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An Evolutionary Perspective

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Context Sensitivity of Post-Acquisition Restructuring: An Evolutionary Perspective

The transformation and integration of acquired businesses is subject to tensions between radical change to match the strategy and corporate culture of the acquirer, and promoting what is valuable in resources and cultural attributes in the acquired organization. Analysts' disagreement, even within the tradition of the resource-based view of the firm, arises from different conceptualizations of the nature of resources. We present an evolutionary perspective that shows not only the merits of competitive selection, but of retaining and developing context sensitivity and diversity.

Our case evidence shows that a defensive focus on short-term efficiency, i.e. downsizing, may destroy valuable human capital and employee motivation, and thus fail to realize the long-term potential of the organization. Investor determined strategies increased allocative efficiency in terms of productivity and profitability more rapidly. However, even in this case, acquirers providing more autonomy to local decision-makers and research units have been able to realize more of the potential contributions of the acquired assets, thus increasing dynamic efficiency.

Our empirical analysis of the tension between change and continuity is based on 20 original case studies in Hungary and East Germany. Foreign investors acquired these firms in the privatization wave of the early 1990's.

1.1. Introduction

The transformation and integration of acquired businesses is subject to tensions between radical change to match the strategy and corporate culture of the acquirer, and preserving what is valuable in resources and cultural attributes in the acquired organization. More then elsewhere, this holds true in Central and Eastern Europe, where local organizations search for new ways to face the challenges of a nascent competitive market economy [Carlin et al. 1995, Newman and Nollen 1998, Uhlenbruck and DeCastro 1998, Stiglitz 1999], and Western entrants are eager to share their views, often with a missionary zeal. The preservation and enhancement of local resources and experience easily conflicts with the objective of creating the institutions, inclusive norms and values, for a market economy. This results in frequent complaints from locals about the cultural insensitivity of Western businesses operating in the region [Soulsby and Clark 1996, Gilbert 1998].

Foreign investors[1] are confronted with this conflict between continuity and change when acquiring local firms, and thus becoming involved in the process of enterprise transformation (ET). We study the reconfiguration of resources during ET on the basis of the resource-based theory of the firm [Barney 1991, Dierickx and Cool 1989, Wernerfelt 1984]. Within this tradition, alternative interpretations of the nature of resources lead to different implications on the merits and demerits of radical investor-driven ET strategies. We analyze the dynamics of change through analogies with biological evolution, drawing on the theoretical concepts developed in contemporary biology [Skelton, ed. 1993, Maynard Smith and Szathmary 1999] and ecology [e.g. Hoffmann and Parsons 1997] as well as evolutionary applications in the social sciences.[2] This perspective suggests that growth and prosperity of a firm, depends on its *adaptation* to the local environment, its creation of internal *diversity*, as well as *selection* among its constituent business processes. Post-acquisition management thus requires an active strategy to initiate the dynamic processes that will generate both specific solutions for the local context, and global capabilities of the investor. Contrary to certain prejudices, the evolutionary view does *not* advocate passivity or allowing inertia to prevent change. Rather, the understanding of evolutionary processes can enhance managerial action.

Our case research in foreign acquisitions in Hungary and East Germany suggests that with both some degree of managerial autonomy and access to complementary resources, firms performed better in terms of developing solutions for the local contexts and new capabilities for use in the investor's global operations. On the other hand, focus on short-term efficiency, e.g. by downsizing, may destroy valuable human capital and employee motivation, and thus fail to realize the long-term potential of the organization. Most such firms increased *allocative efficiency* in terms of productivity and profitability more rapidly. However, acquirers allowing local decision-makers and research units to pursue indigenous strategies performed better in terms of development of product and process innovations, and utilization of acquired resources. Such *dynamic efficiency* may equip the local firm to contribute to the investor's multinational network and to become a specialist within the MNE for a major business activity, in other words to attain a "global mandate" [Birkinshaw and Morrison 1995, Birkinshaw and Hood 1998].

This paper is structured as follows: Section 2 introduces ET in transition, Section 3 introduces our theoretical arguments for respectively discontinuous and evolutionary transformation. Section 4 introduces the cases and methods of analysis. Section 5 analyzes external factors influencing ET, while

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[1] We include West German investment in East Germany as 'FDI' because it shares the economic qualities associated with FDI, an established term in the literature, although 'foreign' does not reflect the political situation. More correct may be 'direct investment from outside the transition economy'.

[2] We consulted evolutionary analysis in related social sciences, ranging from evolutionary economics [Nelson and Winter 1982, Nelson 1995] to sociology [Aldrich 1999, Lewin and Volberda 1999, Grabher and Stark, eds. 1996], management [Kogut and Zander 1993, 1996, Kogut 1996, Spicer et al.

section 6 discusses the role of foreign investors and managerial decisions. Section 7 summarizes, and section 8 suggests implications that go beyond the transition economies.

2. Acquisitions in Transition Economies

For foreign direct investors in transition economies, an acquisition can be attractive as entry mode: it offers access to valuable human capital in local firms, especially their technological skills, and contacts to (informal) local networks and to government agencies. Local brand names and distribution networks are valuable assets in some consumer goods industries, and acquirers also report fewer bureaucratic obstacles to acquiring land and obtaining all the necessary permits required to start or expand production [Meyer and Estrin 1999].

While offering attractive opportunities, acquisitions come at a cost that can exceed the purchasing price. In transition economies, acquisitions often become 'brownfield projects'; i.e. they are extensively restructured and form only a minor building bloc in the establishment of local operations of investor [Meyer and Estrin 1999]. Investors have to establish a 'strategic fit' between their global operations and the new affiliate, and to reconcile organizational cultures that differ due to different historical experiences [Jemison and Sitkin 1986, Uhlenbruck and DeCastro 2000]. This tasks is unusually challenging due to the contrasting capitalist and socialist inheritance of the two merging organizations.

In the socialist regime, firms were established to produce goods or services as specified by the central plan. Consequently, their overriding objective was plan-fulfillment. The incentives created by central planning led however to severe distortions, such as the production of large volumes of standardized low quality products, lack of concern for consumer demand, disregard for externalities. Firms employed far more people than necessary to achieve their output targets, as labor costs were not a constraining variable. Employment relationships were effectively based on lifetime employment and enterprises provided many of the social needs of both current and retired employees. Studies like Berliner [1952] and Kornai [1980] illustrate how the overriding concern of management was to implement the central plan, while few incentives, or in fact opportunities, encouraged product or process innovation.

As this brief characterization recalls, firms have a very different role in socialist and in capitalist societies. Most economic analysts focus on the recombination of resources and analyze enterprise transformation as a move from an inferior state to a superior equilibrium. They are thus primarily concerned with the outcome in terms of productivity and profitability [e.g. Claessens et al. 1997, Smith et al. 1997, Jones et al. 1998].

Some authors go further by drawing analogies to the periodical restructuring of enterprises in

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2000] and transition economics [Murrell 1990, 1992].

capitalist societies [e.g. Djankov and Pohl 1998]. This, however, is not helpful as it misses the essence of transition, the fundamental change of both the rules of the game and performance criteria. The new rules themselves evolve in fact over several years,[3] creating a transition period of high uncertainty. To achieve competitiveness under the new conditions, firms have to change not only their resource configurations, and their skill and capability reservoirs, but also the ways of organizing themselves, of interacting with the environment, and of relating to members of the organization. ET involves change along all these dimensions.

Managers were generally not well prepared to lead the transformation process because many capabilities essential in a market environment were not developed under socialism when other skills were asked for. In fact, the required capabilities are often beyond the experience-horizon of individuals used to the central-plan system. They require not only acquisition of new techniques, but implementation of new systems and procedures as well as a change of the cognitive framework to reassess the criteria of business success and factors contributing to that success [Child 1993, Villinger 1996]. These new capabilities require the acquisition of tacit know-how through interactive learning, Moreover, the organization has to change its corporate culture to shed the remnants of the socialist 'bloc culture' [Sztompka 1993] and to meet the competitive challenges of the market economy [e.g. Newman 1998, Meyer and Moller 1998, Fey and Denison 1999]. This organizational transformation involves changing existing routines, attitudes and possibly even value-systems, which often inhibit organizational change [Michailova 1997]. We therefore take our own, process-oriented definition of enterprise transformation (ET) as starting point:

> *"Enterprise transformation is the process of changing an organization previously adjusted to perform according to the performance criteria and rules of the game of the real existing socialism to perform competitively according to the performance criteria and rules of the game of a market economy".*

3. Transforming the Acquired Business

To capture the process dimension of ET, a dynamic theoretical framework is called for. It has to incorporate the trade-off faced by managers between speedy integration of the acquired firm, and the quality of the integration in terms of utilizing the potential of the local operation without alienating its key personnel [e.g. Haspeslagh and Jemison 1991, Cartwright and Cooper 1996, Ashkenas et al. 1998]. We analyze this trade-off in the tradition of the resource-based view of the firm [Barney 1991, Dierckx and Cool 1989, Wernerfelt 1984]. Divergent opinions on post-acquisition management often reflect

[3] In the spirit of the argument presented below, we could emphasize that firms and their environment co-evolve [Polos et al. 1998, Lewin et al. 1999]. In the interests of parsimony, we assume that firms are too small to have a substantive impact on their environment.

differences in analysts' conceptualization of the nature of resources. We contrast conventional economic arguments for radical change with an evolutionary perspective that draws upon analogies between organizational and biological evolution.

a) The production-function perspective

Economists, even when incorporating the resource-based view, tend to conceptualize firms as bundles of production factors that are combined such as to optimize efficiency for given production functions and market prices. Hence, ET is primarily analyzed as reconfiguring the production process: closing down unprofitable production lines, changing inputs and outputs, and redrawing the boundaries of the firm according to transaction costs considerations [Corbo et al. 1991, IMF et al. 1991]. The initial defensive restructuring of local firms applied these ideas primarily by downsizing [e.g. Brada 1996].

The main competitive advantage of CEE were low labor costs and a technically skilled workforce. Some firms aimed at realizing this competitive advantage by more rigorous application of what during socialism was called 'scientific management', that is the sophisticated division of labor in the production process along Taylorist principles [e.g. Sorge 1993]. Although this mode of organizing has been replaced in most Western industries, some firms restructured their operations to reduce costs by more precise division between skilled and unskilled workers and more rigorous supervisory control, without developing substantive new capabilities. Whitley and Csaban [1998b] as well as Taplin and Frege [1999] show that, in the short-term, some firms showed above average productivity and profitability with such a strategy.

The other side of resource realignment is to bring in complementary resources through acquisition of assets or through organizational learning [e.g. Uhlenbruck and Meyer 2000]. Firms in transition can benefit from their catch-up situation and import better practices and technologies that have been developed in the West. In this way, transition firms save the costs of internal development and ought to achieve major advances in productivity. Firms taken over by foreign investors have a natural advantage in accessing complementary resources. They can overcome the barriers faced by local firms with respect to financial resources, technological and managerial capabilities [e.g. Meyer 1998b], and to crucial business-to-business markets [Schwartz and Zysman 1998, Meyer 2000].

The realignment of the resources of the firm to increase productivity is thus at the center of most restructuring strategies recommended for acquisitions in transition economies. Firm performance ought to increase with both shedding redundant resources and acquiring complementary ones after a time-lag of, say, three years:

Proposition 1a: Acquired firms will show better performance in the medium term if they increase productivity by downsizing, i.e. separation from non-core assets and excess employment.

Proposition 1 b: Acquired firms will show better performance in the medium term if the investor initiates strategic restructuring by contributing complementary assets through investment, training, and upgrading of product range and production technology.

b) The evolutionary perspective

In contrast, the evolutionary view of transition emphasizes value of building on existing resources [Murrell 1992, Kogut 1996, Grabher and Stark 1996]. Firms are social organizations that cannot be assembled and disassembled like Lego-toys. Many resources are intangible and embedded in individuals and teams, in the firm's internal and external network relationships, in its business processes and in synergies realized between business units. The broad concept of resources used in the 'resource-based' literature overlaps with the term 'routines' used in evolutionary economics [Winter 1995]. Routines connote "*behavior that is conducted without much explicit thinking about it, as habit or customs ... [or] as the behaviors deemed appropriate and effective in the settings where they are invoked*" [Nelson 1995:68]. Team-embedded knowledge is an illustrative example of resources embedded in routines [Winter 1993:152-154]. The routines of a firm are the outcome of past selection processes, and embody organizational knowledge. They are, if successful, retained and replicated as the firm grows.

A radical change, like that necessitated by economic transition, requires individuals to change their routines, their internal and external relationships, and possibly even attitudes and value systems. Yet this organizational change is, even so, an evolutionary process that is interdependent with the processes of knowledge generation and organizational learning. Organizations evolve, rather than reincarnate themselves overnight, when facing change in their environment or ownership. They evolve "*through the recombination of knowledge, ... partly by the generative logic of their capabilities but also by the opportunities and influences of the external environment*" [Kogut and Zander 1996:503].

Evolutionary processes are often over-simplified as the 'survival of the fittest' and as an efficient selection mechanism to identify the strongest and most efficient firm. Biologists have a more sophisticated model of evolution [see e.g. Maynard Smith 1982, Gould 1987, Skelton, ed. 1993] according to which evolution is not a one-dimensional process of optimization. Natural selection does not yield the superlative fittest, only the comparatively and tolerably fit under given environmental circumstances. Any present population is the result of a selection process conditioned by its specific environment, and past shocks experienced by this environment. It is relative to this context that the population is 'fittest'. An environmental change can lead to sharply reduced fitness, if not extinction.

Moreover, evolution proceeds along multiple paths. The generation and development of variety is essential to create not only new and potentially superior varieties, but to retain individuals that are better equipped for certain adverse conditions. A species with below average fitness under normal conditions may possess genes that are vital to survive periodically recurring external shocks [Hoffmann

and Parson 1997]. Therefore, *biodiversity* is valuable in its own right because it *generates options* for future development, and *retains options* to deal with unusual situations.

In transferring evolutionary ideas from the natural to the social sphere, we have to transfer not only the concept of *selection*,[4] a.k.a. competition, but the concepts of *'diversity'* and of *'environment specificity'* of the selection. Markets too do not necessarily favor the fitter and more efficient form of organization. Fitness is always relative the competition, and conditional on the environment, which itself may change during the selection process [Carroll and Harrison 1994]. An organization emerging as the 'fittest' under a particular economic, political and cultural context, would not necessarily be the best under changing circumstances. [5] Moreover, evolutionary processes drive not only the competitive interaction between firms, but the development and adaption of capabilities – or 'routines in Nelson and Winter's terminology – *within firms*. Firms with internal processes that generate and adopt superior routines will be more 'fit' in terms of the evolutionary selection facing the firm itself.

Evolutionary economists are therefore concerned that the current reforms in transition economies are too preoccupied with removing institutional legacies for the sake of freeing the competitive forces of markets along Western models [Murrell 1992, Kogut 1996]. This results in the wholesale importation of Western concepts, rules and institutions on both national and organizational level. Too few efforts have been spend on developing new solutions that are better adapted to the transition context. This refers to both the socialist inheritances, and the weak and unstable institutions and consequently high economic uncertainty during the change process. Such high turbulence generally induces firms to intensify their prospecting activities [e.g. Lewin et al. 1999]. Therefore, Kogut [1996] encourages firms in transition economies to focus on learning through experimentation and the internal development of new routines and capabilities adapted to the specific context, rather than the wholesale imposition of imported routines. This would enhance firms' capabilities to operate successfully in the present environment and to react to shocks occurring in this environment.

Secondly, evolution thrives with *diversity*, the development of the divers forms, and the ultimate selection among them. From an evolutionary perspective, transition has the potential of "*creating variety and mutations emerging from the recombination of the inherited forms with emerging ones"* [Grabher and Stark 1996:6]. If one was to optimize the process, one would face the trade-off between on the one hand generating alternatives and allowing them to develop - e.g. by compartmentalizing sub-populations - and, on the other hand, competitive selection. National boundaries create such compartments, and thus enrich the diversity of the world economy, culture and

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[4] Evolutionary sociologists distinguish *selection* of routines and their *retention*, i.e. passing on routines to other generations and organizations [Aldrich 19999, Lewin and Volberda 1999]. We do not discuss retention separately to maintain a parsimonious line of argument.

[5] Hence, a firm prospering under the volatile and uncertain conditions of economic transition, may not do well in a mature market economy, while an organization transplanted from the West to the East may be defeated by indigenous competitors [Grabher and Stark 1996].

technology.

Pulling down barriers radically changes the competitive selection process. If at the same time the rules of engagement change, the organizations face a double shock: not only have they more competitors, but also what used to be successful routines is useless against these competitors.[6] Moreover the ensuing volatility creates conditions that may benefit individuals other than those who would fittest in a stable environment. If barriers were gradually lowered, organizational learning would permit firms in the temporarily protected country to become more competitive by the new, market-based rules of the game, before facing global competition. They may then contribute to the joint knowledge pool to create an even more productive world economy.[7]

What does this imply for post-acquisition strategies? Investors' integration strategies crucially influence evolutionary processes in the new organization, which in turn determines its future resource and capability pool. Investors too face a trade-off between pushing allocative efficiency in terms of productivity in the acquired firm in the short term, and making the most of the potential inherent in the variety of capabilities, resources and organizational forms that now become part of their network.

Tight integration and transfer of all of the acquiring organizations' internal routines, procedures and performance standards may increase allocative efficiency. However, investors may yield higher long-term benefits if they allow for some degree of variety in managerial practice, organizational arrangements and technology. Variety will yield a greater pool of capabilities, from which to select. A foreign acquisition increases the acquirer's diversity of practices. Many local practices may initially be perceived to be inferior, yet they may be better adapted to the environment. Experimentation may be needed to develop new managerial practices that are in concordance with existing cultural values, resources, and routines [Kogut and Zander 1996]. Moreover, supporting local employees to develop their own practices by providing resources and experiences of the MNE may lead to new practices that outperform the established ones yielding new world-wide 'best practice' for the MNE.

Financial analysts can capture the potential benefits of retaining diversity as *option value*. Since the local environment is both uncertain and unfamiliar (i.e. headquarters are uncertain about their assessment of local conditions), option values are potentially high, and may be worth a relatively small investment to retain them. The value of an option arising from acquired resources is positively related to

- the distinctiveness of the local environment
- the value of the resources of the acquired firm, and

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[6] A biological illustration: If two populations meet that were previously separated and one carries a virus that the other is not resistant to, it can kill the whole population. For instance, Europeans brought viruses to America (via their domesticated animals) that killed American Indians, who were not resistant to particular viruses. But similarly, a local disease can kill an invader. So, are Western accounting practices such a virus? Or is the Russian Mafia?

[7] In biological terms: Saved from immediate extinction, adaptive learning would permit the species in the compartment to become fitter by the new fitness criteria. They may then contribute to the joint gene

- the diversity of managerial practice, organizational arrangements and technology added to the MNE network by the acquisition.

These criteria apply to many acquisitions in transition economies, as investors typically bought the technologically most advanced firms. Consequently, acquirers may have more to gain in the long-run if they provide the acquired business with a high degree of autonomy, promote learning processes and knowledge exchange (in both directions), yet abstain from the imposition of world-wide practices and short-term efficiency targets. The greater local idiosyncrasies are, the more loosely the subsidiary should be integrated with the investor, because the more important is the utilization of local assets and a sensitivity to local culture. Loose integration permits two-way learning processes instead of the frequently observed one-way dissemination of what investor considers best practice. With access to resources of the investor and local managerial autonomy, the affiliate may generate diversity that ultimately enhances the investor's global capabilities.

Maintaining diversity, however, comes at a cost. Very high degrees of adaptation and diversity are likely to create high coordination costs within the MNE, which may undermine the potential benefits. Moreover, it can result in endless search for new ideas and unrelated capabilities [e.g. Levinthal and March 1993]. Hence we expect an inverse-U shaped relationship between local adaptation, diversity, and performance after a few years adjustment, say three years.

Proposition 2a: Acquired firms will in the medium term show better performance in the local market, if they are provided with autonomy and resources to develop and maintain a moderately high degree of adaptation to the local environment.

Proposition 2b: Acquired firms in the medium term contribute more to the investor's global resources, if they are provided with autonomy and resources to develop and maintain a moderately high degree of diversity and experimentation within the multinational firm's network.

In theory propositions 2a/2b do not contradict proposition 1a/1b. Both the production-function view and the evolutionary view endorse bringing in additional resources – though they differ on who ought to select them. Downsizing is also complementary to the evolutionary perspective, as at least in theory it ought to be possible to retain those local assets that may generate new growth. However, in practice we observe conflicts between those two aims. Our case evidence provides insight in the nature of these goal conflicts.

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pool to create an even fitter joint population.

4. Research Methodology

This research is based on 20 longitudinal case studies in East Germany and in Hungary. These two countries relied more than any other in the region on foreign direct investment (FDI) as means to privatize their economy [World Bank 1996, Meyer 1998a]. The case firms represent large formerly state-owned enterprises in manufacturing and construction with major restructuring challenges. A foreign investor acquired most of them, yet we also included two firms floated on the stock exchange as a control group. Each case firm was visited up to three times in 1996 and 1997, with in total more than 80 interviews. The two to five interviews per firm lasted between one hour and two-and-half hours each, and were conducted in German, Hungarian or English according to the interviewee's preference. A structured interview guide was used. The interview partners included normally the managing director and top managers responsible for purchasing, personnel and production. This includes the key Western expatriate managers plus a majority of local managers, who had been with the organization since before its acquisition. In addition, we interviewed trade union representatives, what distinguishes this study from earlier ones and permits us to observe multiple perspectives on post-acquisition restructuring.

The interviews covered the history of the acquired firms, organizational and technological changes since its privatization, the relationship with between the investor and the local firm, human resource management, regional and international integration, and changes in supplier relationships. In addition to interviews, a variety of secondary sources were obtained for the case firms, including annual reports, employee newsletters, newspaper reports, marketing materials, and other internal documents. Some firms had participated in case research at an earlier time, and such case reports complemented our own data collection, strengthening the longitudinal dimension of this research. The cases are summarized in Table 1.

The restructuring of enterprises is influenced by external factors, such as national politics and the macroeconomy, and internal factors that are under the control of management. To investigate post-acquisition strategies, we need to separate external and managerial influences. We commence with external factors by comparing the East German and the Hungarian experiences in section 5. We present quantitative measures of ET that are based on hard data or on Likiert-type scales coded by two researchers independently of the basis on the case write-ups (see appendix for variable definitions). This method reduces possible biases arising from managerial perceptions in questionnaire surveys. We observe how environmental conditions predetermine the strategic choices available to management. Similar inferences arise from those cases that were subject to specific external influences of their own.

At the second stage, in section 6, we look at the restructuring strategies pursued by investors that acquired the case firms. These strategies explain much of the variation observed within the two countries. The analysis is based on the detailed qualitative information in the cases. The analysis is designed to be exploratory to refine the presented theory and illuminate its practical implications.

Table 1: The cases

Hungarian Cases				
Name*	**industry**	**acquirer**	**year**	**empl.1990**
SUN(H)	food: vegetable oils	French MNE	1992	2100
DRINK(H)	food: instant drinks, sweets	Swiss MNE	1992	2400
CHOKO(H)	food: cookies, chocolate	US MNE via W. German affiliate	1992	2500
PHARMA(H)	pharmaceuticals	French MNE	1991	4500
CHEM(H)	chemicals	International stock market flotation	1996	5000
BUS(H)	cars and car components	Russian consortium**	1991	5000
ELECT(H)	lamps & equipment	US MNE	1990	17600
PACK(H)	packaging materials	French institutional	1990	1000
SMALL(H)	packaging materials	US MNE	1993	450
ENG(H)	civil engineering	Austrian SME	1991	650
GAS(H)	gas and petroleum refining	International stock market flotation	1991	40000
East German Cases				
Name*	**industry**	**acquirer**	**year**	**empl. 1990**
HOUSE(D)	housing construction	Swedish MNE	1991	2000
RENOVATE(D)	housing renovation	West Berlin SME	1992	330
STEEL(D)	steel products	Slovak Conglomerate	1993	2071
TYRE(D)	tyres	Japanese MNE via W. German affiliate	1995	9500
PHARMA(D)	pharmaceuticals	Italian MNE	1992	2700
POWER(D)	fossil fuel power stations	US / German consortium ***	1992	6500
ENG(D)	civil engineering	Austrian holding****	1993	6800
TURBINE(D)	gas turbines	Multinational MNE via W. German affiliate	1991	4500
GEAR(D)	gear	W. German MNE	1991	3000

Notes to table 1:
* = all names are pseudonyms to maintain anonymity.
** = minority shareholder, majority held by privatization agency.
*** = the acquired firm performed poorly, the Treuhand bought it back, yet it later went bankrupt.
**** = the investor went bankrupt in 1995 and the Treuhand bought back the company.

5. External forces

a) Country Experiences

Both Hungary and East Germany committed themselves soon after the fall of the Iron Curtain to privatize their state-owned firms by selling a large number of them to outside investor. Neither country pursued a voucher privatization, which has been the most common method of privatization elsewhere in the region [Estrin, ed. 1994, World Bank 1996]. Only Estonia relied to a comparable extent on outside investors to privatize the economy. Yet the two countries faced different political and macro-economic conditions, e.g. East German firms faced harsher competitive pressures arising from the radical opening to international trade. In consequence, the institutions responsible for the ownership-transfer had different priorities and means to manage firms under their control. This is reflected in the comparative statistics of the cases in Table 1.

Economic policies in East Germany were influenced by the objectives of quick unification, which made internal borders infeasible. Hence, the 'Treuhand' Agency took an active approach to restructuring that effectively superimposed Western norms on existing organizations. It separated businesses previously linked in a 'Kombinat', closed product lines and business units, and transferred social assets to municipalities. Consequently, the German case firms show far more radical downsizing of employment and social services, which happened largely before the foreign investors took over. At the same time, the Treuhand provided few resources for investment thus effectively postponing strategic restructuring until after privatization [Fischer et al., eds 1996, Bruckner 1997].

Thus, the severity of the initial shock has given firms little time to adjust their organization to the challenges of a market economy. By disrupting established ties, and giving priority to adapting Western structures and practices, firms were given little opportunity to develop their own innovations. Many firms thought to be viable did not survive in East Germany [Geppert and Kachel 1995, Meyer and Møller 1998, Kogut and Zander 2000].[8]

Investors in East Germany acquired generally only the core production units. Some reduced employment further, while others had negotiated a downsizing target to be implemented before they took over the firm (notably TURBINE(D) and GEAR(D)). Most firms were quasi monopolists in their respective territory before 1990, but lost most of their market share with the entry of Western businesses after unification. Most manufacturing firms among the German cases now have adopted their investor's organizational structure and management philosophy, and are integrated with their acquirers supply network, at the expense of disrupting local supply chains. They produce niche products for Germany-wide markets and increasingly for export. Most of the East German case firms achieved substantial productivity increases; and after two to four years of transformation they earn money for

[8] Spicer, McDermott and Kogut [2000] compare privatization with bankruptcy procedures, and are

their investor. Yet we found little evidence of intangible contributions to the investor's resource base in terms of e.g. technological or organizational innovations.

Hence, the particularly severe external shock in East Germany, gave enterprises little, if any, space to develop their own strategies. Foreign investors acquired firms in which the initially steps of transformation had been taken, such that, for instance, resistance to change had already been overcome.[9] Yet the resources of the acquired firms, especially capabilities embedded in teams or network relationships, had been reduced too. Growth opportunities arising from new varieties of indigenous resources appeared limited. Exceptions among our cases are discussed below.

Table 2: Comparison of German and Hungarian Experiences

Mean and standard deviation for selected variables

Variable	Full sample	German cases	Hungarian cases
Downsizing			
lay-offs in % [b]	58.0% (30.2)	76.1% (22.1)	41.8% (27.2)
socials closed in % [b]	44.6% (45.0)	80.4% (24.5)	12.5% (45.0)
diversification [a,b]	2.5 (1.0)	2.4 (1.0)	2.6 (1.1)
Strategic restructuring			
investment	36.8% (35.9)	30.4% (33.5)	42.5% (38.8)
capital stock renewal	2.04 (0.54)	2.03 (0.58)	2.05 (0.54)
supplier switching [b]	52.7% (35.0)	72.0% (29.7)	35.4% (31.0)
new products [a]	2.3 (1.3)	2.8 (1.4)	1.8 (1.1)
product upgrading [a]	2.8 (1.1)	2.9 (0.8)	2.8 (1.3)
Performance			
productivity [a]	3.5 (1.3)	3.7 (1.4)	3.4 (1.2)
productivity [a,b]	3.7 (1.2)	4.0 (1.1)	3.5 (1.2)
profit [a]	3.7 (1.3)	3.7 (1.4)	3.7 (1.3)
export, % of sales [c]	38.5% (38.0)	49.5% (36.7)	31.2% (37.0)
export, % of sales [b,c]	13.9% (27.3)	23.3% (36.3)	5.4% (12.3)
market share	35.6% (36.8)	15.5% (22.6)	53.6% (38.6)
market share [b]	-24.0% (36.4)	-43.7% (42.5)	-6.3% (18.2)

Notes: [a] = measured on a 5-point scale, [b] = measured as change 1990 to 1997, [c] = excludes construction businesses. See appendix 1 for variable definitions.

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concerned that preference has been given to selling off individual assets rather than restructuring firms.

[9] As a peculiarity of the German transition, the wholesale import of Western institutions implied that – in contrast to other East European countries – Western advisors, managers or administrators may have possessed better adapted routines than local people and organizations.

In Hungary, the shock was less severe. Consequently, we observe greater variety of ET, with both successes and failures. Many firms were taken over by foreign investors, who henceforth determine the restructuring strategy [Carlin et al. 1995, Lyles and Salk 1996, Hooley et al. 1996]. Prior research by Whitley and Csaban [1998a] among locally owned firms observed only small changes in their operations. Their Hungarian case firms show, by most criteria, a remarkable degree of continuity in terms of product mix, production technology, and markets.

Management attained considerable control over the enterprises, as the privatization agency took a more hands-off approach. Consequently, we observe more diversity of ET experiences among our case firms. Management could, but did not necessarily, take their own initiatives towards ET and find a potential investor. One consequence was that many firms, especially those still in domestic ownership have gone through an extended period of politicking, BUS(H) and GAS(H) becoming subject of major scandals. This 'organizational politicking' [Antal-Mokos 1998] involved complex interaction between multiple stakeholders concerned about their individual objectives, often of short-term nature. Often, joint objectives, such as maximizing the total value of the firm, were lost out of sight, and the politicking delayed the process thus eroding asset values and precluding some restructuring options. The locally-owned firms furthermore engaged - to varying degrees - in building networks of affiliated firms, many of which were created through spin-offs. The interdependence and high degrees of asset specificity created lock-ins in existing relationships, and made it costly to seek business opportunities with new partners [Stark 1996, Todeva 2000]. Moreover, although top management had often been replaced, the new leaders were typically promoted internally. The continuity of personnel, the continued importance of the political environment and the limited role of product market competition all contributed to continuity in management strategies and behavior.

Five of our Hungarian cases[10] were a 'staggered privatization' [Perotti and Guney 1993], i.e. the ownership was transferred in stages, starting with 30% to 51% of equity. Yet the investor typically attained management control from the beginning and full ownership two to three years later. Though registered as joint-venture, these ventures had little in common with joint-ventures described in the literature [e.g. Beamish and Killing, eds. 1997] as they were primarily a means to accomplish the acquisition.

After the acquisition, the case firms experienced fewer changes in their corporate strategy and less tight integration with the investor than their German counterparts. Restructuring strategies focussed more on investment and less on downsizing (Table 1). Many firms continue to focus on local markets, and they engaged in far less supplier switching while some, like GAS(H), continue to benefit from protected domestic markets. Foreign investors give more autonomy with respect to local marketing,

[10] PHARMA(H), ELECT(H), PACK(H), SMALL(H) and ENG(H).

while decisions over product range and production process are, as in Germany, determined jointly by the investor and local management. Two firms, SMALL(H) and ENG(H) reduced their export to focus only on the local markets. Two other firms, ELECT(H) and CHOKO(H), attained - after initial setbacks - an important role in the investor's European network, increasing their export to sales ratio by more than 25%-points.

b) Outlier analysis

Some of the firms have been subject to specific external influences beyond the control of management, which in part occurred after the set of case studies was assembled. We need to control for these when analyzing the impact of integration strategies of the foreign investors.

Two firms, CHEM(H) and GAS(H), were not privatized to a foreign investor but restructured while under control of the privatization agency and eventually floated on the stock exchange. These firms are among the best performers in the Hungarian sample, which reflects successful restructuring in the case of CHEM(H), and a mix of restructuring and politically motivated protection in the case of GAS(H). These cases suggest that successful ET was not conditional of foreign investors acquiring a firm. However, these experiences may not be generalizable.

Two companies were acquired by East European investors, a Russian consortium in the case of BUS(H) and a Slovak conglomerate undergoing privatization in the case of STEEL(D). The investors aimed at securing the continuity of a vertical link. Both firms were handicapped, as the new owners could not provide urgently needed complementary financial and managerial resources. The investors in BUS(H), one of the most prestigious Hungarian firms before 1990, could not even keep the promised secure market demand. Following a prolonged period of politicking, and difficult relations with financial institutions, the firm faces a bleak future and continues to depend on state support. STEEL(D) faced resource constraints and has radically downsized. The local management achieved a brake-even for the first time four years after the take-over, but weather its optimistic outlook would materialize was highly uncertain.

Two firms were bought back by the Treuhand agency, yet for different reasons. The acquirer of POWER(D) appeared primarily interested in market access and certain key assets, but not the operation in East Germany as such. An observer has thus described its approach as 'asset stripping'. The Treuhand intervened to protect local stakeholders, yet the firm went bankrupt in 1997. ENG(D) had an opposite experience as it was the best performing unit of an Austrian holding. When its investor went bankrupt, it was taken over by the Treuhand to be re-privatized.

The complexity of external forces makes it difficult to interpret these outliers. Three cases, BUS(H), STEEL(D) and POWER(D) suggest that resources provided by foreign investors may be crucial. On the other hand, CHEM(H) and ENG(D) suggest that restructuring with limited investor support but a high degree of autonomy is feasible for some firms if the firm has valuable resources and

a competent and entrepreneurial leadership. While only indicative, this corresponds with the evidence from firms with 'normal' foreign investors in Section 6.

6. Management Challenges

The within-country variation of ET experiences provides insights on the impact of the foreign investors and specific managerial approaches. We use both a simple quantitative analysis and a discussion of the rich qualitative detail in the cases to assess our propositions.

a) Realignment of Resources

Proposition 1a/1b proposed that downsizing and strategic restructuring, notably investment, should enhance restructuring performance. We thus regress proxies of these restructuring measures on performance. The small sample size precludes complex formal analysis, yet the substantial differences observed for German and Hungarian firms (Table 1) imply that we have to control for the country effect. We also control for firm size (i.e. pre-transition employment), and run a simple regression of the following form:

(eq. 1) $$Performance = a + b\,X + c\,SIZE + d\,D,$$

where *X* is a vector including measures of restructuring. *SIZE* controls for firm size (measured by 1990 employment) and D is a dummy controlling for country differences. Our measures of restructuring reflect both defensive and strategic restructuring, an important distinction in the transition economics literature [e.g. Ernst et al. 1995, Meyer 1998b]. We report the results of 56 regressions with seven different performance variables and eight different variables in *X*. The multiple performance variables account for weaknesses of any individual one: productivity and profitability are categorical data, and the market share and export performance in 1990 were determined by regulatory structures, some of which are still in effect. We are interested in the coefficients b's for the different independent variables, and thus report only the sign and the levels of significance for these coefficients in table 3.[11]

[11] The coefficient *d* is highly significant in most equations, while *c* is significant only in some export equations.

Table 3: Signs of regression coefficients

Dependent V / X	productivity 1997 [a]	productivity change [a]	profitability [a]	market share 1997	market share change	export [c] 1997	export [c] change
Downsizing							
lay-offs in % [b]	– **	–	– **	–	–	–	–
socials closed in % [b]	+	–	+	–	–	–	+
diversification [a, b]	–	–	–	–	+	–	–
Strategic restructuring							
investment	+ ***	+ *	+ *	+	+	–	+
capital renewal	+	+	+ *	+ **	+ **	–	–
supplier switching [b]	+	–	+	– **	+	+	+ *
new products [a]	+	+ *	+	–	–	+	+
product quality [a]	+ **	+ ****	+	+	+	+	+ **

Notes: [a] = measured on a 5-point scale, [b] = change 1990 to 1997, [c] = excludes construction businesses (n = 16). See appendix 1 for variable definitions. Significance levels: * = 10%, ** = 5%, *** = 1%, **** = 0,5%.

With a sample size of only n=20, we did not expect many effects to be highly significant, yet the results in table 3 suggest some interesting insights. To our surprise, downsizing is not associated with better performance, in fact firms that downsized in the early 1990s still experience lower productivity.[12] Firms that reduced their diversification since 1990 are, as expected, associated with better performance by most criteria, but this effect is not significant.

Strategic restructuring has a positive impact on performance, in particular on productivity and profitability. Renewal of the capital stock appears crucial to maintain or increase market share. Supplier switching occurs primarily in firms that focus on international markets, illustrating the interdependence of internationalization of sales and procurement, yet the internationalization seems to come at the expense of domestic market penetration. Upgrading of products appears more effective than adoption of new products to improve export and productivity performance.

This confirms the importance of strategic restructuring and investment (proposition 1b), while suggesting caution with respect to downsizing (proposition 1a). Among the cases, some of the heaviest investors are also the best performers, led by ELECT(H) and PACK(H) in Hungary, and PHARMA(D) and TURBINE(D) in Germany. The only case with high investment and below average performance is CHOKO(H). They invested in a greenfield site yet with-second-hand machinery and few changes in

[12] Since downsizing occurred primarily in the early years of transition, i.e. 1990-92, and performance measures were taken in 1996/97, we are confident that reverse causality (weaker performance leading to downsizing) is not the cause of the negative association).

work organization, they achieved few productivity advances. Since we have no other evidence against proposition 1b – neither in the cases nor in the literature – we focus our attention to the obstacles encountered in downsizing strategies.

At the onset of transition, many firms employed considerably more people than necessary to produce their output. This 'excess slack' has been addressed by radical downsizing. Yet, many firms seem to have taken it too far. The short-term productivity improvements failed to translate into long-term productivity advantages. Downsizing has inherent risks arising from three side-effects for which we found evidence in the cases:

- Downsizing can damage the social fabric of the organization and thus undermine employee motivation and cooperative values. In several acquisitions, the investor reduced management layers and replaced local top managers with expatriates or young, Western-trained individuals. This was resented by the local workforce, e.g. in ENG(D) and DRINK(H) where employees associated themselves with competent local managers, and their firing led to widespread de-motivation. Such acceptance problems are not unique for the transition context [Canella and Hambrick 1993].

  Moreover, lay-offs had a traumatic effect on employee morale in several firms, as East European cultures have a norm of paternalistic leaders taking responsibility for their employees beyond a purely contractual principal-agent relationship. The de-moralisation has been described, for example, by the change manager in TURBINE (D):

  > *"Some old managers were simply untenable and they had to go. Everyone knew who they were. But with every competent old manager who was sacked, the work-force just got more and more de-moralised. They associated themselves with these managers and were hence receiving the message that they too were worthless in the new system."*.

- Downsizing can lead to the loss of people, or sale of assets, that are crucial for the firm's core capabilities and resources. In fact, the very capabilities that could generate continuos improvement may be lost. For instance, top managers could take with them their knowledge of local markets and networks as well as of the organization and its technology. We observed cases where expatriate managers determined strategies, but later had to reverse their decisions: For instance, DRINK(H) eliminated its low-tier local brands against opposition from the Hungarian management who was aware of their local popularity. The investor sacked most Hungarian managers, but later re-introduced the local brands because with global brands alone they failed to achieve satisfactory market penetration.

  Also rank and file employees are valuable human capital: GEAR(D) had to re-employ experienced ex-employees when demand was less depressed than predicted. As redundancy payments are sunk

costs, this was a costly mistake. POWER(D) experienced a significant aging of the workforce as lay-off procedures (in part set by German law) protected in particular those with a long affiliation to the firm. This reduced the flexibility and dynamism of the remaining core workforce.

- Downsizing can eliminate slack below the efficient level. While most firms undoubtedly had excess slack, its complete elimination may have been counterproductive. A certain degree of slack can be an important resource for innovation [Nohria and Gulati 1996], for managerial learning [Geppert 1996] and thus for transformation. Some firms, notably in East Germany, seem to have cut the workforce to such extent that no slack remained that could become a source for new growth [see also Thomson and Millar 1999].[13] Several personnel managers and trade union representatives pointed to this problem as they complained that time-constraints inhibit training at all levels, notably in STEEL(D), POWER(D) and GEAR(D).

The crucial strategic issue in restructuring is not *how much* the firm should be downsized, but *how* downsizing helps the company to develop a coherent core competence, and *how* the lay-offs are managed. Hence, the investor should manage the downsizing process, rather than delegate it to local agents or outsiders such as the Treuhand. The leadership needs to ensure that the most productive employees and valuable intangible assets are retained while the least productive units and individuals are selected for separation.

In contrasts two case firms, TURBINE(D) and GEAR(D), requested that the Treuhand would reduce the employment prior to the acquisition. These firms ended up with some of the worst industrial relations among the cases. What explains this apparent contradiction? The answer may lie in the frequency of lawsuits following lay-offs among our German cases, notably in POWER(D) and STEEL(D). Since costs of downsizing, e.g. redundancy payments and reputation loss, are high in Germany, companies avoid taking over people in the process of an acquisition. The legal protection of employees makes it difficult to use selective downsizing as means to increase competitiveness.

We thus conclude that downsizing often undermines the resources and capabilities that long-term productivity and growth can be build upon. In theory, it may be feasible to separate from non-core assets and employees without damaging employee motivation, without loosing valuable assets and to an extent leaves a modest amount of slack to foster creativity. Yet, in practice, the focus on short-term efficiency targets contradicts many of the long-term objectives.

[13] Tan and Peng [2000] provide a formal test of slack in a transition economy and emphasize an ambiguity of theoretical predictions as slack in different types of resources has opposing effects on performance.

b) Local Sensitivity, Variety and Global Mandates

Our discussion of external factors and investor strategies so far paints a bleak picture. What, other than investment, can transform the acquired firm into a valuable business unit of the investor? In propositions 2a/2b we pointed to empowering local agents to pursue independent activities to adapt global strategies to the local environment, and to develop new capabilities for the multinational firm.

One measure for the success of post-acquisition restructuring is the extent to which acquired businesses attained 'global mandates' within the multinational corporation [Birkinshaw and Morrison 1995]. Some affiliates may be content with becoming an efficient marketing channel or an 'extended workbench' producing labor intensive goods at low costs. Yet many East European businesses possessed considerable indigenous capabilities before 1990, such that they ought not to be content with such a secondary role within the MNE network. Many of the case firms in this research were among the (technologically) best in their country before 1989. They thus ought to be capable of winning 'global mandates' within their MNE. Can we find evidence of firms developing their capabilities to become globally competitive?

Two case firms have achieved global mandates; yet even these success stories emerged only after periods of crisis and a change in the investor's strategy. The case of ELECT(H) illustrates the potential of local resources, but also the dangers of insensitive and productivity focussed restructuring. After the acquisition, the affiliate went through a major crisis during a period of downsizing. They lost market share in Western Europe and experienced serious internal conflicts that were widely debated in the national press and risked destroying some of the local assets as research was discontinued and key personnel left the firm. In 1992, an agreement was signed between the investor and the local employee representation, setting the stage for recovery and growth. The Hungarian affiliate became the core of the investor's European operation, while Hungarian research, provided with financial resources and a high degree of autonomy, presented a major product innovation. Today, ELECT(H) has a global mandate not only as a research center, but within the investor's pan-European marketing operation.

GEAR(D) achieved complete restructuring of their product range. 60% of their sales are now a specialized component for a leading car manufacturer. The company's success is based on this major contract, heavy investment in modernization of production, and comprehensive training courses for both technical staff and managers, who additionally were trained through internships in Western subsidiaries of the investor. The local management had shown its initiative in 1990 as they contacted the later investor, and took over the day-to-day operations after less than a year. The financial controller, at the time of our interviews the only Westerner in the local management team, sees the continuity of local management and sensitivity of expatriates as key to their success:

> *"Like this we maintained the internal networks intact, which are of great value. People know who can get things done, who can solve particular problems _ It is very important that West German*

managers behave in a way which is not guided by and which does not confirm stereotypes."

Two subsidiaries operate successful businesses with a high degree of autonomy and adaptation to the local context. They are build with the human capital of the acquired firm, yet benefited from access to resources provided by the investor. PACK(H) was acquired by a financial investor that provided access to financial markets but did not interfere directly into operational or strategic management. It is today a profitable business supplying wrappings for consumer goods across Central Europe, and has in the meantime been partly floated on the Budapest stock exchange. BUILD(D) benefited from know-how transfer from its new parent firm, yet the Swedish headquarters allowed their affiliate a high degree of autonomy to operate in the German market.

Among the less successful firms, insufficient adaptation to local idiosyncrasies emerges a frequent cause. The limitations arise, according to interviewees, from a lack of resources, or from a lack of sensitivity of the investor's management to the local context. Investors such as DRINK(H) and CHOKO(H) installed technology that is not best practice as they focus on low-cost labor-intensive production rather than development of local capabilities. On the other hand, non-financial resources transferred to the acquired business were, in several incidences, insufficiently adapted to the local context. We observed incidences of insufficient adaptation in several spheres of management:

- Managerial training has been designed in headquarters and thus failed to build on existing local capabilities and to address local needs (which could explain why Uhlenbruck et al. [1999] failed to find positive returns on investment in training). For instance, ENG(D)'s personnel manager reported the following incident:

  "One day we (the old management) got this letter from Austria notifying us that we should train people in the following software package. When we had a closer look at it, we realised that the package is concerned with Austrian accountancy procedures, that the training programme includes lessons on Austrian law. ... We simply refused and worked out an alternative training scheme, identified the training needs we have and where to get the training from. Our training scheme has even been adopted by other East Berlin companies in the industry. After many arguments and the demise of a particularly intolerant Austrian manager the investor finally stopped meddling with us and just let us get on with our own plans." [14]

- Marketing strategies often emphasized global brands with little adaptation to local demand, distribution structures and cultures [e.g. Schuh 2000]. Moreover, investors frequently appear unaware of the demand and local idiosyncrasies of the Hungarian market. Most dramatically,

[14] Recall that the investor went bankrupy, while ENG(D) survives and prospers.

DRINK(H) discontinued a lower quality local brand, being unaware of its brand loyalty, while investing in a production facility for a new product that failed in the market place.

- Procurement strategies failed in cases where an internal input production was closed, without considering the capabilities of alternative local suppliers. In our Hungarian (but not German) case studies companies which restructured input production by separating out internal units into independent subsidiaries tended to fare better than companies which closed them alltogether.
- Moreover, expatriate managers were slow to realize that many new forms of organizing production looked deceptively similar to old socialist ones. This led to rather cool welcome of the new management philosophy, e.g. in GEAR(D) and GAS(H). In the words of the operations manager of TURBINE(D):

> *"Formerly we had brigade work, socialist working groups and suggestion systems. Today team work and empowerment are the new ideas. How do you explain to the workforce, many of whom are fed up with the downsides of the old system, that we are not simply changing labels, that we are aiming to change the content of things? … [Our situation is similar] to 'satisfy plans from above' … [and made worse by the fact that] those people who have to motivate the workforce cannot influence many of the decisions … by the investor regarding 'our' company."*

Hence, the potential of local capabilities was realized if it was combined with resources of the investor, and local stakeholders had a substantive influence over the process. Failing to tap into knowledge and skills of local managers, investors endorsed restructuring measures and marketing strategies that did not fit the Hungarian context. On the other hand, diversity can yield promising alternatives if multiple variants are supported. Thus, *providing acquired businesses with a degree of autonomy and access to the investor's knowledge pool can increase their performance in the longer term by improving local adaptation and diversity of practices*. This corresponds with earlier findings that overdetermined organizations exhibit weaker adaptive and improvisation capabilities. However, providing an acquired business with high autonomy requires that it possesses distinct organizational and/or technological competencies, and the investor provides resources that allow experimentation and innovation.[15]

7. Conclusions

The empirical evidence suggests that very few affiliates in Eastern Europe have yet achieved global mandates [also see Marer and Mabert 1999, Lorentzen 1998]. ELECT(H), and to a lesser extent GEAR(D), are exceptions. Their success can be attributed to the realization of synergies between

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[15] These conclusions are consistent with joint-venture research in the region that suggests that joint-ventures perform best with strong resource commitment by the foreign investor and 'shared management' [Lyles and Baird 1994, Fey 1995].

resources of the local firm and those contributed by the multinational investor. Some degree of freedom helps developing local technologies and organizational forms that increase variety within the organization. Local ideas, formed in a different cultural, institutional and scientific context, can flourish and contribute to the MNE's global operations if agents driving the ideas have access to local and global knowledge pools, and the freedom to experiment.

Launching initiatives for global mandates may require a certain maturity of the affiliate [Birkinshaw and Hood 1998]. Yet if investors undermine initiative they also constrain the capability development not only of the subsidiary but also of the investor's global network. The superimposition of corporate strategies, notably of efficiency goals, risks undermining the very resources that global mandates may be build upon. Too often, we observe downsizing without a coherent long-term strategy. If undertaken under duress, it may be insufficient, if not outright damaging, for the firm's medium term prospects. Post-acquisition management thus faces a fundamental trade-off between introducing known best practice and facilitating development of indigenous resources.

Managers ought to be aware of evolutionary processes within the firm . Our case evidence suggests that acquirers tend to err in favor of their own, established business practices. They are very concerned about the evolutionary pressures facing the firm, but do not appreciate that firms 'fitness' may depend on the outcome of internal evolutionary processes. Why is it that investors systematic place too much emphasis on introducing the corporate routines to the affiliate rather than encouraging the development of new routines? Evolutionary theory provides a suggestion. Recall that selection occurs on multiple level, not just between firms, but also within firms. Different groups and individuals are competing for resources, promotion and influence. Managers benefit if their way of doing things is promoted throughout the organization as this gives them a competitive advantage. Ultimately, the natural survival instinct of expatriates leads them to emphasize established modes over new ones. If the local way of doing things was superior, it would threaten their position, and force them into retraining. Yet what is good for integration managers and expatriates is not necessarily good for the firm. It is in the interest of headquarters, and shareholders, to promote a bilateral exchange.

8. Extensions

Our evolutionary approach should be relevant beyond the transition economies. We observed environmental conditions that devalued local assets and in other ways inhibited the evolutionary dynamics that may develop local capabilities. Yet even here, we found positive examples of local contributions leading to better adaptation and to the development of new capabilities for the multinational firm. Elsewhere, the retention and enhancement of local capabilities should be even more important to generate variation within the multinational firm and to contribute to the capability base of the multinational firm.

The difference to the traditional view may lie primarily in the (implicit) assumptions made

about capabilities of the local affiliate. Integration managers (Ashkenas et al. 1998) may assume that they can identify valuable assets in the acquired operation, and presume the investors' organizational modes to be superior. Yet starting from the opposite presumption that the acquired organization has valuable capabilities embedded in its organizational norms and routines that are not immediately observable, investors should provide more autonomy and promote bilateral learning. This would ultimately enhance the knowledge base of the joint firm.

Further research should analyze in greater detail the interaction between the forces of evolution, notably competition, diversity and local adaptation within corporate networks. This includes questions of resource development and organizational learning through internal development and acquisition of new skills and capabilities, as well as trade-offs between productivity increases in the short-term, and strategies to promote development of new, indigenous capabilities in the medium and long run.

Moreover, the evolutionary approach suggests U-shaped relationships between post-acquisition performance and key strategic decision parameters, such as downsizing and autonomy of the acquired operation. Future empirical research on post-acquisition integration should provide formal test of our propositions and analyze non-linear relationships between key strategic variables.

Appendix 1: Variable definitions

Variable	Definition
Downsizing	
lay-offs in %	% of 1989 workforce laid off to lowest point since.
socials closed in %	% of the number of 1989 services discontinued.
diversification	5-point scale from to 'substantially reduced since 1990' to 'increased since 1990'.
Strategic restructuring	
investment	Total investment since 1990 as percentage of sales, last available year
capital stock renewal	Ratio of expected life time of capital stock over age of capital stock
supplier switching	% of suppliers changed since 1990
new products*	5-point scale from to 'all product are essentially the same as in 1990' to ' all products are newly introduced after 1990'
product upgrading*	5-point scale from to 'products are simpler than 1990' to 'radical improvement in product quality'
Performance	
productivity	5-point scale from to 'less than 50% of West European standards' to 'equal or above West European standards'
productivity **	5-point scale from to ' lower than before 1990' to 'radically improved since 1990'
profit	5-point scale from 'never profitable between 1994 and 1997' to 'consistently profitable 1994 to 1997'
export, ***	exports as % of sales (excludes construction businesses)
export, ** / ***	change export ratio, in %-points (excludes construction businesses)
market share	domestic market share 1997
market share **	domestic market share 1997 minus market share 1990

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