Desalegn Abraha
Akmal S. Hyder

VOLUME II

TRANSFORMATION OF STRATEGIC ALLIANCES IN EMERGING MARKETS

Transformation of Strategic Alliances in Emerging Markets

Transformation of Strategic Alliances in Emerging Markets, Volume II

DESALEGN ABRAHA
University of Skövde, Sweden

AKMAL S. HYDER
University of Gävle, Sweden

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To the memory of

My parents Ato Abraha Ghebrekidan and Weyzero Jeddah Tesfazghi and my brother Engineer Kubrom Abraha whom I remember for their never-ending love and care

Desalegn Abraha

My parents Syed Abdul Halim and Salema Begum and my brother Syed Azmal Hyder whom I miss for guidance and inspiration

Akmal S. Hyder

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About the Authors

Desalegn Abraha received a BBA in Management from the University of Addis Ababa in Ethiopia in 1976, an MSC in Industrial Marketing from the University of Uppsala in Sweden in 1989, and a PhD in International Business from the University of Uppsala in 1994. Currently Desalegn is Professor Emeritus at the University of Skövde. He has a broad teaching experience and has so far taught courses on international business, international marketing, marketing research, services marketing, internet marketing, digital marketing, industrial marketing and distribution. His research interests deal with foreign market establishments in network contexts, the internationalization of SMEs, strategic alliances in the international market, bank marketing and the impact of ICT on marketing. He has published two books and about 35 articles in international scientific journals such as the *Journal of International Marketing Research*, *Industrial Marketing Management*, *International Business Review*, *International Journal of Bank Marketing*, *European Journal of Marketing, Journal of Services Marketing*, and *International Journal of Strategic Management*.

Akmal S. Hyder got his PhD from the University of Uppsala in 1988 and is a professor of marketing at the University of Gävle, Sweden. He has a broad teaching experience and has so far taught courses on international business, emerging markets, international marketing, marketing research, services marketing and distribution. He has served as a visiting faculty for nearly two years in the North South University of Dhaka, Bangladesh. Dr. Hyder has a keen interest in international students and teacher exchange program and worked as a coordinator at the University of Gävle for several years. He has published two books and a number of articles in international scientific journals such as *International Business Review*, *Scandinavian Journal of Management*, *Industrial Marketing Management*, *European Journal of Marketing*, *Career Development Management*, *Thunderbird International Business Review, Journal of Services Marketing*, and *Business and Society Review*.

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Foreword

The research work on *Transformation of Strategic Alliances in Emerging Markets* is divided into two parts: Vol I and Vol II. This book is a continuation of Vol I. Vol II starts with case studies, which are included in chapters 1 and 2. Chapter 1 contains cases on Alliances in Fast Complete Adapting countries, while chapter 2 reports cases on Alliances in Medium Complete Adapting Countries. Chapter 3 takes up a discussion and analysis on the cases in different phases following the theoretical framework of the study. The results of the study are reported and discussed in relation to the applied theories in chapter 4. Chapter 5 is devoted to conclusions on the key issues of the study. Finally chapter 6 covers research and managerial implications along with comments on the strategies found applicable to emerging markets.

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Preface

The appropriateness and timeliness of publishing this book is beyond doubt as it deals with how the long-term business relationships and networks have changed over time in emerging market alliances. Initially, the alliances were established among Swedish firms and firms in Eastern and Central European countries (ECE). There have been several differences among the alliance partners, i.e., the Swedish and their local partners. Specifically, the Swedish and the local partners have experienced different attitudes, beliefs, ways of thinking, cultures, traditions, ways of conducting business, concept of time, modes of communication, negotiations, etc.

In early 1990s, many Western firms entered into the complexity of ECE, which we introduce in this study as European emerging markets, without having the necessary preparations. Many promising business ideas failed due to lack of knowledge about the ECE emerging markets in regards to social, cultural, political, legal, and human features. It became clear to Western managers that adequate preparation is a prerequisite for success in the region. However, there has been good sign that networks of relationships and competence in dealing with those networks are gradually developed. This study focuses on the changes that have taken place in motives, resource contributions and exchanges, learning, in relationships and networks development, performances. and the general environmental factors within which the alliances function.

Initially, all European transition markets followed the socialist ideology and had almost the same economic structure, but during the last 30 years of transition, things have undergone many changes. Success in adopting market economy and changing policies have created several gaps among these emerging markets. It has therefore become important to know why some countries have done so well while others fallen behind. This study sees the collaborations as a clear step to reduce the risk of investment by foreign firms and to gradually get accepted by the local governments and the people in the transitional economies. There has been a basic difference in the management style between the Western and Central and Eastern Europe and therefore issues such as how these dissimilar companies make things go, what result they achieve, and what they really contribute to the development and transformation process are stressed in this book.

Many research works have concentrated on different characteristics of alliances, but surprisingly, no fruitful attempt has yet been made to focus on the dynamic aspect of this form of collaboration. In the case of European emerging markets, this absence is crucial as partners have a totally different background and consequently have different ways of doing business. In fact, the ECE region is not only different from the Western countries but also from the other developing countries. Development and conducting relevant research to study alliances in these emerging markets has been set as one of the main objectives of this book. To fulfill this goal, a conceptual framework from a process perspective has been designed to describe and analyze the formation, development, and functional mechanism of strategic alliances in the transition region. This conceptual framework has been used in this work to go into depth for capturing fundamental issues, functional patterns, and changes of the alliance activities.

One of the main reasons for alliance formation is exchange of complementary resources among the partners. We argue that no alliance study can be complete and justified unless this vital issue is duly considered. Moreover, commitments of the partners in regards to formation and operation of alliances are vital to the fulfillment of the partners' motives. Exchange of resources has to be defined and understood as a part of a dynamic and ongoing process, which means that things can change from time to time depending on the partners' understanding and the environment in which alliances operate. Partners' learning is essential and important for the alliance operations and performance. Changes in the partners' behavior can be a consequence of learning that takes place in the alliance.

In contrast to Hyder and Abraha (2003), which contains 20 cases, the current book consists of 10 cases. Out of the 10 cases, eight are discussed in three phases and two in two phases. The current empirical study analyzes and presents 28 mini-cases. Compared to the previous book, the current work deals with two categories of countries, namely "fast complete adapting countries," i.e., Poland and Hungary, and "medium complete adapting countries," i.e. Estonia and Lithuania.

The foreign partners faced many challenges. The first challenge was the scanty knowledge of the markets and the local partners. The second challenge was the process of transformation from central planning to market economy. The third challenge was the law and regulations to accommodate and support the new kind of business not practiced earlier in the region. The last challenge related to the local culture and the challenge of changing people's attitudes. However, the challenge for the local partners was to adjust to the changes and to quickly get back on track. The first opportunity the foreign firms took advantage of was the early entrance in the market. Their other opportunity concerned access to capable partners with wide distribution networks in the region. The local partners, on the other hand, could learn modern marketing and dealing with better technology to increase their competitiveness.

Environmental and institutional factors have been found to play a substantial role in the formation, organization, operation, and finally dissolution of the alliances in the European emerging markets. The speed of change has been rapid in the fast complete adapting countries compared to medium complete adapting countries, which is noticed in the change of ownership structure and increased level of competition. The fast complete adapters have quickly accepted the Western standard and opened their markets for free investment. Many of the foreign firms have expressed their satisfaction over the changes and see virtually no difference in these countries compared to many countries in the West in doing business.

Vital changes came in relation to regulations and business law to ease the business process. The financial institutions became more professional and the foreign firms gradually experienced less difficulty to borrow locally. Things also improved in the Baltic states (medium complete adapters) as more Scandinavian banks operated in this region. This book offers an in-depth knowledge and understanding of the dynamic challenges and opportunities in emerging markets for the academics and the global business actors.

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Part I
Empirical Evidence

Chapter 1

Empirical Studies: Alliances in Fast Complete Adapting Countries

Abstract

In this chapter, six cases are presented, four from Poland and two from Hungary. The Polish cases are Partec Rockwool, PLM, Bulten Tools, and Vattenfall, while Svedala and Getinge belong to Hungary.

The cases have been described in different phases following the conceptual framework, developed in chapter six. All cases we present in three phases except Svedala where there are two phases. In the later case, neither the alliance nor the partners could be traced. Among the cases, level of performance varied. Getinge is the only case where the partners continued with the same alliance and the ownership structure remained unchanged. In Partec, the foreign partner acquired the local shares to establish a wholly owned subsidiary, and in Bulten Tool, the foreign partner became the major owner to have control over the company. Partec Rockwool and Vattenfall had been sold to other companies after amicable settlement between the partners.

The Case of Partec Rockwool (Paroc) in Poland

Phase 1 – Partec Rockwool (Paroc)

Partec Rockwool has more than half of a century experience of developing, manufacturing, and distributing stone wool products for use by the building industry and other industrial applications. Currently it is the leading stone wool manufacturer in the Baltic Region, with Sweden and Finland as its main markets.

Motives

It was Paroc's need of risk financing which was the main purpose of building the alliance in Poland. Searching and securing project financing in the former

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Socialist bloc was the policy of the firm. In principle, the lenders were ready to finance such projects as they were familiar with the concept of risk financing. A proper form of asset security was needed for every project, and as a result, a specific legal design suitable in Polish circumstances had to be developed and applied which consumed a great deal of time. The partners were only financial partners who didn't perform any business activity. The motive was financing, and it was done to spread financing risks.

As its competitors were already established, Partec was a late starter in the Polish market and decided to establish itself quickly by acquiring a local company which was already operating in Poland and producing rock wool products. Paroc identified a state-owned firm which was interested in selling shares as part and parcel of the governments' privatization program. To this end, Paroc in 1998 took over a Polish company that had been operating in the same area of business, and at the same time to avoid taking the full risk, it built a joint venture (JV) with three financial institutions as local partners. It was a time-consuming process to negotiate with the financial institutions. Paroc holds 48% of the shares, with the three financial institutions together holding 52%.

Resources

Paroc's expertise in insulation technology was its major contribution to the JV. Moreover, it was in charge of seeing that everything was in order because of its technological competence. It was also Paroc's responsibility to totally perform the proper management and follow-up of the operations of the JV. Specifically, Paroc was responsible for technology, marketing, product development, training and recruitment of manpower, procurement of materials, and in fact of all operational activities. The three financial institutions are experts in risk financing and the upgrading of old production lines. Moreover, the transfer of the modern technology and investments in the modern and new production plants were financed by the financial institutions which were main shareholders of the alliance. A fourth financier, International Financing Corporation (IFC), was also involved in the project financing. It was clearly specified in the contract that Paroc had the right to buy further shares from its partners.

Learning

Paroc's learning was mainly derived from its employees and the contacts it had with the other actors in Poland. It specifically learned the Polish bureaucratic set up and the need to live with the bureaucracy if it is going to succeed to achieve its objectives. Paroc understood very well that the Western way of doing business can't function for local sales and to that end it found out the role of the local employees crucial in dealing with the local customers. The distribution system in Poland was different as there was no dealer chain for ultimately distributing the products to customers. As things were changing, it took time to establish a well-functioning distribution system. This structure made Paroc's operations both difficult and easy. What made operations easier was that one has to deal with one decision maker because of the centralized decision-making process. The problem was that with only one decision maker, there are equal chances of gaining or losing.

Network

Both Paroc and Izopol SA, one of the local partners, dealt with and established contacts with the Regional Environmental Authorities and the Local Municipality about the building permits. Moreover, Paroc developed contacts with the dealers as they did represent Paroc in the market. Paroc used its Lithuanian network and performance to introduce its firm and its products in Poland when it started to sell its products in the Polish market before the plant in the local market started to operate. Its Lithuanian experience, operations, and performance made it easier for Paroc to get accepted and recognition in the Polish market.

Performance

Paroc's expectations were fulfilled with the financial institutions cooperation. Actually, many things still needed to be developed further; however, the way Paroc's manufacturing operations developed had been a successful part of its overall activities. Although it was in need of acquiring a thorough grip on the Polish market, Paroc's plans of getting established in Poland were largely realized. As a result, Paroc wanted to continue the cooperation arrangements with its partners as the motives for establishing the JV were still valid. The Polish partners were also satisfied with the performance of the JV. The partners also found out that Paroc was very competent to profitably running the business.

General Environment

The Polish culture was in a kind of transitional stage of development toward an advanced market economy. The level of bureaucracy was far greater and has slowed down the JV operations in many aspects. Paroc had to deal with the bureaucracy both in the company and in its relations with the authorities and the other actors it had to deal with in its operations. Different types of complications are created in doing business in Poland which are different from that in the West and such complications consume resources away from more useful activities. Employees are used to an authoritarian style of management, and this is changing with the transition to the market economy. Consequently, the employees are willing to take more responsibility in their operations. Paroc is providing a lot of training to its employees, and this makes its operations slow and expensive.

Two main risks were common in Poland. Firstly, when Paroc started to operate in Poland, it was totally unknown to the territory. Starting to operate in an unknown territory which was a former state economy is always in itself a risk. Secondly, there was a risk of a more commercial nature. Financial institutions are prepared to take some risks not all types of risks. Making applications, filling forms and invoices especially when starting to operate in Poland, and to import goods were really time and resources demanding work. This was because the authorities were very suspicious, and they had to check everything. Taxation authorities were very typical in such routine controls and creating complications. To handle such a problem/s, Paroc local employees who had to travel to the tax authorities 40 kms away from where it had its production plant to fill lots of papers and documents.

Phase 2 – Partec Rockwool (Paroc)

Motives

Paroc's motive to operate in the Polish market was to operate fairly a fairly new market with huge opportunities. Paroc saw that those markets are growing, and when it sees the opportunities that existed and that can be created with the growth, it starts with sales from outside and thereafter it builds a plant inside the country.

Changes of a Market and Customers Structure

Even during the second phase, the alliance partners continued with the same types of resources contributions as they did during the first phase. Paroc started a new line in 2008, next to the old ones and it was the most modern line Paroc had in 2009. In 2009, the company had three production lines in use and it renewed all the machineries and all equipment. It had technical insulation machinery which produces more developed fibers which were used for what they call technical insulation. Paroc around 2008–2009 developed new types of insulation materials that were used to produce the final product. The plant was established in Poland to make use of local low-labor cost and because of the availability and procurement of raw materials. The JV was supplying the Russian market for several years from its production plants in Poland. It was expanding its sales to the Russian market by getting new customer groups there and by building new production lines in Poland. It was building up the market around the production plants in Poland. As the market was growing, it was natural to move into Russia, go to the east, and at the same time, it was also a fairly new market. It was growing very fast until 2007–2008.

Building a New Joint Venture

Paroc can build a new JV in Russia if it finds a partner who is well-known and at the same time who can take care of the market. Then that can be a motive for Paroc to go into JV with business partners in Russia and not only with a financial partner as was the case in Poland and Lithuania for the purpose of spreading the risks. Actually, in Lithuania, Silicatas owned some shares in the JV but it was never a business partner. At the early stage of establishment, the JV was owned by three partners which were Nordic Investment Bank, Nordic Environment Finance Corporation (NEFCO), and Paroc. During the second phase, it was owned by four partners, and as a fourth partner, the European Bank for Reconstruction and Development (EBRD) joined the JV. Around 2009, Paroc bought the two owners the Nordic Investment Bank and EBRD, and there were only two partners in the JV which are Paroc and NEFCO.

Resources

It was Paroc which performed most of the functions of the JV, and the other three partners at the early stage of operations were contributing financial resources only. The only thing which changed during the second phase is that the number of the JV partners is reduced to two, and there is only one financial institute as a partner of the JV instead of three. All the business, i.e., purchasing of raw materials, product development, production technology, production, marketing, sales, customer contacts, etc., were handled and dealt with by Paroc. The partners' resources contributions have not changed, and it has continued and remained as it was in the beginning. During this phase, Paroc also invested in new production lines.

Learning

Paroc learned how to do business in Poland, how the market functions, how the authorities handle matters, how the JV partners should manage the authorities and the other actors relationships, the challenges in the market and how to deal with the challenges, and how to operate in the market to achieve its objectives.

Network

The alliance was helpful to get into close contacts with the local government officials and other authorities as well as with the other actors that the alliance had to deal with as it was very important to have well-functioning relationships with all those actors if a firm is going to achieve its objectives. It was very important for a foreign firm to manage those relationships, and local people were employed to this end. Paroc employed one local person from the old company specifically to manage the relationships with those authorities.

Performance

As Paroc is not the main supplier in Poland, it is not easy to get into the market but Paroc knew this from the very beginning and it decided from its early stage of its operations that this plant has to be placed in Poland to make use of low cost for the staff and for the type of raw materials that it can obtain from the local market. Moreover, its aim was also initially to export products from Poland to Great Britain, Italy and to other West European markets which it is doing at present. Paroc never had the aim Poland to be the main market for the Polish plants. But, as the Paroc products don't stand high-freight costs and long freights, distances, it has to sell its products in the local market also. But that has been tougher than Paroc taught from the beginning to get it profitable in the Polish market. But it became profitable until 2007 starting around 2003. According to Arne Johansson, MD of Paroc, however, the market went down in 2008 and 2009, and its operations went down to zero profit in Poland again. The Polish market is not so easy to win and it has not been profitable as the Lithuanian market.

The Market Structure and How It Operated

Izopol was owned by the state and it had only production, it didn't have any sales or marketing department and how it could manage to reach the market was a mystery for Paroc since Izopol didn't have a single salesperson. The State itself somehow took care of production, the products, and the market. Paroc had to hire salespeople, and it could not have much use of Izopol's contacts in that way. It was very challenging for Paroc during the first phase to understand and to manage the market; however, it later i.e., during the second stage, hired few people from Izopol's finance department, and including the finance director mentioned above earlier who was very important for Paroc to understand and to manage the market and customer relationships. Paroc is about the fourth or fifth in market share and it knew since the very beginning that competition was very strong in the Polish market. Paroc in Poland exports products to Great Britain, Italy, and to other Western European countries. Paroc realized that it is much tougher than it thought from the beginning to make a profitable business in Poland. But it was profitable for four to five years, i.e., from 2003–2006. However, the market went down in 2007–2008, and it was close to zero gain in profits. The Polish market is not so easy to win and the Polish business has not been as profitable as the Lithuanian market.

Urban Migration

The production plant in Poland was situated in the countryside, and it was not easy for Paroc to find white-collar workers that would like to work there. The shortage of white-collar workers became even harder during the second phase which covered the years from 2001–2010. It was not that troublesome when Paroc started to operate during the first phase of its operations there in the 1990s, however, as there was a strong migration to urban areas such as Warsaw and other big cities later it became harder to find white-collar workers. The shortage of white-collar workers in the country side was a problem for the alliance to deal with.

Customer Relationships

Building customer relationships was a problem for Paroc as it didn't have the same market, i.e., the same customers as the company it bought. The company that Paroc bought, Izopol, was an old state plant which never had any sales people, and it never had direct contacts with the customers and the market. Izopol only produced, produced, and produced, and as it didn't have salespeople, it is not easy to understand how it reached the market and the customers. The state