	Extensive	Limited (functions supportive to manufacturing)
Role 2. Minimalist subsidiary	Market-seeking	Narrow and isolated (a host country and neighbouring countries)	Extensive	Limited (Production and routine marketing; development for local adaptation)
Role 3. Export platform	Efficiency-seeking	Very wide (world / region)	Narrow	Very limited (only production)
Role 4. Rationalised producer	Efficiency-seeking	Very wide (world / region)	Intermediates for the other subsidiaries	Very limited (only production)
Role 5. Product mandate	Asset-seeking	Very wide (world / region)	Limited	Wide (most functions, incl. R&D)

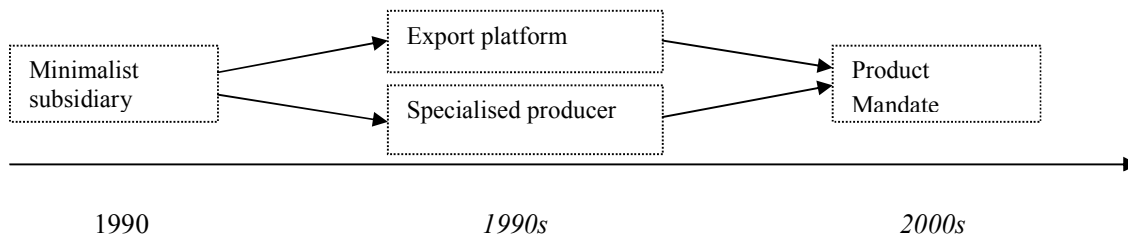
Source: created by authors.

2.2 Transitory Paths

A traditional transformation in the scope typology would start from miniature replica then proceed to rationalised producer and ultimately to product mandate. In the case of the new EU member states, this transformation can be roughly related to the transition dynamics of the 1990s and their accession to the EU in 2004 (*Figure 2*). This model represents a generic pattern and a particular subsidiary may deviate from this straightforward way of subsidiary evolution. Further, each transformation is discussed.

Representation unit: Multinational companies start their expansion overseas from a low degree of commitment, i.e. by establishing a representative office. This office may be a pure sales unit, or a logistics and market office. No specific transitory path can be defined

for this type of subsidiary, however, evolution to a minimalist subsidiary seems as the most logical one.



Source: created by the authors.

Figure 2. Evolutionary Changes in the Subsidiary Roles in the New EU Member States

Minimalist subsidiary: Multinationals started entering the CEE markets in the early 1990s. The markets were closed for Western companies for several decades, and unsurprisingly, most FDI was market-seeking, serving the markets with products already existing in their product lines, the revenue generation was a primary goal.

Towards rationalised production (efficiency-seeking motives): As the local host markets had saturated by the mid-1990s and their low short-term potential became evident, most Western companies started focusing on factor cost savings instead. The liberalisation of trade between EU and CEE economies was a crucial factor. As the subsidiaries started taking advantage of the domestic competitive advantage, they started efficiency-seeking transformation. It was possible in two ways: to export platforms to serve EU market with final goods, and rationalised producers to supply intermediate goods to the other units within a corporate group.

Towards product mandates (created-assets-seeking motives): While the transformation of market-seeking subsidiaries to efficiency-seeking subsidiaries is rather straightforward and explained by improvements of the general macroeconomic situation and proliferation of free trade, transformation towards product mandate subsidiaries is more complex. The regional bloc is a necessary precondition for this transformation, as it needs to be able to sell products to a substantially wide market area. In the words of Pearce and Tavares (2000a: 31), "... the dynamic, creative and high value-added RPM [regional product mandate] status is a possibility that only becomes available to a country that hosts MNEs when it enters a trading bloc". Nevertheless, it is not a sufficient condition as the evolution is less linear and necessary qualitative changes will take time. Knowledge, technology and skills are playing a crucial role. These are higher value-added sources of competitiveness leading to "creative transition" (Pearce, 2005).

3. Data and Methodology

This main objective of this paper is to trace possible trajectory of subsidiary evolution in relation to the regional economic integration. These trajectories were outlined in the previous section. In this section we present the proprietary dataset and the methodology used.

3.1. Data Collection

The paper uses the proprietary dataset, collected in the self-administered web-based survey conducted in 2008 among foreign-owned companies in Czech Republic, Hungary and Poland. The Business Monitor International's 2008 Directory of Foreign Firms is used to form a sample of respondents. The Directory contains names and personal e-mail addresses of senior executives of foreign subsidiaries in respective countries.

Only manufacturing subsidiaries (or supporting manufacturing) were selected. Service firms as such were excluded from the sample. The research instrument in the study was a detailed questionnaire which represented an extended and elaborated version of the other questionnaires used in the academic research on subsidiaries (e.g. Williams, 1998; Holm and Pedersen, 2000; Tavares and Young, 2006). The wording was revised after the comments given by experts in the field and practitioners.

In late May – early June 2008, 1628 email notifications were sent out. 342 emails bounced because the email address had changed. A total of 54 responses were received. Follow-up enquiries to non-respondents were conducted twice, in June and July. As a result of these efforts additional 46 responses were received; thus, overall, counting up to a total of 100 returns usable for the purposes of the study.

100 respondents for the analysis implies a response rate of 7.78 percent and is acceptable within the normal expectations of a survey of this kind, considering typically low response rates in international management studies in general (Harzing, 2000) and in foreign-owned subsidiaries, emerging economies, and the web-based surveys in particular (Couper *et al.*, 1999). Due to the above mentioned problems, it is unsurprising that studies on foreign subsidiaries use a small sample. Hogenbirk and van Kranenburg (2006) use 84 observations for the study of subsidiaries in The Netherlands. Manea and Pearce (2006) received data on 144 subsidiaries in eight CEE countries.

In the data gathering process, subsidiary managers (president or chief executive officer of each subsidiary) were respondents. The quality of the data is very high with a general level of missing values of no more than 15 percent. There are reasonable grounds to believe that the obtained sample is representative. Non-response bias was assessed on a number of variables by comparing early and late respondents. The early respondents and late respondents were virtually identical. Overall, results indicated that non-response bias was not a problem.

3.2 Subsidiaries Characteristics

Most subsidiaries in the sample belong to the following manufacturing sectors: electronics and electrical appliances, automobiles and auto components, and mechanical engineering and instruments. A few subsidiaries operate in such sectors as ICT and software, textile, clothing and footwear, and food processing. Judging by the number of employees, 19% of the sample are small-sized subsidiaries (1-99 employees), 46% are medium-sized subsidiaries (100-999 employees), and 8% are large subsidiaries (above 1000 employees). Some 27% of respondents did not answer the question, but this variable was obtained from the secondary data. Regarding the age of the subsidiaries, the distribution is as follows. 37% of the sample was established (either greenfield or acquisition) in the first mid of the 1990s (up to 1995), 30% - in the second half of the 1990s (1995-1999), 5% - in the 2000s. Some respondents did not answer the question, but this variable is obtained from the secondary data.

The parent companies of subsidiaries in the sample are mainly based in Europe, with the exception of the US (19% of the sample): subsidiaries of German companies – 19%,

French companies – 8%, Dutch companies – 7%, Italian companies – 5, subsidiaries of companies based in other European countries have less than 5%. Some 4% of respondents indicated two countries as the location of the corporate HQ (e.g. US/Japan, Japan/Germany, US/France). This geographical distribution of home countries of subsidiaries in the sample broadly represents actual distribution of source countries of FDI inflows and FDI stocks. As for the mode of entry, the majority of subsidiaries in the sample were established as a result of greenfield investment (48%), more than a quarter (26%) of subsidiaries were founded in the acquisition of a domestic company.

3.3 Variables

Several 7-point Likert scales were used to obtain data, as recommended by Cox (1980). Likert scales are among the most commonly used scaling methods in social research and in IB literature in particular.

Two time periods were chosen in order to emphasise the dynamic nature of subsidiary evolution. There is no universally accepted time period for this type of research. For example, Hood and Taggart (1999) conducted a survey in 1995, in which respondents were asked for a view of development in the period five years before and five years after the survey date. Tavares and Pearce (2004) asked respondents in the survey conducted in 1999 about their activities pre-1986 and in the future (in 10 years).

We use a time span of 5 years, with two points – the present at the time of the survey (2008) and the past (2003).

Subsidiary roles. The definition of each subsidiary type (Section 2.1.) was provided to respondents and they were asked to choose one that characterises their subsidiary the best.

Headquarters Assignment. The headquarters assignment is operationalised as granted decision rights, discretion granted to a subsidiary by the headquarters. The scale developed by Morrison and Roth (1992) distinguishes three levels of decision-making in a multinational company: 1=corporate level (HQ), 2=divisional (sub-HQ) level, 3=subsidiary level. While the levels of 1 and 3 are intuitively clear, the level 2 are more open for different interpretations. Strictly speaking, it relates to the regional HQ or any other level in corporate structures between a subsidiary and headquarters. More broadly, however, it can relate even to a joint decision-making. Various items were considered for this variable, e.g. Morrison and Roth (1992), Birkinshaw (1999), etc. Finally, it has been opted for seven strategic areas as proposed by Williams (1998): (1) overall business objectives and goals, (2) the type of product and product range, (3) target markets and sales strategies, (4) product processes, (5) choice of suppliers, (6) research initiatives, and (7) development of innovations. Taken together these seven decisions indicate the degree of decision-making rights given to a subsidiary, with higher value meaning more decision rights.

Subsidiary initiative. Various proxies to measure subsidiary initiative / leadership have been designed. We relied on the approach used by Birkinshaw (1999), after a slight modification, a 5-item scale was developed. Subsidiary managers were asked to what extent the following changes had taken place in the subsidiary over the recent period of time: (1) New products developed in the subsidiary and sold internationally, (2) new business functions of the subsidiary are attracted by the subsidiary management, (3) new corporate investments are attracted by the subsidiary management, (4) new international business activities of the corporation are first started in the subsidiary, and (5) subsidiary has challenged its major competitors for market leadership.

Local environment dynamism. This group of determinants reflects the influence of the local environment, in which the subsidiary is placed. Woodcock (1994) and Birkinshaw (1999) assess local environment dynamism asking respondents about demanding local customers, competition in the country and domestic competitiveness. Birkinshaw (1996) and Pedersen (2006) propose to build on the main elements of Porter's (1990) diamond model of national competitiveness postulating that firms derive competitive advantage from the presence of local industrial clusters. According to the model, *local business environment* can be assessed using five key items: availability of business professionals, availability of supply materials, quality of suppliers, requirements set by customers and level of competition on the local market. These items are measured on a 7-point Likert-type scale ranging from 1 (very low) to 7 (very high). Taken together, the five factors would indicate the dynamism of a host economy. The higher the value, the more dynamic impulses a subsidiary receives from its local network.

Variables – Composite measures. Several variables are composite measures, each consisting of four to six items. The next step is the assessment if the internal consistency, i.e. a measure based on the correlations between different items on the same test (or the same subscale on a larger test). In order to measure of the reliability of a psychometric instrument, Cronbach's alpha estimation was employed. The results for subsidiary initiative (*SUBINIT*), HQ assignment (*HQA*), environmental dynamics (*LOCDYN*) and local embeddedness (*LOCEMB*) showed good internal consistency, greater than .70 (*Table 2*). Therefore, a composite measure was formed by taking an average of the items (*Table 2*).

Table 2. Descriptive statistics of variables and internal consistency reliability of the test

Variable	Description	Number of items	Stand. Cronbach's α	Means	S.E.	Likert scale
SUBINIT	Subsidiary initiative	5	.867	4.135	.156	7
HQA	HQ assignment	6	.712	1.963	.057	3
LOCDYN	Dynamism of the local environment	5	.747	4.993	.114	7

Source: obtained by the authors via calculations.

4. Results

4.1 Subsidiary Roles and the Evolutionary Paths

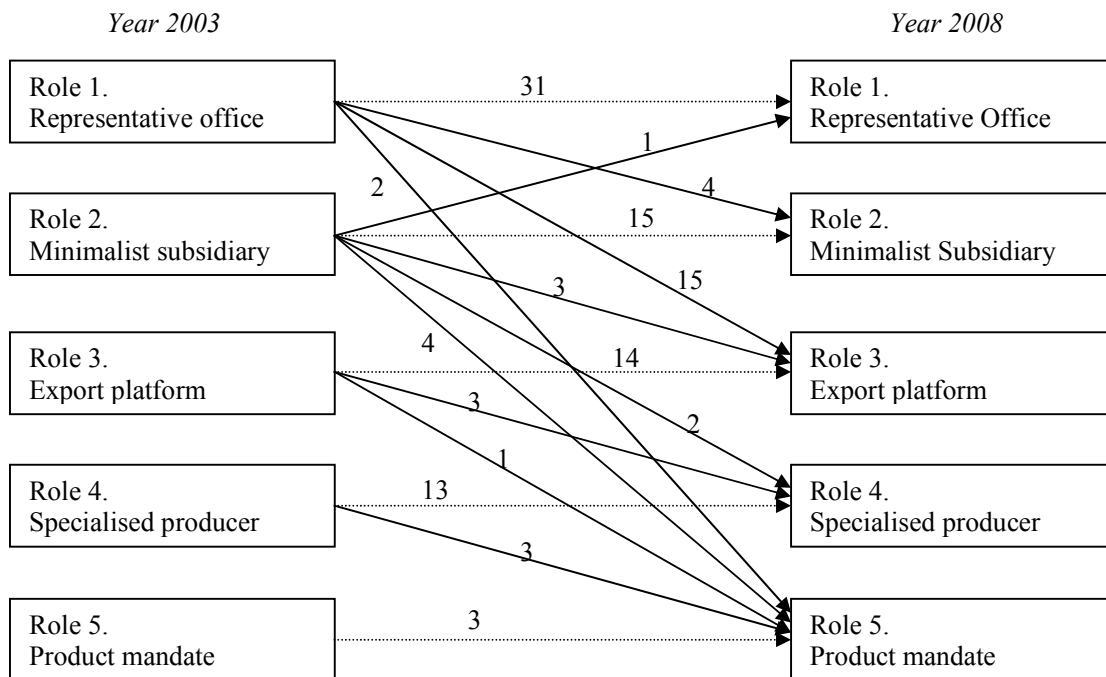
The distribution of subsidiaries according to roles is presented in *Table 3*. As the first approximation, the descriptive statistics supports the argument that the subsidiary evolution (in terms of changing subsidiary roles) does take place. However, it is not a universal process, as many subsidiaries do not change the roles.

Table 3. Distribution of subsidiary roles

Types	2003	2008	No change
Role 1. Representative office	38	32	31
Role 2. Minimalist Subsidiary	25	19	15
Role 3. Export platform	18	18	14
Role 4. Specialised producer	16	18	13
Role 5. Product mandate	3	13	3

Source: compiled by the authors.

The evolutionary changes are graphically presented in the *Figure 3*.



Source: created by the authors.

Figure 3. Patterns of Subsidiary Roles Changes between 2003 and 2008

This graphical representation of changes in roles provides ground for several observations. Firstly, there is a substantial amount of subsidiaries that do not change roles. The highest number is among the Representative offices (31), the numbers for the following three roles are virtually similar – 15 (Role 2), 14 (Role 3) and 13 (Role 4). The Role – Product Mandate subsidiaries existed in 2003, and 3 subsidiaries did not change this role. Secondly, change of roles is not a linear process. There are some cases when subsidiaries leapfrog from Role 1 or 2 to Role 5. Moreover, under specific conditions, a shift back is possible, when a subsidiary assumes a more inferior role compared to its current one.

The EU accession did not entail an automatic transformation of efficiency-seeking subsidiaries to Product Mandates. This is consistent with the premise that the membership in the regional bloc is only a necessary condition for such evolutionary transformation. Observation of the industrial composition suggests that the “creative transition”, i.e. transition towards the Product Mandate subsidiary was manifested strongly in the electrical engineering and car-making, i.e. the industrial sectors where these countries have received large amount of FDI and have developed related comparative advantage. A significant factor can be the expectation of multinational companies in this sector concerning a pool of well-trained engineers.

4.2 Drivers of Subsidiary Evolution and the Evolutionary Paths

The seminal paper by Birkinshaw and Hood (1998) identified three drivers of subsidiary evolution – HQ assignment, subsidiary initiative and local dynamic environment. This study seeks to assess the relevance and significance of these drivers for the changes in

subsidiaries' roles. The analysis will proceed in two dimensions. Firstly, we analyse the relevance and importance of the drivers of subsidiary evolution in relation to each of the five subsidiary roles, i.e. static perspective. Secondly, we investigate the role of the drivers of subsidiary evolution in the changes of subsidiary roles, i.e. in the dynamic perspective. Finally, we compare both perspectives and draw preliminary conclusions.

Static perspective: We employ ANOVA approach to investigate the differences between the three drivers of subsidiary evolution taking a current subsidiary role as a factor. The descriptive statistics and the results of ANOVA analysis are presented in *Table 4*.

Table 4. Characteristics of the subsidiary evolution drivers for five subsidiary roles

	SUBINIT		HQA		LOCDYN	
	Mean (st.dev)	Variance	Mean (st.dev)	Variance	Mean (st.dev)	Variance
Role 1. Representative office	3.5086 (1.58419)	2.510	1.8810 (.52285)	0.273	5.0667 (.94462)	0.892
Role 2. Minimalist subsidiary	3.5375 (1.38124)	1.908	1.8542 (.58650)	0.344	4.4769 (1.36269)	1.857
Role 3. Export platform	4.5222 (1.31263)	1.723	1.9537 (.47073)	0.222	5.0111 (1.15090)	1.325
Role 4. Rationalised producer	4.3176 (1.36713)	1.869	1.9510 (.67125)	0.451	4.8941 (.95686)	0.916
Role 5. Product mandate	5.7231 (.97822)	0.957	2.3194 (.41107)	0.169	5.4500 (.95012)	0.903
Full sample	4.1672 (1.55554)	2.420	1.9615 (.55058)	0.303	4.9862 (1.07218)	1.150
ANOVA	F=6.882 / Sig.=0.000		F=1.615 / Sig.=0.178		F=1.391 / Sig.=0.244	

Notes: Standard deviation in parentheses.

Source: created by authors via own calculations.

Firstly, the ANOVA analysis reports high statistical significance (Sig.=0.000) in explaining the difference in the subsidiary initiative (*SUBINIT*) between groups, i.e. distinctively different patterns of subsidiary initiative in each of the five roles. For the other two variables, no statistical significance was found: Sig.=0.178 for HQ assignment (*HQA*) and Sig.=0.244 for Local Dynamism (*LOCDYN*). The results imply that among the three variables – drivers of subsidiary evolution, the subsidiary initiative emerges as the only being distinctively different between the five groups of subsidiaries.

For the subsidiary initiative (*SUBINIT*), the mean value varied considerable across the five categories, increasing from 3.5 (Role 1) to 5.7 (Role 5). A straightforward explanation for this variance would be that the less advanced subsidiaries are framed into an existing value chain, and find it difficult to transform to another type, hence subsidiary management initiative is discouraged. In fact, subsidiary initiative is both the determinant and the consequences of the more advanced roles. If a subsidiary occupies a more advanced position, by its nature, it requires more proactive position of the subsidiary management.

Considering the HQ assignment (*HQA*), measured at a 3-point Likert scale, its lowest levels were found for the Roles 1 and 2. Roles 3 and 4 are in the middle; and the Role 5 enjoys the highest level of HQ Assignment (2.3194). For the last variable, local dynamism (*LOCDYN*), measured on a 7-point Likert scale, the highest mean value (5.4500) was registered for the Role 5 (Product mandate). The high value of 5.0667, achieved for the Role 1

(Representative office), can be explained the orientation of this type of subsidiary towards the local market, and hence the crucial importance of the local dynamics. Surprisingly, the lowest value (4.4769) was registered for the Role 2 (Minimalist subsidiary). By definition, this type of subsidiaries is market-seeking and therefore, should be more responsive to the dynamism of the local market. A possible explanation is that this subsidiary manufactures products already existing in the product line of the multinational company, with limited adaptation; and these adaptations are not driven by the local dynamism but by other forces.

Dynamic perspective: In this part, we analyse the importance and relevance of the subsidiary drivers according to the evolutionary paths. The section 3.2 presented a number of possible evolutionary paths in the subsidiary roles. For the sake of simplicity, they all were split into four distinctive groups:

(1) Evolution of roles from market-seeking to efficiency-seeking motives (from Roles 1 and 2 to Roles 3 and 4); (2) Evolution of roles from efficiency-seeking to asset-seeking motives (from Roles 3 and 4 to Role 5); (3) Evolution of roles from market-seeking to asset-seeking motives (from Roles 1 and 2 to Role); this is a case of “leapfrogging”, effectively skipping the efficiency-seeking stage; and (4) no evolution, entailing no changes of motives; however, changes may happen between the market-seeking Roles 1 and 2, and between the efficiency-seeking Roles 3 and 4. These changes are not treated as subsidiary evolution, since these roles are rather substitutive to each other).

We use the current levels of subsidiary initiative (*SUBINIT*), HQ assignment (*HQA*) and local dynamism (*LOCDYN*) in relation to the evolutionary paths outlines above. In this exercise we assume that subsidiaries had the same or virtually similar levels of these variables at the time of the evolutionary change. This is a viable assumption since the change of the roles did not happen overnight, and likewise, the variables are not expected to change drastically within a limited period time.

The ANOVA analysis was conducted for these four groups of subsidiaries, and the following results were obtained (*Table 5*). The ANOVA test reports the statistically significant differences for the subsidiary initiative (*SUBINIT*) and HQ assignment (*HQA*), and not so for local dynamism (*LOCDYN*). Subsidiary initiative (*SUBINIT*) fluctuates considerably across the sample. It is measured on a 7-point Likert scale, with 1 meaning extremely low level of initiative, and on the opposite, 7 meaning exceptional pro-activeness of subsidiary management. The value for the full sample constituted 4.1672. It is no surprise that subsidiaries that did not evolve show the lower value (3.9737). However, an even lower score is achieved by the Evolution 1 subsidiaries. It might seem strange; yet, the Evolution 1 is a very basic type of transformation, and it might not be steered by the subsidiary management. As for the Evolution 2 and Evolution 3 subsidiaries, much higher values are recorded. It entails that subsidiary management was a crucial force behind the subsidiary evolution towards the asset-seeking subsidiary type – Role 5. The highest mean value (6.0667 on 7-point scale) belongs to the subsidiaries that leapfrogged the efficiency-seeking motive stage and transformed directly from market-seeking to asset-seeking motives. Strong subsidiary initiative and pro-activeness are required to accomplish such leap.

HQ assignment (*HQA*) is another driver of subsidiary evolution. Measured on a 3-point Likert scale, it reaches the maximum in the case the subsidiary enjoyed a high degree of freedom in its actions. Comparison of the mean values across the five categories leads to a finding similar to the levels of subsidiary initiative. The mean value for the full sample is 1.9615. Below this mean value are subsidiaries without evolution (1.9364) and Evolution 1 subsidiaries (1.5667). Evolution 1 and Evolution 2 subsidiaries achieve higher values: 2.2917

and 2.3889 respectively. It entails that a higher degree of granted decision rights are necessary for more advanced types of subsidiary evolution.

Table 5. Characteristics of the subsidiary evolution drivers for three types of subsidiary evolution

Type	Description	SUBINIT	HQA	LOCDYN
Evolution 1	From market- to efficiency-seeking motives	3.8000 (1.05830)	1.5667 (0.38370)	4.4800 (0.75631)
Evolution 2	From efficiency- to asset-seeking motives	5.5500 (1.11206)	2.2917 (0.55067)	5.2500 (1.18181)
Evolution 3	From market- to asset-seeking motives	6.0667 (0.39328)	2.3889 (0.40369)	5.5000 (1.02567)
No evolution	No change in motives	3.9737 (1.53216)	1.9364 (0.54905)	4.9639 (1.08735)
Full sample		4.1672 (1.55554)	1.9615 (0.55058)	4.9862 (1.07218)
ANOVA		F=5.143 Sig=.003	F=2.745 Sig=.048	F=0.919 Sig=.435

Notes: Standard deviation in parentheses.

Source: created by authors via own calculations.

Last but not least, the dynamism of the local environment (*LOCDYN*) is recognised as an essential driver of subsidiary evolution. Although the ANOVA does not show statistically significant differences between the groups, the mean values for different types of subsidiaries vary greatly. The pattern is consistent with the one for the subsidiary initiative and the HQ assignment.

Dynamic and static perspectives. To sum up, both dynamic and static analyses identify the subsidiary initiative (*SUBINIT*) as significantly different among the groups. Moreover, the dynamic analysis comes to the same conclusion for the HQ Assignment (*HQA*). Overall, a distinctive pattern emerges whereby the most advanced evolutionary paths in a dynamic perspective and the most advanced subsidiary roles in a static perspective are related to the higher magnitude of the drivers of subsidiary evolution.

Discussion and conclusions

The eastward EU enlargement was an important event in the history of modern Europe, in terms of its political, social and economic implications. The time for evaluating the effects of EU membership in Central and Eastern Europe is short. Besides, EU-membership-specific factors are strongly intertwined with some of the transition-specific factors, as they worked in the same direction. In fact, the adoption of the EU's *acquis communautaire* aligned new EU member states with the "old" Western Europe, and thus lowered the risks for FDI.

Prior research (Hoskisson *et al.*, 2000) suggests that at the initial stage of market liberalisation and economic transformation in the CEE region, the market-seeking operations of multinational companies dominated, and hence the market-seeking subsidiaries were established, with little integration in the global corporate networks of multinational companies. Starting from market-seeking strategies they moved to efficiency-seeking strategies and used the region as a workshop to serve the affluent Western European market. The low cost of inputs served as a competitive advantage. Yet, this competitive advantage is being eroded as the local inputs are becoming more expensive (and of higher quality). These considerations serve as a background for the present study.

Changes in each particular subsidiary are determined by an idiosyncratic interplay of enabling conditions and actions of various actors. Each case of subsidiary evolution in terms of changing the roles should be considered separately within its unique context. However, some general trends and patterns can be discerned, which will contribute to our academic understanding of this dynamic, subtle and complex process.

By and large, the change of roles of subsidiaries does take place. Yet, this phenomenon is not linear and automatic. The change may even happen backwards, i.e. the subsidiary transforms to a more inferior role, e.g. by divestment. Further, several cases of leapfrogging are found in the changes of roles.

Prior studies (Pearce and Tavares, 2000a) postulate that Role 5 only becomes available to a host country once it joins a trading bloc. This paper partially supports this claim. In fact, several subsidiaries stated they had the Product Mandate status back in 2003. This might be explained by the continuous nature of the CEE countries' accession to the EU. In the expectation of EU membership, multinational companies had an opportunity to restructure and reorganise their operations in the region.

A distinctive difference is found in the strength of the importance and relevance of the three subsidiary drivers for each of the five subsidiary roles. The identified pattern is that overall, the relevance and importance of each of the drivers of subsidiary evolution are higher for more advanced subsidiary roles.

Both dynamic and static analyses identify the subsidiary initiative (*SUBINIT*) as being significantly different among the groups. Moreover, the static analysis comes to the same conclusion for the HQ assignment (*HQA*). A distinctive pattern emerges whereby the most advanced evolutionary paths in a dynamic perspective and the most advanced subsidiary roles in a static perspective are related to the higher magnitude of the drivers of subsidiary evolution. This finding is broadly consistent with the theory and the concept of subsidiary evolution (Birkinshaw and Hood, 1998). The empirical analysis indeed finds the three drivers of subsidiary evolution important in explaining the transitionary paths of subsidiaries.

The impact of the EU integration on already established subsidiaries of foreign multinational companies has been (and remains) an under-researched topic. This paper aimed to contribute to this nascent research stream on the interplay between the types of subsidiaries and the regional economic integration. The focus of these studies, however, has been on the sourcing patterns of subsidiaries (Tavares and Young, 2006) or strategic motivation and market served in terms of foreign trade (Manea and Pearce, 2006). Our contribution in the present study is the explicit analysis of the relevance and importance of the driving forces of subsidiary evolution for each of the subsidiary roles, as well as the subsidiary competences.

Further, while the main method of analysis of the above mentioned studies has been the static perspective, we analyse this phenomenon from both static and dynamic perspectives, since the subsidiary evolution is a dynamic process. This is a novel approach to the research topic and to our knowledge no study so far has been done in this manner.

Managerial implications

The evidence argues in favour of a gradualist approach to an unfamiliar and economically unstable environment, and yet promising a good potential. In the context of new EU member states, product differentiation and the use of local capabilities rather than cost-competitiveness are the way forward. The use of creative assets in CEE may be a more viable strategy for multinational companies rather than relying on cost-competitiveness. While the European integration creates more beneficial conditions for multinational companies, these opportunities should be carefully exploited by multinationals themselves.

Policy implications

The host country government should strategically link FDI, innovation and regional policies, in order to facilitate subsidiary evolution and therefore, to boost the competitiveness of a national economy.

Further, the policy implications specific to the current situation of the global economic malaise can be formulated. As the global demand for manufactured, or consumer durable goods is shrinking, it is the export-oriented efficiency-seeking subsidiaries that are to suffer the most. HQ may wish to cut or centralise production in specific subsidiaries, hence negatively affecting the others. As the economic crisis is unfolding globally, national governments are limited in their individual response; hence there are hardly any policy measures they can take to help these subsidiaries to withstand the deteriorating conditions. However, the national governments should be aware of these potential developments in this “group of risk”, and be prepared for workforce lay-offs and decreasing tax revenues. On the other hand, there are Role 5 - Product Mandate subsidiaries. They seem to be more resilient in the time of crisis, as the HQ will aim to preserve and support these subsidiaries – “diamonds” in the corporate network. It is hardly possible to imagine complete closure of these subsidiaries. While there can be decline in manufacturing activities of (and subsequent lay-off of workforce), it is reasonable to suggest that the R&D function will still be retained.

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ĮMONIŲ FILIALŲ VAIDMENS EVOLIUCIJA IR REGIONINĖ EKONOMIKOS INTEGRACIJA EUROPOJE

Sergey Filippov, Geert Duysters

SANTRAUKA

Regioninė ekonominė integracija pasirodė kaip sklindanti jėga visuose kontinentuose. Europos Sąjunga (ES), šiuo metu susidedanti iš 27 valstybių narių, reprezentuoja žinomiausias penkiasdešimties metų senumo ir pažangiausias pastangas regioninės integracijos srityje. Prisijungimas prie ekonominio bloko paskatina šalies patrauklumą investicijoms iš naujų užsienio investitorių. Be to, tai priveda prie egzistuojančių korporacinių multinacionalinių kompanijų tinklų konfigūracijos.

Šio straipsnio tikslas prisidėti prie šios atsirandančios tyrinėjimo srovės per sąveikas tarp įmonių filialų tipų ir regioninės ekonominės integracijos prizmę. Straipsnyje nagrinėjama 2004 m. ES plėtra ir jos poveikis užsienio įmonių filialų steigimo Čekijoje, Vengrijoje ir Lenkijoje padariniai. Autoriai pateikia įmonių filialų evoliuciją, išreiškiant jų vaidmenis ir varomųjų jėgų poveikio vertinimą.

REIKŠMINIAI ŽODŽIAI: įmonių filialų evoliucija, multinacionalinės korporacijos, pereinamasis laikotarpis, integracija, Rytų Europa.