

THE MACRO-RISK OF DOING BUSINESS IN CENTRAL AND EASTERN EUROPE

BODISLAV DUMITRU-ALEXANDRU

PH.D. CANDIDATE BUCHAREST UNIVERSITY OF ECONOMIC STUDIES,

e-mail: alexandru.bodislav@infinitemgroup.com

Abstract

What happens when the company that creates country and company rankings is guilty of fraud? The economy must re-evaluate the way it is establishing the hierarchy of business “heroes” and how it classifies the transnational corporations and how countries rank after they are screened for their intermediate ranks at political, economic, financial and country level.

This paper studies the phenomenon of transnational relations and the pressure of multiculturalism on corporate governance done in countries that are situated in the Central and Eastern part of Europe and have as common economic characteristic the fact that they are emergent markets.

Key words: macro-risk, corporate governance, political risk, financial risk, government

JEL classification: E60, G30, G32, O19, P51

1. Introduction

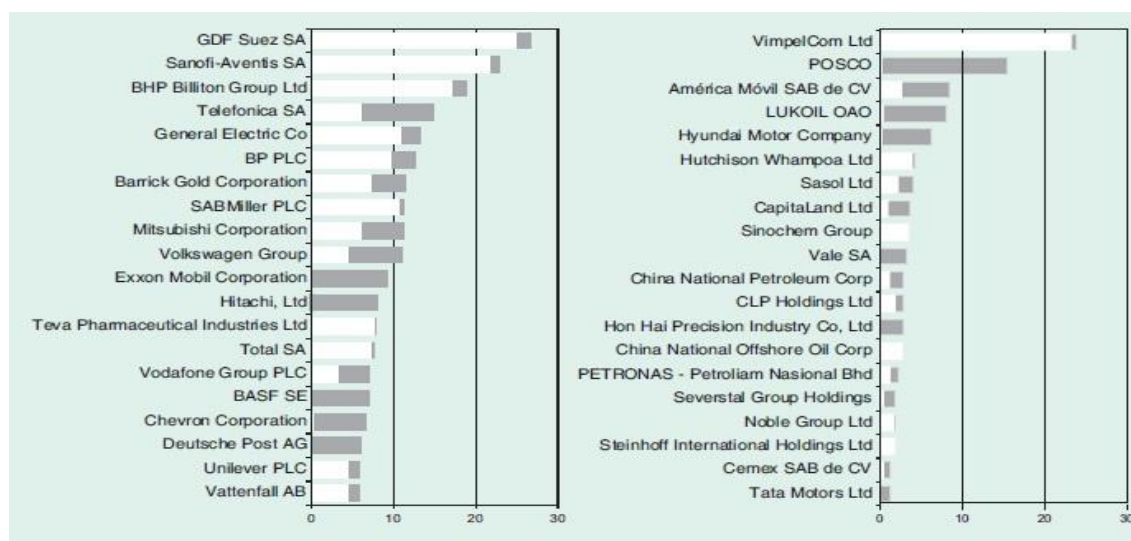
After the alleged allegations and convictions of Standard & Poor’s Ratings Agency and its owner the McGraw-Hill Company by the Department of Justice the entire economy needs to find new ways to evaluate the way it sees risks and how it rates its clients, be them countries or corporations.

Erasmus University from Rotterdam created with UNCTAD (United Nations Conference on Trade and Development) in the year 1990 an indicator that calculates the level of trans-nationality of corporations, an indicator that evolved till nowadays and took the name of TNC (TransNational Corporations). This indicator is developed using data bases that use three ratios between:

- External Assets/Total Assets;
- External Incomes/Total Incomes;
- Employees from External Subsidiaries / Total Employees.

The indicator has a growing scale, the bigger the value the smaller the national dependence of multinationals to their homeland country (the index shows how much globally developed is the company and how big is the degree of openness to the outside). The latest ranking is from the year 2011 and it is distributed as follows:

Figure no.1. The TransNational Corporation Index 2011
(Global Ranking versus Emergent Markets Rankings)



Source: [1] World Investment Report 2012 (Thomson ONE and fDi Markets data bases)

From figure 1 there are three standard works paths given by transnational corporations:

1. Between the transnational level and the size of the country of origin there is an opposite correlation (the companies born in small markets that are part of underdeveloped or emergent markets have the tendency to have a higher degree of openness to developed markets);
2. Since this rank was developed in the year 1990 till the year 2011 it sided between the 50% - 60% gap showing that the global access to markets is limited, being built on a game with zero sum that has winners and losers);
3. A dominant external presence does not show power in transnational market development or information on the company's strategy, but shows the fact that the business is optimal built and gets a large slice of the market because of some competitive advantages had in front of competitors [2].

2. Corporate Governance and institutional multinationalism

The research done on this niche is done by creating a synergy between corporate governance and the derivate behaviour resulted from the multiculturalism created from the multitude of subsidiaries had, this way it results the basic question from academic research that is needed a form of capital protection on the opportunist behaviour of managers (be them at middle level or executive level engagement). The differences between manager, shareholder and stakeholder was underlined by Berle and Means in 1932 [3] and they underlined the differences between shareholders and employees (that usually tend to converge). This problematic was followed in the '60s by the development of the Agency Theory [4] that led to the situational bias of the Anglo-Saxon vision versus the American vision that is molded itself through experimentation [2], synergy that was shifted to institutional sector of the state.

2.1. Corporate Governance and the Multicultural Pressure

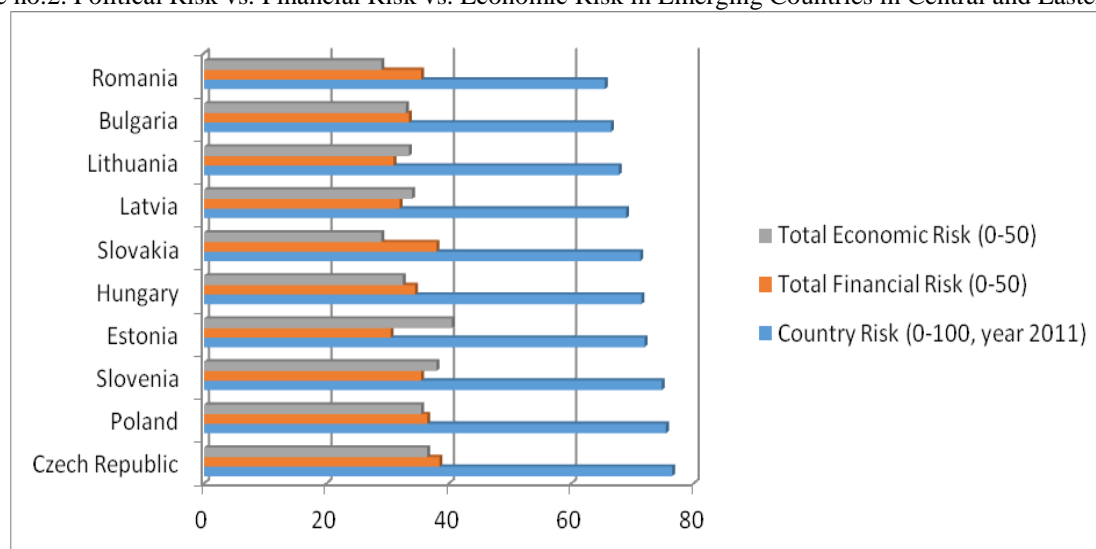
The economic environment from European countries led to the development of entities with the purpose to create a linear flow between existent entities in the production process (labour factor or capital factor), these entities being regulated, supervised and consulted to assure the role of free practice on the labour market and unrestricted flow of capital.

Studies show that a sharp pressure on qualitative economic development of Germany is started with the hierarchical economic structure of the Roman Empire [5] and the building of the Bundeslander based on syndicates, work councils and executive boards [2], this evolution of the labour factor and its framing took place during 6 centuries. Meanwhile, at the global multicultural level the Korean system was developed *Chaebol*, the Chinese system *Quanxi*, the Japanese system *Keiretsu* and the Anglo-American of work enterprises.

In this part of the paper there will be challenged and developed the case of 10 biggest emergent economies from Central and Eastern Europe: Romania, Bulgaria, Lithuania, Latvia, Slovakia, Hungary, Estonia, Slovenia, Poland and Czech Republic, if this group of ten countries would add Croatia the new group would be the one developed by the World Bank in their January issue on the regular economic development report, and the new group will be entitled as EU11 [6].

Multicultural institutional diversity is the engine for the sharpest pressures for acceptance created into emergent economies, these being the secondary result of privatizations in developing countries (or of countries that are newly entered in the democratic system of leadership – [7]) and these being explained also by the inputs of capital (Foreign Direct Investments), fact that was observed in the evolution of multinationals that are entered markets and their developed market share, for example Czech Republic and Hungary (for a high level of FDI) and Romania and Bulgaria for a low level market penetration and market share (low level of FDI). These small entries are combined with the pressure of political instability from those countries that have a negative rate of solving problems, this way involving the country risk and resulting in multinationals and subsidiaries that enter into partnerships with limited responsibility creating this way partnership relations between the country of origin and the host country, creating this way a macro-hedging system on risked capital in the hosting economy.

Figure no.2. Political Risk vs. Financial Risk vs. Economic Risk in Emerging Countries in Central and Eastern Europe



Source: data analysed by the author in January 2013, data bases offered by PRS Group Incorporated (company specialized in Intelligence country analysis [8])

Table no.1. Composite risks of emerging countries from Central and Eastern Europe

No.	Country	Political Risk (0-100, year 2011)	Financial Risk (0-50)	Economic Risk (0-50)
1.	Czech Republic	76,5	38,5	36,5
2.	Poland	75,5	36,5	35,5
3.	Slovenia	74,8	35,5	38,0
4.	Estonia	72	30,5	40,5
5.	Hungary	71,5	34,5	32,5
6.	Slovakia	71,3	38,0	29,0
7.	Latvia	69	32,0	34,0
8.	Lithuania	67,8	31,0	33,5
9.	Bulgaria	66,5	33,5	33,0
10.	Romania	65,5	35,5	29,0

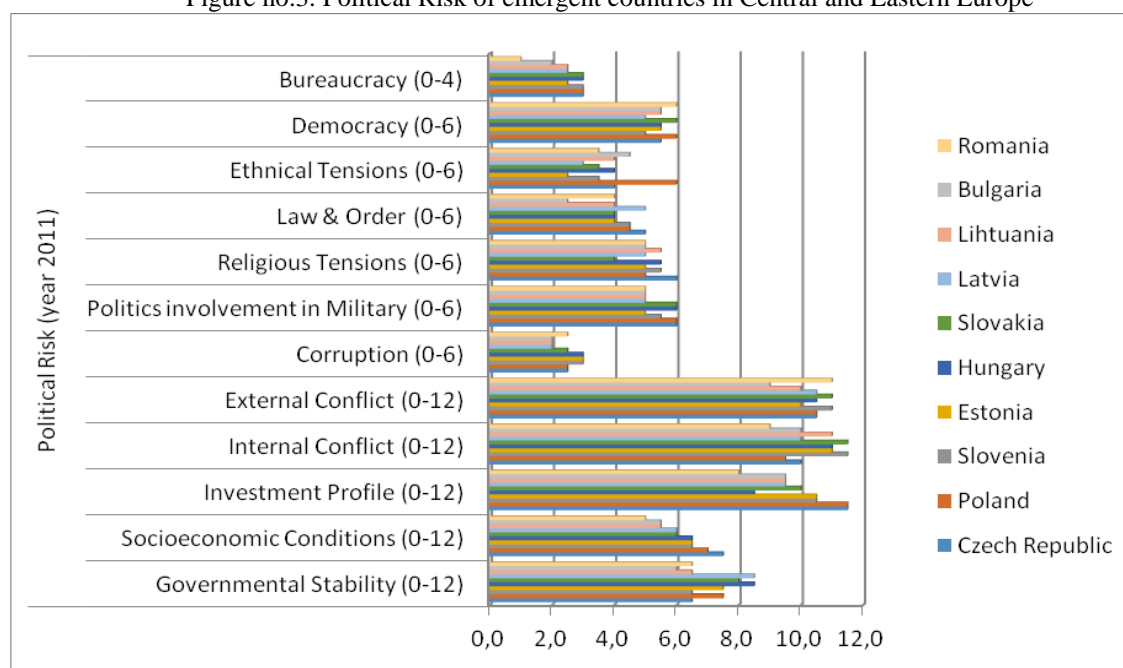
Source: data analysed by the author in January 2013, data bases offered by PRS Group Incorporated (company specialized in Intelligence country analysis [8])

It is easily observed that in Eastern and Central Europe at political level the best developed countries are the Czech Republic, Poland and Slovenia fact that could be observed into their way of creating regulations and promoting themselves on the external market, further will see that these countries are regional champions at attracting FDI and at obtaining the lowest interest rates in the region on Wall Street.

At financial level, which includes the development of the financial sector in that country and the model of doing business or by offering/attracting new players on the financial sector deployment. Leaders in the region are the Czech Republic and Slovakia followed by Poland and lagers could be considered Estonia, Lithuania and Latvia, a surprise validated by the relation of these three countries with the former USSR. The surprise of the top is created by Romania because Romania is lagging at all other indicators or rankings but is situated close to the podium on the financial sector's development.

When we talk at economic level the champions are Estonia, Slovenia and Czech Republic, countries that have established some positive strikes on not bending the rule of borrowing money from international financial institutions, but the real regional problem comes from the bottom of the list, the three losers of the region are: Slovakia and Romania, two countries that rank extremely poor at economic level and Hungary that follows them, but despite the fact it situated itself in near bankruptcy situations it has a well-structured economy and has built government regulations that helped and sustained the local economy and external creditors.

Figure no.3. Political Risk of emergent countries in Central and Eastern Europe



Source: data analysed by the author in January 2013, data bases offered by PRS Group Incorporated (company specialized in Intelligence country analysis [8])

The political risk is composed of twelve indicators that have different values in forming the main indicator so we should discuss on the main players at each indicator as follows:

1. **Governmental Stability:** Hungary and Latvia have the best governments in times of crisis when we see the entire country as an entity, and Bulgaria is the one that has the weakest response for the country as a market economy;

2. **Socioeconomic Conditions:** the Czech Republic is once again the country with the best and linear distribution of wealth in its society, at the bottom being Romania which still lags at “taking care” of its siblings;

3. **Investment Profile:** the Czech Republic and Poland are the countries that attract most foreign investors and have the biggest returns in the region, at the bottom of the rankings is situated Romania, once again, because through its way of developing and deploying the environment for the market to grow by the local government is failing at each chapter of how to build a stable economy;

4. **Internal Conflict:** Slovenia and Slovakia are the champions of the region at this chapter and this is happening because these two countries during history succeeded into keeping their backbone despite the fact that they were destroyed by all foreign enemies, at the other end of the rank there is Romania that is situated in a continuous conflict because its political class and its lack of backbone in developing the right way of doing business;

5. **External Conflict:** Slovenia and Slovakia are also champions at this chapter because of their geographical position explained at the 4th indicator, but the red light is Bulgaria because of its lack of global connectivity, this country doesn't know how to “sell” itself to external creditors, and the sectors that are slightly developed are already sold to other countries;

6. **Corruption:** Slovenia, Estonia and Hungary are the countries that rank best in the region and have the lowest rate of corruption scandals, while Latvia, Lithuania and Bulgaria are the countries with the most numerous corruption scandals;

7. **Politics involvement in Military:** Czech Republic, Poland and Hungary are the countries with the smallest influence of politics in military decisions while Romania, Bulgaria and Lithuania are the countries that have the Army influenced by the political factor;

8. **Religious Tensions:** here a real antithesis could be seen, the champion is Czech Republic and the red light is Slovakia because of the battle between Orthodox and Catholic dissensions;

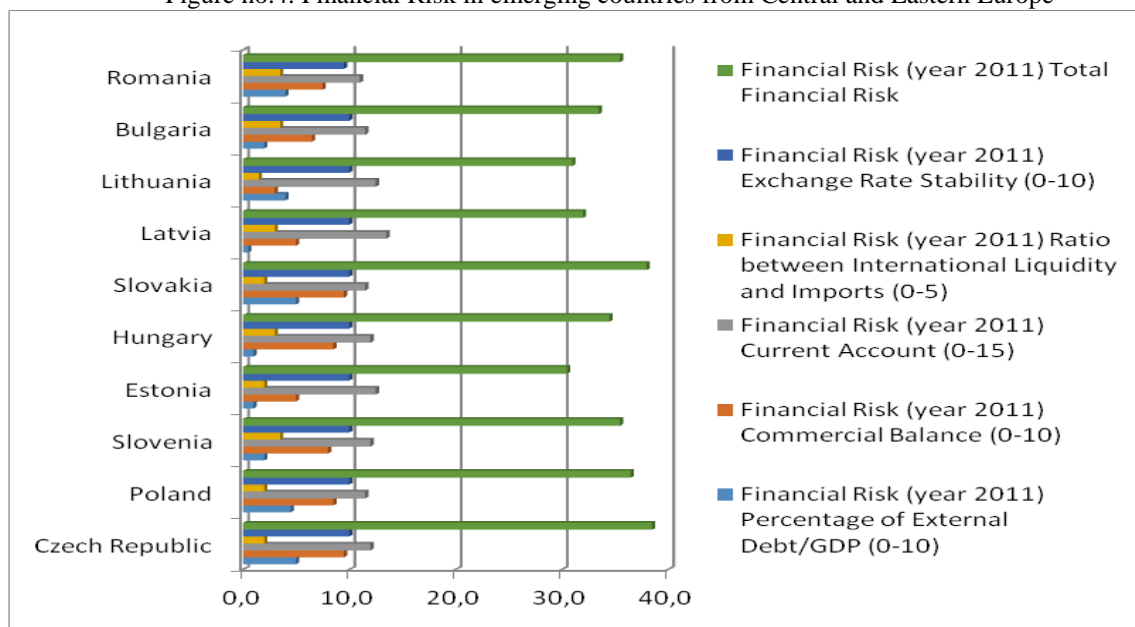
9. **Law & Order:** Czech Republic and Latvia are countries with the fairest and well applied justice system while Bulgaria fails badly at this level because it has a high level of corruption and the justice system is highly influenced by politics and interest groups;

10. **Ethnical Tensions:** Poland is the champion and it succeeded in blowing off any ethnical tensions and the red light is carried by Estonia not because of any national tensions with its neighbors, but because of the demographical distribution of its population;

11. **Democracy:** the champions are Poland, Slovakia and Romania, countries that have a high level of freedom of speech, of social view and expressivity, while Slovenia is the least free country in the region;

12. **Bureaucracy:** Czech Republic, Poland and Slovenia are the countries with the smallest bureaucracy, lowest number of taxes and smallest number of days needed to open a new business, while Romania is the worst example not only in CEE but the entire Europe, it has a large number of taxes (178), there are needed around 23 days to open and activate a new business and the circuit between the private and state sector is not logical and clear and it needs informal incentives to reduce frictions.

Figure no.4. Financial Risk in emerging countries from Central and Eastern Europe

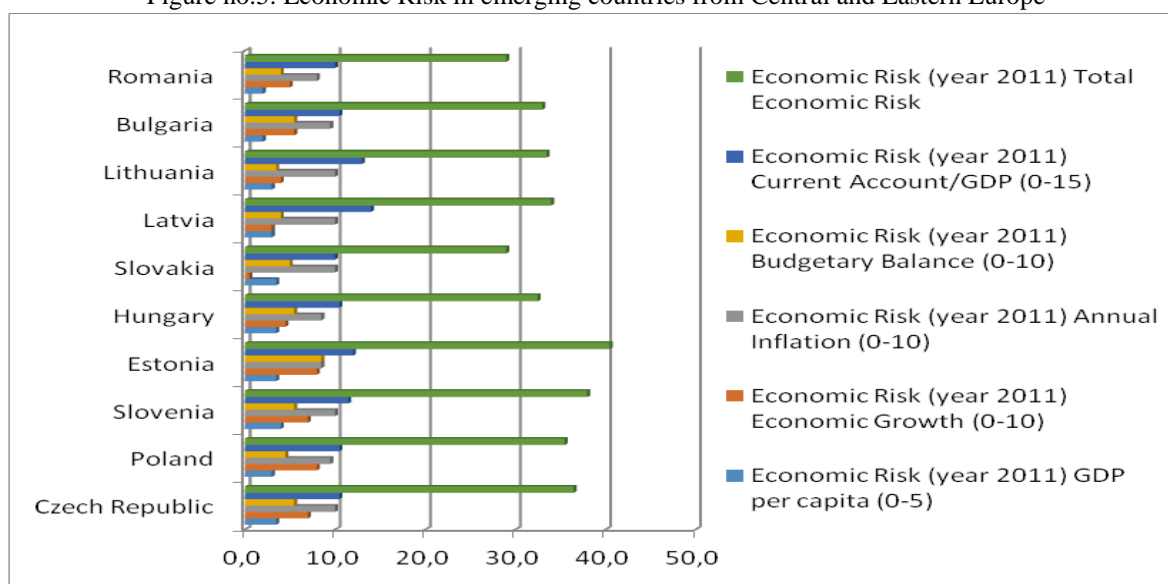


Source: data analysed by the author in January 2013, data bases offered by PRS Group Incorporated (company specialized in Intelligence country analysis [8])

Going further on researching the Financial Risk of countries from Central and Eastern Europe we could deconstruct the financial risk into:

1. **Percentage of External Debt to GDP:** champions are the Czech Republic and Slovakia that have the lowest percentage and the perspective is neutral while Latvia is the country with the worst perspective;
2. **Commercial Balance:** champions are the Czech Republic and Slovakia are the champions of the region while Lithuania has the worst perspective because it is a net importer and it hasn't any resource to ignite exports;
3. **Current Account:** Latvia is the champion because it has built its image on growing its budgetary surplus, while Romania is the country with the worst deploy of financial forces;
4. **Ratio between International Liquidity and Imports:** Slovenia, Bulgaria in Romania seem to be the countries with the best perspective on their international liquidity and imports, but this situation is not created by their evolution, but by their geographical position, the worst country is Lithuania because it is not a node in the European transportation infrastructure and it hasn't any resources that could be used as a competitive advantage;
5. **Exchange Rate Stability:** All countries ranked the same except Romania. Romania has a poor proactive system to create a linear development of the exchange rate's stability.

Figure no.5. Economic Risk in emerging countries from Central and Eastern Europe



Source: data analysed by the author in January 2013, data bases offered by PRS Group Incorporated (company specialized in Intelligence country analysis [8])

Regarding the Economic Risk it is deconstructed in the following sub-indicators:

1. **GDP per capita:** Slovenia is the champion in the region while Romania and Bulgaria are in serious lag for catching up the countries in the region and the ones in EU27;
2. **Economic Growth:** Poland and Estonia are the champions in the region during time, especially after their liberation under the communist regime, while Slovakia is the country with the worst perspective because Slovakia is under the influence of their step-brother, the Czech Republic;
3. **Annual Inflation:** Czech Republic, Slovenia and Slovakia are the countries with the smallest inflation and best perspectives for expected inflation while Romania has the worst perspective after the automatic growth with 5 percent points of their VAT (Value Added Tax);
4. **Budgetary Balance:** Estonia is the country with the best perspective on the budgetary balance while Lithuania is on the slope to future near bankruptcy;
5. **Current Account to GDP ratio:** Latvia is the country that tries to stagnate the evolution of the current account while its GDP is evolving according to their forecasted optimal output, meanwhile Slovakia and Romania are the counter examples because these two countries have the tendency to increase their spending on exports with a rate bigger than the growth rate of the GDP.

After evaluating all the sub-indicators that create the political, financial and economic risk that are quantified in standalone indicators there could be added the research of Steve Brakman [2] and other authors that identified four paths to influence on a 360 degree perspective:

1. **Political conflict and cooperation between nations:** these are opposite at commercial level;
2. **Democracy follows democracy:** democracy enforces the choice of business partners only from democratic countries or to help grow democratic movements in partner countries;
3. **Economic-political cooperation at institutional level:** commercial global agreements and institutional cooperation in the economic and political system;
4. **Military alliances influence commercial flows:** there is a bidirectional connection military cooperation and commercial exchange, having a flow with double sense for nations.

3. Conclusion

After evaluating the situation seen in emergent economies in the Central and Eastern Europe and countries that have in common the fact that they are well-positioned in Europe's heart, that's why Croatia is not taken in consideration and only the actual analysed 10 countries were spotlighted and these countries try to put themselves into the centre of the Europe's commercial flow and try to resist geo-political and economic exogenous and endogenous influences.

Another component that shows the continuous development of the global economy and the capital flow between countries is the Americanization of some countries by implementing some work techniques created in the US and by attracting some legal and regulating components to grow the multinational companies that are in full global expansion.

In practice, USA transformed itself into a virus [9] that infected developing countries through its patented and developed mechanism in the US the management consulting industry that promotes the organizational flow for continuous development as a competitive advantage for new markets by using companies that could offer the needed services. This fact offered global players that originated from the US wings to deploy globally. The main players and creators of subsidiaries at worldwide level are: Deloitte, PriceWaterhouseCoopers, KPMG, Ernst & Young, McKinsey & Co., Boston Consulting Group, Bain & Co. and the investment & research divisions of the large global banking players (JP Morgan Chase, CitiGroup, Goldman Sachs, Morgan Stanley, Deutsche Bank, etc.), and these players are developing and deploying globally and acting in the relation between multinationals and their headquarters (axons represent the linkage between neurons, it is responsible for the unitary function of the Central Nervous System and the cognitive development of the individual) [10]. The business literature is also with American origins assuring this way the subconscious transfer and the standardization to the American management system of the management systems found in emergent or developing economies. The business theory is given by the great American intellectuals: Peter Drucker, Michael Porter, Clayton Christensen, Tom Peters, C.K. Prahalad, Vijay Govindarajan, etc. to assure easy implementation of American business principles in the hosting economy. Under-valued and under-exposed problems where met in the business lifecycles of giants like AT&T, Enron and Arthur Andersen (auditor-consultant of Enron) and led to the creation of new regulations and to representative case studies for the contemporary history of global business, Enron's case being presented from time to time as a business case, but with the same novelty as almost twelve years ago.

The idea of mutual influence between commercial exchange and development policy of the state and of the borderless business environment is based on the mercantilist model developed during the years 2011 and 2012 [11] in the North American and European academic and business research environment and underlines the idea that a country must be a larger exporter than as an importer [2], this fact being a factor of the contrarian policy for the economic environment in which the country is situated and the decision is taken through the political vantage point. Marxists and the followers of the Empires theory where the ones that promoted these policies for stressing the idea of national freedom obtained through global commercial independence, and the perfect example is given by Albert Hirschman in 1945 [12] and it represents the commercial relation between Germany and the political constraints done on the economies of Bulgaria, Romania and Hungary in exchange for political measures taken in international relations between these four countries.

4. Acknowledgments

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