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**THE DETERMINANTS OF LOCATION
CHOICE IN THE INTERNATIONALIZATION
PROCESS OF POLISH COMPANIES:
A QUALITATIVE STUDY**

Abstract

The internationalization of Polish companies via equity entry modes is still a phenomenon limited in scope, especially when compared to that occurring in developed countries, however showing a clear upward trend. Within this research framework the following paper presents the results of a qualitative study devoted to the geographical patterns of foreign expansion of Polish companies. The theoretical analysis, based on the eclectic (OLI) paradigm of international production, the internationalization process model and the Strategy Tripod, is focused simultaneously on the determinants of location choice related to host country and firm characteristics. Case study results indicate that host country choice is related to the investment motives. Moreover, the role of location choice criteria depends on the host country level of development.

Keywords: *foreign direct investment, location choice, international business, internationalization process, firm-specific advantages, location advantages*

Introduction

Foreign direct investment (FDI) from the countries of Central and Eastern Europe (CEE) on a large scale is a relatively novel phenomenon, which – after its emergence in the early 1990s – accelerated noticeably only in the 2000s. Currently Poland remains the major FDI exporter in the region (excluding the Russian Federation). However, while the attention of scholarly research has remained focused on inward FDI into the CEE area (Meyer and Estrin, 2001; Meyer and Peng, 2005), relatively little research has been devoted to outward FDI from these countries. Among the studies on Polish OFDI, the dominance of a macroeconomic view can be identified. The studies of Rosati and Wilinski (2003) and Gorynia, Nowak and Wolniak (2011) reveal a geographical concentration of OFDI in the neighboring European countries. Obłój and Wąsowska (2012) investigated the relationships between host-country resource endowments and the level of Polish outward investment, finding the dominance of market size and economic growth as key determinants, followed by labor costs, which is largely in line with other studies (Czaplewska and Wiśniewska, 2007; Kęпка, 2011; Karpiełńska-Mizielńska and Smuga, 2007). It was furthermore found that while geographic distance was a relevant impediment to FDI, this was not the case for

psychic distance, as the majority of OFDI is concentrated in culturally close CEE economies. Also, political risk specific to the region was not found to be an impediment to capital expansion (Oblój and Wąsowska, 2012). Among firm-level studies, Jaworek (2008) found that the search for new markets was a dominant motive for all investors, while other motives were found to vary with the host countries' level of development. Likewise, while the investment barriers in the new and old EU members included saturated target markets and high competitiveness of host-country rivals, the major impediments in non-EU CEE countries were related to excessive bureaucracy, corruption and regulative instability (Jaworek, 2008).

Apparently, in addition to macroeconomic studies, further firm-level research is needed on the determinants of location choice, considering both host-country characteristics and firm characteristics and strategic motivations. Accordingly, the purpose of this research is to (1) analyze country-choice decisions within the context of company internationalization path, characteristics and resources (2) reveal the impact of FDI motives on the geographical patterns of international expansion; (3) identify specific country-level antecedents of FDI decisions and (4) establish qualitatively grounded relationships between the analyzed variables to provide propositions for further research.

1. Firm-level and country-level determinants of FDI location choice: a theoretical framework

Dunning's eclectic paradigm, also known as the OLI Paradigm (Dunning, 1995, 2001), has been recognized as one of the most prominent theoretical approaches explaining the international business activity of firms. This theory argues that for a firm to become an international player, it must possess certain ownership advantages (O) that can be successfully exploited abroad (e.g. brand name or proprietary technology). Secondly, it has to be advantageous for the firm to use internalization over arm's length transactions with other firms to further exploit its competitive advantages (I – internalization advantages). Thirdly, the firm can use some specific resources (L – location advantages) in the host country (e.g. large markets or low input costs) in combination with the ownership and internalization advantages to strengthen its overall competitive position there. According to this approach, if a firm possesses all the three (OLI) advantages, it is motivated to engage in FDI. While this theory addresses the reasons for firms to engage in FDI, as well as the basic conditions for entry mode choice, it also provides an explanation of location choice in international business activity (Brouthers et al., 2009). Dunning suggests that firm location choice depends on

the company's ability to create and sustain income generating advantages relative to those of competitors (Dunning, 1993). He states that “firms will seek to site their value-added activities at the most profitable points in space” (Dunning, 2001, p. 177). It is further suggested that companies look for host countries where they can operate most efficiently (Dunning, 1998). Arguably, host country factors, such as market potential, political, social and economic stability play a major role in FDI location choice. Accordingly, Dunning's concept of location advantages is inherently rooted in the traditional location theories, which relate location patterns of firms to factor endowments of countries (e.g. Lloyd and Dicken, 1977). However, Dunning (2000) himself notes that conventional location theory has gradually been extended to embrace novel location variables, such as the presence of clusters (Cantwell and Piscitello, 1999), created assets (Kuemmerle, 1999) or government incentives (Dunning, 2005).

Furthermore, also the internalization advantages differ across national markets (Dunning, 1993). Thus, in their location choice, companies should select host countries allowing an efficient transfer of ownership advantages to overcome the potential competitive disadvantage versus local competitors stemming from the liability of foreignness and/or enhance performance (Brouthers et al., 2003). At the same time, companies selecting investment locations differ in terms of their ownership advantages. Since the relevance and suitability of firm-specific advantages may be contingent upon the characteristics of host locations (Erramilli et al., 1997), location decisions have a profound effect on the operations of foreign investors (Makino et al., 2004; Chan et al., 2008). This implies that O and L advantages should be analyzed jointly in determining location choice (Dunning, 1998, 2000; Makino et al., 2002).

Another notion, closely related to the above discussed interplay of location, internalization and ownership advantages, is that of the motivation underlying FDI. Dunning (1993, 1998) grouped the various motives for FDI into resource seeking, market seeking, efficiency seeking and strategic-asset seeking. He argues that resource and market seeking motives characterize initial FDI, while those of efficiency and strategic asset seeking characterize sequential FDI. A growing relevance of the strategic asset-seeking ones can have impact on location decisions, shifting the emphasis to host countries that provide access to knowledge-intensive assets (Dunning, 1998). While the latter category of motives is aimed at enhancing the resource base of a company in a given location, the former three motives can be collectively labeled as asset-exploiting (Galan et al., 2007; Dunning et al., 2009). Accordingly, the location choice can be expected to be

determined by the resource endowments of a host country which match a given investment motive (Buckley et al., 2007).

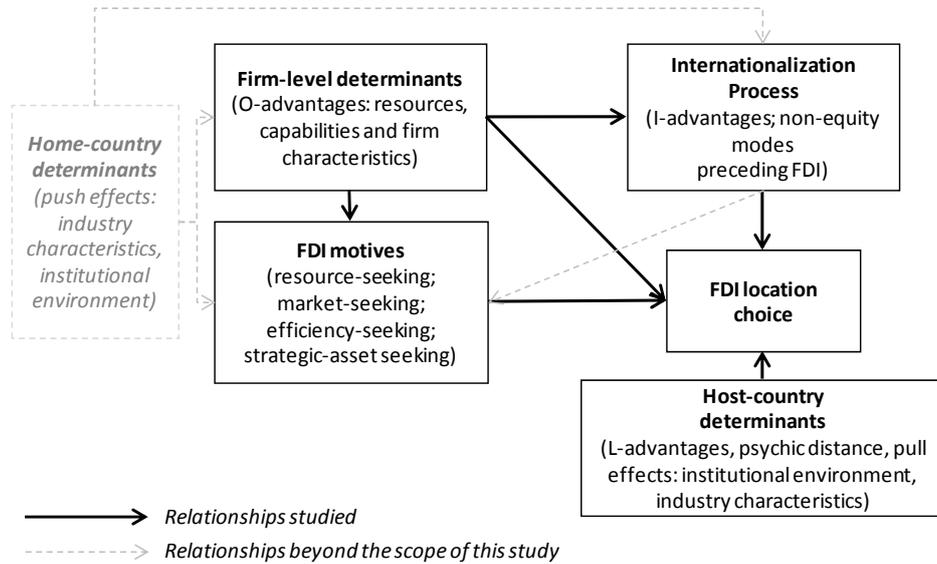
The process model of firm internationalization (Johanson and Vahlne, 1977, 1990) posits a sequential and gradual development of geographical patterns of firm internationalization. Firms will first select foreign countries with similar market conditions and cultures similar to those of their home country, due to the role of “psychic distance” between the home and host countries. Psychic distance was defined by Johanson and Wiedersheim-Paul (1975, p. 308) as the “factors preventing or disturbing the flow of information between firm and market. Examples of such factors are differences in language, culture, political systems, level of education, level of industrial development, etc.”. More recently, Johanson and Vahlne (2009) enriched their process model with the concept of “outsidership”, referring to the knowledge related to a firm’s business environment, including “firms with which it is doing business, or trying to do business, and the relationships between firms in this environment” (Johanson and Vahlne, 2009, p. 1416). The lack of such market-specific business knowledge constitutes the liability of outsidership, pointing to the fact that a firm’s challenges in international business are not merely due to country-specificity, but even more so due to relationship specificity.

The above discussion can be further extended by the three pillars of the Strategy Tripod (i.a. Peng et al., 2008; Peng et al., 2009). The approach combines three perspectives of international business: resource-based, industry-based and institution-based. The resource-based view, analogically to the O-component of the eclectic paradigm, regards ownership advantages as a prerequisite to successful internationalization. Moreover, apart from asset-exploitation motives, firms seek assets in international locations to augment their competitiveness via foreign subsidiaries. Secondly, from an industry-based perspective, an industry’s competitive pressure is likely to result in different levels of internationalization, which in turn affect the strategies firms utilize in these industries. A highly competitive domestic market may induce companies to select attractive foreign locations and avoid head-on confrontations with dominant incumbents in their home market (*push effect*). Conversely, a host country’s sophisticated industry structure may generate incentives to enter that country, for example to enhance an emerging economy firm’s capabilities, knowledge base, and competitive position in its home market (*pull effect*). Thirdly, the institution-based view points to the formal and informal constraints of a particular institutional framework, in both home and host countries, that managers need to include in their decision-making process. This perspective is particularly relevant to emerging and transition economies, where institutional change tends to be more profound than in developed countries and where institutions show significant idiosyncrasies (Peng et al.,

2008). Dunning and Lundan (2008) add the institutional dimension to the eclectic paradigm, asserting that the extent and quality of host country's institutions are gaining relevance in location choice.

The theoretical underpinning of location patterns, as outlined from the viewpoint of several theoretical models, can be summarized in an analytical framework to investigate FDI patterns of Polish companies (see Exhibit 1). This model combines the discussed eclectic paradigm, the internationalization process model, the Strategy Tripod, as well as Dunning's typology of FDI motives to provide a holistic basis for empirical analysis. Inferring from received theory, location advantages and psychic distance, as well as the institutional infrastructure are hypothesized to determine host-country choice ("host-country determinants" in Exhibit 1)*. Secondly, it is expected that the geographical patterns of foreign expansion are simultaneously determined by the possession (or lack of) firm-specific advantages (as asserted by the OLI theory and resource based view), previous internationalization paths (incorporating I-advantages) and FDI motives**. Obviously, there are also interdependencies between firm characteristics, their motives and the internationalization process, which indirectly affect location choice.

Figure 1. Analytical Framework for Studying FDI Location Patterns



* Industry determinants are not explicitly examined in the present study.

** While acknowledging the importance of home-country determinants in the conceptual framework, the present case study analysis concentrates on firm-level and host-country determinants of geographical expansion patterns.

2. Research method

Despite the abundance of research on FDI, the internationalization behavior of companies from emerging and transition economies is a context-specific phenomenon (Meyer and Peng, 2005). Therefore, a qualitative research design was selected to address the above research objectives and allow a better understanding of relationships between the identified variables (Corbin and Strauss, 2008). Ten cases of Polish FDI into both European Union (EU) and non-EU economies were selected. Moreover, the companies undertaking the said FDI differed in age, size, share of foreign ownership, internationalization degree and the primary FDI motives. Data were collected from senior management based in the Polish headquarters by the use of a structured questionnaire, followed by telephone or personal interviews (where appropriate), as well as secondary data analysis. The questionnaire contained questions closely related to the above analytical framework, thus exploring firms' characteristics, their internationalization paths (*inter alia* year of first FDI and number of FDI host countries, non-equity modes prior to FDI), perceived importance of investment motives, main determinants of country choice, as well as the key resources facilitating international expansion or the lack thereof.

Table 1. Overview of case studies

| Company | Product offering | Year of establishment | Year of first FDI | Share of foreign equity | Export ratio (initial/current%) | Number of FDI host countries | FDI host countries | Country of major FDI | Host country** exposure prior to FDI | Dominant motives for major FDI |
|-----------|--|-----------------------|-------------------|-------------------------|---------------------------------|------------------------------|--|----------------------|--------------------------------------|---|
| Company A | Chemical products | 1978 | 1999 | 0% | 0/65 | 4 | Azerbaijan, Russia, Ukraine, Germany | Azerbaijan | Export | market-seeking |
| Company B | Automotive equipment | 1991 | 2001 | < 25% | 2/60 | 1 | Ukraine | Ukraine | None | efficiency-seeking |
| Company C | Bus, trolleybus and trams | 1994 | 1994 | 0%* | 0/51 | 13 | Germany, Switzerland, Austria, Czech Republic, Slovakia, Serbia, Latvia, Denmark, Norway, Greece, Spain, France, Italy | Germany | Export, distribution agreements | market-seeking, strategic asset-seeking |
| Company D | pharmaceuticals | 1935 | 2000 | 0%* | 12/44 | 3 | Russia, Kazakhstan, Turkey | Russia | Export, distribution agreements | market-seeking |
| Company E | interior fittings and building materials | 1992 | 1998 | 0% | 0/70 | 4 | Romania, Belarus, Russia, Bulgaria | Belarus | Export | market-seeking, efficiency-seeking |
| Company F | engineered wood | 1974 | 2004 | > 50% | 0/33 | 1 | Russia | Russia | Export | market-seeking, efficiency-seeking |
| Company G | meat and processed food | 1951 | 2005 | < 25% | 5/20 | 2 | Germany, Russia | Russia | Export | market-seeking, efficiency-seeking |

table 1. contd.

| | | | | | | | | | | |
|------------------|------------------------------|------|------|-------|-------|----|---|---------------|--------------------------------|---|
| Company H | anchoring and fixing systems | 1982 | 2003 | 0% | 30/60 | 16 | Czech Republic, Slovakia, Hungary, Bulgaria, Lithuania, Romania, United Arab Emirates, Ukraine, Kazakhstan, Russia, Germany, France, Ireland, Sweden, Great Britain, Middle-Eastern countries | Great Britain | Export, contract manufacturing | market-seeking, strategic asset-seeking |
| Company I | furniture | 1992 | 2000 | < 25% | 10/60 | 13 | Argentina, Great Britain, France, Czech Republic, Germany, Slovakia, Hungary, Romania, USA, Kazakhstan, Russia, Ukraine, Middle-Eastern countries | Germany | Export, contract manufacturing | market-seeking, strategic asset-seeking |
| Company J | software and consulting | 2006 | 2010 | 0%* | 0/35 | 1 | Germany | Germany | Export | market-seeking, strategic asset-seeking |

* Formally equity is held by foreign investors. However, these are part of the capital group and controlled by Polish owners.

** Usual establishment chain in a given host country.

The qualitative analysis followed the procedures as set out by Eisenhardt (1989) and Ragin (1994). Accordingly, in the first step a within-case analysis was carried out to identify relationships between the examined variables in each case. Next, cross-case patterns were searched for by comparing particular case categories and analyzing within-group similarities and across-group differences of these categories. Thereby, interdependencies between manifestations of different variables could be observed and verified against each case evidence (Yin, 2009) and finally contrasted with extant literature. The main characteristics of the researched cases can be found in Table 1.

3. Empirical findings

Overall patterns. Half of the studied companies showed a geographical concentration of their FDI activities in non-EU developing countries of Central and Eastern Europe. Among these companies, also their major investment projects to date were based in these countries, thus stressing the role of previous experience in operating in similar environments. Other companies balanced out their destinations with developed countries from the EU and beyond, thus partly contradicting the patterns of a gradual geographical diversification. Expansion to more distant locations was more prominent eastwards including the markets of West Asia and the Middle East. Noted absence from the list of targeted country markets included China and the USA. In South America the only host country was Argentina. All investors but one had had previous export experience before

undertaking their first foreign investment. A notable exception was the automotive supplier, who invested in Ukraine without prior exports. Two companies had moreover preceded FDI in given locations with contract manufacturing and two others with distribution agreements. In case of the pharmaceutical manufacturer, the analyzed FDI in Russia was of sequential character, following a previous green-field subsidiary and a strategic alliance with the acquired firm. Half of the sample companies had already undertaken FDI elsewhere before engaging in their largest FDI project.

Role of FDI motives. A relationship between FDI motives and location decisions could be identified among the researched investors. FDI by the chemicals and interior fitting producers (both joint ventures), where the market-seeking motive was dominant, was located in non-EU developing countries (Belarus and Azerbaijan). However, in choosing these host countries, both firms referred to them as springboards for expansion into other, strategically important markets. For the efficiency-oriented greenfield FDI in developing countries (in case of the automotive supplier also coupled with the market seeking factor), the availability and lower cost of production related resources prevailed in the country choice (three cases). In cases where the market-seeking and strategic-asset seeking motives were coupled, developed EU markets (three cases) and Russia (the pharmaceutical firm) were chosen. Interestingly, these countries were accessed by acquisitions of local companies. Two investors in the EU (fixing systems and furniture manufacturers) explicitly stressed the fact that country choice depends on the existence of the sought strategic assets, i.e. the decision is contingent upon the location of the acquired company. The IT consulting firm, which made an acquisition in Germany, indicated this factor as secondary, with the customer network and product portfolio of the acquired firm being key to accelerated expansion. For the pharmaceutical company, the acquisition of a major local player was due to the latter's established brand and pool of registered drugs.

Host-country determinants. In terms of the considered location determinants, differences could be observed between countries at different development levels. The choice of EU countries was in all cases influenced by market size, followed by the existence of previous business contacts in the target market as well as the existence of sought strategic resources, in accordance with the above discussed FDI motives. For non-EU developing countries, geographic proximity was a predominant location advantage, while cultural closeness was not recognized as important for location choice. Further determinants in this country category were the availability and lower costs of resources, corresponding to the drive to reduce production costs. Moreover, companies investing in non-EU countries

also pointed to earlier business ties as a determinant of their investment decision. On the institutional level, the automotive supplier investing in Ukraine underlined the role of fiscal incentives in the host country, good contacts with local authorities and a favorable business climate as pull factors, while the interior fittings producer in Belarus was attracted by fiscal incentives alone. In the EU cases, the investment climate (IT firm, bus manufacturer, fixing system producer) was evaluated as secondary to other determinants. What is equally surprising, EU membership was perceived as a location advantage only in two cases (IT consultancy and anchoring and fixing firm), yet only of secondary importance.

Firm-level determinants. When considering the impact of internal factors on the expansion of Polish firms, four of the six investors in non-EU countries and two of four in the EU regarded experience in host countries as a key advantage in their international expansion. The flooring manufacturer in Russia and the interior fittings producer in Belarus underlined the home-country based advantage of a better understanding of the local environment, as compared to Western competitors. When it comes to the transferability of sales and marketing experience gained in Poland to foreign markets, it was judged as moderate to high in all non-EU countries, suggesting a high applicability of home-market experience. This factor was also stressed by the fixing systems firm, whose major FDI was in the UK, but the host-country portfolio was dominated by CEE countries. On the other hand, also the investors in developed countries saw a moderate usefulness of Polish business experience. Likewise, companies recognized the role of management team skills in advancing international expansion, regardless of FDI locations. Thus, no conclusive relationship can be posited in this regard.

Studies on firm internationalization often use firm size as a proxy for resources they possess. In the present study, no clear relationship between firm size and expansion patterns could be recognized. While the four largest firms in the sample (in terms of employment) were also those with the highest number of FDI projects, there seemed to be no proportional relationship. Likewise, geographical diversification showed no clear relationship with firm age. Three companies founded between 1991-1992 reached a 60-70% foreign revenue level. Meanwhile, the oldest three companies, established before 1989, i.e. in the previous socio-economic system, showed low to moderate revenue internationalization (below 45%). This could be explained by the fact that no international orientation had existed in that earlier system, although these companies had accumulated considerable business experience and resources. Firm resources can also be related to the ownership structure of outward investors. Three companies had a share of foreign equity below 25% (Companies B, G and I) and one had above

50% of foreign equity (Company F). In general, 100% Polish-owned companies favored country market spreading, investing on average in 6,83 countries. On the other end those that had over 25% foreign equity showed lower country dispersion, investing on average in 5,33 countries whereas the one with foreign ownership exceeding 50% of equity (flooring producer) had only invested in one host country.

A clearer pattern could be observed in terms of resource barriers to investments. Companies focused on non-EU CEE countries more frequently pointed to problems on the host country level, particularly knowledge of local regulations and business conduct, which is necessary to cope with business risk, as well as inadequate skills of local employees. Those having a balanced portfolio of EU and non-EU host countries (whose biggest FDI investment to date was in a EU country), faced obstacles on firm level, including weak financial position, obsolete products, low international brand recognition or problematic subsidiary coordination.

Conclusion and propositions for further research

The geographic patterns of Polish outward FDI, revealed in the present study, remain consistent with previous research indicating a regional focus of CEE companies on European markets (i.a. Rugraff, 2010; Svetličič and Jaklič, 2003). The FDI locations included both Western EU countries and EU and non-EU CEE countries. This trend seems to confirm the still limited resources which curb the scope of expansion of Polish firms, staying away from large, both mature and emerging markets located in geographically and culturally distant environments. However, these findings do not entirely fit conceptual models from received theory. While most FDI projects were of the market-seeking type, which corroborates earlier studies of FDI from CEE, the observed relevance of strategic asset* and efficiency seeking motives seems to point to a different profile, typical of mature MNE's. The contribution of this study lies in providing indications that location choice is largely determined by the motivation of outward investors, either focused on resource-exploitation or resource-acquisition. Clearly, more developed countries were targeted by firms striving to enhance their own competitiveness, but at the same time possessing certain ownership advantages. A seemingly higher role of technological advantage and product competitiveness could be observed in case of investors in EU countries, which can be viewed as a success factor in more competitive, developed markets. Hence, the following propositions for further research can be formulated:

* Interestingly, a similar situation was reported in studies of Chinese firms' FDI (e.g. Cui and Jiang, 2010).

H1a: The dominance of strategic asset-seeking motives increases the propensity to invest in more developed countries.

H1b: The possession of proprietary assets increases the propensity to invest in more developed countries.

H2: The dominance of efficiency-seeking motives increases the propensity to invest in less developed countries.

Meanwhile, the expansion to CEE countries was largely determined by the willingness to exploit previous business networks and market familiarity. The role of this home country-embedded advantage relative to investors from beyond the region should receive more attention in future studies on Polish outward FDI. Finally, it can be posited that:

H3: The role of host-country characteristics has a higher influence on location choice than investing firm characteristics in less developed countries, and vice versa in more developed countries.

As it was highlighted in the case studies, firms with different strategic profiles and resource endowments tend to choose different locations for their major FDI projects. However, these decisions are influenced by different sets of criteria depending on the location. Finally, it is somewhat risky to generalize the above propositions and overall results due to the limitations of the qualitative method employed. Thus, in order to draw representative and more binding conclusions, more rigorous testing is suggested on large quantitative samples of firms investing out of Poland.

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