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**“Don’ts” and “Do’s”:
Insights from Experience in
Mitigating Risks of Western
Investors in Post-Communist
Countries**

Charalambos A. Vlachoutsicos
Athens University of Economics and Business
cvlachou@hellasnet.gr

Paul R. Lawrence
Wallace Brett Donham
Professor of Organizational Behavior, Emeritus
Harvard Business School
plawrence@hbs.edu

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“Don’ts” and “Dos”: Insights from Experience in Mitigating Risks of Western Investors¹ in Post-Communist Countries

Introduction

“Emerging markets are not as risky as you think”. The title of an article written by two of McKinsey's investment experts in 2003² sums up a view which has recently been gaining ground among experts³ of western investments in emerging market economies⁴. In recent years several experts have maintained that the way in which large sectors of the business community in the west think about the risks incurred by investing in such countries is flawed. It is argued that uncritical acceptance of the general “high risk” image which attaches to investing in transition countries⁵ has proven counterproductive: the argument goes that far too many companies have shied off from such investments altogether, thus missing out on the multiple opportunities for expanding sales and profits offered by these product hungry, fast expanding, dynamic markets⁶ while far too many western investors have entered these markets in a defensive frame of mind which has proved very prejudicial for the performance of their investments.

¹ Our article is addressed to investors from the USA, and from Northwestern Europe, as the bulk of our evidence is drawn from experience with investors from these areas. Thus, “western investors”, “westerners” or “western investors from mature market economies” are used interchangeably for reasons of stylistic convenience, but, unless otherwise stated they refer only to western investors from the areas stated.

² Mark H. Goedhart and Peter Haden, 2003, “Emerging markets aren’t as risky as you think”, *McKinsey on Finance*, Spring issue.

³ Our evidence is drawn from our extensive, varied and multiple level experiences in dealing with the matters, which we discuss. Details of this experience are given in pages 12 and 13. Since this article is addressed to actual and would- be western investors and managers in post-communist countries, our references to the literature on the subject are informed by our action-oriented approach. Not only do we refer almost exclusively to articles written by analysts who are also action –oriented, but we also make no attempt to give anything like an exhaustive account of this literature. Thus the references that we give are only used to convey the general tenor of the different approaches among analysts of western investments in post- communist countries.

⁴ In much of this literature the term “emerging markets” is used very broadly to include China, India and countries in Latin America. However, this does not affect the relevance of this literature to our arguments since the term “emerging markets” invariably includes the countries to which our article refers.

⁵ Our reference is to post-communist countries that used to be members of the Soviet Block. In the text we shall refer to these as “transition countries”, “post-communist countries” or “ex-Soviet block countries”. We exclude Hungary, Poland and Czechoslovakia, on the grounds that in these countries the process of transition from a State controlled to an open market system has been completed, so that they have been granted full EU membership.

⁶ For example, US companies have proved very reluctant to invest in any emerging economy. By the end of 2002, according to the Bureau of Economic Analysis and agency of the US department of commerce American corporations and their affiliate companies had 1.6 trillion worth of assets in the United Kingdom and 514 million in Canada but only 173 billion in Brazil Russia India and China combined. (Tarun Khanna, Krishna Palepu, and Jayan Sinha, 2005, “Strategies that fit emerging markets”, *Harvard Business Review on line* June 2005).

The approach which looks to the mindset of investors for explanations for the generally disappointing record of their investments in transition countries⁷ goes against mainstream thinking. In the voluminous literature on the risk/opportunity ratio for such investments the view that the preponderance of risks is due to flaws in the business environment holds centre stage⁸. The authors who critique mainstream thinking do not claim that the “high risk image” has become obsolete though of course they emphasize the many developments in these countries which have made their business environments more congenial to western investments. “During the past 11 years of working in Russia and in the former soviet republics, I have been asked many times if it is possible to do business there. My reply has always been yes, but it is neither simple nor easy. Russia is a risky place of business” writes James wade, a founding member of the Russian American chamber of commerce⁹. After carefully documenting all the risk- enhancing features of the current business environment in Russia, the author goes on to argue that most of these risks are manageable. He maintains that if so many western investors experience the frustration of enormous opportunities slipping through their fingers, it not so much because the business environment is inherently risky, as because the companies themselves fail to develop strategies and practices of risk management that are truly adaptive to the business environment in which they find themselves.

Still, while they differ from the mainstream view in that they emphasize the need for western investors to develop a proactive mindset towards risks, these writers continue to be primarily concerned with the so- called “hard” risk parameters: they concentrate on the unstable and volatile business environment of transition countries and do not suggest concrete policies,

⁷ Though major differences in circumstance preclude precise quantitative comparisons, it is generally accepted that the failure rate for western investments in emerging markets is much higher than it is for investments at home. For joint ventures in particular, one author estimates the failure rate of western investments in emerging countries at 50% (Van Oldenberg 1995, 20-23.) According to a report based on ten years’ research on US investments in all emerging capitalist economies, in Russia “ a few multinationals like MacDonalds have fared well but most companies have failed to make headway” (Tarun Khanna, Krishna Palepu, and Jayan Sinha., op. cit) .Altogether, the return on investments made within the mature markets system has been shown to be still considerably higher than the returns on investments made in transition countries

⁸ A simple run down of articles on the Internet about what investment in any one transition country entails is enough to show the strong preponderance of articles warning about risks that are inherent in the business environment of the countries in question.

⁹ Wade James, 2001, “Some Things Companies Should Know to Succeed in Russia: Special Reference to the Mining Industry”, <http://www.russianamericanchamber.org>.

actions and managerial practices investors could “work around” the distinctive risks and challenges that they need to address.¹⁰.

Our article addresses what we shall call “prevalent thinking” in the western business community. We wish to stress that when we say “prevalent thinking” we mean just that and no more. Certainly several western investors who have been operating in these areas for some time have been taught by experience that many of the assumptions and attitudes with which they had started their operations in a post- communist country had given them very counterproductive council on how to conduct their enterprises. Thus these companies have gone a long way towards developing mindsets and adopting practices which are in tune with the requirements for effective interaction with locals. Yet the misconceptions and misguided practices of western investors, which we are talking about, are common enough to justify the term “prevalent thinking”. Indeed, in the authors’ experience traces of the mindsets we describe can be detected in the interaction between westerners and locals even in enterprises which have learned a lot from past mistakes.

Secondly, and most importantly, we wish to dispel any misunderstandings that may be caused by our use of the term “locals”. These days there is considerable variation in the managerial skills, attitudes and even mindsets that local staff brings to bear on their work generally and on their interaction with western colleagues and superiors. Over the years the number of locals with “westernized” business culture and managerial skills has been growing fast. Crucial to the process of “marketization” of many locals, and most particularly among the younger local managers and entrepreneurs, has been what professors and other experts involved in higher education in ex-communist countries have described to us as “an explosion” in management education. Reports received by the authors from academic and

¹⁰ The abstract of Tarun Khanna et al (op. cit) report reads as follows: “Fast growing economies often provide poor soil for profits: The cause? A lack of specialized intermediary firms and regulatory systems on which multinational companies depend. Successful businesses look for those institutional voids and work around them”. See also Knowledge & Wharton, 2003 , on line. “Russia's struggle for competitiveness” for the report on a video conference of Russian and American bankers, businessmen, and academic experts. While the participants generally adopted a risk management approach the central question addressed was how far Russia has advanced in providing a user friendly environment for western investors.

business colleagues in Russia, Bulgaria and Romania inform that management education in the countries of the region has a very substantial increase over the last decade. As a result, thousands of young managers are receiving MBA education¹¹ nevertheless, as westerners have discovered in practice, the scope and depth of “marketization” is very uneven and varies greatly as between individual managers, even among those who have obtained MBAs,¹². Time and again we have experienced and also have been told by American and European investors about greatly varying experiences which they have had with local MBA graduates, who at first sight seemed at ease with western business terminology, skills and business culture. One personnel manager in a multinational company whom we interviewed put the problem in a nutshell. “I interviewed two young men for management positions in the sales department. I was impressed. They both knew their stuff. Could talk about marketing like they were borne to it. I said to myself, “Look at that. Russians are catching up”. I hired them both. Turned out, one took to it like a fish in water the other just would not fit in.

¹¹ To take but the example of Russia. In a personal communication with us Dr Natalia Fey, Executive at Swedish Management Consultants, Kontura International, who is specialized in cross-cultural interaction and doing business in Russia, estimates that in Russia there are now 30-40 officially accredited MBA programs in State universities and business schools and in private business schools. Every year 5000 MBA graduates become available. A significant development is the trend towards specialization of MBA programs in particular areas of management. While five years ago only one general MBA program was available today Universities and business schools run eight different MBA specializations. On the other hand, Dr Fey points out that the need for more MBA graduates is keenly felt and predicts a continuing increase in the number of MBA programs. From the point of view of our article, the relative scarcity of locals who are well schooled in the skills and attitudes which fit in with the western blueprint of doing business, means that western-local interaction across major differences continues to be a major issue in the running of western investments. From the point of view of our article, the relative scarcity of locals who are well schooled in the skills and attitudes which fit in with the western blueprint of doing business, means that western-local interaction across major differences continues to be a major issue in the running of western investments. See also Dunayeva, D. and Viperman, C., 1995 “Similar but different. Why do Russian and American business people, even when they speak the same language, so often seem to be engaging in a dialogue of the deaf?”, *Business in Russia*, June issue

¹² Veiga, J., Yannouzas, J. and Buchholtz, A., 1995 “Emerging cultural values among Russian managers: what will tomorrow bring?”, *Business Horizons*, July-August.. Camiah, N., Hollinshead, G., 2003 “Assessing the potential for effective cross-cultural working between “new” Russian managers and western expatriates”, *Journal of World Business*, 38, 245-261

Thus, we wish to stress that our use of the term “locals” should not be read to imply that we are putting every local in the same boat when it comes to the distance from western business practices and business culture.

Still, we do not use the term “locals” simply for stylistic convenience. What exasperated the personnel manager who talked to us, corresponds closely to our own experience both with young Russian managers who take the professional MBA course at Stockholm school of economics Russia and with local managers in the region who have all the signs of being “westernized” or “marketized” .again and again we could trace problems in effective interaction with westerners to the persistence of a number of fundamental assumptions and values, which completely baffled the westerners, who, like our personnel manager, thought that they had hired someone they could “speak the same language”. Indeed, very often local managers themselves do not realize how they carry attitudes which have their roots in the soviet system from which, at a conscious level, these young people vehemently distance themselves, until something happens that triggers these deeper layers of feeling. Like the ingrained sense that your relationship to the employer goes beyond being judged on your performance alone-- that the worker can expect to be looked after – hence the deep resentment caused by the usual western approach to firing. Or, the assumption that a chance to have your opinions taken seriously is part and parcel of your identity as a worker.¹³ As the troublesome sales manager reputedly argued —to the great irritation of his western boss who had obviously had enough hearing about “how things are done in Russia”— if you impose targets without listening to what the salesmen say, they will just use their considerable evasive skills to keep you happy at the moment without a thought to the problems this might create in the long run. If you have not asked them, they don’t commit.

¹³Lawrence, P.R. and Vlachoutsicos, C., 1990 *Behind the Factory Walls, Decision Making in Soviet and American Enterprises*, Harvard Business School Press (diagram on page 77). See also Vlachoutsicos, C., 2001 “Russian Communitarianism: An Invisible Fist in the Transformation Process of Russia”, in: *Managing Organizational Change in Transition Economies*, edited by Prof. Daniel Dennison, The William Davidson Institute at the University of Michigan Business School, Lawrence Erlbaum Associates, chapter 7 .

Finally we wish to remind the reader that ex-soviet block countries are at different stages of transition from state directed to free market economies. So, our category includes countries that vary greatly on all parameters, which we discuss in this paper, risks in the business environment as well as the skills, attitudes, values and priorities of westerners’ local counterparts. Still, drawing on our experience and on the insights acquired through familiarity with ways of thinking and being in a state controlled economy, we are confident in our view that for the purposes of our argument differences between countries which are in transition are less important than commonalities.

To sum up, in this working paper we do not intend to suggest that the parameters of interaction which we identify are uniform throughout western investments in the countries which we are dealing with. At the same time we contend that these variations occur *within* the overall framework of the basic commonalities which have emerged from our extensive and varied experience with problems of interaction between westerners and locals. Besides our experiences are in tune with one fundamental idea on which all modern theories of social change agree and which has been fully confirmed by the extensive research into processes of social and cultural change in societies around the globe. And this is that change of any kind never happens as a total transformation, an abrupt switch from the old to the new. Understanding social change is as much about understanding how continuities pervade and condition new ways of thinking and behaving, as it is about identifying breaks with the past.

Let us now go back to the model for effective westerner- local interaction which we present in this paper. Our model addresses the mindset that westerners need to cultivate and suggests management tools, which build up a working environment conducive to effective interaction.

In this article, we aim to contribute to the critique that shifts the conversation from the risks themselves onto the mitigation of risks, by developing a perspective on risks and on their mitigation, which has so far received little attention. We shall deal with the so-called “soft” parameters of operating a western enterprise in a transition country, namely with the quality of interaction between investors and managers from mature western economies and their local counterparts. So far research into these parameters has not been conducted in the

context of a broader preoccupation with risk mitigation and has tended to focus on specific issues which impact on the working relationship between westerners and locals¹⁴ such as, e.g., structures of authority, leadership beliefs and styles, modes of empowerment or performance appraisal. In this paper we adopt a holistic approach. We deal with effective interaction as an integral and crucial part of risk management in western investments in transition countries and shall articulate a comprehensive model for effective interaction with locals. Our model addresses the mindset, which westerners need to cultivate, and suggests management tools which build up a working environment conducive to effective interaction.

Our central thesis is that flawed westerner- local interaction is very costly and that western investors grossly underestimate how damaging ineffective interaction really is. We hope to show that it constitutes a major stumbling block to effective risk management and stands in the way of the enterprise availing itself fully of the multiple opportunities for profit offered by these product hungry, fast expanding, and dynamic economies. In fact we shall go as far as to claim that flawed interaction constitutes a major risk, if not the greatest risk, for western enterprises in transition countries. Expressed in positive terms, we propose that effective interaction between westerners and locals is the necessary condition, the *sine qua non* for the success of western investments in transition countries: it generates profits and maximizes the chances that the enterprise will counteract the so-called “hard” risks which are specific to operating in a transition country.

¹⁴ For example, Marsden defined “indigenous management” as utilization of “...local, folk or vernacular knowledge and organizational methods, in the service of appropriate development strategies” Marsden, D. (1991) Indigenous Management, *International Journal of Human Resource Management*, 2(1): 21-37. For a detailed discussion and bibliographic references to such studies see Paul R. Lawrence, Charalambos A. Vlachoutsicos and Snežina Michailova, From West-East knowledge transfer to effective working relationships: Lessons from Commercial Capital S.A., *Journal for East European Management Studies*, Vol. 10 4/2005. See also Robson, M., Leonidou, L., and Katsikeas, C. (2002): Factors influencing international joint venture performance: Theoretical perspectives, assessment and future directions: *Management International Review* 42(4): 385-418

We shall develop our central thesis by structuring our evidence around the following themes:

- On the whole, and with several notable exceptions, investors and business executives from mature western economies pay far too little attention to the quality of their interaction with their local counterparts.
- This cavalier approach is part of a comprehensive mindset, a kind of “syndrome” of interdependent beliefs, attitudes and precepts for action, which investors and managers from mature economies bring to bear on the manner in which they interact with their local colleagues. This mindset, includes several misconceptions both about the nature of the differences between western and local ways of thinking and behaving in business and about how best to cope with the difficulties arising from these differences. We shall present different components of “prevalent thinking” and will then proceed to deconstruct the misconceptions which each such component entails.
- Misconceptions about the “realities” of dealing with locals and the practices which such misconceptions lead to, engender vicious circles of cross purposes, misunderstandings, resentments and lack of trust.
- These vicious circles are not written in stone. It is well within the power of western investors and executives to generate a benign interaction dynamic.
- The westerners’ best guides for meeting the challenge of effective interaction with locals *across* differences in business practices, concerns, priorities and values, are the basic principles of good management and the managerial tools which they normally apply in business interactions *within* mature economies.

This may sound paradoxical. After all, this article is about how westerners should develop adaptive management practices based on the need to understand and take into account differences between their own and local basic assumptions, perceptions, concerns and behavior patterns. However, the paradox is only apparent. Our article is indeed very much

about how managerial tools which are applied at home should take account of differences which do not occur between interaction partners in western mature economies. What we are saying is that what matters is that to develop adaptive managerial practices which are informed by the principles and the spirit that inform good management at home.

However, as Wade writes, all this is neither simple nor easy (see footnote 9)

- Dominant among the themes that run through this article is the proposition that a benign interaction dynamic can only be set in train under one very demanding proviso: what is required is no less than a 180 degree turn of the mindset which informs the practices of most western investors and executives who conduct business in an ex-communist country. Furthermore, and most importantly, westerners need to develop managerial practices which are applied in the spirit of these changes of mindset and give them form and substance
- As already mentioned, we shall present a comprehensive model for effective interaction of westerners with their local counterparts. Thus we shall articulate alternatives to widespread western misconceptions on these matters and will articulate managerial practices which generate a positive interaction environment.
- To say that all this is neither simple nor easy is to put it mildly. In order to be effective, the changes which we shall propose must be driven by an open mind, by a genuine “I have much to learn” approach to difficulties, by genuine commitment to the process of understanding what is required and by the will to do what it takes. And what it most certainly takes is substantial investments in time and money. What this article hopes to show is that the cost of neglecting the quality of interaction with locals are so high and the benefits derived from effective interaction are so substantial, that a western investor would be wise to estimate in advance the effort and cost that this 180 degree turn of mindset entails, and to be sure before proceeding that the resulting business plan meets the strictest western criteria of a wise investment.

As its title suggests, this article is addressed to actual and would- be western investors and managers in transition countries. It is written in the hope that readers will recognize their assumptions, attitudes and practices in the mirror that we hold up to what we call “prevalent thinking “ of the western business world. What is more, we hope that our contention that those who cling to such a mindset are their own worst enemies will strike a responsive chord. Therefore, it behoves us to give an account of the authors’ credentials for the task which they have undertaken and to inform our readers of the evidence on which we are basing our assessments and proposals.

Dr. C. Vlachoutsicos has been doing business with Russia and several Balkan countries since the soviet era. With a business experience which goes back to the times when these economies were owned and run by the state and spans all the phases of their transition to an open market economy, Vlachoutsicos has become intimately acquainted with continuities and changes in perspectives, concerns, priorities and behavior patterns which come into play in the interaction of local officials, managers and entrepreneurs with western investors and executives. From 1985-1994 he was a fellow at the Russian research center of Harvard University. During the ten years when he served as senior executive counselor at commercial capital, S.A. (cc) a leading Greek venture capital company investing in countries of the Balkan and black sea region, Dr. Vlachoutsicos and the company’s management team have worked out and tested a comprehensive method for establishing and operating investments in these countries. Many of the propositions and “don’ts and dos” set out in this article derive from the experience of applying this management model to cc’s investments. As management consultant to western investors in transition countries, Dr. Vlachoutsicos has acquired an overview of widespread assumptions attitudes and managerial practices adopted for investments in transition countries and has had the opportunity to follow how vicious circles of interaction with locals are generated, to trace their far reaching adverse effects on the enterprise and test out the benefits derived from following a different course. Since the 1980s, Dr. Vlachoutsicos has directed several research projects in this subject, including the pioneer Harvard Business School research on Russian managerial principles and practices, which he co-directed with Paul R. Lawrence. He has published widely on issues connected

with strategies, policies and methods for planning, negotiating, establishing and operating western investments in transition countries, has participated in several international conferences and has been teaching MBA courses on these issues as visiting professor at the international MBA program of Athens university of economics and business and as associated senior research fellow at the at the Stockholm school of economics Russia (SSERU).

Professor Paul R. Lawrence, Wallace Brett Donham professor emeritus of organizational behavior, Harvard business school has published widely (twenty-five books and numerous articles) on organizational theory and human behavior. He is among the founders of organizational behavior as a discipline. His book "organization and environment: managing differentiation and integration", he co-authored with Jay Lorsch, first published in 1967 by Harvard business school press, was reprinted in 1969 and once again in 1987. This book was awarded with both the academy of management's award "best management book of the year", the American college hospital administrators' book award (1969) and named "one of the best books in management' by the *economist*. When written the book introduced a revolutionary perspective on organization by revealing that, depending on environmental uncertainty and complexity, different industries need to implement different kinds of organizational structures and practices. His most recent book, (*driven: how human nature shapes our choices*, co-authored with Nitin Nohria) offers a major step toward a unified theory of human behavior.

Thus this paper draws on a large fund of varied experience, both at the level of hands- on involvement in business experience dealing with transition countries and at the level of academic research and analytical thinking on the issues at hand. Our paper also draws on a data bank consisting of reports about personal experiences of interaction with westerners. These reports were written as a course assignment by the young Russian managers and entrepreneurs who attended the lectures, which dr. C. Vlachoutsicos has been giving since 2001, as part of the SSERU MBA program.

PREVALENT THINKING AND ALTERNATIVE PROPOSITIONS

1) On the risks incurred by western investments in transition countries:

*Prevalent thinking*¹⁵: investments in ex-soviet block countries, as indeed in any emerging market economy around the globe, are far riskier than in countries with mature market economies. Unlike mature markets, such transition countries do not offer the means by which the risks entailed in a business venture can be specified, calculated and managed. In these business environments, where the rules of the game are neither stable nor transparent, the normal process of risk taking, which is what business is about, is distorted by the operation of pervasive, unpredictable, incalculable, and therefore inherently unmanageable risks.

Our proposition: we propose that while there is much that is volatile and opaque in the business environments of the countries with which this paper is dealing, their markets “are not as risky as you think”. In fact the generalized, poorly specified “high risk” image which attaches to investments in the imperfect markets of transition countries becomes a self – fulfilling prophesy, in that it clouds the investors’ view of effective strategies of risk management.

Much of the fallacy of a generalized “high risk image” is that it mythologizes risks. That is to say, the distinctive risks attaching to investments in transition countries tend to be perceived through the distorting lenses of a general sense of insecurity about operating in an “alien” business environment. Once westerners manage to approach such risks in the same pragmatic spirit as they approach the multiple risks entailed in business decisions at home, the risk scenario changes. Volatility, lack of transparency, the fact that much of what a western businessman can take for granted about his partners and executives at home may be quite off the mark when it comes to dealing with locals, are transformed from elusive pervasive dangers to risk -inducing factors with concrete manifestations in concrete

¹⁵ Much of this thinking applies to emerging markets in general but this makes them all the more wrong for transition countries because of the distinctive feature of advanced education, etc.

contexts. Approached with the pragmatism, which the western business world is so renown for, these sources of risk can be factored into the normal processes of risk calculation. Which is to say that they become manageable.

But we go further than that in our critique of the “high risk image”. It is not just that risks are manageable. It is also that when it comes to “objective” risk conditions, i.e. Conditions which require the investment of large sums of money without guarantee of satisfactory returns, one can easily list substantial advantages of transition markets over mature ones, at least when it comes to consumer products. Thus for mature markets, one might think of the huge amounts of money which firms risk as a matter of course on the uncertain outcome that they will be able to increase their share of the market or overcome the resistance of brand-saturated consumers to new brands. Add to this the high cost of getting a product on the shelves of large chain retailers and of keeping it there under intensely competitive circumstances. By contrast, conditions in transition countries favor capturing market shares at substantially lower expense. Not only is brand saturation low, but also an investor can find unoccupied territory for a wide range of products and services. Assets can be acquired at low cost and competition remains relatively mild, one reason being that so many western investors are still wary of venturing in the reputedly “high risk zone” of transition countries. Thus, in many vital respects business predictions are a lot safer here than they are in the western world. To give but an obvious example: the prediction that credit card penetration in Romania will increase to eventually reach western European levels is much less risky than the prediction that a massive advertising campaign will secure the success of a new toothpaste in a mature western market¹⁶.

Altogether, the undifferentiated high risk image and the fears which are associated with it can be highly detrimental to western investors. Many western investors prove faint hearted in a

¹⁶ For example, CC established in 1999a company in Romania with the objective of exploiting the opportunity presented by the growing credit card market in Romania. It developed full third-party processing services for the local banking sector and supported the introduction of card-based financial products. The company developed services that cover the full issuing and transaction acquiring range. It was the first entrant in the Romanian market, which, in 1999 had 0,03 cards per capita, while Greece had 0,66 and EU 1,03. By 2005 it had risen to 0,32, 1 and 1,28 per capita correspondingly. Consequently, the growth of the company was explosive. By now, it services 21 banks, 16 in Romania, 4 in Serbia, Montenegro and the Former Yugoslavian Republic of Macedonia and 1 in Cyprus. During 2005, transactions grew by 225%, revenues by 21,6% and EBITDA by 411%. As a result, its current owner is able to negotiate the sale of the company with strategic investors whose offers range between 30 to 38 million Euros.

transition country, thus allowing major opportunities for profit to pass them by. A recurrent theme in the stories by St. Petersburg MBA students was their frustration with the refusal of their western colleagues and bosses to grasp “golden” opportunities, for fear of taking risks, which to a local manager with experience of the distance between form and practice in local institutions, seemed largely hypothetical and in any case quite manageable.

2) On “what” and “how” -- a central distinction

In mature western markets the distinction between the what (the ends) and the how (the means) - between a company’s core best practices and the ways these are actualized -in the course of executing particular projects, is taken for granted and only rarely generates issues which require thinking this distinction through. As a rule these attitudes persist in western investments in ex-communist countries. Yet in these unstable business environments, where westerners cannot operate in the context of shared understandings about the organization of work, it is crucial for an investor to be very alert about this distinction and to adopt deliberate practices assuring its application.

By *WHAT* we understand the values, policies and best practices that constitute the mark and competitive advantage of the investor’s company at home, lending the company its success and its distinctive character and tone. To put it differently: the ‘*WHAT*’ consists of the company’s cornerstone competencies which, at home, are treated as non negotiable. These «what» principles and core competencies could range from production technologies, (essential machinery and levels of skill required of operatives) quality standards and associated methods, management information systems (MIS), marketing and customer relations practices, employee relations practices, supplier relation practices and ethical codes of conduct. These are all examples of the kinds of core managerial practices and values with which the company personnel are required to identify, practice and take pride in.

HOW, refers to ways and means to enact and put into practice the firm’s core values and practices: modes of decision making, communication lines, management styles and procedures which are adopted to optimize effectiveness, taking into consideration the

distinctive constraints as well as the forces which are operative in each environment. Most important the “how” includes ingrained cultural traits, and locally distinctive ways of being effective.

With these distinctions in place, the mindset of integration gives new meaning both to “insist on the western blueprint” and to “do as the Romans do” and enables the westerner to make a coherent synthesis between the two maxims and reshape them into the following overall guideline:

“Be adamant on the *WHAT BUT*, at the same time, be optimally flexible on the *HOW*.”

Our experience indicates that succumbing to the convenience of cutting corners on the «what» in the name of «adjusting» to local constraints is self defeating. A successful company adds value by doing what it knows best how to do. This holds anywhere i.e. In the market of a transition country as well as at home. Any deviation from these basic principles and tenets jeopardizes the investment. Therefore, the westerner should invest all the effort and time required in order to secure genuine alignment of locals with the

Company’s values and best practices. Compromises on these issues usually get the worst of both worlds: they may well not give in enough to satisfy the locals and still give up too much of what is needed for the competitive edge of the investment.

Flexibility on ways and means is just as important. It is a truism to say that business environments in mature economies are quite different from those in transition countries. Western investors discover this -- often to their considerable cost. And yet many, if not most, do not think of developing strategies and ways and exerting efforts to cultivate the flexibility required in order to deal with these differences. Our proposal insists that the very same “what’s” which in a mature market dictate a specific set of “how’s”, may well dictate quite different “how’s” in the context of a local market. Indeed, it would be quite wrongheaded not to draw on and utilize the large fund of insider know-how which locals command on getting

things done. Flexibility on “how” pays heed both to fundamental tenets of the local work environment and to the knowledge of locals of ways and means to get things done.

In other words, instead of “when in Rome, do as the Romans do”, we suggest “when in Rome, tell the Romans where you want to go, but let them show you the ways and byways of getting there” ...

On the basis of the above “what” / “how” distinction, we developed a set of guidelines and appropriate practices.

A) Westerners to take responsibility for the “what “ and locals for the “how”:

Having decided to avail itself of an investment opportunity in an ex- communist country, a western company spends time and often considerable sums of money on pre-investment negotiations. The what/how distinction offers the would-be investor a useful frame of reference for conducting negotiations. Difficulties that stem from different perspectives and conflicting interests in relation to the WHAT/HOW distinction are bound to arise. We believe that these difficulties serve as a good testing ground for the would-be investor to assess his chances of success. Thus if the company’s negotiators fail to reach or at least move a long way towards reaching alignment with their local counterparts, it should not attribute this to failure in communication which will be sorted out in time. Rather, it should take this failure as a signal that his company’s principles, values and best practices may well be incompatible with those of his local counterpart. Such a signal should be taken very seriously. The fact that despite efforts no alignment could be reached, even at this early stage, when it is reasonable to assume that all parties are highly motivated to reach agreement, should not be glossed over with notions such as, “in time we will overcome these difficulties”, or still worse, “ they will learn to accept our ways”. Chances are that any investment which this company sets up in the particular country will keep coming up against insurmountable problems in their interaction with locals. We strongly suggest that under these circumstances the best course for the would- be investor is to cut his losses short by abandoning the project. Knowing when to

abandon a project is as important as grasping good investment opportunities. This guideline we call “complete or abandon”.

B) The WHAT/HOW distinction as a guide for the division of responsibilities within a joint venture:

We propose that westerners should take responsibility on the «WHAT » and locals should take responsibility on the « HOW». This distinction provides an overall organizing framework for effective interaction between westerners and locals. Obviously, however, to accept this overall framework is one thing and to agree on how to apply it is quite another. Which leads us to our next major guideline?

“use joint task forces as standard management practice and integrate them in all levels of decision making in the company”

3. On operating practices.

Prevalent thinking:

Two seemingly quite incompatible notions inform the practices of many westerners when dealing with locals.

I.) the western business world has accumulated a huge body of experience on how to succeed in a competitive market economy. Hence, the necessary condition for successful investments in transition countries is that the western blueprint is applied. This means that gaps between westerners and the locals with whom they cooperate must be closed: the sooner the local partners change their ways to fit the western blueprint for success the better.

II.) the «business environment» and the «culture» of transition countries are so fundamentally different from those pertaining to the west, that basic western principles of sound management become inoperative. Hence western investors will need to adjust their central business tenets to local mentality: “when in Rome do as the Romans do”.

This second maxim has gradually evolved as westerners came to realize that their uncompromising resolve to get locals to “forget their ways” and adopt western business practices was counterproductive.

Experience has shown that in practice westerners are often caught between these two ways of acting and tend to veer between a « make them change» approach and a (do -as -the- Romans- do) approach, adopting either one or the other in a haphazard *ad hoc* manner with the result that confusion and inefficiency are generated at many levels of management.

Our proposition: the two practices can be integrated into a coherent and productive approach to interaction with locals under the principle “*bridge the gaps*”. This principle gives new direction to westerners’ thinking on interaction by providing a way to implement the “what and “how” division of labor suggested above.

A) On the metaphor “bridging the gap”

The metaphor “bridging the gap” conveys the processes involved. A bridge does not actually merge the two sides of a river bank but establishes communication between them. What is more, the stability of a bridge depends on how thoroughly the engineers have studied, understood and taken into consideration the distinctive characteristics of each of the sides to be linked --quality of soil, angles, tensions and who knows what else! In other words what is needed for projects when two different groups in an enterprise are required to work together is informed and painstaking bridging work rather than attempts to close up the differences. Finally, bridging does not threaten. It can stop anytime any of the sides feels uncomfortable.

This approach to differences is well established in the western business world, where it is widely recognized that the mark of good management is the ability to understand and try and accommodate the different concerns, priorities and ingrained mindsets which come into play whenever two groups are required to cooperate, ranging from mergers between companies with different company cultures to cooperation between different departments within the same firm. It is therefore remarkable that westerners, who apply these bridging skills as a matter of course when dealing with each other, so often resort to “make them forget their

ways” tactics in their interaction with locals in transition countries. If bridging is required anywhere, it is surely in these investments, where interaction takes place across profound gaps relating to national and business culture, mindsets, priorities and concerns. Instead of “getting these people to change their mentality” westerners should concentrate on using their bridging skills.

What we are saying, then, is that investors from mature economies need to make a serious and sustained effort to learn about the territory on the other side. The westerner must take the job of understanding the local business environment and his local partners very seriously indeed. Here, as in the west it is all about knowing “where the other fellow is coming from”. The difference, when it comes to cooperating in transition countries, is that it takes sustained and systematic learning, understanding, and a major mindset adjustment on the part of the westerner. The job is much harder because here - as we have shown earlier when we referred to the differences in the level and scope of “marketization” even between individuals who have graduated from MBA courses - the westerner can easily be misled into thinking that a local manager is fully “westernized” when in fact familiarity with western executive skills in no way guarantees that deeply rooted local values and approaches to business have been eradicated.

To “bridge” rather than «iron out» differences does not mean that no change will occur in the process. Just as once a bridge is built and people start meeting each other the contact itself generates change on both sides, so also the bridging work in the context of business cooperation instigates change. We find it convenient to think of this change as convergence rather than transformation.¹⁷

B) Guidelines for developing bridging practices

In what follows we shall articulate and explain a central distinction, which we have found to be of great value as a central frame of reference orienting the processes of “bridging the

¹⁷This was put to an HBS case writer studying a Commercial Capital (CC) investment most aptly and eloquently by Tudor Ionel, Financial Manager of Titan: «we used to be a family, now we are a team.» See Harvard Business School Case, Nr. 9701- 087 “Identifying and Realizing Investments in Eastern Europe B”, opt. cit.

gaps”. Furthermore we shall demonstrate the crucial importance of the joint task force structure as a managerial tool, which serves to turn the principle of bridging gaps into cumulative experiences of creative interaction between western and local managers

On joint task forces in western investments in ex-communist countries

There is of course nothing new about our proposition when one thinks of how western companies go about the business of decision taking at home. Yet joint task forces are all too often neglected or not used with the necessary care by them in their investments in post-communist countries. Which refers the reader to the contention we made in the introduction to this paper, namely that westerners are well advised to use in these investments the managerial tools, which they normally apply at home. The fact that joint task forces are so rarely used by western companies in ex-communist countries tells a lot about prevalent westerner ways of handling their relationship to locals far too many western managers limit local input to asking for the specific pieces of information, which he regards as relevant to understanding or solving a problem or planning a project. The westerner then usually proceeds to process this information according to his own lights, without drawing locals into the decision making process. Yet, a joint task force in which all parties involved get together so that the plan submitted to the final decision makers includes relevant inputs from all participants are even more useful in investments abroad than they are in the west, where the cooperating sides interact on a foundation of shared implicit understandings, common frames of reference and a common terminology. Joint task forces ensure, among many other things, that westerners and locals come to a common understanding on what the division of responsibilities along the what/ how distinction actually entails in practice, in each instance.

commercial capital (cc) in its investments used joint task forces at all levels of decision-making. Its own direct experience, as well as the accounts of locals and westerners who have worked together in a joint task force¹⁸ left it in no doubt that the joint task force provides an ideal environment where western and local colleagues can learn *from* one another and *about*

¹⁸ We are referring to the narratives submitted to us by MBA students in St Petersburg as well as to material from talks with western executives as part of the consultancy work done by the authors for US corporations.

each other; provided that it is conducted in the spirit of open exchange, where all participants are encouraged to articulate their true perspectives, concerns and priorities. This learning process does more than inform westerners and locals about where they agree and where they disagree. Talking openly about these matters helps participants grasp the other’s point of view and understand what is at stake for them when they take this or that position. This very process greatly enhances the participants’ sense that they are all engaged in a common effort to bridge differences. A recurring theme in the narratives of both Russian and western managers about their participation in joint task forces is that in the course of this give and take they come to feel that the gaps between them are smaller and easier to bridge than they seemed to begin with. A process of alignment gets under way, which generates excitement and gets the chemistry of emotional involvement going. The “us” and “them” starts gradually evolving into a “we” — a sense of common commitment to the task force and its objectives, which greatly enhances everyone’s motivation to engage in the creative bridging work which we have already described.

All this may sound too good to be true. So let us hasten to add that these processes are often fraught with barriers and conflict. There will be many instances when there is intense disagreement on several issues, including whether a particular matter touches upon the fundamental non-negotiable “what” of the investor, or whether it is a matter of “how” on which the local manager should be given the primary role. Indeed, as might be expected, the more successful the task force is in creating a spirit of open interaction the more likely it is that disagreements will surface—which of course is part of what a joint task force is all about.

Altogether, setting up joint task forces, which become environments for effective interaction, is difficult. We emphasize yet again that “learning about each other” “creative bridging work” “open exchange of ideas” are very arduous processes. Short of these commitments on the westerners’ part joint task forces might well do more harm than good, as locals are likely to see it as yet one more piece of democratic window dressing, yet another proof of western condescension.

Altogether the importance of deploying the resources required for setting up effective task forces cannot be overstressed. Many an investment has paid heavily for the westerners neglect in setting up structures in the context of which the input of local managers occupies a recognized place as integral to the planning and decision making process. On the other hand, if it is set up in the right spirit, the joint task force is the ideal management tool for generating the alignment required for the success of a project or indeed the company itself.¹⁹

Nevertheless, there is no inherent “magic” about the joint task force as such. The success of it is primarily up to both sides. It cannot work unless they truly believe that they have much to gain by integrating the systematic use of joint task forces to decision making processes at all levels and unless they are fully determined to do all it takes to make this work — which is a lot, as we keep saying.

To all this let us add that in the course of exploring ways to accommodate differences it may well become apparent to a task force that different positions on the project at hand are so incompatible that alignment cannot be achieved. In which case the company is well advised to reassess and re-think the particular project. Our experience, at any rate, suggests that unless it is thoroughly refashioned that project has very little chance of success .

4. On “strange” and “incomprehensible” behavior of locals

Prevalent thinking: locals’ behavior is often incomprehensible and frustrating to the western investor. In the western business community one knows where you are when you are dealing with colleagues, partners or competitors. In transition countries you don’t. Locals can easily be seen as behaving irrationally, allowing their emotions to interfere with their judgment, pretending that they know when they don’t and as unpredictable as the business environment in their countries. ²⁰

¹⁹ For a more detailed exposition of the joint task force as management tool see P. R. Lawrence & C. A. Vlachoutsicos, 2003, “Bridging Over Troubled Waters” Working Paper, Harvard Business School

²⁰ This is a pervasive discourse in the US and North European business community.

Our proposition: there is a sound inner logic to the behavior of locals, which very often escapes western investors. Indeed, the less “rational” the behavior seems to western eyes the more sound its inner logic is likely to be. Learning to unravel this inner logic is one of the basic skills, which are required for successful investments in these markets.

We have coined the term “inner logic” in order to make the point that if one were to see the environmental and cultural givens of any one situation from the perspective of the locals, behaviors which seem strange and irrational from where the westerner stands, can be shown to be perfectly rational i.e. Best suited to meet the local’s concern and to serve his priorities. In other words, if local behavior in any one situation seems “strange”, “ignorant”, “stubborn” etc — and hence impossible to negotiate with— it is because the westerner misses crucial pieces of information which would enable him to make sense of local behavior and thus grasp the logic of the particular impasse.

This manner of looking at the many communication difficulties and impasses, which westerners come up against in the course of dealing with locals, puts the matter of effective interaction on an entirely new basis. The task is no longer defined in terms of the westerners “educating” locals into more rational ways of behaving. Our proposition puts the shoe on the other foot: what is required in order to get over communication impasses is first and foremost for westerners to approach seemingly irrational local behavior as a signal alerting him that there are aspects of the situation of which the westerners are unaware... Indeed the more incongruous, irrational, or perverse the local reactions to a particular proposal or project seem to be, the greater the need for westerners to take particular care to identify and understand the unspoken concerns, perspectives, considerations and fears which make it “logical” for locals to behave as they do.

Here are some handles to help unravel the inner logic that informs apparently irrational behaviour:

- Fear of losing employment
- Fear of loss of power or influence.

- Shame due to shortages and/or shortcomings of all sorts cause concern to cover these up so as not to be «shamed in front of the outsider»
- Accumulated resentments and painful defensiveness as a consequence of a sense of inferiority to the west. In the course of teaching at SSERU in St. Petersburg, we have monitored changes in this respect, in view of the fact that these days Russia has every reason to feel that its economy is doing as well if not better than Europe and the us. Certainly our students in 2006 are far more self-confident than their counterparts in 2000, who were clearly weighed down by the sense that they come from a system , which has “failed”. And yet, as we interact with today’s students, it becomes evident that they still use the western business world as the standard to which they strive to measure up.
- Concealed self-serving agendas and entrenched local understandings on how best to realize them.
- Violation of essential latent values²¹. Hidden personal agendas have many facets and affect the company in different ways. Here we shall deal with only two: a) the tendency to prioritize power over profit in concerns regarding their job and b) local values regarding the relationship between work and family.

A) Power over performance

Western investors often come up against major difficulties, which can be traced, to the fact that key managers in the local enterprise react to any new idea or proposal with a private agenda, namely to keep the maximum amount of managerial power or to protect personal interests in their own hands. This agenda often engenders behaviors, which undermine the effort of the enterprise to perform to a high international competitive standard.

²¹ For example, the intense hesitation of local managers to fire employees they have hired, indicates the communitarian values they have internalized.

The very idea that power and profit motives may be at odds, may sound strange to western ears. To a western businessman the two hardly sound incompatible. Indeed the idea that business success is tied to performance that can be gauged by profitability has wide currency in western thinking, both at the level of theory and at the level of common sense. In transition countries, however matters seem to stand quite differently: in the context of business operations, power and profit appear and operate as clashing top priorities. Indeed it is actually possible to talk *grosso modo* in terms of a split. It would take us too far to delve into the whys and how’s of this matter. The fact remains that local managers and /or partners more often than not are first and foremost oriented towards maximizing their own personal power, while western investors and executives are mainly oriented towards maximizing the company’s performance. Not that they are not concerned with power, but they expect it to be used in order to enhance company performance. They know that they are operating in a system where individual power is the natural consequence of ones making substantial contributions to the firm’s success.

Take the frequent reaction of local managers to company schemes to offer managers some degree of ownership as a performance bonus. To the great puzzlement of their western colleagues, many local managers do not seem to focus on how such schemes might improve efficiency and financial returns. Instead, they react to these schemes as though they were first and foremost about making sure that the managers already in the firm enhance their position in the internal power hierarchy²²

Although things are changing, it would still be very unrealistic of westerners to assume that as locals absorb more and more of the western business culture, they are bound to realize that they got their priorities the wrong way round, and grasp that in a market economy if you put your energies into maximizing profits, power will follow as a natural by-product. The local tendency to perceive their domain as a personal fiefdom has too long a history behind it to just fade out on its own. The challenge for the western investor is to transmute the old concept of power from political clout to performance-oriented managerial influence on

²² The business case “Starting from Scratch: Corporate Governance of South East Bank Europe” published recently by the Institute of Management Development, Lausanne presents a perfect example.

policy decisions and on implementation. Thus, ways have to be found in each case to foster empowerment, which locals can recognize as contingent upon their own contributions to the collective success of the firm. To do this will ensure that the essential “what” is not jeopardized i.e. The enterprise’s competitive advantages based on over-all performance.

B) Transgressing boundaries

Closely linked with the concern with power is the fact that locals are embedded in informal networks of family relations as well as close personal professional alliances. Within these networks the exchange of favors is not just a matter of mutual benefit but constitutes a moral obligation. Thus it is not uncommon for a local manager to operate as a nucleus of personal networks of favoritism, which remain invisible to the company since the westerners cannot possibly keep track of their local employees’ personal world. All too often favoritism goes beyond nepotism within the company and cuts across the company’s boundaries. For example, a sales manager may not think it “improper” to cut deals with some clients or suppliers of the company in the spirit of exchange of favors even to the apparent disadvantage²³ of the enterprise he/she works for.

A strong ally for the company in coping with such problems is strict adherence to the guiding principle “be adamant on the what”. In this case it is about adhering to the principle that decisions at any level should be taken with “due process”, that is with “checks and balances”. The challenge in this case is to ensure the local managers’ true commitment to “due process” in the form that it is established in the enterprise. Our experience in western investments in which we were involved as consultants gives us good reason to believe that such commitment can be cultivated, provided that the company has demonstrated to local staff its own commitment to them. To put it differently, the western company can only expect its local staff to commit to due process if they feel that the working environment fashioned by the company deserves their loyalty.

²³ We use the adjective “apparent” because many such dealings could actually be to the advantage of the company as the clients involved might influence their networks to buy its goods or use other valuable intangible services beneficial to its interests

5 On cooperating with locals.

Prevalent thinking: they don’t know, therefore all you have to do is to teach them.

Our proposition: cultivate a mindset for what we have coined “equivalence”²⁴ towards locals and develop practices, which genuinely embody this maxim. The maxim holds that the inputs of westerners and locals, while varying in content and form, are of equal value and importance to the success of the investment and that each party has a great deal to teach the other and has a great deal to learn from the other. The mindset of equivalence accords the local partner the same degree of trust and eventually creates the same degree of mutual respect between westerners and locals as that which prevails among successfully cooperating western businessmen.

It is essential that the mindset of equivalence be demonstrated in the managerial practice which the company establishes. What is required is to adopt practices and to set up frameworks for decision making, which demonstrate to local counterparts that the westerner truly and genuinely intends to listen as much as to speak, to receive local input as much as to offer his own. Talk of reciprocal equivalent relationships which are not backed by practical measures can do more harm than good: the last thing locals can tolerate is condescension.

Our earlier suggestion that westerners should lead and take the main responsibility on issues relating to «what » and that locals should assume the central responsibility on “how” matters, as these terms have been defined above, is a perfect example of equivalence in action. On a practical level there is a lot to be gained by making the best of local knowledge about ways and means. Secondly, and most importantly, the acknowledgement by westerners that there are many areas in which locals can make a unique and invaluable contribution creates a

²⁴ The mindset of EQUIVALENCE refers to taking the locals seriously, respecting them and treating them as equals. This is very important for effective interaction as equivalence causes them to feel acknowledged and appreciated and consequently they collaborate and contribute their own local expertise to the common benefit. This is a very common mistake made by Westerners who feel they are superior in terms of technology, business and market knowledge and have to deal with inferior, ignorant people. Westerners need to realize the value of locals who know the conditions and remedies in their country, factories/businesses and their markets much better than them and that they have at least as much to learn from locals as they have to teach them.

climate of true cooperation which, as our experience has shown, constitutes a social capital on which the enterprise can draw in solving problems and taking full advantage of opportunities.

Furthermore, it is crucial for the western investor to school himself into a new mode of decision making. Equivalent relationships in transition countries can only be implemented if the basic tenet of western decision making is changed: the typically western decision by rank or majority should be replaced as much as possible with decision by consensus. Obviously striving for consensus is a painstaking and, on the surface, «costly» process. However such a process is worth all the effort that is expended on it. This is because majority rule carries no resonance with locals and is highly unlikely to gain their true consent and acceptance. Thus, it does not really make sense to locals that a decision taken by the majority is binding on those who did not agree with it. So the price which the company pays if no consensus is reached on a particular decision is that the minority in any one vote will simply not feel obliged to implement this decision. On the contrary, they are likely to feel that they have no responsibility for carrying out or for that matter, to try to limit any ancillary damage resulting from a decision on which they have not agreed. The cost of such disengagement is surely much heavier than any investment which the company makes in order to secure consensus. In this context it must be kept in mind that defenses, fears etc apart, locals have solid reasons and self serving motives to wish to reach agreement and therefore will cooperate as long as they see that their views, even if not accepted, are being acknowledged and given due consideration. The structure that can best put the principle of equivalence into practice is the careful use of the joint task force to which we made reference earlier.

The term itself, “joint task force”, helps induce a spirit of equivalence in its deliberations.²⁵

²⁵ For a detailed exposition of the joint task force as management tool see P. R. Lawrence & C. A. Vlachoutsicos “Bridging Over Troubled Waters” Working Paper Nr. 04-02, Harvard Business School, Division of Research, Oct. 2003

6 On safeguarding one's interests.

Prevalent thinking: in the strange, volatile, non-transparent and corruption-ridden business environment of an emerging market the western investor always needs to be on his guard. The best risk mitigating strategy is suspicion. Take care to always cover your back.

Our proposition: your best protection is trustworthy counterparts. The most effective shield against risks is to take the time and effort required to forge and nurture effective relationships, a “chain of mutual trust” with local stakeholders.

Trust is personal and not institutional. Therefore, in order to gain realistic perceptions about people, problems and opportunities, the western investor follows a chain, each link of which is a person trusted by the previous person. For example, for obtaining reliable information about the background, financial condition and character of a prospective candidate partner or employee, the “chain of trust” method would be applied as follows:

Before doing anything in a transition market of the region, the western investor must be able to build a close personal trusting relationship with a broadly experienced executive in the region who has as reputation for reliability as a “transformer. We call “transformer” a bicultural individual (local or even western in origin) who has intimate knowledge and expertise of how to do business both in the bureaucratic, favor-prone, and legally and culturally different business environment of their particular transition country while at the same time they know well western business values, priorities, practices and behaviors. As a result transformers can eventually be useful in all stages of bridging between the two cultures both inside the company and between the reorganized company and the external world in the country of operation. Such a transformer constitutes the first link of the chain.

This transformer can be expected to have their own trusted network of locals with reputations for integrity that can be recruited for their knowledge and experience in their own field. The initial transformer can then with the help of his trusted local network, select a knowledgeable senior executive from the chosen industry as the prospective candidate venture partner this is the second link of the chain.

Meanwhile the transformer can be building a trusted relationship with two or three others who have first hand knowledge of the selected partner and the plant involved. These people could provide reliable information on the status of the plant and its managerial team. One of these people will, hopefully, have a direct relationship of trust with the prospective partnership candidate who could vouch for the background, character, experience and reliability of the candidate and, if needed, could make the initial contact.. This is the third link of the chain of trust that would precede any direct negotiations with the prospective local partner.

We do not contend that the western investor does not need to be concerned about protecting himself: the imponderables which are still at work in these markets and which affect the behavior of locals are often inimical to the westerners’ projects, certainly in the short run. What we are suggesting is that westerners, who try to mitigate risks by being constantly on their guard and suspecting everyone around, are acting against their best interests. We propose that on the contrary, by far the most effective safety policy for the western investor is to be pro-active i.e. Invest resources in order to create a chain of trust by plugging into the mechanisms for trust, which operate in these markets.

Setting up chains of trust should not be confused with networking. Networking is an overall policy which is of course as necessary in transition countries as it is anywhere else. Setting up chains of trust, on the other hand, is a more specific method designed to reach trustworthy local parties who are able and experienced in addressing the distinctive problems and risks which arise in the unstable, volatile business environments of transition countries, with their imperfect institutions, their endemic unpredictability of formal laws, rules and regulations and of their haphazard application.

The crucial importance of interpersonal trust has been remarked on by other students in this area. According to our view, the collapse of the soviet system was a radical shock to the reservoir of personal trust and networks that people had to employ in order to cope with perennial shortage and the other hazards of life under soviet socialism in their everyday lives. During the soviet era institutional trust had quickly eroded, leaving only trust built on the

basis of established one-on-one relationships. Our experience fully confirms this: when there is so little reason to trust in the reliability, objectives and effectiveness of institutional systems, local managers had to fill the void by building up networks of interpersonal trust. It is on these networks that local people relied, and some still do, to create a context in which they fill the gaps left by the ineffective planning system, and can get their job done. The challenge, then to the western investor consists of attaining two closely interrelated aims. First to find local counterparts with whom the investor can develop mutual trust and secondly to find ways to draw on the networks of interpersonal trust which each such local has in place. The “chain of trust” method is extremely well suited to meet these challenges.

Again we are bound to emphasize that locating key persons whom one can trust requires time and patience. It is also crucial to realize that using trust as a shield against risks is not a one way street. It is not only about finding people whom the western investor can trust. It is just as much about the western investor becoming trustworthy in the eyes of the locals with whom he interacts. In this regard, too, setting up a chain of trust is invaluable. The fact that the contact between the western investor and the various locals with whom he interacts is mediated by a local link, serves to integrate the western investor into the local trust mechanisms. In the eyes of the locals this counts as an *a priori* credential that the western investor is a person to be trusted.

7 On negotiating with locals.

Prevalent thinking: good “deals” are struck by hard bargaining. Hard-nosed haggling is of the essence.

Our proposition: haggling with locals is fraught with risks of producing agreements that will not be implemented. The formula for a good “deal” is: regard negotiation as a process of three phases. Therefore maximize the time and energy you spend on clearing the ground and on creating consensus during the pre-bargaining phase so that as little as possible is left to agree on during the bargaining phase.

Locals in transition countries tend to define bargaining with a westerner as a confrontational zero sum game situations. Many reasons account for this. One reason is the locals’ pervasive sense that westerners have one up on them. This confrontational stance is intensified by the pervasive suspicion of westerners, whose reputation has suffered a lot from the unfortunate experiences of many locals created by western “hustlers” who have been swarming over them with promises they do not fulfill and contracts they do not implement. More important, perhaps, are the fears evoked by many of those obscure contract clauses and conditions that western lawyers usually insist on.

Altogether, western investors are well advised to circumvent direct bargaining with locals as much as possible and especially during in early discussions. A way to do this is to divide the negotiating process up into phases and define as phase I a process which involves no bargaining but does instead do a lot of preparatory clearing the ground by joint task forces comprised of the competent project managers and, if needed, specialists of both sides.

The “pre- bargaining” phase gives both sides the opportunity to learn from each other about each other’s priorities, concerns and company cultures and to work out a joint proposal to their respective superiors for decision in the relaxed setting of a task force and the camaraderie it often creates. In our experience, a great number of issues are thus resolved before the bargaining phase starts and momentum for concluding the deal is set in motion. Thus, the number of issues left for direct bargaining between top managers is often drastically reduced in the process of pre-bargaining. Brief and clearly worded clauses by the westerners’ lawyers can do much to address locals’ tensions and suspicions. One sided requirements are to be avoided at all costs. Altogether, the pre-bargaining phase should be used as an opportunity to shift the accent from competition to cooperation, from “i win you lose” to joint problem solving and adding value for both sides. Conducted in the right spirit, pre bargaining can also do much to convince locals that they are entering a win-win relationship as equivalent counterparts.

Here again, the joint task force comes into its own. We have found it most effective to relegate as many issues as possible to joint task forces. In the process of working together in

an attempt to reach alignment on specific issues, people are likely to feel more as partners than as antagonists and, most importantly, people on both sides are likely to identify with a positive outcome of negotiations. More often than not members of these task forces receive key managerial positions in the partnerships or joint ventures that ensue. A key to the success of this process is to leave as much time as needed for the pre-bargaining to be completed. Hurry and impatience to clinch a good deal has often caused severe losses to both of the sides.

8. On motivating locals.

Prevalent thinking: all you need in order to get good results is to pay locals well. “money talks louder than mindsets”.

Our proposition: paying well is nowhere near enough to motivate locals to committing themselves to a dedicated effort toward achieving the common goals. Good pay is only one, albeit important, condition for success. Often locals are even willing to sacrifice money for other considerations such as genuine influence on business decisions, opportunities to learn valuable new skills, and some degree of security in regard to discharge.

We regard good remuneration and opportunities for monetary rewards or “bonuses” as indispensable but by no means sufficient conditions for motivating locals to exert their best effort. In our experience in some instances, exorbitant monetary rewards have boomeranged as they can lead to less respect for the westerner and to kindle competitive greed. Other important needs must be satisfied in order to receive optimum value. Such needs are:

Learning.²⁶ the constant and high-level learning opportunities provided to the local staff in a number of investments by cc have yielded multiple benefits. Planned and conducted in the spirit of equivalence, courses in managerial and other skills, with high priority given to thorough learning of English are very well received. Local staff feels that they are getting solid knowledge, which improves their productivity and consequently their job security.

²⁶ Following paragraphs “Learning”, “Bonding” and “Security”- Source: “Driven. How Human Nature Shapes our Choices”, Paul R. Lawrence & Nitin Nohria, Harvard Business School, Jossey Bass, 2002 pp 55-129

Bonding. Local managers and employees are seeking a sense of membership in the firm. They want to belong. If the firm’s leadership demonstrates that they care about the employees, they will in turn care about the firm. They will feel rewarded by their affiliation with the firm and will work to sustain it. Here again, the key lies with every practice which embodies the principle of equivalence. Well planned learning courses, as well as the use of joint task forces have proven highly effective because, in this manner, both learning and bonding needs are addressed.

Security. Providing some degree of job security is a powerful motivator for local managers and employees. With little or no social safety net, the prospect of unemployment in transition countries is terrifying. Efforts by the firm to sustain jobs build commitment and loyalty in turn. Unlike what many westerners believe, it is the sense that the company is genuinely interested in keeping a good employee in employment that strengthens the local manager’s motivation on the job.

Local managers in our investments at commercial capital have often been approached by other firms with most attractive remuneration packages. We lost only one good manager in this manner. Reasonable pay along with opportunities for earning a bonus, our methods of training, empowering, and generally relating to locals in the context of equivalence, has over the years proven to be a much more solid guarantee than high salaries in order to retain, motivate, integrate and render management teams and staff optimally productive.

9. On managerial staffing

Prevalent thinking: put a western manager in charge of local operations. To put and keep his investment on the right track the western investor usually believes that only a westerner, ideally a manager transferred from head office, can meet this challenge, since the skills required are precisely what locals are lacking i.e. A high level of the western company’s specific managerial expertise and a thorough understanding of, and commitment to, its production, marketing and financial know how.

Our proposition. Where prevalent thinking says «westerner» we say “transformer.” We do not dispute the need for integration of local ways with the western investor’s company standards. Where we differ from prevalent thinking is on our idea about the qualifications needed for the job. Our experience indicates that a westerner’s managerial expertise and knowledge of his parent company do not constitute a sufficient guarantee for the transfer of attitudes and skills, which are necessary for the good operation of investments in transition countries. Integration is a two-sided process, needing two-sided competence and readiness to open and to learn. Hence to keep your investment on the right track you need an operating manager whose knowledge and competence spans both the local and the western business environment. You need a person with a strong foothold in both worlds. You need what we have called “a transformer.”

The following may be said to be the minimum components of the job of managing the local enterprise effectively:

A) locals need to be motivated and trained into the skills and mindsets which are compatible with the best practices of the parent company and which promote at the same time effective operation of the enterprise in the local business and market environment

B) locals need to be motivated to implement and operate the investment by drawing on their knowledge of local conditions, on their experience of how best to get things done in their country and on their local networks

Thus a manager cannot be effective unless he combines:

- · thorough understanding of the investor’s company’s best practice, priorities and concerns
- · extensive experience with the local business environment
- · profound knowledge of local skills, mindsets priorities and fears
- · a potent local network

Two categories of managers are most likely to have the required combination of qualities:

- i) Western managers who have lived and worked in comparable positions in the country where the investment is located for a long period of time. Expatriates are obviously the major pool for finding transformers, who have had prior extensive experience in managing investments of other western companies in the particular country.
- ii) managers of local origin who are intimately familiar and experienced in the ways of the western business world.

Transformers must have a record of successful management in a western owned or western controlled company in the transition country where the investment is made.²⁷ managers with these qualifications come bearing gifts which a western manager straight from head office is in no position to bring. Having worked in the country in question as managers of western controlled companies, transformers not only bring their intimate knowledge and competence in both local and western contexts, but are also bound to have developed trusted local networks and chains of trust which can prove a major resource for the success of the investment.²⁸

The executives whom western companies usually favor for top positions i.e. Managers appointed straight from within the western investor’s company usually without experience in the particular transition country, do have one advantage over transformers. This advantage consists of their intimate knowledge of the real strengths and weaknesses as well as specifics and inner workings of the parent company’s best practice and business culture. However this advantage cannot outweigh the relative disadvantage of lack of experience in operating in local conditions, insufficient knowledge and unsuitable mindset of how to interact with local

²⁷ While significant commonalities exist between the business environments and the local business practices of transition countries, our experience indicates that each transition country has enough distinctive features that it cannot be assumed that a transformer in country A can be effective in country B. Furthermore, he does not have one of the major tools required: personal trusted networks.

²⁸ For example, we obtained excellent results by being able to employ a Greek as General Manager of our investment in Titan Mills in Bucharest, the ex-General Manager of another large western owned food industry in Romania.

staff. Certainly the kinds of people whom we suggest would need to be familiarized thoroughly and be gradually integrated in the management team of the investor's company at home. We have found this to be a relatively simple matter for people who have experience in western management, even if not in the investor's particular company. In the west, management skills are known to travel light as between different enterprises that belong to the same broad business culture, as is the case with western firms generally.

However, while the people whom we recommend can overcome their particular disadvantage fairly easily, this is not at all the case for a western manager lacking local experience. For such a person to familiarize themselves with local ways and conditions and acquire the specific skills, and, most importantly, the mindset required for effectively communicating with and motivating local staff is a daunting task and one which not all western emissaries have found themselves able to fulfill effectively.

10 On corruption

Prevalent thinking: you cannot do business in transition countries unless you bribe.

Our proposition: bribing is by no means necessary in order to establish and to implement investments successfully. What is more, bribing exacerbates your risks and is on all levels the worst possible foundation on which to build your investment.

The prevalent believe is that emerging markets in general, and transition countries in particular, are wrought with corruption at all levels of public and private sectors. Therefore, you cannot achieve anything in transition countries unless you bribe your way into deals, facilities or anything else a company requires for effective functioning is perhaps one of the most entrenched and most widely held beliefs in the west. Indeed, locals very often play into this belief and encourage it in more or less subtle ways. As a matter of fact, it needs to be understood that the perception of local relevant practices is completely distorted if the western perception of corruption is applied.

The issue of bribing and how to deal with it provides an excellent instance of what we are saying regarding the “what” and the “how”.

In this context it is very helpful to refer to the well-known distinction between “gratuities” and “bribes” both directly and indirectly entail giving money in instances where it is not legally required. However “gratuities” serve to «oil the wheels of the system». Here a modest sum is given to a local official, operator, etc. By way of a gratuity so as to motivate him or her to accelerate providing a service to which you are legally entitled. It is used as a corrective in a system that is slow, overloaded and generally inefficient with a grossly underpaid staff. ²⁹One clear way to distinguish between “gratuity” and bribe is to provide gratuities only for services that do not entail any illegality. It is just a device for jumping a queue which is often intentionally played up to be very much longer than it actually is.

A bribe is quite a different matter, since it involves paying someone in a position of power in order for them to provide a substantial benefit to which the company is not clearly entitled by law or, at worst, a benefit which is outright illegal. A typical practice is for the company to pay a public official in order for him to secure for this company a license or an order or other deal which by rights should go to a competitor. Such practices clearly enter corruption territory. It would take us far beyond the purpose of this article to try and address the highly complex issue of corruption and the particular forms it takes in transition countries as compared to corruption in the western world, which also seems to exist. The point which we wish to make is simply to emphasize the distinction between bribing and gratuities and show how it connects to the distinction between “what” and “how”

Bribing is an instance of a “what” which, we presume, directly contravenes an important best practice of the western company. Gratuities, on the other hand, belong to “how” territory and on this it is advisable for western investors not to make the decision but, instead, to leave matters in the hands of his local partner as long as they faithfully observe the “no bribes” rule.

Bribing is not only morally wrong, it is important to keep in mind that it also actually exacerbates risks. Again and again we have seen competitors getting themselves into a nightmare once they start on the bribery track. The local grapevine very soon finds out which western investor is prepared to act in this manner. Henceforth this firm will find itself entangled in a gray web where more and more services and more and more approvals which used to come to them free start costing them more and more to obtain. It has happened more than once that such a company grinds into a halt as it reaches the stage when it can hardly make a single move without having to pay a bribe. Add to this the danger of getting into serious trouble sometime in the future by politicians on a «clean-up corruption» ticket, or by new occupants of positions in the bureaucracy who discover illegalities in licenses granted by their predecessor and create problems in order to receive a bribe themselves.

Our propositions tested

One of the authors, Dr. C. Vlachoutsicos, in his capacity of senior executive counselor of cc, was involved as a member of the strategic taskforce in an investment by commercial capital S.A. (CC), the venture capital arm of a leading Greek bank, in the privatization of the Romanian state flour mill “titan”. In this capacity, he applied the model exemplified by the ten points above. The application of this model in titan mills was studied by a HBS case research team, under professor Ray Goldberg and the cases Harvard business school cases, Nr. 9-901-005 and 9-901-012 commercial capital a and b and Nr. 9-701- 087 “Identifying and Realizing Investments in Eastern Europe A And B” were written and used

CONCLUSION

We shall now focus on one of this paper’s recurring themes, namely that to develop mindsets and practices in accordance with our propositions “takes time”. This is intended both as a statement of fact and as an exhortation. What we are saying is, first, that it is essential for westerners to realize that in order to reach the required level of understanding of varying

²⁹ The New York Times (April 12, 2006) published a piece entitled “Focus on Poverty, not graft, World Bank critics say” making the point that instead of focusing on anti-corruption measures in poor countries we should focus on alleviating poverty where the root of the problem could be traced.

perspectives and concerns and in order to develop the managerial practices which effectively embody such understandings, they will need to invest far more time when the players are westerners and locals in transition countries than when it is a question of bridging gaps between westerners in a western business settings. It follows that quick fixes do not work. Unless westerners invest all the time that is needed to build and implement practices based on a genuine and profound understanding and respect, such practices are likely to backfire. Which takes us back to the maxim “it takes time and effort and you should take all the time and effort it takes.”

Finding themselves in markets which offer multiple opportunities in all kinds of goods and services, many westerners tend to develop something like a “gold rush mentality”. In this state of mind many decisions are taken in a hurry and little priority is often given to the time consuming task of building and aligning with a solid management able to meet the challenges of the constantly changing conditions which are characteristic of transition countries.

What many westerners do not sufficiently appreciate is the potential long-term rewards of creating a solid management team in their transition country ventures. Consumer purchasing power in these countries is rapidly increasing and will be expanding for a long time to come. This well known dynamic will generate demand for more and more varied goods and services. Another factor which should be taken seriously into account is the prospect that an increasing number of these countries are gradually entering the EU³⁰. Furthermore, a rapidly growing middle class is developing with demands for sophisticated products, for high quality products with trendy designs and for advanced home technologies and these people have the means to pay for what they want. The focal aim then, for the firms who are already operating in these countries should be to adopt a long term view and solidify the advantages which they now enjoy by building their enterprises on solid managerial foundations.

As we hope to have shown in this article, if western investors in transition country firms are to build up a managerial structure able to meet the challenges of the future, they need to take a very critical view of their preconceived ideas of transition countries many of and invest

³⁰ In 2004, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia were accepted as EU members. Furthermore, Bulgaria and Romania have been accepted for entry as of January 1st, 2007.

time and effort in order to develop new mindsets and new managerial tools to sharply improve the quality to their interactions with local managers at all levels of their reorganized firms. Such a program will go far in mitigating their risks and enabling them to establish sustainable profitable investments in the region