THE OTHER EUROPE

A COMPLETE GUIDE TO BUSINESS OPPORTUNITIES IN EASTERN EUROPE

CHRISTOPHER ENGHOLM

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The Other Europe

To Bernard A. Engholm

Preface

In the months following the fall of the Berlin Wall, I became increasingly awed by the human commercial energy unleashed by the opening of markets in Central-Eastern Europe and the former Soviet Union. During that time, throughout my home state of California, business groups and associations intent on profiting in the "New East" proliferated, and many of my business associates packed their bags and headed off to Warsaw, Budapest, and Prague. While attending Eastern European business conferences that seemed to spring up everywhere, I was moved by the eloquent pleas of Eastern European officials for foreign investors to come to their countries and by the commercial daring of American business people who were taking the plunge. It was then that I committed myself to chronicle firsthand what I had witnessed once already in the People's Republic of China five years before—the opening of a new megamarket.

This time, though, I would issue a clarion call in a book beckoning U.S. firms to move into the former Eastern bloc as fast as possible, since I remembered well the opportunities missed by corporate America in Asia because of a lack of initiative. Experience had also taught me that the "gold rush in Eastern Europe" would not last and that disillusionment with both the markets and the investment climates would surface as soon as foreign executives experienced the frustration and uncertainty of dealing with unempowered bureaucrats, buyers without foreign exchange, and a legal and political atmosphere that made business forecasting impossible. I recognized that many American firms might enter Eastern Europe without caution, not having learned from the past mistakes of their brethren, and get burned. I decided to write a book about our corporate pioneers in the region, who, in many cases, have found profits across the Rhine—people who had reinvented themselves to operate in transitioning economies and whose insights could help others do the same.

Time was of the essence as business suitors headed East en masse. But alas, in the course of fifteen months of research, travel in the region, and interviewing people who had started up businesses there, I found that the countries I would include grew in number from eight to twenty-five. Deadlines passed as Yugoslavia exploded and Mikhail Gorbachev braced the world for the dissolution of the U.S.S.R. into fifteen new countries. To my great surprise, corporate America did not sleepwalk through Eastern Europe's opening or turn tail and run when the going got tough. In 1992, American investment in the region topped that of all other countries, even surpassing neighboring Germany. This book is about the people responsible for this bright statistic—those out there on the front line whose experience can educate others aiming to venture into "the Other Europe."

Christopher Engholm

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Introduction

Cosmonaut Sergei K. Krikalev* had orbited planet Earth in the Mir Space Station for five months longer than planned. He thought he would never get to come home. Orbiting the Earth for 306 days starting in October 1991, he had been delayed in space because his country didn't have the money to bring him home. Finally, a German-Russian mission was sent up, funded by German private interests, to fetch Sergei back to Earth. During his 10 months in space, as the space station passed repeatedly overhead, 250 miles above Eurasia, much had happened down below.

What was Sergei Krikalev returning home to?

Earth Life had Changed

"A lot of things have happened without me," he said in a radio transmission to reporters. "I will have to restore my normal physical condition and return to normal, everyday Earth life." Indeed, he would. He had hailed from Leningrad. It was now called St. Petersburg. His return flight would touch down in Kazakhstan, which was now an independent republic, no longer a part of the Soviet Union. In fact, the Union of Soviet Socialist Republics had ceased to exist.

That wasn't all. The Cold War had ended, and the Soviet Communist party had met its demise in the aftermath of the August putsch. Yugoslavia had endured a civil war that resulted in its division into five independent states. Nationalism in Czechoslovakia threatened to divide the country into two independent republics—one controlled by Czechs, and the other by Slovaks. The members of the Warsaw Pact had dissolved their political union and their trading organization, Comecon, orienting their trade away from the East and toward the West. And market economics had come to replace state-controlled socialism for 400 million people in Eastern-Central Europe and the former Soviet Union. Moreover, the countries of what was known as "the

*Pronounced *sur'-gay kreek'-uh-lawf.*

Other Europe" were vying to become part of the European Economic Community!

Russian television announced: "Krikalev's return after almost one year's absence is like a favorite story out of Soviet science fiction, in which cosmonauts who have spent a short time in space return to Earth, where ages have gone by and everything—everything—has changed."

By radio, however, Sergei told Western reporters gathered at the once-off-limits Flight Control Center north of Moscow: "Before, the republics were united in the Union of Soviet Socialist Republics; now they join the Commonwealth of Independent States. Therefore, the changes might not be so dramatic as they appear at first glance." In reality, the changes were dramatic; after forging 53 cross-border agreements, almost none of which had been implemented, the three-month-old commonwealth was teetering like a monolithic political Humpty Dumpty, threatening to fall apart completely. Cosmonaut Krikalev was lucky to be making it home at all.

While he had floated in orbit, capitalism had taken root and grown in the East. West and East had "Come Together," as the ubiquitous Philip-Morris cigarette-advertising billboards now commanded passersby from Warsaw to Bucharest. Western advertising had been plastered grotesquely across the gray facades of former government buildings, train stations, and airports. The corporate logo of the American computer giant Digital Electronics now stood atop the spire of the Stalinesque Palace of Culture in the heart of Warsaw. The Warsaw Stock Exchange now occupied the building that once contained the headquarters of Poland's Communist Party! East and West now groped for common ground in "mutually profitable business deals."

For the West, a new market frontier (representing 430 million consumers—including the former U.S.S.R.—with half the buying power of Western Europe) had been laid open for exploration and exploitation. Over half of all the factories in Eastern Europe needed technological upgrading, and it was no secret that Eastern Europeans produced 15 percent of the world's gross national product (GNP) and that Hungary, Czechoslovakia, and Eastern Germany had a combined GNP greater than China. If current trends continued, the pundits predicted, the European market (including Eastern and Western Europe) would be bigger than the U.S. market by 1993. Moreover, the U.S. government had embarked on a concerted effort to vigorously support U.S. business activity in the region as part of its strategy to strengthen the region's embryonic democracies. Corporate America hit the ground in the New East sprinting.

In early 1991, a survey conducted jointly by *The Wall Street Journal*, Booz-Allen & Hamilton, and *Nihon Keizai Shimbun* (Japan's leading business newspaper) found that one of every three corporate CEOs in North America, Asia, and Western Europe planned "to build or buy factories in Eastern Europe during the next four years." That meant *one out of every three* CEOs around the world! A survey conducted only two years before had reported that *only one CEO out of 20* had such plans to expand into Eastern Europe. Of 1,500 American CEOs surveyed in early 1991, 35 percent of them indicated that their companies intended to initiate business ties in East Europe within 12 months, as reported in *The Wall Street Journal*. A survey conducted a few months later indicated that *67 percent* of American executives believe that the Eastern European market would become a "major world market comparable to Western Europe" within two decades.

With a speculative enthusiasm of the sort and degree that must have fueled the California gold rush, Western business declared open season on the markets of the East. When I spoke to former U.S. senator Gary Hart about the phenomenon, he compared it to the opening of the Klondike—a new frontier ripe for exploitation by enterprising traders and investors. Senator Hart had practiced what he preached: He hitched his fortunes to the region by becoming an international business-development consultant focusing on Eastern Europe and Russia. The big four U.S. accounting companies rode into the region on the coattails of their clients; not to do so would have been left in a cloud of Fortune 500 entrepreneurial dust. Nearly every multinational corporation headquartered in the United States was formulating plans to expand in the New East. Overnight, PepsiCo set up 60 bottling plants in the region. Honeywell sold $50 million worth of goods there in 1990 alone. Japanese companies ogled the region, too. Ten of Japan's largest *soga sosha* trading companies set up offices in *each* of the countries of the former Eastern bloc. While Cosmonaut Krikalev had drifted aloft, Eastern Europe had become a lava-hot landscape of commercial opportunity; and interest among international executives and entrepreneurs was growing despite sporadic social unrest and growing political uncertainty throughout the region.

Meanwhile, a new business mentality surfaced in the East—Get Rich Quick. Ex-Communist officials were among the first to learn the ways of capitalist enterprise. Like sharks, they snapped up pieces of their state-owned command economies and sold them for dollars and deutsche marks. Even Lenin's corpse was put up for sale—for foreign exchange only, mind you. A competition had begun between the newly market-oriented countries of the region. Their objective: To attract Western investment. Western-style preferential-investment laws were hastily enacted. Austerity measures were implemented and tightly enforced in order to gain favor with the International Monetary Fund (IMF) and the World Bank and thus win desperately needed development loans.

Within the investment pipeline there began a trickle, and then a flow. The numbers made the outside investment in the China market of the early 1980s look miniscule in comparison. America's trade with Eastern European countries increased 275 percent between 1987 and 1989, *before* the Berlin Wall came down. United States exports to Hungary increased 80 percent in 1991, even as recession began to squeeze the region. By the end of 1990, over 9,700 foreign ventures had been established in Poland, Hungary, and Czechoslovakia, representing over $1.2 billion in foreign investment. PlanEcon, a Washington database company, predicted that by 1993 Hungary, Czechoslovakia, and Poland would be attracting $3.5 billion a year in foreign corporate investment.

But the social costs had been staggering. Unemployment in the East had rocketed as plants shut down or were auctioned off to management or foreigners. In Poland, 1.3 million workers, and in Romania 10 percent of the working population lost their jobs. Some observers predicted that joblessness in Eastern Germany would climb to 50 percent of the working population! Inflation soared with the loss of sources of cheap energy and raw materials from the Soviet Union; it ranged from 30 percent in Poland to 316 percent in Bulgaria in the first quarter of 1991. Higher prices, loss of jobs, and curtailed welfare subsidies ripped a widening gash in social safety nets. Economic austerity measures encouraged by the IMF meant loans were withheld and interest rates were raised. Hundreds of thousands of people found themselves unable to deal with the rough transition to capitalism.

Massive new investment was needed. Western companies wanted to help, but a U.S. recession put plans on hold. Germany plowed money into Eastern Germany but had little to donate to other countries. That didn't imply, however, that German companies were not active in the New East. One could not help but overhear the incessant panicked refrain: "The Germans are everywhere!" German companies had moved with lightning speed in Eastern-Central Europe, capturing a 30–45-percent share of the markets and accounting for 26 percent of the joint-venture deals signed in the region. (The United States has signed only 11 percent of these deals; Austria has penned 25 percent.) Czechoslovakia's president, Vaclav Havel, even agreed to return to Germans their holdings in the Sudetenland (northern