1998

Private enterprise in Bulgaria: A strategic assessment of opportunities in an emerging democracy

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PRIVATE ENTERPRISE IN BULGARIA:

A STRATEGIC ASSESSMENT OF OPPORTUNITIES IN AN EMERGING DEMOCRACY

by

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presented in partial fulfillment of the requirements

for the degree of

Masters of Business Administration

The University of Montana

1998

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6-2-98

Date

Conklin, David G., M.B.A., May, 1998 Business Administration

Private Enterprise in Bulgaria: A Strategic Assessment of Opportunities in an Emerging Democracy (105 pp.)

Chairperson: Clyde W. Neu, Ph.D. CWN

The decade of the 1990s has been one of dramatic changes in many Eastern European economies and the fundamental principles that guide them. The collapse of the East Bloc and its economic model opened the door for private enterprise. However for a variety of reasons many East Bloc nations have been slow to restructure their centrally planned economies into market-based economies or to provide a environment suitable for private enterprise to flourish.

In Bulgaria, since the adoption of a new constitution in 1991, seven successive governments have failed to implement the policies, legislation, regulations, standards, and incentives needed to permit market reforms to take hold. The result has been a decline in the standard of living to the level of the early 1970s, a decline in domestic consumption, loss of foreign markets, especially in the former East Bloc, and the loss of much of the domestic market to foreign competitors. Bulgaria has been described as a microcosm of what was wrong with the Soviet communist economic system. An understanding of how the restructuring of its socioeconomic system is affecting Bulgaria's ability to become an effective international competitor provides valuable insight into the opportunities and risks private enterprise investors should expect in former socialist countries.

This strategic assessment identifies the climate for private enterprise investments and future trends within Bulgaria. It begins with an overview of Bulgaria's economic, historical and geopolitical context and the current government's vision, objectives, and strategies. Key industries and markets are identified by total export value, and categorized into potentially globally competitive industry clusters by upstream, industrial and supporting, and final consumption functions. Factors affecting private investment are identified and analyzed using categories from Porter's studies of national competitive advantage.

Strategic business management tools and techniques are used to forecast industry cluster and market segment opportunities on a countrywide basis. The analysis suggests industries that may be attractive to investors include: petroleum/chemicals, textiles/apparel, food/beverage, and materials/metals. The best competitive strategies are to compete on the basis of low cost at an acceptable level of quality. Bulgaria's geographical and logistical advantages could be enhanced by adoption of an industrial policy and an export-promotion strategy. A visual risk assessment model identifies the risk factors that pose danger to private enterprise investments.

Investors can benefit from emerging private enterprise opportunities in Bulgaria; but only if they are cautious, know their industries and markets well, and are able to accept a good deal of risk.

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PREFACE

I am fortunate to have been able to live and work in Bulgaria during 1997 and 1998 as a representative of the United States of America to the Republic of Bulgaria. Although my degree emphasis was on government and non-profit organizations in international business, I did not originally anticipate the opportunity to complete it in a foreign country. As a reserve Lieutenant Colonel in the U.S. Army however, I found that an unexpected active duty tour as Deputy Chief of a United States military liaison team can change many plans. While working on this study in Bulgaria I learned much about the economy and culture of Southeastern Europe. I found that I could not understand or assess economic trends or business strategies without a knowledge of the culture and turbulent history of the Balkans. On the surface, Bulgaria looks and feels like much of the rest of Europe, but down deep there are feelings, traditions, and long-held beliefs that distinguish the Bulgarian character from all others.

This paper is understandably written from an American point of view, most importantly because I discovered that American business generally has little knowledge and direct contact with Eastern Europe, outside of a few multinationals. Even these have discovered that their lack of knowledge about cultures and traditions has cost them dearly at times. I found the British, the Dutch, and the Germans much more knowledgeable and involved in business ventures in newly emerging democracies, and with good reason, as their contact has been closer and continuous.

Unlike my preconceived notions of Eastern Europe, I found the people of Bulgaria to be rich in warmth and friendliness, and the country of Bulgaria to be wealthy in scenery and history. I also found that this 5,000 year old treasure chest of culture carries with it the curse of wars and conquests, the memories of which create a popular folklore that lies deep within the subconscious mind of the people and affects their daily decisions about their lives and their future. Add to this mix the upheaval of transition from a centrally-planned socialist political-economic structure to a democratic market-based system; and you can begin to get an idea of the forces that affect this economy; the businesses that compete in it; and this business environment that is becoming increasingly and inevitably global.

I would like to thank my colleagues and friends in Bulgaria who helped with this study, many of which are listed as References under Business Contacts. Special thanks also to Colonel Joseph B. Corcoran, Chief of the Military Liaison Team; Janet R. Potash, Second Secretary and Economic Advisor at the American Embassy; Lyubaslava Boyanina, Co-Director of Lyub Travel Agency; Snejana Ianeva, Director of the Information Resource Center at the American Center, and Stormy Good-DeLepper, Professional Paralegal and Editor. At The University of Montana I had the good fortune to have on my committee: Dr. Clyde Neu, Chair, Dr. Nader Shooshtari, and Dr. Paul Larson. Finally, I must acknowledge the contribution of my family—Mary, Chris, and Dacia. Although they did not write a single word, they supported, encouraged, and inspired me during the year despite being separated by thousands of miles.

I. INTRODUCTION

We, Bulgarians too, must develop the feeling of a nation which enjoys equal rights with the other European nations.
Ivan Bogorov, No. 1, "Bulgarski Orel," the first Bulgarian newspaper, 1846.

In a recent report on financial market trends, the Paris-based think-tank Organization for Economic Cooperation and Development (OECD) noted that the process of globalization shows little signs of relenting. Cross-border investment continues to pursue potential profits offered by rapid deregulation, privatization, and the removal of monopolies across much of the world during the 1990s. It is estimated that privatizations alone hit a record $88 billion in 1996 (The Wall Street Journal, July 15, 1997). Yet foreign investors must deal with a unique set of issues, opportunities, and constraints in every nation. The Eastern European country of Bulgaria is no exception (see map Figure 1).

Productivity and profitability in any company and industry are inextricably tied to the differences among nations, their differences in national character, and their corresponding effects on competitive success. Nations prosper in industries that draw momentum from unique elements of their histories and characters. The national environment shapes the way opportunities are perceived, the way skills and resources are developed, and how efficiently they are mobilized. Nations such as Bulgaria, and the regions within Bulgaria, also differ markedly in economic prosperity as a result of these forces.

For many years some nations, including Bulgaria, have resisted international competition in order to preserve their national identity. However Michael Porter (1990,

Figure 1. Map of Europe.

736) argues that instead of submerging national character, the removal of distortions to open international competition make national character more decisive.

In other words, globalization makes nations more, not less, important. Dominant nations tend to export their culture and character to other nations (such as the United States has done with its firms, its media, its political power, and its military power) which in turn increases their competitive advantage. As globalization continues, countries such as Bulgaria will increasingly have to make choices between maintaining historical ideologies by restricting international trade and foreign investment, and upgrading national well-being by rewarding more competitive business methods.

The decade of the 1990s has been one of dramatic changes in many European economies and the fundamental principles that guide them. Many former Soviet republics and Eastern European socialist nations including the Republic of Bulgaria have admitted to themselves that some of their basic premises have been obstacles to economic progress. Many are slowly beginning to restructure their centrally planned economies into market-based economies where the decisive advantage for effective and peaceful competition for world markets is based on innovation, competition, and reward for effort. These possibilities may be tested soon as European Union agreements are implemented which eliminate restrictions on trade and investment within the 15 member countries. This is an exciting time for both political and business leaders in Bulgaria, and effective leadership must be developed at all levels if incentives, effort, perseverance, innovation, and competition are to become the basis for economic progress and productive, satisfied citizens.

Research Problem

Just as the principal economic goal of a business is to produce a high and rising standard of living for its owners, the goal of a nation is to do the same for its citizens. In a free and open economy, competitive advantage depends on how productivity resources (labor and capital) are employed. The productivity of human resources determines their wages, while the productivity of capital determines the return it earns for its holders. Productivity is also an important determinant of a nation's standard of living.

Productivity growth will require the Bulgarian economy to continually upgrade itself. This means that the firms doing business in Bulgaria must relentlessly improve productivity in existing industries by raising product quality, adding desirable features, improving product technology, and/or boosting production efficiency. To increase their productivity, and thus competitiveness, firms must develop capabilities to produce increasingly differentiated products and introduce rising levels of automation to boost output per worker. In addition, they must develop capabilities to compete in sophisticated industry segments, and in new and sophisticated industries.

Through international trade, Bulgaria can raise its productivity and eliminate the need to produce all goods and services within its borders. Bulgarian firms can specialize in those industries and segments in which they are relatively more productive, and import products and services where they are less productive than foreign firms. Both imports, as well as exports, are integral to productivity growth as no nation can be competitive in, and export, everything. Competitive advantage is gained by expanding exports from the most productive industries, shifting less productive industries abroad through foreign investment, and importing goods and services where Bulgaria's firms are less productive.

Therefore it is important to note that as Bulgaria's economy develops, striking differences in competitive success across industries will appear. International advantage will become concentrated in narrowly defined industries as a result of differences from other countries' national economic structures, values, culture, institutions, and histories which contribute profoundly to competitive success (see Table 1). These differences will become even more apparent if economic policies are eliminated which emphasize protectionism and intervention, because it is these policies that keep firms and entire national industries from being truly competitive. As trends in globalization continue to remove impediments to trade and the protection of noncompetitive domestic firms and industries, each nation takes on a growing significance as a "home base" for a unique set of successful global competitors and particular industries based on core product and process technologies. The problem is to predict which firms and which industries in Bulgaria have the greatest potential for profitability and competitive advantage, and to determine how and when to invest capital. To do this, one must first understand how the determinants of competitive advantage are created and sustained within the Bulgarian national context.

Table 1. A Comparison of Economic and Demographic Characteristics for Bulgaria and Selected Countries, 1996.

Characteristic	*Bulgaria*	*Hungary*	*Germany*	*USA*
Population (millions)	8.4	10.2	84.1	268.0
Land Area (sq. mi.)	42,822	35,919	137,830	3,675,031
Nominal GDP ($ blns)	$10.2	$44.3	$1,450.0	$7,636.0
GDP Growth (% change)	-10.9%	1.0%	4.6%	4.8%
Industrial Production	-7.9%	3.4%	4.6%	3.8%
Annual Population Growth	-0.5%	-0.4%	-0.2%	0.6%
GDP Per Capita	$1,038	$4,357	$17,900	$27,607
GDP per employee	-7.3%	1.4%	3.8%	1.8%
Exports as % of GDP	47.9%	32.0%	30.1%	8.1%
Imports as % of GDP	45.8%	-38.0%	24.9%	10.4%
Inflation	123%	23.6%	1.4%	2.9%
Exchange Rate (per $)	177.6	152.6	1.81	--
Average monthly wage	$82	$315	NA	$2,248
Unemployment	12.5%	10.5%	12%	5.4%

Sources: IMF, Bulgarian National Bank, Bear Stearns, World Almanac.
NA = Information not available

Until 1989, Bulgaria was one of the former East Bloc satellite states that followed the Soviet centrally planned economic model most strictly. There was no private business to speak of, and even retail trade was thoroughly "socialized." Only farmers were allowed to have the personal use of small plots of land, although they could not own them, a situation similar to that of collective farmers in the Soviet Union.

The collapse of the East Bloc and its economic model opened the door for private enterprise in Bulgaria. During the last seven years, however, only limited progress was made in restructuring legal, economic, and political systems in the country. This led to a paralyzing financial crisis and economic collapse in January 1997 (see Table 2). The result was a decline in the standard of living to the level of the early 1970s, a decline in domestic consumption, and the loss of foreign markets, especially in the former East Bloc, as well as the loss of much of the domestic market to foreign competitors (Dadak, 1995).

Table 2. Selected Measures of Bulgarian Economic Performance.

Economic Indicator	*1990*	*1995*	*(projection) 1997*	*(forecast) 1998*
GDP Growth (% change)	-9.1%	2.1%	-8.0%	3.0%
CPI Inflation	21.6%	62.2%	1,049%	30%
Population (millions)	8.95	8.40	8.38	8.37
Industrial Production Growth	NA	-6.3%	-9.0%	4.0%
Unemployment Rates	NA	11.1%	16.5%	19%
Exports ($millions)	2,500	5,344	5,000	5,200
Imports ($millions)	3,300	5,224	4,700	5,000
Current Account Balance ($millions)	-1,200	-361	162	NA
Budget Balance (% of GDP)	NA	-6.6%	-6.2%	-3.0%
Gross External Debt ($millions)	10,900	9,539	9,832	9,900
Net Foreign Investment ($millions)	10	163	600	NA
Average Exchange Rate (lev/$)	2.4	67.2	1670	NA

Source: IMF, Bulgarian National Bank, Bear Stearns, 1997.
NA = Information not available

It is not clear how long it will be before Bulgaria will be able to generate the sustained, rapid economic growth necessary to raise its standard of living. As in most transition economies, foreign investment—especially in new plant and equipment for production of goods for export—is vital for achieving such growth (Bakhshian & Wyzan, 1997). Unfortunately, the Bulgarian attitude toward foreign investment has been encouraging in principle, but discouraging in practice. Although Bulgaria has one of the more liberal foreign investment laws in the region, successive governments have limited their encouragement of foreign direct investment to rhetoric while failing to implement policies, legislation, regulations, standards, and incentives (American Embassy, 1997).

In April, 1997 Bulgaria's ruling Socialist party finally bowed to public unrest and was replaced by a United Democratic Forces (UDF) coalition party in early elections (Hanke, 1997). Since then, Bulgaria generally has pursued sound macroeconomic policies and political democratization, which has resulted in low inflation and a stable currency. Bulgaria now needs to rejuvenate its restructuring and privatization programs in order to reverse the nation's stagnant, deteriorating economic performance.

Purpose of Study

The purpose of this study is to conduct a strategic assessment of the climate and future trends for private enterprise in the emerging democracy of Bulgaria. It is demonstrated that generally accepted business management tools and techniques can be used to identify and analyze industry and market opportunities on a countrywide basis. The analysis suggests specific strategies and methods that private enterprise can use to monitor and take advantage of new opportunities as market-based economies develop in Bulgaria and other newly emerging democracies.

There are two reasons to study Bulgaria's transition from a centrally planned to a market-based economy. First, the Bulgarian economy was patterned more than any other in the region after the gargantuan Soviet system with a massive heavy-industrial sector, huge agro-industrial complexes, and an ever-increasing concentration of the population in urban areas fed by a corresponding depopulation of the countryside (McIntyre, 1988).

Some have called Bulgaria the "most Soviet" of the Eastern European countries, referring to it as the "16th Soviet republic" (Yarnal, 1995). Second, on a per capita basis and adjusted for purchasing power parity, Bulgaria was perhaps the least efficient economy in the world during the communist era. Nowhere were the excesses of the Stalinist love for giant enterprises and production-at-any-cost more apparent. Bulgaria has been described as a microcosm of what was wrong with the Soviet communist economic system (Somogyi, 1993). An understanding of how the restructuring of its socioeconomic system is affecting Bulgaria's ability to become an effective international competitor will provide valuable insight into the opportunities and risks private enterprise investors should expect in former socialist countries. Also, Bulgaria is a small country, with roughly the land area and population of Pennsylvania, so the scale is large enough to provide complex interactions between society and industry, but small enough to be manageable for this study.

How can Bulgaria achieve international success in particular industries? What are the determinants that shape the environment in which local firms must compete? What are the attributes that promote or impede the creation of competitive advantage? Answers to these questions begin with a country overview in Chapter II, which first explains the historical and geopolitical context that affects Bulgarian business decisions and operations. This is followed by an outline of the current government's policy statements regarding its vision, objectives, and strategies. Chapter III reviews Bulgarian industries and their markets that may have potential to become internationally competitive.

Chapter IV is an external environment scan. It includes data about economic, financial, political, legal, social, and competitive issues; and markets, production costs, and labor productivity. This chapter discusses factors affecting private and foreign investment, and relies heavily on concepts from Michael Porter (1990) and international trade theory. Chapter V assesses Bulgaria's current strategic position, including internal strengths and weaknesses, and distinctive competencies and competitive advantages, using specialized business forecasting tools and techniques. This is followed by a modified Threats, Opportunities, Weaknesses, and Strengths (TOWS) Analysis to determine the current strategic position of key industries and markets.

In the final chapter (Implications and Recommendations), current and future trends that are likely to affect key industries and markets in Bulgaria are identified based on the above business management theories, tools, and techniques. A Visual Investment Risk Assessment Model is suggested as a tool for predicting industry and market investment risk in transitional economies where accurate and precise financial measures do not exist.

Definition of Terms

There is a glossary at the end of this paper that defines many of the specialized terms and abbreviations used herein. A more thorough treatment of some of the broader concepts, business tools, and techniques is provided below.

To investigate why nations gain competitive advantage in particular industries and the implications for firm strategy and for national economies, Harvard Business School professor Michael Porter conducted a four-year study of ten important trading nations (Porter, 1990, 21). Based on the study, he developed a theory of national competitive advantage which states that success in international trade comes from the interaction of four country- and firm-specific determinants, which are represented within Porter's Diamond of National Competitive Advantage (see Figure 2). These determinants, and the components used in their assessment, are defined below (Porter, 1990):

1. **Factor Conditions.** The nation's position in factors of production, such as skilled labor or infrastructure, necessary to compete in a given industry:

    a. Human resources
    b. Physical resources
    c. Knowledge resources
    d. Capital resources
    e. Infrastructure

2. **Demand conditions.** The nature of home demand for the industry's product or service:

    a. Nature of buyer needs
    b. Size and pattern of growth
    c. Mechanisms for transmitting demand conditions to foreign markets

3. **Related and supporting industries.** The presence or absence in the nation of supplier industries and related industries that are internationally competitive:

    a. Location of supporting industries
    b. Competition among supporting industries

4. **Firm strategy, structure, and rivalry.** The conditions in the nation governing how companies are created, organized, and managed, and the nature of domestic rivalry:

a. Nature of competition
b. Investment in R&D

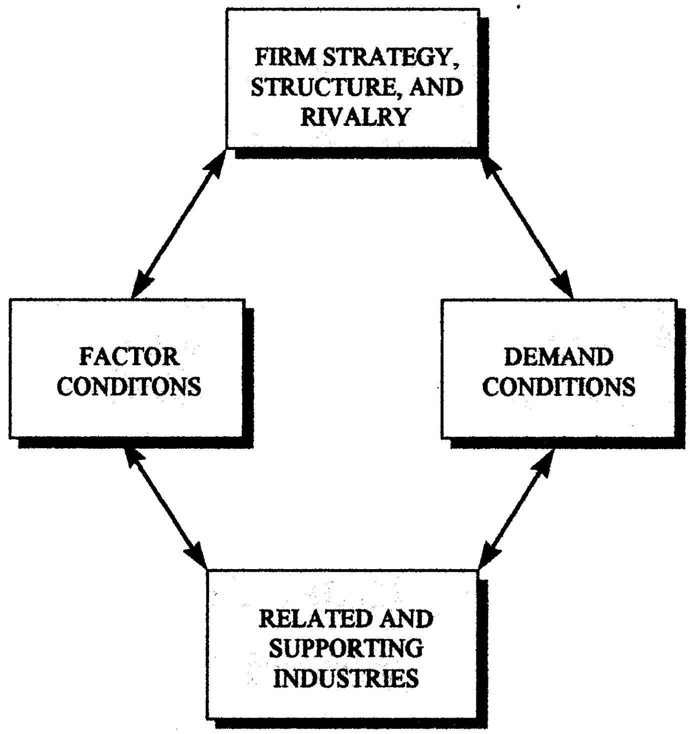


Figure 2. Porter's Diamond of National Competitive Advantage (Porter, 1990).

The other specialized business forecasting tools and techniques that are used in this paper are defined below in the order they appear in the reference by David (1997):

1. **External factor evaluation (EFE) matrix.** A technique that allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information (p. 129).

2. **Competitive profile matrix (CPM).** A technique that helps identify a firm's major competitors and their particular strengths and weaknesses in relation to that firm's strategic position (p. 130).

3. **Internal factor evaluation (IFE) matrix.** This strategy-formulation tool summarizes and evaluates the major strengths and weaknesses in the functional areas of a business, and it provides a basis for identifying and evaluating relationships among those areas (p. 164).

4. **Threats-opportunities-weaknesses-strengths (TOWS) matrix.** Also known as a SWOT matrix, this matching tool helps managers develop four types of strategies based on analysis of the above, four key external and internal factors (*i.e.*, threats, opportunities, weaknesses, and strengths) (p. 180).

5. **Strategic position and action evaluation (SPACE) matrix.** Another matching tool for stage 2 analysis of appropriate conservative, aggressive, defensive, or competitive strategies based on external and internal dimensions (p. 184).

6. **Boston Consulting Group (BCG) matrix.** This is a portfolio matrix designed specifically to enhance efforts to formulate competitive strategies within an industry (p. 187).

7. **Internal-external (IE) matrix.** This is another portfolio matrix which plots various industries on a nine-cell display of various strategies with weighted scores (p. 190).

8. **Grand strategy matrix.** This is a popular tool for formulating alternative strategies using four strategy quadrants based on competitive position and market growth potential (p. 191).

9. **The quantitative strategic planning matrix (QSPM).** This analytical technique is designed to determine the relative attractiveness of feasible alternative actions (p. 193).

II. COUNTRY OVERVIEW

> *. . . the Bulgarian reality is inextricably mixed with the symbolic and the abstract. We are subject to the impact of far more factors and forces than the Western citizen can imagine. While the citizen in the West is constantly striving to acquire ever more, our main instinct is to preserve what we have.*
>
> Georgi Markov, "The Truth That Killed," (Kaplan, 1996, 191).

Historical and Geopolitical Context

Bulgaria (see map Figure 3), is bounded by the Black Sea to the East, the Danube River to the North and mountains along its frontiers with Greece and the former Yugoslav Republic of Macedonia. The country has an area of 111,000 sq. km (42,822 sq. mi.) and a population of 8.3 million (Panov, 1997). Bulgarians have a keen sense of national identity distilled by centuries of turbulent history. In a constantly repeating cycle of grandeur, decline and national rebirth, Bulgarian states have striven to dominate the Balkan peninsula before succumbing to defeat and foreign tutelage, only to be regenerated by patriotic resistance to outside control. The Bulgarian culture, religion and language are essentially European despite over 500 years of occupation by the Ottoman Turks. The Bulgarian language was profoundly influenced by the brothers Cyril and Methodious, who in 863 created and spread the Slavonic alphabet throughout the region. The Bulgarian language is distinctly Slavic and has similarities to Russian and Polish. Most Bulgarians belong to the Bulgarian Orthodox Church, an autonomous branch of the Eastern Orthodox Church. Christianity was established as the state religion in 864. The church contributed to the development of the Bulgarian nation by preserving its language and cultural traditions in isolated monasteries during the time of Turkish occupation.

Figure 3. Map of Bulgaria.

Bulgaria experienced two major periods of autonomy prior to 1393 when the country fell to the Turks. The first Bulgarian kingdom was established in 681. The city of Pliska in northeastern Bulgaria was its capital. It was said to rival Constantinople in the vigor of its commercial and intellectual life. The first kingdom reached the height of its power in the early tenth century. By the eleventh century, however, decline had set in. In 1014, the Byzantines defeated the Bulgarian forces in a battle that resulted in the intentional blinding of 14,000 Bulgarian prisoners. The Byzantine Empire ruled Bulgaria from 1018 until the late 12th century when two brothers, Ivan and Peter Asen, launched a successful revolt that led to the establishment of the Second Bulgarian Kingdom. The second kingdom, with its capital in Turnovo, had many popular and powerful rulers. A gradual deterioration of the second kingdom culminated in its fall in the late 14th century to the Ottoman Turks.

The following five hundred years of Turkish occupation had a distinct and long lasting impact on the Bulgarian national consciousness. Being geographically the closest of the Balkan nations to the heart of the Ottoman Empire, Bulgaria had to endure the full force of the Ottoman thrust into Europe. Bulgarians had virtually no rights or influence over their government while under the "Ottoman Yoke." Bulgarian boys were frequently taken from their families at an early age to serve in the Ottoman's famed elite Janissary Corps.

By the nineteenth century, the gradual weakening of the Ottoman Empire, the rise of nationalism in Bulgaria, and a cultural heritage preserved in the monasteries created conditions for Bulgarian literature and culture to flourish. During this period a Bulgarian national revival began, inspired by such figures as the famed revolutionary, Vasil Levsky. By 1876, the movement's momentum inspired Bulgarian patriots to launch the "April Uprising." The uprising's brutal suppression by the Ottoman Turks helped provoke the Russo-Turkish War, which ended in 1878 with the defeat of the Ottoman Turks and the liberation of Bulgaria (Naughton, 1996).

Both Russian and Turkish influences can be seen in present day Bulgarian life. Reminders of the Turkish presence can be seen today in the deteriorating or converted

Turkish baths, the occasional mosque, and the sizable ethnic Turkish population. Many Turkish words also have made their way into the Bulgarian language, and traditional Bulgarian music has a unique oriental quality to it. Bulgaria also has strong historical links to Russia. Similarities in language and religion, along with Russia's contribution to Bulgaria's liberation, create a feeling of friendship and brotherhood. No small part of this friendship was due to the fact that, although thousands of Russians died liberating Bulgaria in 1878, the Russian army did not occupy the country, but returned to Russia.

The Treaty of San Stefano, which ended the Russo-Turkish War, created a large Bulgarian nation, including present day Bulgaria, and parts of Macedonia and Greece. The Western European powers at the Congress of Berlin in 1879, however, insisted that this potential power be restricted to occupying land between the Balkan Range and the Danube. Greater Bulgaria was thus dismembered into three major regions: the Principality of Bulgaria, Eastern Rumelia, and Macedonia. In 1885, The Principality of Bulgaria and Eastern Rumelia united and in 1908 became an independent Bulgarian state, and until 1946 was a constitutional monarchy.

Bulgaria participated in the First Balkan War of 1912 against the Ottoman Empire, but Bulgarian territorial ambitions for Macedonia received a severe setback in the Second Balkan War the following year, in which the country lost a considerable part of its territory. At the outbreak of World War I Bulgaria remained neutral, waiting to see which side could deliver the coveted Macedonia. In October 1915, Bulgaria entered the war on the side of the Central Powers. In 1918, Bulgaria's territorial ambitions were again thwarted with the collapse of the Central Powers. Indeed, from 1912 through 1918, Bulgaria lost both territory and thousands of lives in unsuccessful efforts to gain Macedonia.

At the outbreak of World War II, Bulgaria again found itself in a balancing act between the great powers. Forced to choose between Stalin and Hitler, Bulgaria's King Boris III, sided with the Axis powers in March, 1941. Enjoying early success with the Nazis, Bulgaria was able to reclaim approximately the same borders as those established by the treaty of San Stefano in 1878. However, when Hitler's armies invaded Russia in June 1941, Bulgaria attempted to remain neutral by not sending its troops to fight against the Russians. Notably, Bulgaria did more than any Balkan nation to protect its Jewish population by refusing to hand them over to the Germans. Bulgaria, facing impending invasion by the Russians in pursuit of Nazi forces, switched sides and began to fight for the Allies in September 1944. After the War, Bulgaria was briefly occupied by Soviet troops, but when the war was over the major units went home. This is another reason why the Bulgarians hold no resentment towards the Russians.

In September 1946, following a referendum, the monarchy was abolished and a People's Republic declared. By 1947, the Communist Party had fully established its control. In 1956, Todor Zhivkov came to power, and was to rule the country for over thirty years. A highly centralized economic policy gave priority to nationalized industries, resulting in a rapid rise in their share of the economy. In agriculture, collectivization was imposed and cooperatives were reorganized into larger agro-industrial complexes (Brown, 1970). From the 1970s onwards, economic growth slowed; and by the second half of the 1980s, it came to a standstill.

In November 1989, communist rule in Bulgaria collapsed. The transition to democracy, inspired by similar developments in other former communist countries, was sudden but peaceful. Todor Zhivkov was removed from office and an interim government led the country to its first free elections since World War II. Since then, Bulgarian political life has seen repeated changes of government and a significant degree of polarization, but also respect for constitutional order and a virtual absence of violence (Baylis, 1994). Elections in June 1990 were won by the Bulgarian Socialist Party or BSP (also called the "Red" party), successor to the Communist Party. However, the BSP government was soon forced by an economic crisis in November 1990 to resign and be replaced by a temporary "program" government that pushed through the current constitution in July 1991. New elections in October 1991 resulted in a coalition government led by the Union of Democratic Forces or UDF (also called the "Blue" party). That too was replaced by a non-party government in 1993. In 1994 the BSP government was returned to parliament and was again forced by renewed economic troubles to resign in February 1997, to be replaced by an interim government (Beck, 1996; Holman, 1996). President Stoyanov, elected two months earlier with UDF support, played a substantial role in bringing the country through the ensuing political crisis to new elections in April 1997, which produced a majority for the UDF and its allies (European Commission, 1997).

<u>**Government Vision, Objectives, and Strategies**</u>

After the Soviet Union's demise, Bulgaria chose to adopt a slow approach to economic reform. This is a route much championed by former communists in Russia, as well as many other nations now making the transition from centrally planned economies to market-based economies. The argument in Bulgaria, as elsewhere, was that this transition could minimize the pain. It was reasoned that radical reform or "shock therapy," as it was called, would impoverish the masses, while a gradual approach to capitalism could cushion everyone (Agresano, 1994; Washington Post, 1997).

The results in Bulgaria were nothing short of disastrous. Gradual reform, in practice, meant continuing state subsidies to hopeless factories and banks. Instead of helping workers, these subsidies simply offered great opportunities for official thievery on a massive scale. Bulgaria's currency spiraled into hyperinflation, its banks went broke, and children and the elderly became malnourished. While the reformers in parliament argued to get the state out of the economy, the socialists resisted, thereby opening more opportunities for corruption (Jones, 1996). A deep economic crisis began in Bulgaria in May 1996 and reached its apogee when the consumer price index (CPI) rose 242.7 percent in February 1997 alone. The lev fell from 70.4 to the dollar at the end of 1995 to 2,045.5 to the dollar just 14 months later, as the national bank's foreign reserves fell from almost $1.5 billion in June 1995 to roughly a quarter of that in January 1997. The average monthly wage nose-dived from over $127 in December 1995 to under $25 in February 1997 (Frank, 1997; Wyzan, 1998). At the beginning of 1997, Bulgaria teetered on default on external debt payments. Mass public demonstrations against the ruling Socialist Party led to early elections and a new government took office for the seventh time in as many years.

In a 109-page document entitled "Bulgaria 2001," the newly formed government laid the foundation of a four-year reform program coinciding with its expected term of office. The major tenets of this reform program are as follows:

> The ultimate goal of our program is (for) Bulgaria to enter the new millennium as a civilized European country. We know how difficult this will be; we know that the confidence we have received is unique and that it will not be given to us over again. That is why we are determined not to ruin the chance given to us by the Bulgarian people through their votes. (Republic of Bulgaria, 1997).

The program document's major objectives and strategies are restated below:

1. Institutional Building of Democratic Bulgaria (democratic institutions).

Private initiative -- to achieve before the end of the first year, a positive economic growth on the basis of financial and economic stabilization, and to create favorable conditions for the development of private initiatives.

2. Regional Development, Urbanization & Construction (plans, laws, policies).

Policy -- to balance and sustain regional development with a view to gradual bridging over disproportionate funding, to offer actual possibilities for overcoming the crisis, to offer future social and economic prosperity; and to support the strengthening and development of local self-governance.

3. Order and Security (fighting crime and corruption).

Organized Crime -- to provide order and safety for the citizens; to overcome the organized crime and the Mafia.

Government Corruption – to fight corruption "regardless of its political color" (*i.e.* Red or Blue party) so that Bulgaria will become a state governed by the rule of civil law instead of bureaucratic decree; and to send clear signals that it is stable and ready to enter Europe. The intent is to eliminate the possibilities for corruption through deregulation and liberalization, as well as through enhancement of the judicial system (Bulgarian News Agency, July 25, 1997).

4. Bulgaria and the World (European integration and regional security).

Restoring Bulgaria's International Image – by abiding faithfully with agreements with international financial institutions such as the World Bank, and the International Monetary Fund (IMF), and by seeking closer relations with neighboring countries and Western Europe (King, 1996). This includes acceding to European Union (EU) legislation, and applying for NATO membership.

5. Financial and Economic Reform.

Financial Stabilization – A currency board was established on July 1, 1997, as demanded by the IMF, which introduced a fixed foreign exchange rate at 1000 Bulgarian Leva (BGL) = 1 German Mark (DM). The advantage for a small, closed economy like Bulgaria was the establishment of a stable macroeconomic environment encouraging investment and facilitating long-term planning (Bulgarian News Agency, May 13, 1997).

This has restored confidence in the Bulgarian currency, reduced inflation and interest rates, and placed tight restrictions on the government's freedom to print money to finance itself. Currency in circulation is now required to be covered by foreign hard currency and gold reserves, and restrictions are placed on budgeting and financing the national banks.

Structural Reform – to privatize state-owned enterprises so that each of them can have a responsible manager; to restructure or close down loss-making enterprises so that they can stop accumulating losses on behalf of all Bulgarians; and to serve as a source of funds for both the budget and payments on the budget deficit and international loans (Hristova, 1997). These reforms are to include:

- Accelerated privatization and foreign investment
- Banking supervision, restructuring, and privatization
- Tax reform
- Price liberalization
- Liquidation of loss-making state-owned enterprises
- Reopened stock exchange as of October, 1997

Industrial Policy --

- **Trade Policy and Foreign investment** -- to work out up-to-date industrial, trade, investment, and infrastructure policies.
- **Revival of Bulgarian Agriculture** -- to completely restore private ownership over the land and breathe new life into Bulgarian agriculture.
- **Bulgarian Tourist Industry** – to increase the supply of tourist services and raise them to international standards, and to simplify customs and border formalities.
- **Infrastructure** – to secure reliable and efficient energy; postal, telecommunications, and transport systems

6. Preservation of Nature (preventing further pollution of Bulgarian nature).

Policy -- to create modern legislation and State policy, introduce economic regulators to accelerate solutions, provide tax preferences for environmental investments, and create mechanisms for financing environmental projects.

7. Social Policy and Health Care.

Policy -- to establish a social policy that will make every Bulgarian citizen feel safe for his or her present days and for the future.

Administrative Reform – to remove burdensome state regulation of both industrial production and trade, to reform labor laws, consolidate the education system, and restructure free government health care and insurance.

8. The Young People.

Policy -- to keep Bulgarian youth in Bulgaria by providing them with opportunities for creative fulfillment and a chance for a better future.

9. Education and Christian Values.

Education -- to ensure the successful functioning of the system of general education; to introduce a law on vocational education and training; and to guarantee the survival of science in these difficult financial times.

Christian Values – to abide by the principle of separation of state and religion; while guaranteeing a partnership between the executive branch and church institutions; and ensuring the place of the Bulgarian Church both in the field of education and in its traditional role in the army (although religious freedom is allowed, the Bulgarian Orthodox Church is the official state religion).

10. Culture.

Policy -- to preserve educational and cultural traditions, while simultaneously creating favorable conditions for active exchange with leading countries and artists.

11. The Bulgarian Spirit.

Policy -- to restore the significance of universal (especially Christian) values as the basis of the public moral; to enrich our national identification; and at the same time to work for its integration into the common European context.

The above national priorities, as stated by the current government, stress financial and economic reform, but lack specific targets and a commonly shared long range vision. However, it is significant that the new government has already begun to implement some of these priorities (Tsenkov, 1997). If it can continue to do so without alienating the population during the many hardships to come, it may become the first government in seven years to complete a full term in office.

III. KEY INDUSTRIES AND MARKETS

Probably it will always escape them, The wealthy men of the West,
What our people fought and died for, And would defend again,
Or why hordes of our brothers and uncles, Conquered field and hills in days gone by, To build the Kremikovtsi factory, To dig for coal and ore. . .
George Djagarov, "Miracles," (Ward, 1991, 117).

In the past, Bulgaria relied on the market and material base supplied by its communist trading partners. Over three-quarters of its exports went to communist nations, with 56 percent going to the Soviet Union alone. Most of the rest went to developing countries closely tied to the Soviet bloc. Manufactured or semi-finished products made up approximately 60 percent of Bulgarian exports. However, even though nearly two-thirds of the country's gross domestic product (GDP) came from heavy industry, Bulgaria had to import most of its raw materials, including fuels and metals (World Bank, 1991). The country did generate a large agricultural surplus that allowed it to become a net exporter of food. It was, in fact, often called "the breadbasket of the Communist bloc" (Krooth & Vladimirovitz, 1993). Foodstuffs, including tobacco, wine, cheese, and fresh vegetables, accounted for more than 20 percent of exports. During the 1980s, total trade turnover (exports plus imports) equaled 100 percent of the national income.

Until the end of World War II, Bulgaria was a nation of village-based peasant farmers with approximately 80 percent of the population directly dependent on agriculture. In the following decades, many towns became cities as job seekers left the land to work in huge government-owned factories. When communist rule ended in 1989, just 35 percent of the population still lived in small towns and villages. Despite the emphasis on heavy industry, communist Bulgaria did not relegate agriculture to a second-class status. Not only was there little urban-rural differential in Bulgarian society, there was little difference within most other occupational, social, and regional categories. Women were almost totally integrated into all aspects of socioeconomic life. The state was committed to a policy of 100 percent employment that guaranteed all adults a job with reasonable pay. Thus, ethnic Bulgarians (who totaled 90 percent of the population) achieved a level of social and economic equality possibly unrivaled in the Soviet bloc (Yarnal, 1995). Unfortunately, unequal treatment of the two most important ethnic minorities, ethnic Turks and gypsies (also known as Roma), persisted throughout the communist years and remains an issue today. Many institutions created by the socialist state and the mindsets they instilled are enduring and present a significant barrier to Bulgaria's transition from a planned economy to a market-based economy (Danailov, 1994).

When Soviet bloc trade patterns were disrupted after 1989, Bulgaria's foreign trade, including the once-steady agricultural export market, suffered the worst collapse in Eastern Europe. Total volume of exports fell 60 percent in 1991, and Western markets have not yet filled the void (Wyzan, 1993). Since then, only limited progress has been made in reorganizing manufacturing operations, or in work force structure and training, strategic planning, and product development, quality, design, and marketing. There is no money for major investments in machinery and new technology, and most plants are simply struggling to survive without the resources and motivation to become international competitors. The situation in Bulgarian industry today is characterized by significant state ownership, under-utilization of capacities, large losses and debts, declining investment and production, and overall lack of international competitiveness.

In order to identify whether any Bulgarian industries may become successful international competitors, they were positioned using a tool called the Cluster Chart (see Figure 4). This technique, using Porter's (1990) classifications, provides a crude visual profile of all the industries in which there is evidence of potential international success based on export market share combined with clustering of supporting industries.

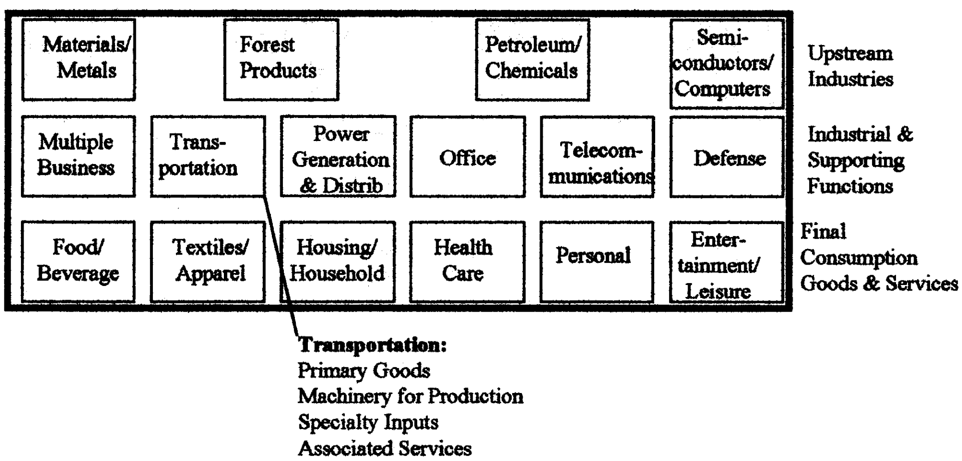


Figure 4. Cluster Chart (Porter, 1990).

Table 3 below shows the top fifteen Bulgarian industries in terms of export value that were used to construct the country profile. The cluster chart in Table 4 shows the resulting clusters of potentially internationally competitive Bulgarian industries. There are no significant clustering of industries in industrial and supporting functions, so this category is not shown in Table 4. Table 5 then groups these industries according to percentage of exports by broad cluster using Porter's methodology (1990, 739). This crude visual profile shows that there are four broad industry sectors in which international competitive positions are related. These may be sufficiently clustered to gain competitive advantages from both rivalry and from other related and supporting industries (see Chapter I, Figure 2). Two clusters, material/metals and petroleum/chemicals, are classified as upstream industries that make products used in making other products. The other two clusters, food/beverage and textiles/apparel, are classified as final consumption goods and services industries. The characteristics of these four and other potentially competitive broad industry clusters and their markets are discussed below within the categories of upstream industries, industrial and supporting functions, and final consumption goods and services.

Table 3. Top 15 Bulgarian Industries in Terms of Export Value.

Industry	*Share of Total BU Exports*	*Export Value ($ millions)*	*Import Value ($ millions)*
Pig iron, iron, steel	2.0%	68.4	16.5
Tobacco	2.0%	66.9	17.3
Nuclear reactor boilers, machines	1.9%	63.7	73.4
Electrical machines, equipment	1.4%	45.3	37.8
Fertilizers	1.3%	43.9	0.0
Fossil fuels, derivatives	1.3%	42.9	258.7
Soft drinks	1.3%	42.6	3.5
Copper, derivatives	1.2%	41.5	8.4
Non-knitwear	1.0%	34.4	0.0
Plastics	0.9%	31.7	25.7
Organic chemicals	0.8%	27.2	20.0
Inorganic chemicals	0.7%	23.3	7.3
Essential oils	0.7%	22.3	0.0
Meat	0.6%	20.3	1.0
Live animals	0.2%	5.6	0.4
TOTAL	17.3%		

Source: Panov, 1997, 74. Note: Data for Jan-Sep, 1996

Table 4. Clusters of Potential Internationally Competitive Bulgarian Industries, 1997.

UPSTREAM INDUSTRIES:

Primary Goods	**MATERIALS / METALS** Pig iron, iron, steel Copper, derivatives	**FOREST PRODUCTS** NONE	**PETROLEUM / CHEMICALS** Organic chemicals Inorganic chemicals Fossil fuels, derivatives Plastics Essential oils	**SEMICONDUCTORS / COMPUTERS** NONE
Machinery	Electrical machines, equip	NONE	NONE	NONE
Specialty Inputs	Reactor boilers, machines	NONE	NONE	NONE
Services		NONE	NONE	NONE

FINAL CONSUMPTION GOODS AND SERVICES:

Primary Goods	**FOOD / BEVERAGE** Tobacco Soft drinks Meat Live animals	**TEXTILES / APPAREL** Non-knitwear	**HOUSING / HOUSEHOLD** NONE	**HEALTH CARE** NONE	**PERSONAL** NONE	**ENTERTAIN-MENT/LEISURE** NONE
Machinery	NONE	NONE	NONE	NONE	NONE	NONE
Specialty Inputs	Fertilizers	NONE	NONE	NONE	NONE	NONE
Services	NONE	NONE	NONE	NONE	NONE	NONE

Source: Porter, 1990, 739; Panov, 1997, 74.

Table 5. Percentage of Exports by Potential Internationally Competitive Bulgarian Industries by Broad Cluster, 1997.

Materials / Metals		**Forest Products**	**Petroleum / Chemicals**		**Semiconductors / Computers**	UPSTREAM INDUSTRIES Share of Country Exports: **10.9%** Share of World Exports:
Share of Country Exports: **6.5%**			Share of Country Exports: **4.4%**			
Multiple Business	**Transportation**	**Power Generation & Distribution**	**Office**	**Telecom-munications**	**Defense**	INDUSTRIAL & SUPPORING FUNCTIONS
Food / Beverage	**Textiles / Apparel**	**Housing / Household**	**Health Care**	**Personal**	**Entertainment / Leisure**	FINAL CONSUMPTION GOODS & SERV Share of Country Exports: **6.4%** Share of World Exports:
Share of Country Exports: **5.4%**	Share of Country Exports: **1.0%**					

Source: Porter, 1990, 739; Panov, 1997, 74.

Note: Shading identifies broad sectors in which the nation's international competitive positions are related.

Upstream Industries

Materials/Metals. In ferrous metallurgy, a relative stabilization of steel output can be observed. Compared to other Central and Eastern European Countries, the steel industry is of medium size. Weak domestic and export demand and quality problems are among the reasons for the recent decline, along with urgent need for modernization, privatization, and restructuring. This is also the case for the non-ferrous sector, where most exports are destined for the EU as well as other Eastern European countries and the Middle East. Growth will not return soon, since a stricter government approach to energy pricing is removing one of the key advantages of the sector.

Forest Products. The overall situation in Bulgaria is characterized by significant state ownership, under-utilization of capacities, large losses and debts, declining investment and production, and overall lack of international competitiveness.

Petroleum/Chemicals. The chemical and oil refinery industry did not suffer so much from the decline due to increased exports of basic chemical products on traditional international markets, and certain subsectors (such as pharmaceuticals) remained profitable independently of the crisis. The primary markets are Russia and other CIS countries. Exports of soda ash go mainly to EU countries, although new markets are developing in Asia (South Korea). Strong exporters have been recently privatized, including two world-class producers in their respective products (calcinated soda and carbamide).

Semiconductors/Computers. The economic and social effects made possible by combining information technology and telecommunications are great. Although Bulgaria played a prominent role in the communist countries' information technology production, these possibilities are proving ineffective due to the lack of technological and manufacturing innovation. Nonetheless, before 1989 general education was a priority. The result is that demand for computers is above normal expectations given the level of GDP per capita. The number of host computers on the Internet (25,000 equivalent to 0.4 per 1000 inhabitants) suggests that Bulgaria has not yet reached the level that the average EU country reached two years ago.

Industrial and Supporting Functions

Multiple Business, Office, Defense. The defense, mechanical engineering, and machine industries were geared toward production for the Soviet bloc. Overall recovery will be very difficult. The sector stabilized as a whole at a very low level, but many enterprises suffered badly from the crisis and are among the heaviest loss-makers. On the other hand, there are strengths such as a highly skilled labor force and, in certain subsectors, good quality capital stocks, which attracted some FDI. The situation is critical in electrical and electronic engineering, and office related industries, and urgent restructuring measures are needed. Almost all output was destined for the former Soviet bloc and apart from a few enterprises that had already developed trade with Western markets, the companies in this sector did not manage to restructure and adapt to new conditions.

Transportation. Bulgaria has a long border with Greece and is on the traditional route from the Middle East to Central and Western Europe. Three Pan-European

Transport Corridors as identified at the Pan-European Conference in Crete cross Bulgarian territory. The fourth corridor is the Danube River, which forms most of Bulgaria's northern border with Romania. The war in former Yugoslavia led to a rise in transit traffic to and from Greece and to a diversion of transit traffic to and from the Middle East. Bulgaria's economic problems caused a sharp reduction in the demand for cargo and passenger transport. Exceptions were maritime cargo transport, resulting from a redirection of the Bulgarian fleet's operations out of the Black Sea basin, and air passenger transport. Bulgaria has been faced with the need to invest in significant improvements to its road network and there is a need to develop the previously very limited border-crossing infrastructure. The lack of investment in infrastructure and equipment for transport during the last decade poses major problems, especially since most public transport equipment will have to be imported. Much of the existing equipment originated from the former Soviet Union, and substantial investments will be needed to replace non-standard or out-of-date equipment.

Power Generation and Distribution. Bulgaria is more than 70% dependent on external energy sources. Oil, gas (26% and 17% of the energy balance) and nuclear fuels are all imported mainly from Russia, and so are most of the limited coal imports. Indigenous solid fuels, particularly low quality lignite, are extracted uneconomically and are a chief source of environmental pollution. Hydropower plays a limited role in the energy sector; uranium mining ceased in 1990. Bulgaria's energy sector is two to four times less efficient than the EU average, contributing to pollution. This situation is due to the heritage of low prices, a lack of energy efficiency policies and obsolete technologies. Bulgaria is an important transit country for natural gas supplies in the region, including Greece (Barrett, 1996). Its regional role may increase in the longer term through oil imports via the Black Sea port of Bourgas and through future gas imports from Central Asia and Iran. Bulgaria's link to the Western European interconnected electricity system is technically feasible, but will require substantial investments and is therefore not expected in the short term. Bulgaria operates a nuclear power plant at Kozloduy, producing around 40% of Bulgaria's electricity. It consists of six reactors of Soviet design and construction that are considered not to meet the safety objectives generally accepted in the EU.

Telecommunications. Although Bulgaria is developing its telecommunications network, much of the equipment remains obsolete and telecommunications services need to be developed. The intention to sell a majority stake in the state telecommunications company has been announced, and should be followed by much-needed investment in upgrading the system. Several existing projects are beginning to produce results, but the telecommunications infrastructure is about seven years behind the EU average, and remains a barrier to information services.

Final Consumption Goods and Services

Food/Beverage. Bulgaria has a strong agricultural tradition (notably in fruit and vegetables) and the food industry has been a logical branch for the country to develop. It has attracted some foreign investors interested in export potential and the low-cost of local production (Thurston, 1996).

In the **agriculture industry,** the majority of private farm holdings are less than two hectares (about 5 acres), and are often split into separate plots too small to economically farm. However private farms have been important social buffers during the transition period. A total of 1.6 million household plots of less than one hectare (2.47 acres) represent 15% of the total area, and 400,000 family farms have between 1 and 10 hectares (ha). Only a few family farms have more than 10 ha. Most of the privatized land is leased to 3,000 private cooperatives, averaging 700-800 ha, often on an annual basis. However there are 2,000 state-managed farms and registered companies still in operation. Approximately 33% of the agricultural land consists of cooperatives, 12% individual farms, and 10% state farms.

Both **arable** and **livestock** production have declined heavily by approximately fifty percent since 1990. Sharp decreases in wheat and feed grain production (barley, maize) occurred from 1995 to 1996. Wheat production dropped 53% from 3.4 million metric tons in 1995 to 1.8 million tons in 1996 (1 metric ton = 1.1 ton). Sunflower production dropped 30% from 760,000 tons in 1995 to 530,000 tons in 1996. Both decreases occurred as a result of reduced areas planted combined with very low yields. Cereal grain shortages have led to accelerated destocking, the need for imports, further reductions in beef cattle and pigs, and substantial price increases.

The decline in the production of **perennial crops** (orchards, vineyards) is significant also, due to market difficulties during the first years of transition and then to lack of care during the land restitution process (Due and Schmidt, 1995).

The **fishing industry** in 1995 produced a total catch of 2,500 metric tons, all from the Black Sea. The high sea fleet consists of six distant water freezer trawlers and sixteen Black Sea vessels, of which five were in private ownership. No catches were registered from distant waters in 1995 compared with a catch of 5,000 tons in 1994. Only two distant water vessels operated on a full-time basis in 1995, on a cost-sharing basis with foreign operators catching non-Bulgarian quotas. Production of inland fisheries amounted to 4,000 tons in 1994 (mainly carp and trout) from 20 state farms employing 500 people plus unspecified output from six privately-owned aquaculture enterprises. Statistics on ownership, production, and employment for 1995 are not available, but production has declined due to the financial problems of state enterprises, and a lack of investment by the newly-emerging private enterprises.

Textiles/Apparel. The position of the textiles and clothing industry is unstable as it was among the worst hit by the transition. The industry is experiencing strong competition from Asian producers. However, the combination of low labor costs, a skilled workforce, and relatively high quality standards may be attractive to foreign investors.

Housing/Household, Personal, Entertainment/Leisure. Many of these industries are represented by small and medium-sized private sector businesses.

Virtually non-existent in the late 1980s, the private sector has grown to account for 38% of value-added products and services in 1995 and approximately 41% of total employment. By the end of 1996, 321,000 private companies were registered (a significant increase over the proceeding three years) compared to 20,000 public owned companies. Data on the size of private companies are not collected, but all available sources suggest that the vast majority are micro-enterprises with less than five employees. An unstable economic environment, high interest rates, high and unstable taxation, and legislative uncertainty are major constraints to private companies in expanding their activities. There is no special legal framework to protect or encourage private companies in Bulgaria at this time (Stewart, 1995).

Health Care. The overall health care situation in Bulgaria is grave. The health system is still socialized, and faces major difficulties, including occasional shortages of medicine and basic medical instruments. Recent legislation does not allow doctors who work for state institutions to open private practices.

Overall, Bulgaria's largest volume of foreign trade, 49%, was with OECD member countries, of which EU countries captured nearly 39% of total trade turnover. The largest trading partners within the EU countries are Germany, Italy, Greece, France and the United Kingdom. The second major market for Bulgarian trade is Central and Eastern Europe, and the CIS states, which account for 36% of total turnover. Russia and the Ukraine account for nearly 26% of this portion. Asia and other countries make up the remaining 15% (see Figure 5). Countries neighboring Bulgaria account for 17% of trade volume.

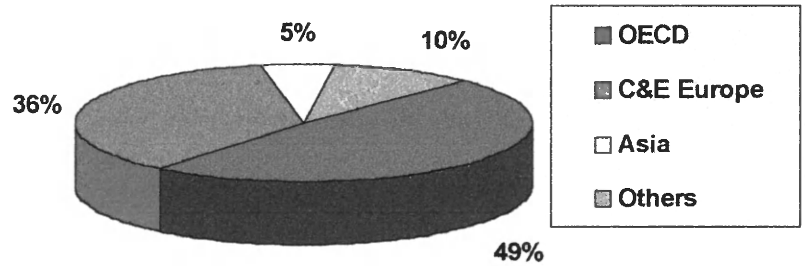


Figure 5. Bulgaria's Foreign Trade Distribution (Foreign Investment Agency, 1997).

IV. FACTORS AFFECTING PRIVATE INVESTMENT

> *Collective!* *The endless speeches, reports, articles, interviews have planted that word in my mind – a parasite which I am powerless to uproot. What was 'collective' about our life in that hut? We shared no common purpose, no common interest, no common rhythm.*
>
> Blaga Dimitrova, "Journey to Oneself," (Naughton, 1996, 319).

Against a background of chaotic government, poor communications and other public services, inefficient state-owned enterprises, and pervasive subsidies, most of Bulgaria's industries competitive advantage is based on low-cost labor. This partly offsets the fact that Bulgaria imports most of its energy and many raw materials as well. Similarly, the difficulty in obtaining capital limits both start-up and expansion activities. Currently, the great majority of successful industries, such as textiles and rose oil, are characterized by both low labor costs and low capital requirements for entry. Capital-intensive industries are frequently state-owned or *de facto* local monopolies controlled by one of the large financial groups, such as Multigroup, which has access to capital. Few have competitive advantage in global terms. Telecommunications and postal service have been poor, financial services almost non-existent, and transportation and logistics a nightmare over the antiquated road and rail systems (Bloomen, 1994).

Porter (1990, 546) suggests that in addition to the four determinants of national competitive advantage (see Chapter I, Figure 2, and Figure 6 below) there are four distinct stages of national competitive development: factor-driven, investment-driven, innovation-driven, and wealth-driven. Bulgaria's current situation is similar to that of post-World War II Italy, which was then at the factor-driven stage where virtually all internationally successful industries drew their advantage almost solely from basic factors of production, whether they were natural resources, optimum crop growing conditions, or an abundant and inexpensive pool of semi-skilled labor. Most developed countries have been at this stage at some point in time, as are nearly all developing nations and centrally planned economies such as Bulgaria at present. Yet even some prosperous countries such as Canada and Australia are at the factor-driven stage of development today. Therefore, the discussion below regarding factor conditions is the most relevant currently to the competitive development of Bulgaria's enterprises.

FIRM STRATEGY, STRUCTURE & RIVALRY

- Does the style of management and prevailing types of organizational structures in the nation match industry needs?
- What types of strategies exploit national norms of organization?
- Does the industry attract outstanding talent in the nation?
- Do investor goals fit the competitive needs of the industry?
- Are there capable domestic rivals?

FACTOR CONDITONS

- Does the nation have particularly advanced or appropriate factors of production? In what segments? For what strategies?
- Does the nation have superior factor creation mechanisms in the industry (*i.e.* specialized university research programs, outstanding educational institutions)?
- Are selective factor disadvantages in the nation leading indicators of foreign circumstances?

HOME DEMAND CONDITIONS

- Are the nation's domestic buyers for the industry's products the most sophisticated or demanding? In what segments?
- Does the nation have unusual needs in the industry that are significant but will likely be ignored elsewhere?
- do domestic buyer needs anticipate those of other nations?
- Are the distribution channels in the nation sophisticated, and do they foreshadow international trends?

RELATED & SUPPORTING INDUSTRIES

- Does the nation have world-class supplier industries? For what segments?
- Are there strong positions in important related industries?

Figure 6. Choosing Industries with Favorable Home Base Advantages (Porter, 1990, 603).

Factor Conditions

Currently Bulgaria, like most transition economies, is a factor-driven economy, which means that virtually all internationally successful industries draw their competitive advantage solely from basic factors of production, such as natural resources, skilled labor or infrastructure. Therefore, the quantity and quality of the following factors is of primary importance for successful enterprises, although the mix will differ greatly between industries.

Human resources. This includes the quantity, skills, and cost of personnel, including management. The population of Bulgaria is about 8.3 million. In recent years, the population has declined a little. The birth rate is below 9 per thousand, and falling, while the death rate has risen to over 13 per thousand. About one-fifth of the population is under 15 years of age, while about 15% are 65 or older. In broad terms, this is similar to the population structure of the EU. Approximately half of the population has completed secondary education. The average adult has 9 to 10 years of formal education.

Average wages are low and were equivalent to about $82 per month during 1997 (Business Central Europe, 1997). Exchange rate movements in 1996 and early 1997 drastically reduced the real value of wages. The average wage fell at one stage to as little as $10 per month. The lower unemployment rates (see Chapter I, Table 2) in Bulgaria during 1995 (11.1%) as compared with 1997 (16.5%), reflected generally those who were younger and more skilled finding jobs. On the one hand, this was encouraging, in that it suggests that new jobs were being created in the economy. On the other hand, those who remain unemployed tend to be older, less skilled, or unskilled workers who can be expected to face increasing difficulties in finding employment. A substantial retraining effort will be needed.

Approximately two-thirds of the population live in urban areas. The standard of living is significantly higher in cities and towns, but rural dwellers are able to grow food for their own consumption. Labor force participation rates are higher and unemployment rates lower in urban than in rural areas, therefore a much larger percentage of the urban population is employed.

Standards of education are also substantially higher in towns and cities. Almost 75% of the rural adult population have no education beyond primary level. The equivalent figure for urban dwellers is about 35%. Women tend to have less formal education, and lower rates of labor force participation than men, but the differences are not substantial.

By mid-1996, significant regional variations in unemployment had emerged, with rates varying from well under 10% in larger urban areas to 20% and more in some rural and mountainous regions. The large-scale industrial restructuring that is now under way in the petroleum and chemicals industries is causing sharp jumps in regional unemployment rates, since much industrial employment is concentrated in single plants in one location. This unemployment is also concentrated by industry sector, raising the prospect of regional concentrations of workers with outdated skills.

Physical resources. This represents the abundance, quality, accessibility, and cost of land, water, minerals, timber, hydroelectric power sources, fishing grounds, and other physical traits. Physical resources also include climate, and location relative to suppliers and markets. Bulgaria's one natural factor of historical importance is location. It has a long border with Greece and is on the traditional route from the Middle East to Central and Western Europe. Four Pan-European transport corridors cross Bulgarian territory. The war in former Yugoslavia led to a rise in transit traffic to and from Greece and to a diversion of transit traffic to and from the Middle East. This has resulted in additional congestion on Bulgaria's main roads, at border crossings, and at Danube river crossings.

Total agricultural land in Bulgaria consists of 6.3 million ha (15.6 million acres), of which 4.7 million ha represent arable land used mainly for cereal grains (49%) and pasture (18%). However, a significant amount of land has remained uncultivated for the last few years because of the slowness of the private ownership restitution process, as well as low farm prices. Around 5.1 million ha (12.6 million acres -- 81% of Bulgaria's total agricultural land area) has been claimed for restored private ownership by the heirs of the former private owners (nearly 1.7 million in number) under the heavily amended Farm Land Act of 1991. By April 1997, land ownership certificates had been issued for only 50% of the restitutable land (2.4 million ha) (European Commission, 1997). The lack of legal title is a major barrier to investment and development of an active land market.

Bulgaria's environmental problems are very serious and have not been effectively addressed. Bulgaria has high emissions of air pollutants, in particular sulfur dioxide and particulates originating from thermal power plants, heavy industry, domestic heating, and motor vehicles. Local air quality poses significant risks to human health. Industrial and municipal waste is another area of major concern: waste management practices are elementary, especially for disposal activities, and incineration is not regulated. Soil pollution and erosion are also serious. Groundwater quality is generally good for drinking water supplies. However, in localized areas there are problems of contamination by metals, as well as by sulfates and nitrates from fertilizers. Even so, Bulgaria enjoys an impressive bio-diversity, and the protection of the country's natural heritage has traditionally been a priority.

Knowledge resources. This represents the scientific, technical, and market knowledge of goods and services that reside in universities, research institutes, statistical agencies, business literature, market databases, trade associations, and other areas and disciplines. Bulgaria's relatively high level of education combined with a common language, religion, and identical school curriculum nationwide, as well as compulsory military service for all males, yields a well-trained workforce with the ability to work together. Like Germany, Bulgaria has a large pool of trained engineers. Unfortunately, effective mechanisms for creating generalized factors such as leading universities and a large science establishment are absent. Also absent are mechanisms to create advanced, specialized factors for particular industries such as a well-developed apprenticeship system, a strong vocational school system, a tradition of working in an industry for generations, an emphasis on teamwork, or an emphasis on in-company training.

Foreign Direct Investment (FDI) can be used as a significant source of technology transfer and innovation. This is particularly important in transition economies, as domestic funds for Research & Development (R&D) are limited both by cutbacks in public spending and by economic restructuring in general. Bulgaria has attracted a only small amount of FDI so far, and reported R&D spending has fallen by a factor of almost three since the late 1980s (European Commission, 1997). R&D activities also appear to have suffered from an uncoordinated approach to policy, including a lack of incentives for private research. This is compounded by the significant "brain drain" that has occurred due to the economic problems.

In 1996, spending on education was 4% of GDP and represented 1.6% of the state budget. There are approximately 1.2 million primary and secondary school pupils, 223,000 college students, and 112,000 teachers in Bulgaria (Panov 1997, 101). Problems facing the education and training system also stem from Bulgaria's severe economic straits, which have meant dwindling budgetary allocations for education (from 6.1% of GDP in 1992 to 4.5% in 1995) and have, on occasion, even led to acute cash shortages for the operation of schools, the provision of school books, and the payment of teachers' salaries.

The budget problem has not prevented steps being taken to reform the educational system at all levels. Key statutory instruments have been the State Educational

Requirements Act of 1991 (objectives and entitlements in the educational sphere), the Academic Autonomy Act of 1990, and the Higher Education Act of 1995. The latter formed the basis for The National Agency for Assessment and Accreditation for higher education, set up in 1996, and for the transformation of semi-higher education institutions into higher education establishments. Curricular change within secondary and post-secondary education focuses on introducing a stronger vocational emphasis monitored by Regional Educational Inspectorates. A serious challenge exists in continuing vocational training, as a result of the closure of training centers within state-owned enterprises and in view of the rise in unemployment. Programs have been established to integrate young people into the job market and to combat school drop-outs and social exclusion.

The main challenges for the education and training system are to continue the positive structural, financial, and curricular reform initiatives developed in recent years, despite a very adverse budgetary and economic environment. Specific areas requiring attention are: further reform in financing education and training, more effort to upgrade the knowledge and skills of teachers, and more investment in the education infrastructure. The efficiency of the vocational training system will depend on identifying economic and labor market trends, and establishing labor market policies based on the principles of life-long learning (Jones, 1995).

Government support is channeled through the Academy of Sciences, higher education establishments, and through programs under the Ministry of Education, the

Ministry of Science and Technology, and the Ministry of Industry. Total expenditure in this area was 0.62 % of GDP in 1995 (down from 1.13 % in 1993). The number of personnel supported decreased about 18% over the period from 1990 to 1995 (European Commission, 1997). A major decrease also occurred in the number of researchers employed in industrial research units. Private sector initiative is limited, and basic and applied research are to a predominant extent conducted in the country's Academies of Sciences, public research institutes, or research units of state-owned enterprises.

Capital resources. This is the amount and cost of capital available to finance industry from a variety of sources such as bonds, equity, venture capital, and secured and unsecured debt. Savings rates and capital markets affect both the amount and forms available. Although countries such as Japan also began the post-World War II period with little capital, accumulation took place rapidly, due to an extraordinarily high savings rate (Porter, 1990). In Bulgaria, capital markets still remain underdeveloped. The equity market is in an embryonic state and cannot be viewed as an alternative source of finance for the corporate sector (Center for the Study of Democracy, 1997). State-owned insurance companies have a dominant share of the market, although some private companies have emerged. Foreign insurers have not yet entered the insurance market. The market for short-term instruments is limited to the interbank money market. Activity has declined as a result of the current problems within the banking system.

Investment has fallen to very low levels: fixed investment accounted for under 15% of GDP in 1996. This fall can be ascribed to several factors: slow privatization, coupled with a lack of incentives for managers to run state enterprises efficiently, poor lending practices in the banking system, a lack of funds for private investment, cutbacks in public investment, and uncertainty about economic policy (Euromoney, 1995; Jones, 1995).

The problems of the financial sector in Bulgaria are connected with the situation of the enterprise sector. Imprudent lending, poor supervision, and an absence of "hard budget constraints" (the idea that debts have to be repaid) resulted in mounting losses in these sectors, which derailed progress towards macroeconomic stabilization. The stock of debt owed to banks by loss-making state-owned enterprises was estimated in late 1995 to be of the order of 20% of GDP (European Commission, 1997).

In common with most of the countries in transition, the inheritance of central planning in Bulgaria included a burden of non-performing loans, and an absence of experience in assessing creditworthiness of borrowers. These difficulties were exacerbated by the slow pace of structural reform, and the inadequate and partial implementation of the reforms that have been attempted. Previous recapitalizations of banks were not followed by action to prevent a recurrence of bad debts. This created an expectation that the state would ultimately bail out insolvent banks and firms, which spread to the private sector. Weaknesses in banking supervision and in legislation contributed to the emergence of a private sector banking and enterprise "bad loans" problem as well (Center for the Study of Democracy, September, 1997).

Infrastructure. This is the type, quality, and user cost of the transportation system, communications system, mail and parcel delivery, payment and fund transfers, health care, housing, and cultural institutions. Bulgaria has been faced with the need to invest in significant improvements to its road network and there is a need to develop the very limited border-crossing infrastructure. The lack of investment in infrastructure and equipment for sea, rail, air, and bus transport during the last decade also poses major problems. Substantial investments are needed to replace non-standard or out-of-date equipment. The transition from a controlled economy, giving preference to the use of rail and inland waterway, to a market-based economy, giving users a free choice of mode of transport, will lead to a shift of traffic onto roads. To improve links with its neighbors, between 1995 and 1999 Bulgaria plans to invest ECU 600 million from its own budget in transport infrastructure to be used by international traffic, principally the pan-European corridors. This is equivalent to around 1.2% of GDP, but will probably not be enough to meet the needs, given the current poor state of the road network, particularly for heavy truck transport. Any cuts in this amount, as a result of budgetary constraints, could further aggravate this weakness.

As a result of the economic crisis, the health system faces severe financial problems, leading to a shortage of medicines and medical instruments. The telecommunications network is relatively well developed, with a telephone penetration rate of 37.5% as of January 1997 (about 40% planned for the year 2000) (European Commission, 1997). However, the average waiting time for a telephone connection is 18 months, and much of the equipment is of an obsolete electro-mechanical design that now needs to be comprehensively replaced. Investment in digitalization has begun, with 2.8% digitalization achieved by March 1997. The government plans to reach current EU levels of penetration and digitalization within fifteen years. The government is obliged by law to deliver letters, parcels, money orders, newspapers, and magazines. Several national and international operators are offering profitable international courier services and the delivery of periodicals in big towns without any obligations. This situation causes financial losses to the national operator.

Demand Conditions

Nature of buyer needs. The economic crisis of 1996 and 1997 had a drastic impact on the population. Hyperinflation caused by government increases in the money supply to cover bank losses on bad debts resulted in public sector wages and pensions falling steeply, with serious effects on living standards. The share of income spent on food increased, and accounted for over half of household purchases. While households spent relatively more on food, overall consumption declined. Even so, the demand for computers is one market segment that is above normal expectations given the level of GDP per capita, although Bulgaria has not yet reached the level that the average EU country reached two years ago. Unfortunately, if Internet connections follow the same pattern of growth, the telecommunications infrastructure will remain a brake on this demand. Similarly, the demand for cellular phones is high due to poor quality and long waiting times for state-owned telephone service, in contrast with the high quality and immediate availability of cellular service from privately-owned firms.

National passions also provide important clues as to where Bulgaria's buyers are sophisticated and demanding consumers. It has been estimated that 60% of nation's entire population are smokers. Children become smokers generally in their teens, and are used to selling cigarettes on the streets at even earlier ages. Aside from the morality and health issues involved, cigarette smoking is a common pastime, even among medical doctors. The state-owned Bulgartabac Holding Company, one of the world's largest tobacco concerns that will be privatized this year, relies on a delicate network of small growers. Cigarettes are relatively inexpensive, selling from $0.25 per pack for local brands to $1 per pack for American brands, and Bulgarians are large consumers of this product.

Another national passion is the informal morning, noon, and evening "coffee klatch" meetings of friends at the local coffee clubs. Coffee, tea, soft drinks, Bulgarian wine, and brandy are all very much in demand and are consumed in large quantities with sales supported by numerous cafes, bars, and small private retailers of these products.

Size and pattern of growth. Although the sales of non-alcoholic beverages dropped 30% in 1997 due to the loss of purchasing power by Bulgarians, this national pastime is a good indication for the potential of the market (see Figure 7). Currently, there is no active domestic rivalry to upgrade domestic demand in Bulgaria. Demand in many industries is restricted by both purchasing power and government ownership of telecommunications providers, electric and gas utilities, liquor and tobacco companies, and virtually all other important industries. Only the proposed privatization of these industries, with independence and a profit motive, will produce more forward looking and sophisticated buyers than the government monopolies typical of Bulgaria (Center for the Study of Democracy, 1993).

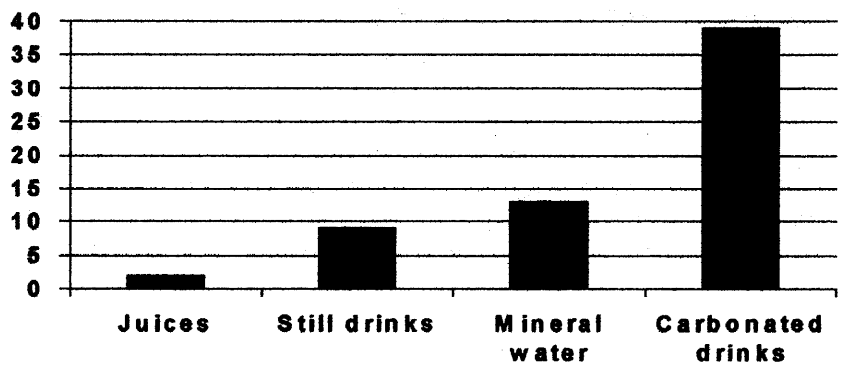


Figure 7. Annual Consumption of Soft Drinks in Bulgaria (Liters per Capita), 1997 (Vlahov, 1997).

Mechanisms for transmitting demand conditions to foreign markets. Systematization and standardization of the above products and associated services are the keys that unlock economies of scale and make it possible to replicate the product or service with minor modifications abroad and train local personnel to replicate the well-defined steps involved. The ability to provide relatively low-cost standardized products and services is the reason why tobacco companies like Rothmans, soft drink companies like Coca-Cola, Gas station/travel shops like Shell, and fast food chains such as McDonald's, Kentucky Fried Chicken, and Pizza Hut are becoming fast-growing private enterprises, even in Bulgaria (Puchev, 1995). This approach is beginning to be used by Bulgarian firms as well to get their products to international markets. Some recent examples include sales to newly industrializing countries of cigarettes, manual typewriters, small arms, and clothing.

Related and Supporting Industries

Location (clustering) of supporting industries. Bulgaria is an important transit country, particularly for gas supplies in the region including Greece. Its regional role may increase in the longer term through oil imports via the Black Sea port of Bourgas and through future gas imports from Central Asia and Iran. Although Bulgaria's link to the Western European interconnected electricity system is technically feasible, this will require substantial investment and is not expected in the short term. The current process of structural adjustment at the regional level is influenced by the regionally differentiated decline of industrial and agricultural activities. Most significant is the decline in the manufacturing industry in the regions of Haskovo, Russe and Varna. For agriculture, the most affected regions are Bourgas, Varna and Plovdiv. There are large regional disparities to potential economic development due to varying endowments of infrastructure and human resources.

Clustering of supporting industries occurs mostly in the following regions, for the following industries:

- Vidin – chemicals, textiles and clothing, food processing, orchards, vineyards, mixed farming, sunflowers.
- Pleven – petroleum refining, machinery and metal goods, food processing, mixed farming, sunflowers.
- Ruse – petroleum refining, chemicals, textiles and clothing, machinery and metal goods, food processing, orchards, vineyards, mixed farming.
- Vratsa -- chemicals, textiles and clothing, machinery and metal goods, food processing, mixed farming.
- Sofia/Pernik -- chemicals, textiles and clothing, ferrous and nonferrous metallurgy, machinery and metal goods, food processing, light industry, mixed farming, tobacco.
- Sliven – textiles and clothing, machinery and metal goods, food processing, light industry, orchards, vineyards, mixed farming.
- Varna/Devnya – chemicals, textiles and clothing, shipbuilding, machinery and metal goods, food processing, mixed farming, sunflowers.
- Bourgas – petroleum refining, chemicals, shipbuilding, machinery and metal goods, food processing, orchards, vineyards, mixed farming, sunflowers.
- Plovdiv -- chemicals, textiles and clothing, ferrous and nonferrous metallurgy, food processing, orchards, vineyards, tobacco.
- Yambol – chemicals, textiles and clothing, machinery and metal goods, food processing, cotton.

Competition among supporting industries. In Bulgaria, most industries rely on basic factor conditions and/or unusually heavy demand for competitive advantage. In order to be sustainable, the bases for advantage must be broadened. Since Bulgarian industry is starting with little more than a basic factor advantage, the path to sustained competitive advantage will be a long one. Initial advantage, as shown in Chapter III, Table 4, has been gained in only a few segments of a few industries, and their supporting industries, for this reason. In standardized, price-sensitive segments of the more sophisticated industries, technology obtainable through licenses and by purchasing foreign machinery is beginning to overcome the lack of home demand advantages, because models and features are well-established and easy to copy. This has been well-documented in the case of compact disc production with export sales of 45 million copies last year (although licenses were not obtained, and Bulgaria faces international sanctions for allowing this piracy to double in one year)(Radio Free Europe Newsline, 1997).

Firm Strategy, Structure, and Rivalry

Nature of competition. Bulgarian industry remains dominated by state enterprise, with private firms accounting for under one-fifth of output. Overall, little progress in restructuring or privatization has been made. Developments in Bulgaria's economy during 1996 revealed serious weaknesses in the competitiveness of its industrial base. The sectors that contributed most to the positive export performance in 1995 were shown to depend for their competitive advantage on artificial, unsustainable conditions such as subsidized energy and interest rates. A recovery in output that took place in 1994 ran out of momentum towards the end of 1995. The pick-up in output had been concentrated in sectors such as chemicals and metallurgy that were particularly energy-intensive and export-oriented. These sectors were able to take advantage of subsidized energy and the boost to external competitiveness provided by the sharp depreciation of the currency which occurred in Spring 1994 (Boland, 1994). However, real appreciation of the lev during 1995 eroded away this price advantage.

In 1996, weak international demand for metals resulted in Bulgaria being unable to take advantage of the renewed depreciation of the lev to boost exports. Moreover, from mid-1996 onwards, prices for oil and gas have been increased to world market levels, depriving Bulgaria's energy-intensive production of much of its competitiveness. The artificially low prices charged for energy up until mid-1996 encouraged waste. Bulgaria is estimated to use two to four times more energy per unit of output than European Union economies (Bowles, 1995; European Commission, 1997).

Bulgaria's relatively weak competitive position is also linked to its narrow industrial base. Exports are unduly concentrated in a small number of basic industrial and agricultural goods. Even with the benefit of a dramatic improvement in price competitiveness following the steep currency depreciation in 1996, Bulgarian products were largely uncompetitive on international markets. This situation is related to the gaps already identified in the country's transition to a market-based economy. Improvements in competitiveness also have been slowed by very low levels of foreign direct investment (Puchev, 1997). The overall atmosphere of uncertainty created by persistent political instability and an ambiguous attitude to market reforms also creates a climate in which corruption can thrive. Civil servants' involvement in the management of state enterprises creates a potential conflict of interest with their responsibilities to implement government policy.

Finally, Bulgarians do not usually function well in hierarchies and aspire to working on their own, or in a close-knit company. Managers desire independence and their own areas of responsibility instead of working in groups. There is interpersonal competition that would be very rare in Japan, for example. This is one reason why the management structures and systems necessary for large companies have not worked well for Bulgarians.

Investment in Research & Development. Private sector initiative is limited and basic and applied research is to a predominant extent conducted in the country's Academies of Sciences, public research institutes, or research units of state-owned enterprises. Regular cooperation with the European Community started only in 1992.

So far, there has been a lack of strategic direction or policy for R&D. The existing infrastructure and research institutions have suffered greatly from the lack of economic reforms. Policies are needed to stimulate innovation and the creation of small and medium enterprises, and to provide the fiscal environment to encourage technological innovation and development. Bulgaria will need to restructure the organization of R&D, which at present is very centralized, and take the necessary administrative and financial measures to promote and further encourage private sector

R&D. There is a need to distribute grant funding outside central government, to evaluate and coordinate projects within both public and private sectors, and to provide accurate, timely, and internationally comparable statistics that can be used to develop better economic indicators.

The biggest challenge in this regard, however, is for Bulgaria to diminish the wide-ranging presence of the state in the economy. Unless drastic economic reforms are undertaken, performance will continue to depend on governmental decisions and financial support (Milanovic, 1994). The competitiveness of the whole system remains weak and does not allow full participation of Bulgarian scientists in domestic or international R&D efforts.

The Role of Government

Government can create the opportunities and pressures for continued innovation by stimulating early demand, confronting industries with the need for new technology with symbolic projects, establishing prizes for quality, and encouraging rivalry. Policies on taxes, health care, antitrust, regulations, environment, finance, and money all can do harm or good to one or more groups of industries. Given limited resources, government must select the industries and sectors on which to concentrate factor creation, but the choices are unpopular, and the quick and easy choices of subsidy, protection, macroeconomic management will be insufficient or counterproductive in the long run.

Government's effect on factor conditions. The budget problem has not prevented steps from being taken to reform the educational system at all levels. Steps have been taken to transform semi-higher education institutions into higher education establishments. Although curricular changes within secondary and post-secondary education focus on introducing a stronger vocational emphasis, a serious challenge exists in continuing vocational training, as a result of the closure of training centers within state-owned enterprises and in view of the rise in unemployment. However, programs have been established to integrate young people into the job market.

Research and Technological Development activities that improve the competitiveness of industry and the quality of life, as well as support sustainable development, environmental protection, and other common policies lack strategic direction. Existing infrastructure and research institutions have suffered greatly from the lack of economic reforms. Policies are needed to stimulate innovation and the creation of small and medium enterprises, and to provide the fiscal environment to encourage technological innovation and development (Center for the Study of Democracy, January, 1997).

The Bulgarian banking sector is relatively fragmented. Seven state banks account for more than two-thirds of total assets, and 16 banks are under special supervision or are undergoing bankruptcy procedures demanded by the National Bank. The Government is undertaking a complete restructuring of the financial sector, including establishing a currency board, bank licensing, a strengthening of accounting and external auditing provisions, a new law on bank insolvency, and strengthening the National Bank's Bank Supervision Department. Also under review are the National Bank's regulations on capital adequacy, loan classification, and liquidity. The Bulgarian securities market is still at an early phase of development, and is affected by deficiencies concerning organization and regulation of the market as well as by a lack of transparency in the financial market. Existing privatization funds are to be transformed into investment companies. Although the legal monopoly of the state insurance companies has been dismantled, a private insurance market characterized by fair competition does not yet exist.

A relatively restrictive immigration policy is practiced by the government, although equal treatment is, in theory, guaranteed by the Constitution. Work permits are usually granted for a period of one year, extendible for a further two years, and are issued on the basis of full-time employment.

There are also issues of impartiality, transparency and confidentiality with Bulgaria's national statistics agency; as well as deficiencies in sectors such as external trade, transport and regional statistics, financial accounts, coverage of the business register and related business surveys, as well as a need to fully implement internationally comparable classifications.

Transparency in granting state aid to state monopolies has not yet been achieved. However, since 1996, state aid to the 135 main loss-making state-owned enterprises and public undertakings (representing around 78% of total losses by state-owned companies in 1995) have been substantially reduced. Prices of services delivered by public utilities for electricity, gas, liquid fuels, water, and telecommunications have been raised to cost-recovery levels, although state subsidies still exist for central heating and public transport.

Government's effect on demand conditions. Bulgarian legislation does not include any general provisions or standards for product safety. There is no known legislation imposing labeling requirements for clothes and textile products and existing legislation on the safety of toys is weak. Legislation on cosmetics is, in general, close to European law, but not fully compatible. Currently, the concept of civil liability for damage caused by defective products does not exist in the Bulgarian civil code.

Bulgaria also is heavily affected by organized crime and drug trafficking. The Government response is having some effect, but the scale of the task is large. For the most part, Bulgarian officials have little, if any, practical experience in working with their EU counterparts and institutions. Given the trans-national nature of the problems facing Bulgaria (immigration policy, drugs, organized crime) and its Balkan neighbors, more effective regional cooperation mechanisms need to be developed.

Government's effect on related and supporting industries. Since 1990, Bulgaria has followed a general policy of trade liberalization; more recently, it has started to fully liberalize prices (Apostolov, 1994). The conditions for a secure and transparent legislative environment for private economic operators are being achieved gradually (Davis, 1996). There are very few discriminatory measures currently in place. The Bulgarian Constitution provides that foreign capital enjoys the same legal protection as the capital of nationals. However, international capital flows into Bulgaria are still relatively modest. Foreign investment flows to Bulgaria were low up to the end of 1996, but have since picked up. To attract foreign investment, legislation has been adopted and a Foreign Investment Agency has been established.

The fact that there is no Civil Service Act has made it easier for political parties to gain control of the Civil Service, and changes of government have been accompanied by changes at all levels of the administration. Considerable discretionary power and a lack of clarity in allocating responsibilities and powers among Civil Service departments have allowed corruption to take hold easily. The process of dispensing justice in Bulgaria also is marked by serious shortcomings. The courts are overburdened with work and take a long time to deliver their judgments. A shortage of qualified judges, low salaries, complex legal procedures, and a plethora of new rules all contribute to this situation (Friedberg and Zaimov, 1994).

The impartiality of public radio and television in Bulgaria has often been questioned, since the opposition was given much less air time than the governing majority, not only during the presidential election campaign in November 1996, but also in the run-up to the April 1997 general election.

Recent credit risk indicators for the Bulgaria are shown in Table 6 and reveal that the economy has continued a roller coaster ride based on the slowness of free-market reforms and privatization of state-owned industries. These industries continue to lose productivity and efficiency due to lack of investment, advancing technology, corruption, and bureaucratic management policies.

Table 6. Recent Credit Risk Indicators for Bulgaria.

Key Indicator	*1993*	*1994*	*1995*	*1996*
Gross ext debt/curr acct recpts	239.7%	185.0%	132.8%	138.8%
Net ext debt/curr acct recpts	227.2%	167.2%	115.6%	132.1%
Debt service ratio (1)	17.9%	20.4%	13.1%	15.8%
FX reserves/financing gap (2)	56.6%	93.6%	291.5%	117.3%
Current acct balance (% GDP)	-10.6%	-0.3%	-0.2%	0.4%
Budget balance (% GDP)	-12.0%	-5.5%	-5.7%	-11.7%
Import cover (months) (3)	1.8	3.4	3.0	1.4

Source: Bear Stearns, 1997.

(1) Total interest & amortization payments on medium & long-term debt/current account receipts.

(2) Official foreign-exchange reserves/short-term debt & medium-term & long-term principal payments minus current account balance.

(3) Official foreign-exchange reserves divided by value of monthly imports of goods & services.

The huge financial losses accumulated by state-owned companies during the 1990's made it clear that the choice was to privatize or liquidate. The privatization of telecommunications is underway, and in other sectors, such as transport, postal services, and energy, policies are being formulated. Utilities, alcohol, oil, salt and coal mining are still State monopolies. The mass privatization that is planned, if carried out, will shake up companies in these industries and allow for more aggressive management. Privatization also can create more competition in large industries such as telecommunications, electric and gas utilities, and especially financial services (Rayome, 1995). Government policy should celebrate the entrepreneur, and actively seek foreign investment, especially in distressed areas where welcome new jobs can be created in supporting industries.

The Role of Chance

In the histories of most countries and most industries, chance events play a role. They create discontinuities that allow shifts in competitive position. They can nullify previous advantages, or create new opportunities. In other words, they can play either a negative or a positive role. Some examples are: inventions, technological breakthroughs, changes in input costs such as brought about by oil embargoes, shifts in exchange rates, surges in world demand, political decisions, and wars.

During this century, the Balkan wars, World War I and II, the Cold War, the Gulf war, and the war in Bosnia have had major impacts on the Bulgarian economy. The negative effects from these wars include loss of markets, loss of territory, loss of human resources, loss of technology, loss of momentum, and loss of goodwill, as well as the loss of world-class minds who have fled the country. In 1991, Bulgaria's situation was not unlike that of many other Central and Eastern European countries. In 1998, however, Bulgaria lags behind most of these countries due to the choices it has made. Nevertheless, recent events point to a revival of effort and motivation to compete internationally. Not unlike post-World War II Japan, Bulgaria has the ability to leapfrog generations of process technology and penetrate emerging segments unhindered by past investments if it chooses to do so. In the selected industry segments shown in Chapter III, Table 4, both Bulgarian and Eastern European demand may grow rapidly, even after other more prosperous countries reach higher levels of saturation.

One opportunity for an external stimulus to strengthen Bulgaria's industries and economy is the 2004 Olympic Games to be held in Athens, Greece. As in many other countries, including Korea and Japan, the Olympics can become a vehicle to upgrade Bulgaria's image as well as a catalyst to further internationalize Bulgarian industry, but only if the right choices are made now and infrastructure development is far enough along to help achieve the desired effect.

V. CURRENT STRATEGIC POSITION

Not even the unfinished and deserted skeleton of Lazar's windmill spoils the beautiful view on all four sides of our village. For ten years it has stood on the bare hill above it like a jagged monster . . left by the skillful and masterly hand of Lazar Dubak, famed for his jokes and his various plans and ideas, begun with enthusiasm and abandoned with a good-natured, deprecating smile.

Elin Pelin, "The Windmill," (Naughton, 1996, 321).

International strategic management is a comprehensive and ongoing management planning process aimed at formulating and implementing strategies that enable firms to compete effectively internationally (Griffin and Pustay, 1995). The development of various international strategies or comprehensive frameworks for achieving a firm's fundamental goals is dependent on the quality of the environmental scanning process, and an analysis of its threats, opportunities, weaknesses, and strengths (TOWS). The following assessment of Bulgaria's current strategic position for private investments is based on a three-stage process.

The first stage is the input stage. Here, overall external opportunities and threats, and internal strengths and weaknesses are described and assessed. The second stage is the matching stage, which attempts to match strengths with opportunities, while minimizing threats and weaknesses. The third and final stage is the decision stage. Although a number of assessment tools are used in each stage to provide analysis from a variety of standpoints, it should be remembered that business forecasting, especially on a grand scale, and without accurate data, must always rely heavily on the use of good judgment. The techniques below are best used as visual means to classify and sort business information and clarify important relationships.

External Opportunities and Threats

An external audit of private enterprise investments in Bulgaria based on internal company and external trade sources and available literature, revealed priority external opportunities and threats that must be considered in developing investment strategies. An **External Factor Evaluation (EFE) Matrix** allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information (see David, 1997, 129). Table 7 shows the matrix that was developed for Bulgaria. Eleven critical success factors are listed as either opportunities or threats. Each factor is then given a weight and a rating. Normally weights are industry-based, and ratings are company-based. In this analysis, weights are based on the relative importance of that factor to potential success in business, while ratings are based on how effectively government strategies are responding to that factor.

This matrix reveals that Bulgaria is currently below average with a score of 1.96 (2.5 being average) with respect to pursuing strategies that capitalize on external opportunities and avoid threats. The greatest opportunities shown on the EFE matrix, both weighted at 0.15, are Bulgaria's location relative to the markets of Europe and the Middle East, and the amount of foreign venture capital currently available in EU and U.S. markets. Unfortunately, government response in providing the legal and infrastructure needs to allow industry and business to capitalize on these opportunities has been poor. Major threats include continued unstable economic and political events in

Table 7. External Factor Evaluation (EFE) Matrix for Private Enterprise Investments in Bulgaria.

	Key External Factors	Weight (1)	Rating (2)	Wtd. Score
	Opportunities			
1	Bulgaria is a key trade route between Central and Western Europe and the Middle East.	.15	2	.30
2	USA, EU, NATO providing money and expertise to help Bulgaria create stable economy in the Balkans.	.08	3	.24
3	Potential corridor for new oil and gas lines from the Caspian region to Greece and Italy.	.05	3	.15
4	International financial markets and foreign venture capital funds are relatively healthy.	.15	1	.15
5	Advancing process technology allows leapfrogging competition and entrance into new market niches.	.07	1	.07
6	2004 Olympic Games in Athens, Greece can become a catalyst for investment opportunities.	.05	1	.05
	Threats			
1	Globalization and rapid technological advances threaten outdated industrial base and infrastructure.	.10	2	.20
2	Global consumers demand more reliable, complex products and services than domestic consumers.	.10	2	.20
3	Markets subject to unstable economic conditions and political events, especially Russia and Balkans.	.15	3	.45
4	Accession costs will preclude Bulgaria from joining EU and NATO in the near-term, thus delaying economic and trade benefits.	.05	2	.10
5	Private investment heavily dependent on foreign capital and health of international financial markets.	.05	1	.05
	Total Weighted Score	100%		1.96

(1) Weights: The relative importance of that external success factor to potential success in business; 0.0=not important, 1.0=very important, summation of all=1.0.

(2) Ratings: Indicate how effectively government strategies respond to that external success factor; 4=superior response, 3=above average, 2=average, 1=poor response.

the Balkans, followed by the threat of globalization and rapid technological advances outpacing the outdated Bulgarian industrial base, and global consumer demand for more reliable and complex products and services. The government response has been predictably better at acting on threats than it has been in perceiving opportunities.

Internal Strengths and Weaknesses

An internal country audit revealed ten critical success factors that impact private investments in Bulgaria. These factors were used to develop the **Competitive Profile Matrix (CPM)** (David, 1997, 130) shown in Table 8, which compares the strategic position of private enterprise investments in Bulgaria with Hungary, a similar sized ex-Soviet bloc Central European country for which data is available. The total weighted scores in the CPM have the same meaning as the EFE in Table 7. However, the critical success factors are broader, and provide a comparative analysis with another country.

Although circumstances surrounding some of the success factors are much better than they were a year ago, the results reveal some of the reasons why private enterprise investments in Bulgaria are currently being outpaced in other transitional economies in Central and Eastern Europe. The slow start of administrative and market reforms in Bulgaria, combined with political and especially financial instability during the past seven years, has kept potential investors away from Bulgaria in comparison with Hungary. These three factors have been exacerbated by corrupt government officials and organized crime. Overall, the above four factors account for nearly two-thirds of competitive profile differences between the two countries.

Table 8. Competitive Profile Matrix (CPM) for Private Enterprise Investments in Bulgaria.

	(1)	**Bulgaria**	Hungary	**Bulgaria**	Hungary
Critical Success Factor:	*Weight*	*Rating(2)*	*Rating (2)*	*Wt. Score*	*Wt. Score*
Political stability	0.20	3	3	0.60	0.60
Crime & corruption	0.15	1	2	0.15	0.30
Financial stabilization	0.15	2	3	0.30	0.45
Administrative and market reforms	0.15	1	3	0.15	0.45
Capital & currency markets	0.10	1	2	0.10	0.20
Infrastructure upgrading	0.05	1	2	0.05	0.10
Corporate culture and management expertise	0.05	1	2	0.05	0.10
Education and training	0.05	3	2	0.15	0.10
Foreign investment policies	0.05	1	3	0.05	0.15
Competitive environment	0.05	1	2	0.05	0.10
Totals	100%			1.65	2.55

Sources: Bear Stearns, 1997; Business Central Europe, 1997.

(1) Weights: The relative importance of that external success factor to potential success in business; 0.0=not important, 1.0=very important, summation of all=1.0.

(2) Ratings: Refer to current country strengths and weaknesses; 4=major strength, 3=minor strength, 2=minor weakness, 1=major weakness.

Similarly, a list of Bulgaria's major strengths and weaknesses was developed from the previous discussion and used to construct the **Internal Factor Evaluation (IFE) Matrix** shown in Table 9 (David, 1997, 165). This strategy-formulation tool summarizes and evaluates the major strengths and weaknesses in the internal audit of the country- and industry-specific factors described in Chapter IV. It also provides a basis for identifying and evaluating relationships among those areas. Bulgaria is slightly above average (2.5 being average) in its overall internal strategic position based mostly on reforms made during the past year, with one major strength being the establishment of a currency board that renewed confidence in the currency, stabilized inflation, the money supply, and interest rates. The other major strength is the new popular political leadership that promises an energized reform program.

Important factor weaknesses for private enterprise investments in Bulgaria that must be overcome include frequent legislation revisions and reversals by the parliament, and a continued reliance on bureaucratic law and decree, especially at regional and local levels of governments. Also, low-paid administrative officials who are easy to corrupt, and a correspondingly high economic crime rate, encourages tax evasion, bribery, and widespread disrespect for laws and regulations. Other factor weaknesses that the government has yet to address as identified earlier in Chapter IV also are shown in Table 9. They include the burdensome tax and regulatory system, poor infrastructure, lack of effective ownership in the agricultural sector, limited capital markets and financial services, and a generation of managers with a socialist "mindset."

Table 9. Internal Factor Evaluation (IFE) Matrix for Private Enterprise Investments in Bulgaria.

	Key Internal Factors	Wt. (1)	Rating (2)	Wtd. Score
	Strengths			
1.	Currency board has stabilized currency exchange rate, inflation, and interest rates	.15	4	.60
2.	New, reform-oriented administration with a solid majority in parliament and a high level of popular support.	.15	4	.60
3.	Significant economic assistance from multilateral and bilateral institutions.	.03	3	.09
4.	Association agreement with EU, planned membership in Central European Free Trade Association.	.02	3	.06
5.	Readily available inexpensive, well-educated workforce.	.05	3	.15
	Weaknesses			
1.	Civil law subject to frequent revision, reversal, and ineffective implementation by bureaucratic law and decree.	.15	2	.30
2.	Corruption in government administration, high economic crime rate, and spreading vandalism.	.15	2	.30
3.	Obsolete production, transport, and communication infrastructure.	.10	1	.10
4.	Return of agricultural land to owners not resolved, ownership extremely fragmented.	.06	2	.12
5.	Fragile banking and financial services sector lacks functional capital and equity markets.	.04	2	.08
6.	22% value added tax, import taxes, income tax, burdensome regulations, increased wage pressure.	.05	1	.05
7.	Management "mindset" does not emphasize loyalty, training, quality, or service.	.05	2	.15
	Total Weighted Score	100%		2.70

(1) Weights: Importance to potential success in business; 0.0=not important, 1.0=all important, sum=1.0.

(2) Ratings: Refer to current country strengths and weaknesses; 4=major strength, 3=minor strength, 2=minor weakness, 1=major weakness.

Strategic Assessment

The second stage of this three-stage decision-making framework is the matching stage (David, 1997, 179). Matching critical success factors is the key to effectively generating feasible alternative strategies. Based on the factors above, a number of business tools can be used to assess the range of strategies available for private enterprise investments in Bulgaria. The **Threats, Opportunities, Weaknesses, Strengths (TOWS) Matrix** (Table 10) is one tool that is useful for developing four types of strategies. Strength/Opportunity (SO) strategies use internal strengths to take advantage of external opportunities. Weakness/Opportunity (WO) strategies improve internal weaknesses by taking advantage of external opportunities. Strength/Threat (ST) strategies use strengths to reduce external threats. Weakness/Threat (WT) strategies are directed at reducing internal weaknesses and avoiding threats.

This analysis indicates that investors in Bulgaria can pursue several logical strategies appropriate to specific industry clusters. For some, the best near-term SO strategy may be to pursue the low cost market segment due to the abundance of inexpensive labor. However, cheap labor is a fleeting advantage and long term efforts should be directed toward upgrading existing technologies to penetrate existing markets and enter niche markets. The WO strategies that appear most promising are franchising in consumer products and services, and joint ventures in industrial products in order to minimize capital and management outlay and risk. Currently, the best ST strategy is the use of discounted Brady Bonds to purchase shares in companies being privatized. The

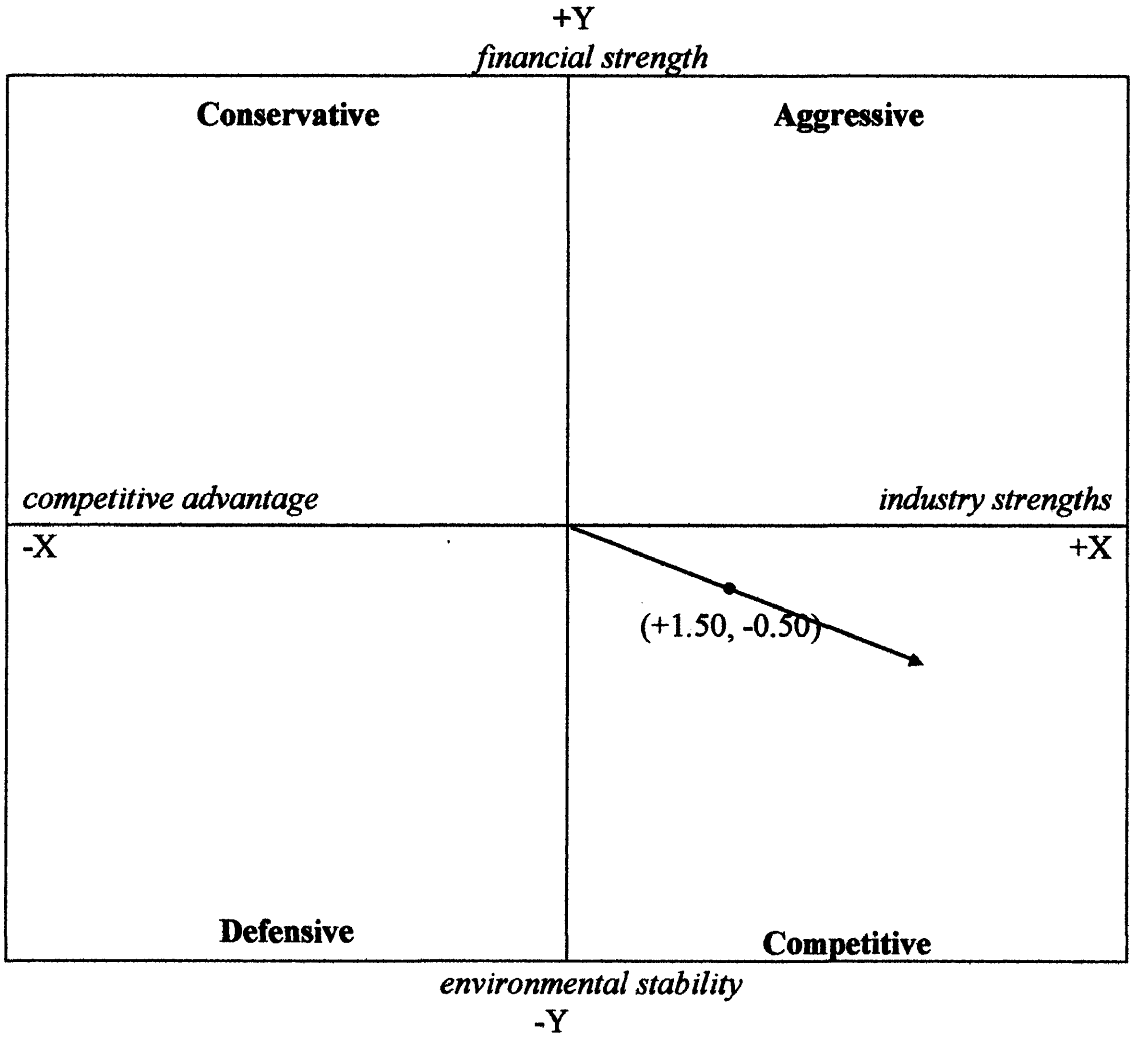
Table 10. Threats, Opportunities, Weaknesses, Strengths (TOWS) Matrix for Private Enterprise Investments in Bulgaria.

	STRENGTHS - S	WEAKNESSES - W
	1. Stable exchange rate 2. Reform-oriented govt 3. EU econ assistance 4. Trade agreements 5. Educated & inexpensive workforce	1. Frequent law changes 2. Corruption, econ crime 3. Obsolete infrastructure 4. Agric land problems 5. Fragile financial mkts 6. Complex taxes & regs 7. Socialist mgt mindset
OPPORTUNITIES - O 1. Europe & Mid-East trade route 2. Tech assistance funds available 3. Oil & gas corridor 4. Venture capital avail 5. Access to new global technologies 6. 2004 Olympic games in Athens, Greece	**SO - STRATEGIES** 1. Develop low cost products (S1, S2, S3, S5, O1, O2, O4, O5) 2. Enter new niche markets (S4, S5, O4, O5, O6) 3. Penetrate Europe & mid-East (S3, S4, O1, O6) 4. Develop transit & supply partnerships (S3, S4, O1, O3, O6)	**WO - STRATEGIES** 1. Acquire existing producers (W3, W6, O4) 2. Franchise to control quality & service W3, W4, W7, O1, O4, O6) 3. Market thru existing & emerging retail (W2, W3, W6, W7, O1, O5, O6) 4. Joint venture w/govt as minority partner (W1, O3) 5. Use tech assist funds to improve quality (W3, O2)
THREATS - T 1. Globalization outdating industrial base 2. Global demand will require increased quality 3. Balkans unstable politics & economics 4. EU and NATO benefits not avail yet 5. Unstable international financial markets	**ST - STRATEGIES** 1. Use Brady Bonds to buy down govt ownership at discount prices (S3, T1, T5) 2. Purchase and restructure undercapitalized but sound businesses (S1, S5, T1, T2) 3. Operate state-owned concessions (S2, S3, T2, T3)	**WT - STRATEGIES** 1. Mobile processing plants for food products (W3, W4, T1, T2) 2. Import employee incentive and training programs (W7, T2) 3. Offer industry financial & technical services (W6, W7, T2, T4, T5)

purchaser's cost is reduced, and the government is able to redeem the bonds without having to pay cash. The WT strategy that has the most promise, especially due to the small size of the average farm, is to process food and agricultural products on-site, then transport the resulting value-added product to international markets. This is already being done in the wine and meat industries.

Given the potential strategies identified above, a Strategic Position and Action **Evaluation (SPACE) Matrix** (David, 1997, 184) was developed (see Table 11) to broadly assess potential internationally competitive industry clusters identified in Chapter III, Tables 4 and 5. Due to financial strength and current industry strengths, but weak competitive advantages in an unstable, highly nationalized industry environment, private enterprise investments in these four industry clusters in Bulgaria were placed in the competitive quadrant of the SPACE Matrix. This suggests that firms in these industry clusters should focus on competitive strategies. The range of competitive strategies which could be pursued include: backward, forward, and horizontal integration, market penetration, market development, product development, and joint venture. Currently, the most successful investors are pursuing integration strategies in Bulgarian industry.

Table 11. SPACE Matrix for Potential Internationally Competitive Industry Clusters in Bulgaria.

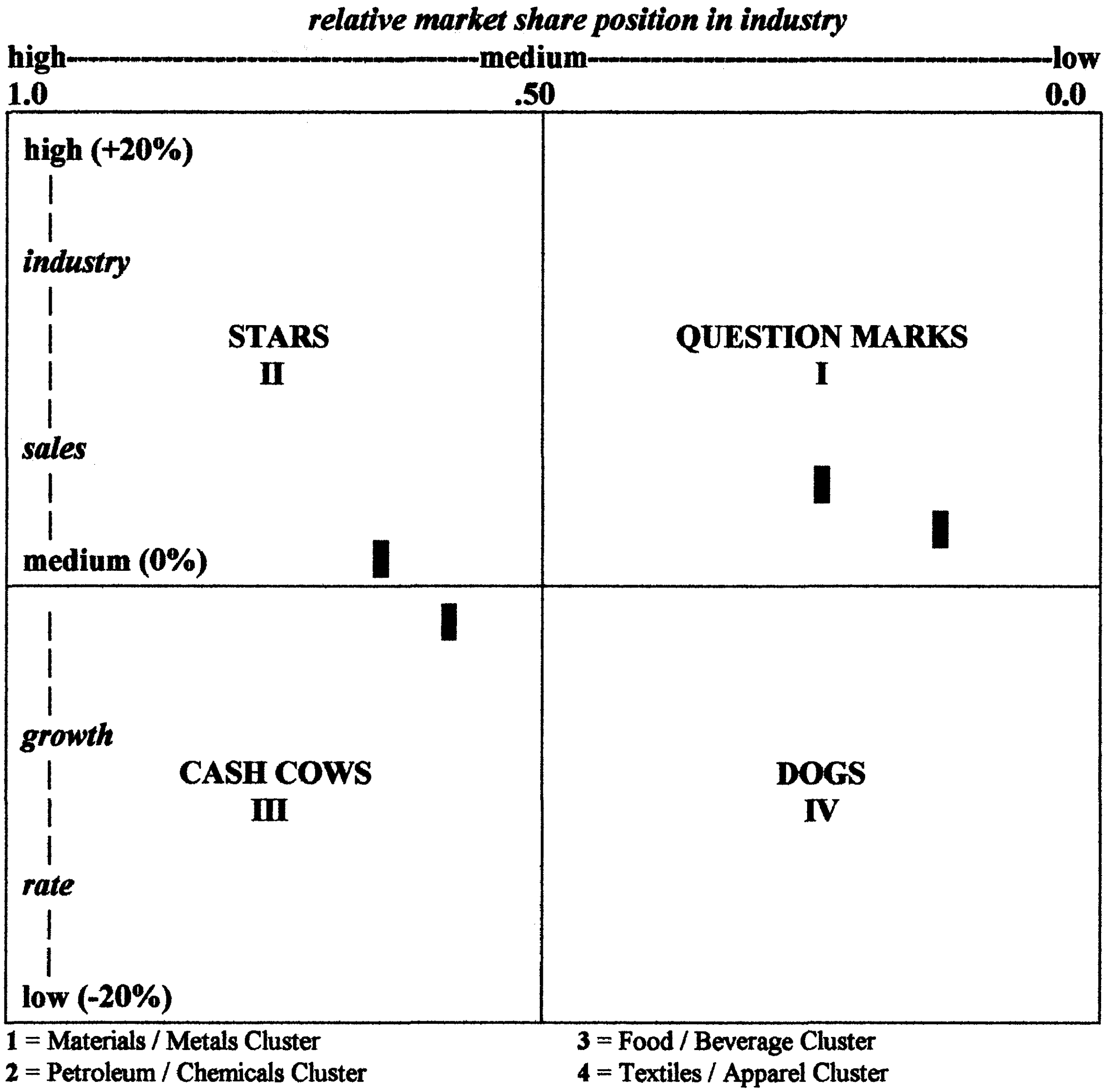


Source: David, 1997, pp. 184-187.
Formula: Financial strength (+2.50); Industry strength (+3.50); Environmental stability (-3.00); Competitive advantage (-2.00); X-axis: (+3.50)+(-2.00) = +1.50; Y-axis: (+2.50) + (-3.00) = -0.50

In order to address potential internationally competitive industry clusters as individual profit centers that can represent a significant portion of private enterprise investments in a Bulgarian portfolio, the **Boston Consulting Group (BCG) Matrix** (David, 1997, 187) was used because it visually portrays differences between clusters in relative market share and growth rates. Also, it places less reliance on revenue and profit data that may not be available or may not be accurate. This is the matrix that separates the "stars" from the "dogs" and the "cash cows" from the "question marks" and each industry cluster from the other. It is shown in Table 12. The petroleum/chemicals cluster (2) is in the Stars quadrant. This industry cluster has a relatively high share of country exports at 4.4% (see Chapter III, Table 5), and a higher than average industry growth rate internationally. In order to maintain dominant position, some strategies suggested are forward, backward, and horizontal integration, market penetration, market development, product development, and joint ventures. Clearly, this cluster represents Bulgaria's best long-run opportunity for private enterprise growth and profitability.

The materials/metals cluster (1) was placed in the Cash Cows quadrant because the industry growth rate is low due to weak domestic and export demand despite its currently commanding the highest share of country exports at 6.5%. Due to outdated technology, loss of subsidized energy inputs, and loss of traditional Soviet Bloc markets, industry growth will not return soon and retrenchment is an appropriate strategy, followed by product development and/or concentric diversification. Both the food/beverage cluster (3), with 5.4% of country exports, and the textiles/apparel cluster (4), with 1% of country exports, were placed in the Question Marks quadrant of the BCG matrix. The food/beverage industry cluster enjoys a healthy growth rate and good domestic and international demand. Internationally, however, market share is low, and cash needs are high. Most intensive strategies such as market penetration, market consolidation before low-cost production facilities and technologies can be implemented.

Table 12. BCG Matrix for Four Potential Internationally Competitive Industry Clusters in Bulgaria.



The textiles/apparel industry cluster has an even weaker position and lower market share due to strong competition from Asian producers combined with a lack of domestic related and supporting industries. The high Value Added Tax (VAT) rate of 22%, complicated customs regulations, and long border crossing delays are also discouraging to potential investors. The strength of Asian economies and the speed of Bulgarian regulatory and tax reform will be prime factors in determining whether pursuit of intensive strategies or divestiture will be the right choice for this industry cluster.

Another way of visually portraying possible strategies is the **Grand Strategy Matrix** (David, 1997, 192). This matrix is based on two evaluative dimensions: competitive position and market growth. The one shown in Table 13 was prepared to formulate alternative strategies for the four potential internationally competitive industry clusters identified in Bulgaria. Quadrant I industries can afford to take advantage of external opportunities and take risks when necessary. Based on the previous analysis, probably only a few industries in the petroleum/chemicals cluster will be able to pursue Quadrant I strategies. Quadrant II industries are in growth industries, but are weak competitors. Industries in the Bulgarian food/beverage cluster best fit this description, and many are pursuing Quadrant II strategies. Both the materials/metals cluster and the textiles/apparel cluster are generally made up of Quadrant III industries whose success will depend on making some drastic changes quickly to avoid demise. Based on the government's continued involvement in, and ownership of, a majority of the industrial and agricultural sectors (85%), currently no potential internationally competitive Bulgarian clusters have strong enough competitive positions to actively pursue Quadrant IV strategies.

Table 13. Grand Strategy Matrix for Four Potential Internationally Competitive Industry Clusters in Bulgaria.

Rapid Market Quadrant II - **food/beverage** Market development Market penetration Product development Horizontal integration Divestiture Liquidation *Weak Competitive Position*	*Growth* Quadrant I - **petroleum/chemicals** Market development Market penetration Product development Forward integration Backward integration Horizontal integration Concentric diversification *Strong Competitive Position*
Quadrant III - **materials/metals** - **textiles/apparel** Retrenchment Concentric diversification Horizontal diversification Conglomerate diversification Divestiture Liquidation *Slow Market*	Quadrant IV Concentric diversification Horizontal diversification Conglomerate diversification Joint ventures *Growth*

The third and final stage in assessing the current strategic position of potential internationally competitive industries is the decision stage. A **Quantitative Strategic Planning Matrix (QSPM)** was prepared to analyze the relative attractiveness of feasible alternative actions as shown in Table 14 (David, 1997, 194). The QSPM provides for an objective evaluation of alternative strategies, based on external and internal critical success factors previously identified in Tables 7 and 9. Attractiveness scores were developed for each of the four potential internationally competitive industry clusters identified in Chapter III, Table 4: 1) material/metals; 2) petroleum/chemicals; 3) food/beverage; and 4) textiles/apparel. The four clusters were weighted against critical success factors in the categories of Opportunities, Threats, Strengths, and Weaknesses and given total scores. This ranking favors the petroleum/chemicals industry cluster by a small margin over the textiles/apparel industry cluster, followed by the food/beverage industry cluster. The materials/metals industry cluster appears to have the greatest hurdles to overcome to gain a position as an international competitor in tomorrow's global economy. However, note that the magnitude of the difference between the total attractiveness scores is not large, indicating that the relative desirability of investing in one cluster over another is not large either. The scores are not guesses, but are rational, defensible and reasonable. Nevertheless, they are based on intuitive judgments and educated assumptions and are only as good as the previously presented material. Therefore, Chapter VI attempts to summarize the implications of the previous analysis, provide insight into the risks inherent in the decision-making process in emerging democracies, and make some recommendations.

Table 14. QSPM Matrix for Four Potential Internationally Competitive Industry Clusters in Bulgaria.

			STRATEGIC ALTERNATIVES			
	Industry Cluster:		**1**	**2**	**3**	**4**
	Critical Success Factors	wt	as/tas	as/tas	as/tas	as/tas
	Opportunities					
1	Bulgaria is a key trade route between Central and Western Europe and the Middle East.	.15	3 / .45	3 / .45	4 / .60	4 / .60
2	USA, EU, NATO providing money and expertise to help Bulgaria create stable economy in the Balkans.	.08	3 / .24	4 / .32	3 / .24	3 / .24
3	Potential corridor for new oil and gas lines from the Caspian region to Greece and Italy.	.05	3 / .15	4 / .20	3 / .15	3 / .15
4	International financial markets and foreign venture capital funds are relatively healthy.	.15	3 / .45	3 / .45	4 / .60	3 / .45
5	Advancing process technology allows leapfrogging competition and entrance into new market niches.	.07	4 / .28	4 / .28	3 / .21	3 / .21
6	2004 Olympic Games in Athens, Greece can become a catalyst for investment opportunities.	.05	2 / .10	2 / .10	4 / .20	3 / .15

			STRATEGIC ALTERNATIVES			
	Industry Cluster:		1	2	3	4
	Threats					
1	Globalization and rapid technological advances threaten outdated industrial base and infrastructure.	.15	1 / .15	1 / .15	2 / .30	2 / .30
2	Global consumers demand more reliable, complex products and services than domestic consumers.	.10	1 / .10	1 / .10	2 / .20	3 / .30
3	Markets subject to unstable economic conditions and political events, especially Russia and the Balkans.	.10	1 / .10	1 / .10	2 / .20	2 / .20
4	Accession costs will preclude Bulgaria from joining EU and NATO in the near-term, thus delaying economic and trade benefits.	.05	2 / .10	2 / .10	1 / .05	1 / .05
5	Private investment heavily dependent on foreign capital and health of international financial markets.	.05	1 / .05	1 / .05	2 / .10	3 / .15
	Strengths					
1	Currency board has stabilized currency exchange rate, inflation, and interest rates	.15	3 / .45	3 / .45	4 / .60	4 / .60
2	New, reform-oriented administration with a solid majority in parliament and a high level of popular support.	.15	4 / .60	3 / .45	3 / .45	3 / .45
3	Significant economic assistance from multilateral and bilateral institutions.	.03	3 / .09	4 / .12	2 / .06	2 / .06
4	Association agreement with EU, planned membership in Central European Free Trade Association.	.02	4 / .08	4 / .08	2 / .04	4 / .08
5	Readily available inexpensive, well-educated workforce.	.05	3 / .15	3 / .15	4 / .20	4 / .20

		STRATEGIC ALTERNATIVES				
	Industry Cluster:		**1**	**2**	**3**	**4**
	Weaknesses					
1	Civil law subject to frequent revision, reversal, and ineffective implementation by bureaucratic law and decree.	.15	1 / .15	1 / .15	2 / .30	2 / .30
2	Corruption in government administration, high economic crime rate, and spreading vandalism.	.15	1 / .15	1 / .15	2 / .30	2 / .30
3	Obsolete production, transport, and communication infrastructure.	.10	1 / .10	1 / .10	2 / .20	2 / .20
4	Return of agricultural land to owners not resolved, ownership extremely fragmented.	.06	3 / .18	1 / .06	1 / .06	3 / .18
5	Fragile banking and financial services sector lacks functional capital and equity markets.	.04	1 / .04	1 / .04	1 / .04	1 / .04
6	22% value added tax, import taxes, income tax, burdensome regulations, increased wage pressure.	.05	2 / .10	1 / .05	1 / .05	1 / .05
7	Management "mindset" does not emphasize loyalty, training, quality, or service.	.05	1 / .05	1 / .05	2 / .10	2 / .10
	Total Weighted Scores		4.31	5.40	5.25	5.36

1 = Materials / Metals Cluster
2 = Petroleum / Chemicals Cluster
3 = Food / Beverage Cluster
4 = Textiles / Apparel Cluster
as=attractiveness score (1=not acceptable; 2=possibly acceptable; 3=probably acceptable; 4=most acceptable)
tas=total attractiveness score

VI. IMPLICATIONS & RECOMMENDATIONS

"What are you waiting for? Our brothers are fighting already," Benkovski thundered at the top of this voice, everybody joining in. "Let's wait a little!... Let's see how matters really stand... The time is not ripe yet, we have not got anything ready," the men of Panagyurishte tried to protest.

Zahari Stoyanov, "Notes on the Bulgarian Uprisings," (Naughton, 1996, 318).

One of the most important attributes in industry is the ability to provide early insight into needs, environmental forces, and trends that others have not noticed. Better insight and early warning signals lead to competitive advantage. Developing new strategies that are earlier or clearer than others is also aided by being in the right country at the right time. Conditions in Bulgaria currently provide a difficult environment for firms wishing to attain international competitive advantage, but it is also up to individual firms to recognize and seize opportunities as they occur. A shortage of government revenues has led to budgetary pressures that have limited spending on education, R&D, and infrastructure. Falling relative average income levels have made consumer demand conditions less advanced except for a small luxury segment. Profitability is often achieved through government protection, harvesting of market position through underinvestment, and avoiding globalization altogether. Therefore, each investment decision and each individual firm, even in potential internationally competitive industry clusters, must be evaluated on a case by case basis. This purpose of this study is to identify factors, suggest tools, and present trends that will assist decision-makers.

Key Industries and Markets

Based on the analyses in the previous chapters and a good deal of judgment, it appears that Bulgaria has four potential internationally competitive industry clusters that are of interest to private investors (see Chapter V, Table 14). They are discussed below.

1. Materials/metals. This is probably the weakest of the four due to the lack of restructuring and investment in infrastructure. Quadrant III retrenchment strategies are called for here (see Table 13). These could include retrenchment, divestiture, and concentric diversification strategies such as adding products for niche markets that are not being serviced elsewhere. Once retrenchment and divestiture can be accomplished, strategies may call for diversifying product lines by offering lifetime service and parts contracts to customers as a marketing package as market growth improves.

2. Petroleum/chemicals. This is the strongest cluster in terms of its total attractiveness score in Table 14. Quadrant I growth strategies are called for here (see Table 13). Selective diversification is most likely the best strategy in this sector overall. followed by product and market development and penetration. These strategies provide the ability to blunt global competition by marketing new products in new outlets in emerging international markets, such as adding sales and service outlets in other countries.

3. Food/beverage. Due to a weak competitive position, Quadrant II growth strategies are appropriate for this final consumption goods industry cluster (see Table 13). Receiving the third highest total attractiveness score in Table 14, competitive advantage can best be gained by providing technologically superior products and services, and by marketing them well. Sales to Romania, Greece, and Turkey, backed by excellent customer service, with products that are differentiated from those of competitors by both service and quality are recommended. Re-entering markets in Russia and Central Asia coupled with the penetration of foreign markets in the U.S.A. and Canada could lead to future worldwide operations. The challenge to this cluster is whether, and/or how fast, effective management and customer service attitudes can be instilled into the workforce. This is another reason why this cluster ranks only third in total attractiveness.

4. Textiles/apparel. This is the second strongest cluster in terms of its total attractiveness score in Table 14. However, Quadrant III retrenchment strategies are also recommended here due to its slow market growth (see Table 13). Once retrenchment and divestiture have been accomplished in this cluster, additional strategies that may be used are selective diversification to blunt global competition with new products in new emerging international markets. First of all, competitive advantage must be gained by using increased technology to produce superior products at a lower cost than Asian and African producers. Only top-of-the-line quality can assure continued competitiveness. Market expansion to the USA and Canada and penetration of existing foreign markets could serve well in future worldwide operations. Again, success will depend on whether effective management and quality control attitudes can be instilled into the workforce.

Opportunities for Strategic Alliances

Any company must expose itself to external pressures and stimuli to create the environment for the relentless improvement that brings with it competitive advantage.

Often, this means that "outsiders" to the firm, the industry, and the established social structure, often based in other nations, must be sought out to catalyze change. Bulgaria's international position is weak even in its most basic industry clusters: transportation-related goods and services, machinery, electronics, machine tools, apparel and related products, steel and other materials, and agriculture. Both "outside" capital resources and "outside" ideas are needed in these industries in transitional economies like Bulgaria. Strategic alliances of this type are currently most viable in the petroleum/chemicals cluster, and food/beverage cluster.

Privatization is beginning to create competition in upstream industries, as well as final consumption goods and services. Deregulation is beginning to do the same for capital markets and financial services. Although Bulgaria has very little capital resources, financial aid and foreign loans are beginning to fill this crucial gap, as they did in Korea after the Korean war (Porter, 1990). If Bulgaria can do as Korea did, and demonstrate progress, foreign investors will gain confidence and foreign capital will pour in. An abundance of capital is not required for international success, even in capital-intensive industries, if there are institutional mechanisms to channel available capital into productive investments. American firms have already shown interest in Bulgarian optronics, military/industrial enterprises, large Black Sea resorts, the Bulgartabac Tobacco Holding Company, and the Neftochim Chemical Plant. At this time, however, the overall foreign investment image of Bulgaria remains negative, according to Ilian

Vassilev, Executive Director of Bulgaria's Foreign Investment Agency (Bulgarian Business News, 1998).

Use of Business Management Tools and Techniques

Figure 8 shows a Visual Investment Risk Assessment Model developed as a result of this study to assess industry and market investment risk in transitional economies where accurate and precise financial measures do not exist. This is a modified "fishbone" diagram based on a format used by the U.S. military in Europe to assist Eastern European countries in their integration into NATO. In this study, the upper half of this model consists of observed conditions representing the four categories and their elements of the theory of national competitive advantage (see Chapter I, Figure 2). The lower half of the diagram consists of three categories and their elements representing observed government effects on competitive conditions, and one category and its elements representing observed competitive conditions.

Information was gathered on each element according to time and resources available. That element was then colored green, amber, or red based on the impact it is judged to have on overall investment risk. Green indicates favorable impact; amber indicates caution, or unknown, and red indicates unfavorable conditions exist for that element. Then each of the eight categories were given a color according to the preponderant color of their elements. Finally, the overall investment risk for Bulgaria was given a color according to the preponderant color of the eight categories. The Visual Investment Risk Assessment results shown in Figure 8 are based on an

Figure 8. Visual Investment Risk Assessment Model.

Factor Conditions	Demand Conditions	Related and Supporting Industries	Firm Strategy, Structure, and Rivalry
Human resources			
Physical resources	Nature of buyer needs	Location (clustering) of supporting industries	Nature of competition
Knowledge resources	Size and pattern of growth	Competition among supporting industries	Investment in Research & Development
Capital resources	Mechanisms for transmitting to foreign markets		
Infrastructure			

Overall Investment Risk Assessment Bulgaria - 1998

Government's Effect on Factor Conditions	Government's Effect on Demand Conditions	Government's Effect on Related and Supporting Industries	Competitive Advancement Conditions
Subsidies		Foreign investment policy	Factor creation mechanisms
		Trade policy	Motivation
Information	Foreign aide and political ties	Influence on new business formation	
Capital and currency markets	Technical standards	Regulation of competition	Domestic rivalry
Infrastructure	Buyer information	Policy effects on individual and company goals	Demand upgrading
Science and technology	Procurement policies	Policies toward the media	Selective factor disadvantages
Education and training	Regulation of products and processes	Reinforcement of industry clusters	Capacity for new business formation

Values: Favorable (Green) Caution (Amber) Unfavorable (Red)

Note: Diagram based on U.S. European Command NATO Integration diagram, 1997.

analysis of the information collected in this study for 1998. The model can be used in assessments at various levels as well, including national, industry, and firm levels. The model can also be easily and quickly revised as new information becomes available. The results of the assessment for Bulgarian business investments show that four of the eight categories currently have unfavorable conditions, while four show caution is advised. However, some elements also have favorable impacts, thus the overall investment risk assessment is judged to be amber. Another way to say this is that a smart investor who is willing to absorb greater than normal risk, who invests in carefully selected industries and markets, by appropriate methods, can realize the greatest potential profit. Like many business tools, this model cannot replace good judgment. It is designed only to aid in decision-making by clarifying and characterizing many of the elements that must be considered when making decisions about investment opportunities in transition economies.

Risks in Doing Business

Bulgaria's crisis reflected both poor macroeconomic policy and severe structural problems, especially the failure to privatize enterprises and banks or even to change the way they operated. As can be expected, in a country transitioning from a centrally-planned to a market-based economy, business, financial, and political risks can be great. The pace of reform is slow and successive governments often display the same incompetence and corruption as their predecessors. When this is the case, it is unlikely that economic problems will be solved soon. In Bulgaria, as in many other transitional economies, there is a tiny elite of foreign-trained specialists in top government positions that are committed to change and are working hard to achieve that aim. But government is often paralyzed by huge budget deficits and pressure from various lobby groups that demand favors. Local government bodies also can be antagonistic toward national goals if they are from the opposition party. Not much trust can be placed in the judiciary either, which is often a politicized institution (Schmidt, 1997).

Other sources of risk are revealed in politics and culture. Many government employees from lowly clerks to high-ranking officials, lack a sense of duty and commitment. Many officials at all levels display little concern either for the work ethic or the responsibilities of their office. These attitudes have roots in the Ottoman era and account for the low productivity and bureaucracy. Another problem is that government salaries are low, when compared with salaries paid by international organizations, or even local newspapers, which prompts many qualified people not to take government jobs. Poor pay also opens the door for corruption to take hold.

Another source of business risk, is how restructuring is done by the government. There is a pressing need to fire incompetent employees, downsize, and hire fewer, but better qualified, people when companies are privatized. Labor unions are also a strong interest group demanding that governments maintain jobs for them when companies are privatized. Often the parliaments give in, contributing to the perception of the government as "patron," as is customary in the Balkans. As was the case when the socialists were in power, many party members consider state-run companies their property, not that of society as a whole.

Another burden of the past that slows the pace of change and increases risk is that many people associate any form of joint effort with communist collectivism and are thus reluctant to pool their resources for the common good. Agricultural productivity is stunted by the recent proliferation of dwarf holdings and unwillingness in the small villages to form agricultural cooperatives. Agricultural wealth thus remains underdeveloped since the villagers lack the necessary vision, leadership, or resources to become more prosperous (Schmidt, 1997).

Conclusion

The only industry clusters that are attractive as potential international competitors are, in order: petroleum/chemicals, textiles/apparel, food/beverage, and materials/metals. Based on this study, the best competitive strategies for these industries at this time are to compete on the basis of low costs at acceptable quality levels. Bulgaria's geographical and logistical advantages could be further enhanced by adoption of two key government policies. First, an industrial policy that promotes the competitiveness of the above industries; and second, an export-promotion strategy that encourages firms in these industries to compete in foreign markets. The domestic market in Bulgaria is too small to produce the economies of scale or competition needed for import-substitution strategies to be effective.

Bulgaria's economy, which was on the brink of chaos last year, is seen among the best emerging market performers this year, according to some analysts. To a degree, the reason the economy looks so well this year is because it looked so bad in 1996 and 1997.

The past year has been tumultuous but a transformation of the government's role in the economy and its relationship with business and industry has begun. However, much more structural reforms are necessary for Bulgaria to achieve sustainable growth, and a healthy market-based economy is still years away. By 1999 it will become clear if the reforms have been effective. As this study indicates, investors can benefit from emerging private enterprise opportunities in Bulgaria; but only if they are cautious, know their industries and markets well, and are able to accept a good deal of risk.

APPENDIX
ON-LINE SOURCES OF BULGARIA BUSINESS INFORMATION

Name	*Address (http://)*	*Type of Information*
BISNIS	www.itaiep.doc.gov/bisnis/ bisnis.html	Business leads, useful contact information, embassy reports from U.S. Commerce Dept
Bulgaria Online	www.online.bg/main/bulgaria. html	Overview, business, law, politics, news and media, sport, leisure, & statistics
Bulgarian WWW servers	www.acad.bg/rice/servers.html	Academy of sciences, universities, news web sites
CEEBIZ.COM	www.ceebiz.com	Stories from Central and Eastern European business journals
Center for the Study of Democracy, Sofia	www.csd.bg	Bulgaria economic and business policy papers
European Commission	www.europa.eu.int/comm/	EU comparison statistics
Internet Securities	www.securities.com	Industry and regulatory information for two dozen countries including Bulgaria
RFE/RL Newsline	www.rferl.org/newsline	Daily e-mail summary of events in the region
The World Factbook	www.odci.gov/cia/publications /nsolo/factbook/bu.htm	Maps, flag, basic country statistics
Travel Bulgaria	www.travel-bulgaria.com	General, cultural, and tourist information
Wood & Co.	www.wood-co.com	Market reports and economic studies on Central & Eastern European industries

Data is current as of May 1998.

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GLOSSARY

Acculturation: process of understanding and learning how to operate in a new culture.
Affiliated bank: partly owned, separately incorporated overseas banking operation of a home country bank.
Balkans: the 7 countries of: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, The Former Yugoslav Republic of Macedonia, Romania, Serbia.
Baltics: the 3 countries of: Estonia, Latvia, Lithuania.
Barter: form of countertrade involving simultaneous exchange of goods or services between two parties.
Boston Consulting Group (BCG) matrix: a portfolio matrix designed specifically to enhance efforts to formulate strategies for operations within different industries.
Brady Plan: plan developed in 1989 by U.S. Treasury Secretary Nicholas Brady to solve the international debt crisis; involves writing off a portion of the debtor nations' debts or repurchasing their debts by selling "Brady bonds" at less than face value.
Bulgarian Leva (BGL): official currency of the Republic of Bulgaria, a soft currency; 1 BGL = 100 Stotinkis; exchange rate fixed at 1000 BGL=1 DM (German Mark) as of 7/1/97.
Bureaucratic law or decree: legal system based on interpretations, actions, and decisions of government employees.
Central Europe: the 5 countries of: Czech Republic, Hungary, Poland, Slovakia, Slovenia.
Central Independent States (CIS): the 11 countries of: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.
Centrally planned economy (CPE): economy in which government planners determine price and production levels for individual firms.
Civil law: law based upon detailed codification of permissible and non-permissible activities; world' most common form of legal system.
Competitive profile matrix (CPM): a technique that helps identify a firm's major competitors and their particular strengths and weaknesses in relation to a sample firm's strategic position.
Culture: collection of values, beliefs, behaviors, customs, and attitudes that distinguish and define a society.
Distinctive competence: component of strategy that answers the question "What do we do exceptionally well, especially as compared to our competitors?"
Eastern Europe: the 12 former socialist countries contained within the Balkans and Central Europe.
European Commission: twenty-person group that acts as the EU's administrative branch of government and proposes all EU legislation.
European Currency Unit (ECU): weighted "basket" of EU currencies used for accounting purposes within the EU.
European Union (EU): an economic union designed to further Europe's regional economic and political integration created by the treaty on European Union (Maastricht

Treaty) in 1991; current 15 member countries are: Austria, Belgium, Germany, Spain France, Great Britain, Greece Italy, Ireland, Luxembourg, Netherlands, Portugal, Sweden, Finland, Denmark.

Expatriates: collective name for Parent-Country Nationals (PCNs) and Third-Country Nationals (TCNs); people working and residing in countries other than their native country.

External factor evaluation (EFE) matrix: a technique that allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information.

Foreign direct investment (FDI): acquisition of foreign assets for the purpose of controlling them; under U.S. regulations, FDI occurs when an investor owns at least 10 percent of the voting stock of a foreign company.

General Agreement on Tariffs and Trade (GATT): international organization that sponsors negotiations to promote world trade.

Globalization: the process of removing barriers to international trade and investment.

Grand strategy matrix: a popular tool for formulating alternative strategies using four strategy quadrants based on competitive position and market growth potential.

Greenfield investment: form of investment in which the firm designs and builds a new factory from scratch, starting with nothing but a "green field."

Gross domestic product (GDP): measure of market value of goods and services produced in a country.

Gross national product (GNP): measure of market value of goods and services produce by resources owned by a country's residents.

Hard currencies: currencies that are freely traded and accepted in international commerce; also called convertible currencies.

Internal factor evaluation (IFE) matrix: a strategy-formulation tool that summarizes and evaluates the major strengths and weaknesses in the functional areas of a business; it also provides a basis for identifying and evaluating relationships among those areas.

Internal-external (IE) matrix: a portfolio matrix that plots various industries on a nine-cell display of various strategies with weighted scores.

International Monetary Fund (IMF): agency created by the Bretton Woods Agreement to promote international monetary cooperation after World War II.

Joint venture: special form of strategic alliance created when two or more firms agree to work together and jointly own a separate firm to promote their mutual interests.

Market-based economy: economy in which the open market determines price and production levels for individual firms.

Multinational corporation (MNC): incorporated firm that has extensive involvement in international business, engages in foreign direct investment, and owns or controls value-adding activities in more than one country.

National competitive advantage, theory of: theory stating that success in international trade is based upon the interaction of four elements: factor conditions, demand conditions, related and supporting industries, and firm strategy, structure, and rivalry.

Nationalization: transfer of property from a privately owned firm to the government.

Nontariff barrier (NTB): any governmental regulation, policy, or procedure other than a tariff that has the effect of impeding international trade.

Organization for Economic Cooperation and Development (OECD): organization whose 25 members are among the world's richest countries and consist of Canada, Mexico, the United States, Japan, Australia, New Zealand, and 19 Western European countries.

Parent-Country Nationals (PCNs): are citizens of an international business's home country.

Political risk assessment: systematic analysis of the political risks that a firm faces when operating in a foreign country.

Political risk: change in the political environment that may adversely affect the value of a firm.

Privatization: sale of publicly owned property to private investors.

Purchasing power parity (PPP): theory that the prices of tradable goods, when expressed in a common currency, will tend to equalize across countries as a result of exchange-rate changes.

Quality: totality of features and characteristics of a product or service that bear on its ability to satisfy stated or implied needs.

Soft currencies: currencies that are not freely traded because of legal restrictions imposed by the issuing country, or that are not generally accepted by foreigners in settlement of international transactions; also called inconvertible currencies.

Strategic alliance: business arrangement in which two or more firms choose to cooperate for their mutual benefit.

Strategic position and action evaluation (SPACE) matrix. Another matching tool for stage 2 analysis of appropriate conservative, aggressive, defensive, or competitive strategies based on external and internal dimensions.

Strategic position and action evaluation (SPACE) matrix: a matching tool for stage 2 analysis of appropriate conservative, aggressive, defensive, or competitive strategies based on external and internal dimensions.

The quantitative strategic planning matrix (QSPM): an analytical technique is designed to determine the relative attractiveness of feasible alternative actions.

Third-Country Nationals (TCNs): are not citizens of an international business's home country or of the host country.

Threats-opportunities-weaknesses-strengths (TOWS) matrix: a matching tool which helps managers develop four types of strategies based on analysis of the above four key external and internal factors.

TOWS analysis: analysis of a firm and its environment to determine its threats, opportunities, weaknesses, and strengths.

World Bank (IBRD): officially known as the International Bank for Reconstruction and development, which was established by the Bretton Woods agreement to reconstruct the war-torn economies of Western Europe and whose mission changed in the 1950s to aid the development of less developed countries.

World Trade Organization (WTO): successor organization to the GATT founded in 1995; created by the Uruguay Round negotiations.