

MASTERARBEIT

Titel der Masterarbeit

“Market Entry in the Energy Sector in South Eastern
Europe - The Case of EVN AG in Bulgaria and
VERBUND AG in Turkey”

Verfasst von

Dimitar Krumov

angestrebter akademischer Grad

Master of Science (MSc)

Wien, 2014

Studienkennzahl lt. Studienblatt:

A 066 914

Studienrichtung lt. Studienblatt:

Masterstudium Internationale Betriebswirtschaft

Betreuer:

ao. Univ.-Prof. Mag. Dr. Josef Windsperger

Author's Declaration

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Acknowledgement

I would like to express my gratitude to my supervisor Univ.-Prof. Dr. Josef Windsperger for the engagement and useful advices and remarks along the process of writing this thesis. Furthermore I would like to thank Mr. Markus Friedrich for introducing me to the topic as well as the support along the way. Also, I am very grateful to Mr. Werner Casagrande and Mr. Thomas Reitböck, who have willingly shared their valuable time and knowledge during the process of interviewing. I would like to thank Mr. Martin Vladimirov for the priceless comments on my work.

No words can express the gratitude to my family members. Not only that they supported me financially throughout my studies, but granted me with their unconditional love and patience. Without them I would not be the person I am now. I can only hope that I will be able to come up to their expectations in the future as well.

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Introduction and statement of the problem

With the accelerating speed of globalization and the ever more expanding borders of the European Union (EU) there is little doubt that more and more firms are seeking new markets all over the globe. Although the peak year 2007 for Mergers & Acquisitions (M&A) is already gone the global economic and financial crisis has not pulled down a lot the number of deals worldwide (Thomson Financial, 2013). This does not mean that all of them are a success story, but it indicates, that is still, and most probably will continue to be in the future a hot topic.

Although with a relatively low value in comparison to EU in general, the South Eastern Europe (SEE) is an interesting market to step on. It continues to be the poorest region in the EU – Bulgaria in particular (The World Bank, 2013). The country is still struggling with the effects of the financial crisis - growing unemployment, stagnation of the economy, political uncertainties, and the absorption of EU cohesion funds (Pop, 2013). Turkey on the other hand (a non-EU member, but a country with a big influence on it) has been lately a positive example for steady economic success. After experiencing a short economic downturn in 2008, it has been able to keep its steady GDP growth rate ever since. The land has a large population with an expanding middle class and very dynamic trade. For a number of reasons both countries caught the attention of different investors in the last decade, who invested in various sectors of the economy. The Energy, Mining and Utility sectors are in the leading positions lately (<http://www.mergermarket.com/info/>, 2013).

The energy sector is very specific and very important to each country, because it affects all other industries and the whole population. In most cases it is heavily regulated and has a strictly specific structure each country. A multinational firm (MNF), which wants to expand to a new market in the utilities sector, must prepare carefully its strategy. The literature on the topic is vast and offers a lot of information and practices how it should be carried out and what type of entry should be chosen (Shimizu, et al., 2004).

It is also essential to draw a line between theory and praxis. Using the experience EVN AG in Bulgaria and VERBUND AG in Turkey - two companies involved in the utility business with solid international exposure, a study can be conducted to show where does the theory prove to

be right and what are the factors, which play the most significant role in the decision-making in the multilayered energy sector in SEE.

The main aim of the thesis is to conduct a practice-oriented research. The first objective will be to compare and contrast different theories, using various sources in order to formulate certain hypotheses, which are to be proved in the practice. Therefore the first two chapters will compile the main ideas from theoretical point of view. The first one will be more comprehensive and will describe in detail the Mergers & Acquisitions (M&A) process. The main focus will be on the pre-merger and the merger phases, the factors, which play the most significant role on the decision-making whether a market should be entered and how this should be conducted. The second chapter will present the Joint Venture (JV) theory and its specifics. This theoretical overview will lead to the development of hypotheses, which are to be tested in the following parts (Dul & Hak, 2008).

The last two chapters will consider two cases – in Bulgaria, where EVN AG has conducted an acquisition and the JV, which VERBUND AG had formed in Turkey. The company itself will be introduced before and at the time of the deal. The energy industry, the political, economic and environment will also be described at the relevant time. The acquisition process and the relevant experiences will also take place in this part.

The thesis will end with series of conclusions based on the study so far. The experiences of the two companies will be compared with the hypotheses and with each other – where they overlap and where they differ. It will be discussed whether each one had chosen the right market entry mode and something could be performed better. The thesis will end with a conclusion and recommendations.

1. Mergers & Acquisitions – theoretical foundations.

There is a vast theoretical basis on the subject. In this section the most important aspects of the mergers and acquisitions (M&A) as a market entry strategy will be described. The main focus will be on the pre-merger and the merger phases, the factors, which play the most significant role on the decision whether a market should be entered and how this should be conducted. These theoretical foundations will serve as a starting point for the hypotheses, which will be tested in the next section by describing and analyzing the experiences of the two companies in Bulgaria and Turkey.

1.1 M&A – definition and explanation of the term

First of all, in order to prevent any inaccuracies, it should be made clear what is to be understood under the term “Mergers & Acquisitions”. The roots of the term can be traced back to the end of the 19th century during the so called “First Merger Wave”: from 1897 until 1903 (Faulkner, et al., 2012, p. 21). This wave took place in the United States and was followed by others – until the middle of the 20th century mostly there. This is why this Anglo-Saxon term is used nowadays all over the world in its original form.

Although this pair is almost always used together depicting similar processes, in the scientific literature there are differences in between the meaning of the two. But if its two parts are interpreted separately, there is a certain difference to be noticed. The process, in which two companies decide to fuse and establish one entity than rather operate on their own, is known as “Merger” (Eulerich, 2009, p. 11). This is more typical, if the firms are more or less the same size. The most distinct feature which differentiates the merger from other forms of cooperation (like the joint venture (JV), also called strategic alliances) is the legal existence of just one firm. In the practice the real mergers do not happen that often. Many deals in which one company buys another are proclaimed to be mergers so that the entity, which is acquired, does not provoke negative rumors about its stability (McClure, 2013).

Every purchase of shares or assets of a company (plant, division, the whole company) is called an “Acquisition” (Sherman, 2011 , p. 3). The shares can range everywhere from 1% to 100%. The seller usually remains separate from the buyer and operates as a subsidiary or a sub-division, preserving its legal independence, while his economic and business independence are restricted. The buyer modifies his ownership structure and exercises his managerial, economic and legal influence over the seller according to the proportion of his part (Eulerich, 2009, p. 13).

As (Dutta, et al., 2011) and other authors mention many of the acquisitions are called “mergers” to introduce the deal in a more attractive way to the markets and the general public. For the purposes of this thesis the term M&A will be used in the context of the acquisition of one entity by another – either just by shares or as a wholly-owned subsidiary (WOS). Therefore, the terms “merger”, “acquisition” and “M&A process” will be considered as synonyms.

1.2 Types of M&A

According to the strategic objectives of the firm there are three basic types of M&A: horizontal, vertical and conglomerate acquisitions. Their main characteristics are:

When the buyer and the seller of a company or parts of it are in the same field of business, this is called a horizontal acquisition (Root, 1994, p. 165). Such entities could be competitors, could have similar, if not the same products, and therefore have the same target group of clients. Common arguments for a horizontal acquisition are economies of scale and gaining market power, but by far not the only ones. In the next section the motives for M&As will be discussed in detail. These types of restructurings are often regulated by the state (Weston, et al., 1990 , p. 83). The main problem in this case is the concentration of market power in one or several firms, which could lead to monopolistic or oligopolistic structures in fields, where competition is needed. Therefore, the deal needs to gain the approval of the state structures that are responsible for the regulation. This is not typical for mergers within a single country, but there are also international regulatory structures.

The vertical acquisition is classified as a fusion between companies, which are on different stages of the production chain (Wirtz, 2003 , p. 18). The buyer becomes a supplier (Downstream-

M&A) or a client of the seller (Upstream-M&A). These types of acquisitions have several advantages for the firms, which have chosen to integrate vertically. Many transaction costs can be avoided, such as transportation, searching for the best market price, communication and coordination costs, etc. Another perceived goal might be the wish to secure deliveries to the company or its distribution. Among the disadvantages of the vertical integration are the higher fixed and administration costs (Eulerich, 2009, p. 17). Such M&A's could also draw the attention of public anti-trust authorities. For instance, if the firms from a certain sector have few suppliers and one of the major ones is acquired by one of them, this firm could later exercise price pressure on the input prices (Weston, et al., 1990 , p. 84).

The third form of M&A is the conglomerate. By this form there are acquisitions of companies, which operate in different business fields unrelated to the field of the buyer (Root, 1994, p. 165). The conglomerate firm requires therefore different managerial skills since it is involved in different industries. According to (Weston, et al., 1990 , p. 85) the three major types of conglomerates are the financial or managerial and the concentric companies.

1.3 Objectives and motives for Mergers & Acquisitions

Many authors examine the question what drives a company to engage in an undertaking, which is influenced by many factors (a lot of them external and out of the control of the firm), and risk substantial financial resources. Obviously the managers of the buying firm and the shareholders of the acquired one expect s certain benefit (Trautwein, 1990, p. 284). There are various reasons and theories for this gain – both macro-and microeconomic. They give explanations from the point of view of both the buyer's and the seller's. Since this thesis examines the market entry from the perspective of the VERBUND AG and EVN AG, namely these relevant motives of the buyer will be taken into account - (Wirtz, 2003 , p. 58) summarizes them as follows:

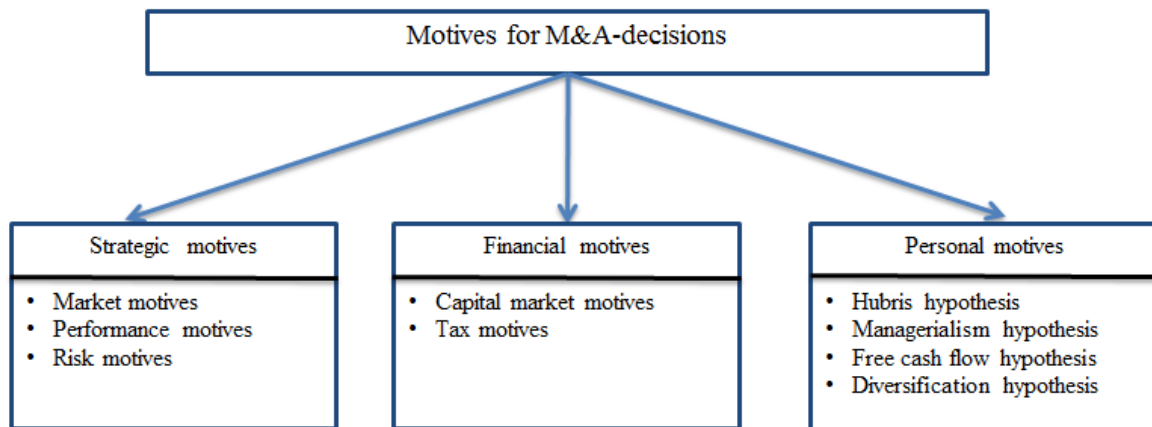


Figure 1: Buyer's motive for M&A's [source: (Wirtz, 2003, p. 58)]

1.3.1 Strategic motives

These motives represent the strategic goals of the company. There are many theories written on the subject why M&As exactly occur in the business world. Probably, the most common term that is mentioned on the topic is the word “synergy”. It means that when a firm buys and merges with another, a certain value is created over the simple sum of the two of them (Dutta, et al., 2011, p. 170). According to (Wirtz, 2003 , p. 59) the synergies that are created as a result of the mergers can be divided in three major groups. The market power synergy arises out of the growth of the market power of the new bigger company and from the decrease of the number of competitors, or from the new cross-border entry. The performance synergy is a result of the improved use of common resources. The risk synergy emerges from the different forms of diversification.

1.3.1.1 The market motives

As a starting point discussing the market motives of a firm to acquire a new company the theory of the market – based view (MBV) must be mentioned. The main idea of the theory is that the market power of the firm explains its value and its better performance over the one of the other

competitors (Makhija, 2003, p. 437). Thus, the bigger the market share of the firm, the better results it is expected to achieve. In the best case the firm would have a monopoly position. By this logic business sectors with high entry barriers are much more promising with respect to profits than industries, where new competitors can easily enter. Kathrin Bösecke summarizes in her research three major sources of market power: barriers to entry, monopoly power and bargaining power (Bösecke, 2009, p. 17). The size of the firm is often positively correlated with a higher bargaining power. When the company is a valuable client to its suppliers or has monopolistic/oligopolistic power over its customers, then it can exert pressure in eventual bargains or negotiation. This is also considered to be an important precondition for profitability and success.

Further studies on the market power problem have led as well to the development of the monopoly theory. This theory looks at the monopoly as a tool to exercise market power, but the leading position is not achieved through other factors (like the natural monopoly for example). It is secured through M&A as a rational process (Eulerich, 2009, p. 61). With the market power the company has the opportunity to set the price and the quantity of its product in a way to maximize its profits. In contrast to perfect competition, where the market equilibrium is reached, when the marginal costs (MC) are equal the marginal revenues (MR) -the price, the monopolist can set the price higher than the MC and produce an output, which is lower than in the competitive case (Jansen, 2008, p. 133).

The type the M&A is not important (horizontal, vertical or conglomerate) (Trautwein, 1990, p. 286). If a firm acquires companies from different industries, as it would be in the case of the conglomerate for instance, this can lead to a stronger support between production departments, decrease costs and result in gains of market power. Cross-subsidizing a product using profits from one successful market to fight for another could be also another way to exercise the conglomerate power (Schmidt, 1999, p. 139). As mentioned before, by vertical integration a company can put pressure on its rivals if it acquires a common supplier or distributor. Under the monopoly theory a company's stock prices should rise, when a merger is announced and drop, if it is cancelled (Trautwein, 1990, p. 286).

Last but not least, the M&As are a fast way of to extend a business into new geographic markets (Schweiger & Very, 2003, p. 8). Recently this process was aided by the opening of new markets

and deregulations. A good example for this is the European Union – one of the most important objectives, which it has, is to create a common market within its borders.

1.3.1.2 Performance motives

Along with the market motives the M&As are viewed as a way to increase the joint performance of the companies. The efficiency theory views the way to do this through different types of synergies. Trautwein distinguishes three main types: financial, operational and managerial synergies (Trautwein, 1990, p. 284).

The financial synergy is achieved in several ways. The first one is by decreasing the risk of the company's investment portfolio. If the company invests in different industries, the risk of insolvency is dispersed (Gomez & Weber, 1989, p. 43). Another proposition is that of (Weston, et al., 1990, p. 198), according to which the company saves financial costs due to de increased debt capacity. Financial costs can be also saved by establishing an internal capital market. This market would not experience such information asymmetry and allocate capital in a more efficient way (Bösecke, 2009, p. 27). Nevertheless, this idea for synergy has not been proven and has received wide criticism. Some scholars claim that on an efficient financial market such synergies cannot be possible (Trautwein, 1990, p. 284).

Operational synergy is achieved through the elimination of functions, which are common for both firms and their transfer to just one of them. Departments like Accounting, Human Resources, Research and Development seem to be among the obvious ones, which duplicate themselves (Gomez & Weber, 1989, p. 43). This effect is called "Economies of scale". These economies occur, when with the rise of the production the costs per unit falls (due to the quantity and the drop of fixed costs per unit of output). The "Economies of scope" on the other hand have a similar idea, but its definition is more difficult to be derived. The main idea is that two heterogeneous products would be produced cheaper by one firm than if they were produced by two different (Jansen, 2008, p. 135). The economies in this case come from common costs, which would be the same for both products – joint purchase, distribution or service. The unification of the manufacturing processes leads to specialization and faster, cheaper and more precise

production. Efficiency-related theories and arguments are one of the most widely approved and praised reasons for corporate acquisitions.

The main concept behind the managerial synergy is that the different companies have differently-efficient management and the M&A can improve the planning and monitoring abilities of the acquired firm (Macharzina & Wolf, 2005, p. 703). In many enterprises the know-how is a very cost intensive input factor, therefore the acquisition can be an efficient way to transfer managerial experience. The buyer might see potential for improvements in the seller's firm, of which he would like to take advantage of. For many scholars this argument seems to be implausible and without sufficient empirical proofs by the majority of mergers. It does not seem convincing that the M&A activities could be used as a sort of disciplinary measures. Otherwise the incompetent managers could be simply replaced with better ones (Weston, et al., 1990 , p. 193).

1.3.1.3 Risk motives

These motives are based on the portfolio theory by Harry M. Markowitz. According to him one can design such a portfolio, which with respect to a certain level of risk could give maximum possible expected return up to a certain frontier. A person just needs to choose stocks from negatively correlated companies in order to secure a given level of risk and to achieve stable returns (Markowitz, 1993, p. 5).

The risks can be divided into short-term and long-term (Wirtz, 2003 , p. 64). The short-term risks in the context of a firm are those, which are related to a dependency of a company on the development of a product or a line of business. These risks can be diversified through the development of a new line of business or the entry into a new branch. This can be easily and quickly accomplished through M&A of a company, whose income is negatively correlated with the one of the acquiring company. For example if an oil company acquires an airline – when the prices of oil are high the oil company will benefit at the expense of the cash-flow of the airline and vice versa.

The long-term risks could be hedged through cross-border entry on developing markets with high growth potential (Lucks & Meckl, 2002, p. 9). The other opportunity would be to get rid of firms

in poorly performing markets. That way the effects of a domestic market in stagnation could be avoided. Diversification could be achieved also through internal growth. But if the firm lacks the excess capacity, the experience or does not have the time to choose this path, the M&As are a promising opportunity. It is another question, though, how well the management involved in one industry can be efficient in another.

1.3.2 Financial motives

Apart from the strategic motives mentioned so far, there could be also another type of incentives. Behind the objectives of a company to acquire another firm could stand purely financial motives. There are two major types – the first ones are the financial market motives and the other ones are the tax considerations.

1.3.2.1 Capital market motives

It was already mentioned above that part of the performance motives for M&As are the financial synergies that could arise out of them. The merger of two companies can improve the fund-raising ability of the enterprise. It is the result of broadening the credit and the capital basis of the merged company (Wirtz, 2003 , p. 65). This is valid for both the liabilities and the equity. The fusion can also help the firm reach new investors, since its new larger size will meet the requirements of large-scale investors.

Another aspect of the question is the undervaluation and the restructuring of the enterprise, which is to be acquired. The valuation theory postulates that the M&As are a result of the belief of some investors that they have superior information for the true value of the firm, which is above its total market value (Weston, et al., 1990 , p. 252). The asymmetry can result in a stock price lower than the book value or the historical costs (DePamphilis, 2012, p. 11). The q-ratio is one of the instruments, which measure the undervaluation of the firm: it is defined as the ratio of the market value of the stocks divided by the replacement costs of its assets. If this ratio is less than one, it

means the firm's stocks are undervalued. The lower the q-ratio is, the more undervalued the firm is.

1.3.2.2 Tax motives

The acquiring company might also aim tax benefits from the M&A process. The tax hypothesis states that a transfer from the treasury to the shareholders of the buyer is possible (Eulerich, 2009, p. 67). When the acquirer buys a firm with accumulated losses from past periods, it can use them to offset future profits. The taxes due can be decreased by eventual unused tax credits by the target enterprise. The amortizations of assets or hidden reserves are also a source of tax benefits. Differences in the taxation rates in different countries should also be taken into account. The buyer could transfer part of the income of the combined company to the country of its subsidiary, if there is an arbitrage opportunity there.

Another important source of gains is the taxable nature of the transaction (DePamphilis, 2012, p. 12). The seller might not be willing to conclude an agreement, if the transaction is not tax-free. Otherwise he just might require a higher price for the firm to compensate for the liability.

1.3.3 Personal motives

There are a number of investment incentives, which do not have purely economic motives. They arise, when a large company is not managed by the owners, but from external agents. These are the so called agency problems. In this section four major types will be discussed.

1.3.3.1 Hubris hypothesis

The hubris hypothesis was introduced by Richard Roll (1986) and it offers an explanation why a big part of the M&As fail. The word "hubris" is generally explained as: "exaggerated pride or self-confidence" (Merriam-Webster, 2013). According to the theory of the efficient markets the

price of a company's assets is formed by taking into account the whole available information about it. The hubris hypothesis is also based on the presumption of the efficiency of the markets. Therefore, a manager should not pay more for a company than this price. Yet in the real world this is not the case. Many firms are ready to pay a premium for the purchase of another one. Roll's explanation why the decision-makers pay too much for their targets is the overconfidence and over-optimism in their own abilities to derive synergies in the post-merger integration (Roll, 1986, p. 199). It is also questionable how rational an individual can be in conditions of uncertainty.

A quite recent study presented by Bogan and Just (2009) stresses on the difference in the decision making between executives and non-executives. The main goal in the paper is to test a conformation bias. The results suggest that executives take to review less pages of information and are less likely to change their decision after reviewing new information (Bogan & Just, 2009, p. 942). The majority of managers tend to fully ignore important information such as the integration costs. A possible explanation could also be the search costs. Nevertheless, the overconfidence can lead to misguided acquisition strategy.

1.3.3.2 Managerialism hypothesis

The managerialism explains the M&As as processes driven by the selfishness of the decision makers, who strive after more prestige, influence and higher pays. The basis, on which this hypothesis was first built by Mueller (1969), was that: "managers maximize, or at least pursue as one of their goals, the growth in physical size of their corporation rather than its profits or stockholder welfare" (Mueller, 1969, p. 644). The managers of big companies are put constantly under pressure to sustain earnings' growth in order to keep the price of the shares sufficiently high. As the enterprise grows, they are forced to make larger investments to support this value, because smaller acquisition would not have the same impact on earnings (DePamphilis, 2012, p. 11). The managerialism hypothesis could not receive an empirical support, since Lewell and Huntsman came to the results, that the manager's compensation is positively related to the firm's profit and not to its size (Wirtz, 2003, p. 70).

1.3.3.3 Free cash flow hypothesis

The hypothesis, which is related in some extent to the managerialism hypothesis, was developed by Michael Jensen, who defines the free cash flow as: “cash flow in excess of that required to fund all projects that have positive net present values when discounted at the relevant cost of capital” (Jensen, 1986, p. 323). The hypothesis is based on the presumption that with the growth of the resources of the company the influence of the manager expands. The chances for promotion of the middle management also rise. Therefore, the decision makers on high and middle positions are interested in the investment of the excess cash as a way to induce further growth of the company and to secure their influence. The shareholders are on the other hand interested in these cash flows and would like to receive them in the form of dividend payment. This also maximizes the share price. In order to receive control over these means, the managers, according to Jensen, are ready to issue new debt (stocks). This is a way to “promise” that they will pay out these cash flows more effectively in the future (Weston, et al., 1990 , p. 205).

1.3.3.4 Diversification hypothesis

This hypothesis was introduced by Jensen und Meckling (1976). It mixes elements from other different theories like the theory of property rights, agency theories and theory of finance (Jensen & Meckling, 1976 , p. 305). Unlike the composition of a stock portfolio, the managers cannot diversify that easy their human capital resources. They are dependent on their personnel, which is considered to be the most valuable asset in a company. Therefore, the managers try to acquire firms from different levels of industries in order to smooth indirectly the income from human capital. These types of acquisitions do not always correspond to the interests of the owners of the enterprise.

In summary, there are various motives and strategic objectives behind the decision of a company to undertake an M&A. It is rarely that there is just a single reason behind this process. Moreover

the motives themselves often merge into and complement one another. According to a study of Nguyen, Yung and Sun 80% of the sampled acquirers have multiple merger reasons. The coexistence of both value-increasing and value-decreasing motives is also common (Nguyen, et al., 2012, p. 1373). It should be noted that different types of M&As (vertical, horizontal or conglomerate) pursue different objectives (Walter & Barney, 1990, p. 84). Additional factors like culture, institutional differences, experience and others play a crucial role over the strategic intentions of an entity. They are to be discussed in the next section.

1.4 Factors influencing a successful cross-border M&A

The market entry through M&A process is not a spontaneous event, or at least it should not be. The successful implementation requires a careful and diligent planning. This creates the necessity for a number of factors to be taken into account – both external and internal. In this section of the thesis the main factors will be examined in two major groups: the firm-level and the country-level ones.

1.4.1 Firm-level factors

Achieving a merger success depends on number of factors. Some of them are in control of the company and can be directly influenced and mastered by it or they simply depend on the characteristic features of the enterprise. These are the so called firm-level factors.

1.4.1.1 Strategic vision and fit

In the section above a number of management incentives were mentioned which vary in their motives. Before an acquisition the firm must answer the important questions like what are the goals that it strives to achieve with this process, and whether it has the resources and the

competence for them. The strategic vision and the rationale behind the M&A should be clarified. Whether it is to enter new markets, to consolidate market power within a certain domain, in terms of products, know-how or human resources, the company should always harmonize the acquisition with its overall strategy (Duncan & Mtar, 2006, p. 398). In the cross-border acquisitions the buyer should also take into account various factors, which are not in control of the entity. The M&A does not end with the conclusion of the deal. A post-merger integration plan and policy is no less important than the merger itself. The decision-makers in both firms must analyze and unify their strategic fit in order to take advantage of the synergy possibilities that are expected to emerge (Epstein, 2005, p. 39).

A very famous example for merger difficulties, due to the unclear strategic fit, is the Daimler-Chrysler deal. The M&A was intended to increase the market share. Both companies could benefit from cohesion on different levels – parts, R&D, management, technologies. Nevertheless, there was corporate and national clash of cultures. Both firms had a long and rich history. The deal was not seen as merger of equals by the Chrysler employees, but rather as a ruthless invasion into their established practices (The Economist, 2000). There were also technical differences – in order to use cost synergies the two branches of the company needed to co-ordinate the development and production of their new models, so that they would be released at the same time, for example. At the end the deal the M&A could not deliver the desired goals and the share price of the new company fell below the prices of the separate ones.

According to a study published in 2002 by Harzing, the corporate strategy influences the choice of acquisition as an entry mode along with other factors. The author based her research on the institutional theory and defined corporate strategy as an independent variable. After the analysis of firms from different industries she concluded that firms, which pursue a multidomestic strategy, tend to prefer the acquisition as a market entry strategy. (Harzing, 2002, p. 222). The multidomestic companies concentrate on using firm-specific-advantages. This makes them more adaptable to the business and political environment typical for a certain country.

1.4.1.2 Previous acquisition experience

The experience of a company in the field of M&As according to numerous studies is undoubtedly a relevant factor. Many studies confirm the importance of competence building, which is a result of the exposition of the firm to different circumstances, problems and gained experience. Hitt et al. (1998) found that two thirds of “the acquiring firm or both the acquiring and target firms had considerable experience in implementing change in the years prior to the acquisition. As a result these firms were more flexible with developed adaptation skills.” (Hitt, et al., 1998, p. 100). The practical background of a company in the M&A processes allows it to choose more carefully its acquisition targets and conduct more successful negotiations. The paid premium also tends to be smaller in these cases. Very & Schweiger (2001) stress on the importance of taking a different approach, when a company plans to acquire an entity in another country. The lack of knowledge of the specific country must not be neglected (Very & Schweiger, 2001, p. 27).

Haleblian & Finkelstein (1999) suggest that the learning process is not linear, but is rather U-shaped. Inexperienced companies might generalize their experience after conducting one or two successful acquisitions and use the same routine in their next deals, although there might be some or even sufficient dissimilarities (Haleblian & Finkelstein, 1999, p. 29). This could be due to an over-confidence, which results in less-careful evaluation of the target and higher premium paid for the M&A. The behavioral learning theory also explains why more experienced acquirers go through each deal differently. Therefore, learning from the experience is very important. Conn et al. (2004) find strong support that multiple acquirers perform better than single acquirers. They also suggest that if the first acquisition was not successful, then an improvement in performance followed. On the other hand after a first successful acquisition the managers tend to result in a negative bid order (Conn, et al., 2004).

Yet what is the implication of the international experience on the choice of market entry in general? In a recent study Kuo et al. (2012) confirm the hypothesis that high control entry modes are preferred, when the company already has such experience. Internationally inexperienced firms are more inclined to choose joint ventures (Kuo, et al., 2012, p. 258). Haleblian et al.

(2006) also suggest that a successful cross-border acquisition will subsequently encourage the firm to conduct others later (Haleblian, et al., 2006 , p. 357).

1.4.1.3 The acquirer's competitive advantages

The Transaction cost (TC) theory considers the proprietary assets owned by the firm as a further important factor influencing the choice of the entry mode of the firm. These assets are mostly specific for the company – brand name, know-how, products, technologies, marketing and organization skills, etc. (Chen & Hu, 2002, p. 194) . In the conditions of an imperfect market these assets cannot be transferred very easy, especially if they are intangible – since the knowledge is essential for many investing firms, the uncertainties regarding the demand could make the transfer very costly. The imperfect markets create the transaction costs, because it is not possible to create a contract, which will cover all possible situations. It would be also difficult to enforce its conditions at all times, because the agents could cheat (Hennart, 2010 , p. 262). According to the TC-based logic the firm should choose an entry mode, which will transfer in the cheapest and most appropriate way when entering a new market. In a study conducted for China, as being one of the world magnets for foreign investments, Chen & Hu find strong support for their prediction that foreign firms are much more likely to choose a high control entry mode over contractual and equity joint ventures for the transfer of their specific proprietary assets (Chen & Hu, 2002, p. 206). Similar results had been also found by Delois & Beamish (1999). As the TC theory suggests “greater degree of proprietary content in marketing and technological assets both lead to higher ownership rights” (Delois & Beamish, 1999, p. 924).

As far as the protection of competitive advantages goes, some scholars suggest that the acquisition might not be the best choice. Brouthers & Brouthers (2000) have developed a model of diversification mode choice. They have analyzed a sample of Japanese companies entering Western Europe and claim that high-tech firms would prefer *greenfield* start-up ventures over an acquisition. The reason is that training the acquired employees might be much more difficult, expensive and even unsuccessful in the end. Transferring your own trained personnel to the foreign subsidiary might prove to be more beneficial (Brouthers & Brouthers, 2000, p. 95).

Furthermore Hennart & Park (1993) have found evidences that the companies with strong competitive advantages prefer to set up a new venture in their cross-border expansions rather than the acquisition of a local firm. This is an easier way to transfer your own technological advantages. Nevertheless if a faster entry is needed, the demand is growing slowly or is even decreasing, the acquisitions have an advantage (Hennart & Park, 1993, p. 1068).

1.4.2 Country-level factors

As a participant on the market, the firm is exposed to a number of external factors, which are not in its control. The uncertainties are increased even more when the firm is involved in international business operations. The influence of some major country-level factors will be discussed in the following section.

1.4.2.1 Cultural distance (CD)

There are many important issues that must be considered by the top management, when a M&A is being discussed. A lot of them concern the choice of the acquisition object, its evaluation, pre-deal management, the acquisition itself, etc. Very few are the companies, which have a structured post-deal integration plan, which takes into account the ability to integrate human resources from a different country successfully. The problem has been examined by a number of scholars and the consistent view is that a high level of cultural distance could ruin the success of M&As (Shimizu, et al., 2004, p. 321). There are different definitions for the term “culture”. For the purposes of this thesis the following definition will be taken: “The cultural distance between two nations reflects existing differences in certain values, norms and behavioral rules between them” (López-Duarte & Vidal-Suárez, 2013, p. 2253). The reason why this is such an issue at all, as already mentioned, is that the each company consists of people, who interact with each other and with employees from other entities, and are all culture-bearers. In cross-border M&A different organizational and cultural concepts collide. The main problems arise out of the unwillingness for change in the working methods, the feeling of threat to the ones in higher position in the firm and the national

pride (Faulkner, et al., 2012, p. 408). Therefore, the cultural distance could be seen as a further variable in the country risk assessment for the investors. It is also important for the degree, to which the comparative advantages of the acquirer can be applied in the acquired company.

There are different methods for measuring the CD – Schwartz's and GLOBE's approach for example have been developed in the last 15 years. Yet one of the most used in research is the Hofstede's approach (1980). There are four basic dimensions, which characterize the country's culture specifics. They are labeled as Power Distance, Uncertainty Avoidance, Individualism and Masculinity (Hofstede, 1980, p. 22ff.):

- Power distance - depicts the inequality in societies and organizations and the extent to which the members on lower levels of the hierarchy accept the higher authorities. In societies with low power distance the people demand equal rights and distribution of power between its members. In societies with high power distance there is a strict hierarchy, which does not need to be justified;
- Uncertainty avoidance – shows how comfortable people in a certain culture are with possible unknown situations. Countries with low uncertainty avoidance are more practice-oriented and others with stronger uncertainty avoidance prefer sticking to principles;
- Individualism – describes the dominating orientation of the individual towards the society – individualistic or collectivistic;
- Masculinity – in countries with high masculinity orientation personal qualities like competitiveness, ambition, success, performance and wealth are valued. In more feminine societies the focus is on social performance, cooperation, and modesty;

The influence of the cultural distance as a variable by itself in the entry mode choice and its role in the M&As in particular is rather ambiguous. Ahern et al. (2012) find strong support that specific dimension of national culture – trust, hierarchy and individualism, exercise ascendancy over the volume and synergy gains of the acquisition. If the cultural distance is high between the countries, the companies tend to embark on smaller-scale mergers and make lower profits (Ahern, et al., 2012, p. 19). Tseng & Lee (2010) found support for the hypothesis that the JVs are preferred over the WOS, when there are significant cultural differences. The reason for this is that

the acquired firm might feel threatened by the buyer and the exchange of information between the two cultures, when they are partners (Tseng & Lee, 2010, p. 413). Lopez-Duarte & Vidal-Suárez (2012) stress on the results that CD does not always affect the choice of entry by itself, but it exercises influence in combination with the political risk. Language distance is much more important for investors and when it exists, they prefer not to collaborate with a partner (López-Duarte & Vidal-Suárez, 2013, p. 2258). Morschett et al. (2010) also did not find evidence for the unambiguous influence of the CD over the choice of investment mode (Morschett, et al., 2010, p. 67).

1.4.2.2 The institutional factor

The institutional theory can be traced back to the 19th century and combines different sciences like sociology, political science and economics. It emphasizes the importance of external factors on the decisions and the behavior in a company. These factors have different dimensions: political, cognitive and sociological (Huang & Sternquist, 2007, p. 615). In this sub section the thesis will focus on the institutions in the sense of political stability, institutional stability, the legal framework and regulations. The reason this factor is discussed is that it is proven many times that it can be decisive in a number of international projects.

On a broader basis the political stability reflects the likelihood of “...unfavorable change in the governmental regime of a country or in the policies issued by this regime” (Slangen & van Tulder, 2009, p. 279). This likelihood is positively correlated with the estimation of the political risk in a region or a country. It is usually the government in a country that sets the course of the policy. Usually it strives to encourage the economy in different ways, but sometimes its measures might influence it in a negative way the business of multinational companies (MNEs). Al Khattab et al. (2007) summarize the political threats in three major groups according to their source:

Source of threat	Threats (source of harm)
Host-government	➤ Expropriation and/or confiscation ➤ Contract repudiation ➤ Currency inconvertibility ➤ Ownership and/or personnel restrictions ➤ Taxation restrictions ➤ Import and/or export restrictions
Host-society	➤ Terrorism ➤ Demonstrations, riots and insurrection ➤ Revolutions, coups d'état and civil wars
Interstate	➤ Wars ➤ Economic sanctions

Table 1: Classification of political risk according to its source [source: (Al Khattab et al., 2007, p. 735)]

The political insurance agencies could hedge some of the risks mentioned above, but not all of them. They offer the coverage of assets in cases of expropriation, currency inconvertibility, contract repudiation and confiscation. Other risks resulting from government characteristics and not from its decisions remain uninsured – racial policies, taxation and ownership restrictions (Al Khattab, et al., 2007, p. 736).

The institutions are on the next step under the government as a tool to implement the policies, the laws and the regulations, which had been passed by the politicians. Therefore the term “public institutions” can be defined as: “... attributes of legislation, regulation, and legal systems that condition freedom of transacting, security of property rights, and transparency of government and legal processes...” (Slangen & van Tulder, 2009, p. 279). The institutional factor can be a much more sensitive variable in transition economies, which are known to be turbulent in both political and economic sense. This increases the unpredictability and the volatility of the decision makers. The security of the property rights is a key issue in this problematic, but this significance is derived by a great extent from the TC theory. Firms with high specificity of the assets demand higher level of ownership. If we put this the way around, firms in high-technology sectors demand security for their assets, when they are to be transferred to another market. As it was

already mentioned the know-how in its different forms (patents, managerial experience, technologies, etc.) is one of the main comparative advantages for many firms, especially when the assets are proprietary and specific (Delois & Beamish, 1999, p. 917). This leads to the logical conclusion that the higher the external risk, the higher the cost of a firm would be to transfer, monitor and guard these advantages. The amount of the costs can influence in a negative way the willingness of a company to engage in a cross-border market entry and expansion behavior (Brouthers, 2002, p. 205).

Legal regulations are the expression of the will of the legislative power and the ground, on which the institution exercise their regulative functions. The legal framework and its forcing are even considered by some authors to be strongest environmental factor faced by the company. The rule of law could also have a twofold effect on the business environment in a country. On one hand it establishes certain rules of the game and protects the participants by reducing the risks, but on the other could raise the barriers for new entrants (Huang & Sternquist, 2007, p. 616). Usually the more important one industry for the state and the government is, the heavier the regulations and the entry barriers are being imposed – the energy industry and utility business are typical examples.

A distinct example for a company, which has suffered the consequences of political volatility and the lack of respect for property rights and the rule of the law, is the experience of Royal Dutch Shell in Russia. Shell and its Japanese partners gained the right from the desperate at that time for foreign investments Kremlin in 1994 to exploit the rich in oil and gas Sakhalin fields. The Shell-led consortium negotiated the term that it would start to pay the state for exploitation rights after the full capital costs have been recovered (Green, 2007). In 2006, when the prices of oil and gas started to rise significantly, this was not to president Putin's taste anymore, who needed the income for the state budget and control over additional fields since Russia was becoming a key supplier of natural gas for Europe. After several months of pressure from different ministries and threats over environmental violations, the Royal Dutch Shell was forced to reduce its share in the project from 55% to 25% and by selling the difference to the state-owned energy group Gazprom (Macalister & Parfitt, 2006).

There are several implications to be made. The first one is that the unpredictability of the institutional environment is more likely to force the company to choose a share ownership structure for the company in the host market rather than a WOS (Tseng & Lee, 2010, p. 413). This way the entrant is sharing the risk with a local player, who is more familiar with the rules of the game and can serve as an intermediary with the local institutions and government. The M&As are also not considered to be a very appropriate way of entry for countries with high legal restrictions (Brouthers, 2002, p. 213). On the other hand the contrary hypothesis has been confirmed by Dikova & van Witteloostuijn (2007) – the acquisitions are positively associated with a greater institutional advancement (Dikova & van Witteloostuijn, 2007, p. 1029). Higher ownership levels are preferred also in countries with high degree of intellectual property protection (Delois & Beamish, 1999, p. 926).

1.4.2.3 Market potential and conditions

The host market is the environment, in which a firm will be operating after implementing the cross-border M&A strategy. The assessment of this factor is almost obligatory, if the acquiring firm wants to develop its business successfully in the country. There are several indicators, which describe the market attractiveness.

The market size influences the investment decision of a firm. A larger size indicates a bigger potential and enhances resource commitment in the new market. If the decision to enter into a new country is based on profit expectations, which in broad terms are the difference between the revenues and the costs, then a larger size is associated with greater development opportunities and access to a larger number of potential clients and presuming a larger income. The risk potential of growing markets is considered to be lower than the one in shrinking markets or such in stagnation. The fixed costs of internalization can also be distributed on a broader basis (Chen & Hu, 2002, p. 196).

The growth rate of the market is proposed as another indicator for the attractiveness of the market (Hennart & Park, 1993, p. 1058). In such cases the firms usually prefer a fast market entry mode. Buying an existing local entity is considered to be a good choice, when the momentum of the demand is to be grabbed. The M&A allows quick access to local assets and experience. Other authors like Morschett et al. (2010) emphasize on the importance of the speed of knowledge building as an important component of the entering of fast growing markets. They describe the knowledge transfer after an acquisition as slower and somewhat problematic due to a potential lack of willingness for cooperation by the local subsidiary. A joint venture might prove to be faster and with lower opportunity costs (Morschett, et al., 2010, p. 62). In this sense the cultural distance and the market potential are two risk determinants, which equilibrate each other. A country with a great cultural distance might still be attractive to the investing company, if it anticipates adequate returns for the risk taken. In a recent study conducted among export managers, the market attractiveness was ranked as a leading factor (Malhotra & Sivakumar, 2011, p. 605).

The speed of entry is especially important in developing economies, which offer higher returns on the investment as a compensation for the higher risk induced by the more unstable and riskier environment. Being among the first movers to such market the buyer company can establish certain standards, which can serve as a barrier to other competitors. The gathered information and experiences from the host market is a further advantage. It also has the chance to seize a larger share of the market and gain the trust of the local customers. On the other hand some researchers write in support of the argument that it might be better to be not the first, but among the first foreign entrants in a new market in order to analyze the mistakes of the your competitors and to prepare themselves more carefully for the possible setbacks (Calantone, et al., 2010, p. 833).

The analysis of the economic environment in the target country can include various variables. They have to be considered on both short-term and long-term basis. There has to be made a distinction between such harming the value creation just in the short run and others with a prolonged influence. This is important for the evaluation of the M&A – in a weak economy, for instance, a strong merger might look as a worse deal from the perspective of the stock markets, if its value is less than a poor acquisition in another stronger market (Epstein, 2005, p. 41).

There seems to be no unambiguous answer whether the acquisitions are a good choice for big and fast growing markets or not. Nevertheless, most researches tend to promote this view. Morschett et al. (2010) could not prove the statement that M&As are preferred for large markets. He used data from the China as a host market. On the other hand Chen & Hu (2002) found support for his hypothesis using the same country as a research field. They also claim that "... high control entry mode is more efficient for multinationals to enter into industrial sectors with high potential" (Chen & Hu, 2002, p. 196). According to Hennart & Reddy (1997) the acquisition is preferred in rapid growing markets.

2. The Joint Venture – major characteristics and issues

This is the other market entry mode, which was used by one of the two companies. Although there are many similarities between the joint venture and the acquisition in terms of strategic, financial and managerial goals perceived by them, there are also some significant differences. In the next section the paper will focus mainly just on the specifics of the joint venture, which distinguish it from the M&As.

2.1 Joint Ventures – definition and types

There are different definitions for the term JV depending on the form of the relationship between the companies, which form it. In general terms this is a strategic alliance established by the equity and resources of two or more other entities. These two economically and legally independent parties continue to function separately. The new venture is also legally separate and semi-autonomous company (Weston, et al., 1990 , p. 349). A very important difference between the legal type of the entity and its equity structure is to be made. The term joint venture describes the purpose of the entity and the origin of its equity. At the same time the legal form of these strategic alliances can differ from firm to firm – Limited (Ltd.) or other juridical form (Trost, 2011, p. 5).

A distinction must be made between the different types of JVs according to their different dimensions. As already mentioned the more typical strategic alliance is founded by equity capital from at least two other companies – these are the so called “equity joint ventures”. Each partner provides a certain percentage. It is not necessary to be exactly 50/50 %, the proportion could be different – 30/70%, 60/40%, etc. (Trost, 2011, p. 4). The other major type is the “contractual” or “cooperative” joint venture. In this case there is no establishment of a new legally and economically separate entity. Its purpose is more or less used for the purposes of a single project between two firms, which consign the needed resources (Jansen, 2008, p. 179). This project could be a joint marketing campaign, product development and is finite.

With regard to spatial dimensions the JVs can be international or domestic, depending on whether both partners are from the same country or not. Some of them are limited in time – when there is a special purpose for the cooperation. In other cases the strategic alliance might be indefinitely formed and be just the first step to a merger or a withdrawal from a market. The other two dimensions, which define the JV, are the functional dimensions – the field of the cooperation, and the dimension of economic relationship (Eisele, 1995, p. 18). The following table summarizes the different classifications:

Dimension	Joint Venture Form				
Functional	R&D	Procurement	Production	Marketing and Distribution	Other Services
	More than one function				
Temporal	Temporary		Prolonged		
Spatial	Domestic		International		
Economic relationship	Horizontal	Vertical		Conglomerate	
Contractual	Equity		Contractual		

Table 2: Dimensions of Joint Ventures [source: Eisele, (1995), p.18]

The thesis will focus only on the international equity joint venture (IJV) with at least one of the headquarters outside the host country. The term “strategic alliance” or just “alliance” will be used as a synonym.

2.2 Motives for Joint Ventures

Many of the motives to choose an IJV as a market entry mode are similar or the same as the ones mentioned in the M&A chapter. The reason for this are the general incentives of the firms to undertake a cross-border market entry at all – like the personal motives of the managers to some extent, or the synergy motives. Weston et al. (1990) summarize the general reasons in seven main points as follows:

Major motives for JVs:
1) To augment insufficient financial or technical ability to enter a particular line of business 2) To share technology and/or generic management skills in organization, planning, and control 3) To diversify risk 4) To obtain distribution channels or raw materials supply 5) To achieve economies of scale 6) To extend activities with smaller investment than if done independently 7) To take advantage of favorable tax treatment or political incentives (particularly in foreign ventures)

Table 3: Rationales for Joint Ventures [source: Weston et al., (1990), p.334]

2.2.1 Knowledge transfer

There is sufficient theoretical evidence that the dominant reason for establishing alliances is the knowledge transfer from the local partner – according to Berg et al. (1982) this was the expressed leading motive in around 50% of the examined cases. It is how the market entry of foreign firms on Asian markets in the 1990's is being explained with almost 250 000 JVs and a volume of 100 billion USD just in China (at the end of the 1990's) (Jansen, 2008, p. 181). The TC theory explains this in a very logic way. When a company enters a new country for the first time it is very possible that the local conditions and ways of doing business will be unfamiliar to it. The acquisition of this knowledge is related with certain costs, which, depending on the cultural, institutional and economical distances, might be quite high. It would also be more time consuming for the new entrant to gain it by itself. Attracting a local partner would logically reduce these costs, speed up the process and help the entrant to transfer its assets, among which know-how, on the local market (Hennart, 1991, p. 485).

2.2.2. Resource sharing

The resource based view (RBV) regards the establishment of a strategic alliance as way to help companies exchange technological and/or managerial resources. Different companies possess diverse competitive advantages. This way there are opportunities to achieve economies of scale and further synergies. According to Das & Teng (2000) the JVs are the result of “resource integration among firms” (Das & Teng, 2000, p. 34). A good example is the GM-Toyota alliance, which were the founders of NUMMI Inc. in 1984 in the USA. Both big car producers hoped to benefit from the partnership. GM aimed to gain experience in the advanced technology of building small and high-quality vehicles and management techniques for cost reduction. Toyota, on the other side, hoped to acquire information on how to operate best in the conditions of the USA car market and production, dealing with labor, suppliers and contractors (Jansen, 2008, p. 183).

2.2.3 Risk sharing

Another main motive for JVs is to diversify and mitigate the risks associated with the project. The risks could have different origin - political, financial, systematic, cultural, legal etc. The main role of the local partner will be to provide specialized knowledge for the environment, but not only. In business, where high technology is used and the profits are not sure, the JVs are something natural. In the oil industry it is sometimes common for two firms to build an alliance for the exploration of potential oil fields, sharing technology, capital, management and labor (Eisele, 1995, p. 26). Companies share expenses and restrict the liability in case of bankruptcy and debts only to the extent of the assets of the newly formed entity.

2.2.4 Legitimacy

In the environment of the emerging and developing economies the volatility is high – especially in political and economic sense. Institutional theory postulates that institutions in a country influence the decisions of the firm in a non-economic way. Foreign firms need legitimacy in

order to be able to operate freely on the host market. Building an alliance with an already legitimate firm can substantially decrease the time and the costs to do it (Ang & Michailova, 2008, p. 554). Undertaking an M&A or establishing a greenfield entity could be seen as an aggressive way to enter the market by the local authorities. The MNE could become a subject of a discrimination policy (taxed with higher rates, for instance) (Yan & Luo, 2001, p. 7). An IJV, where at least one of the partners is from the host country might have a more positive image – the entrant would not be seen as a colonizer, whose goals are to gain profits and transfer them abroad. Most countries have, therefore, some kind of investment law, which regulates the size, the industrial sectors and the procedures of the investments of foreign companies.

2.2.5 Other advantages

Nevertheless, the influence of the institutions and the government can also be positive and non-oppressive. The foreign investments contribute to the GDP and reputation of the country and it is normal and logical, that most of them try to attract foreign investors. There are different types of incentives – government guarantees, customs duty exemptions, subsidies, exemption of IJVs from certain unfavorable laws, etc. (Gutterman, 2002 , p. 92). A very significant motive for strategic alliances is the favorable tax policy. If the one party has the intangible assets, the other can offer depreciable facilities. The annual depreciation lowers the taxable income and increases the actual profit of the entity (Weston, et al., 1990 , p. 333). Another incentive is the so called “tax holiday”, which exempts the company from certain taxes for a specified period of time. There are countries with generally lower tax rate than the entrant’s home country, where a part of the business could be transferred.

2.3 Risk mitigation – origins and problematic

The impressive economic progress of the BRIC (Brazil, Russia, India and China) countries throughout the 1990’s, the relative stabilization and liberalization in many aspects of many countries from the former Eastern (Communist) Bloc and the remarkable development of Turkey

in the 2000's have given a new impetus of the IJV as a preferred market entry mode after its decline in the preceding decades (Meschi & Riccio, 2008, p. 251). Certain country-specific variables have contributed to this change. The developing countries are subject to dynamic economic, political and social processes, which inevitably go along with the rising attractiveness for foreign investors of their markets. In the presence of a local partner these uncertainties can be reduced in several ways. While the foreign partner provides upstream assets like know-how, technology and significant part of the investment, the local one will tend to the successful development of the alliance via personnel, access to the host market, distribution network, knowledge of the local legislations and legitimacy in front of the local authorities and population/customers. This should decrease the "liability of foreignness", described as the additional economic and social costs of a company from operating abroad (Rodriguez, et al., 2005 , p. 389).

The developing country governments are especially interested in JVs, because in this way they encourage technology transfers, employment, capital inflow and the improvement of the reputation of the region (Rodriguez, 2008, p. 642). Yet, in transition economies the ruling parties tend to change more often and thus commitment to certain policies is also very volatile. A clear recent example is Ukraine, whose political instability and swinging between Russia and the European Union is obviously affecting the intentions of the investors in a negative way, who since the beginning of the financial crisis in 2008, have become much more risk averse (The World Bank , 2013).

On the other hand many of the local firms in developing countries are facing significant rise in the competition coming from MNE or just increased import of foreign goods. The governments feel pressure from the local business to protect it by introducing certain protectionism policies, which might be obvious or "hidden" since many of them participate in international organizations - like the World Trade Organization (WTO), where such measures are not allowed. According to the Centre for Economic Policy Research in London, which conducts annually a survey called Global Trade Alert (GTA), protectionism is defined broadly as "... anything that hurts another country's commercial interests" (The Economist, 2013). In a recent research of the European Central Bank it was estimated that only a small number of the members of the WTO, responsible for only 13% of the overall import of the G20 countries, have implemented more than 60% of the

total measures classified as protectionist since 2009. These are Argentina, Brazil, India, Indonesia, Russia, South Africa and Turkey (European Central Bank, 2013). The risk of expropriation is also a threat, which should not be underestimated. The presence of a local partner with a certain bargaining power can reduce the hazards (Rodriguez, 2008, p. 646). The Wall Street Journal and The Heritage Foundation publish annually an “Index of Economic Freedom”, which can be used as a proxy for the effect of economic freedom on the economic activity (Mantecon, 2009, p. 643).

The government policies moderate another very significant variable for the foreign entrants – the demand. Macroeconomic factors like the interest rate, default on payments, employment policies, laws and regulations, power and influence of labor unions, general unemployment and education affect directly the income levels and the welfare of the population (the customers of the companies). They all determine the environment, in which the firms in a country must operate. The consumption of the products and services of the IJV have direct impact on the profitability of the project (Meschi & Riccio, 2008, p. 254).

The cultural distance contributes to the riskiness of a host market. The main reasons are the higher costs of communication and monitoring and evaluation. The development of the marketing and the production strategy must be based on the local specifics, a part from which is the local culture. An inappropriate advertisement, for instance, might induce hostility towards the product and the firm. The relational risk has to also be taken into account. It derives from the possibility of conflicts and frictions between the two partners (Kaufmann & O’Neill, 2007, p. 437). In the next sub-section their relations will be discussed in detail.

In the scientific literature the general opinion prevails that the higher risk in a host country is positively correlated with preference for an IJV over M&A. Lower institutional and governance quality, higher cultural distance, regulatory unpredictability, lower income of the population contribute to the perception of a market as a riskier and thus to the choice of IJV, which has a lower level of internalization - (Tseng & Lee, 2010), (Cui & Jiang, 2009), (Morschett, et al., 2010), (Slangen & van Tulder, 2009), (Dikova & van Witteloostuijn, 2007).

2.4 The learning perspective

The importance of the IJV as a knowledge transfer method was already mentioned in the previous sub-section. From the point of view of the strategic alliance the learning process has two main directions. The first one is to learn how to manage the joint entity and how to cooperate and function with respect to your partner. The second perspective, on which I will be focusing, considered in this particular part of the thesis is, the learning from the host-country partner, which in broad terms are capabilities and skills needed for the successful operations on the given market (Lane & Lubatkin, 1998, p. 462).

The successful knowledge transfer is important for a number of reasons. It enables the entering firm to recognize threats more easily, which will grant it with longer time to response and help it to form a better response tactic. The IJV will also help market entrants to recognize market possibilities more quickly. Secondly, the learning experience is imperfectly imitable, since it is a very specific know-how based under the subjective conditions of the particular market under the influence of a particular partner (Farrell, et al., 2011, p. 480). The success of the knowledge transfer depends on the extent of achievement of the primary goals set by the MNE. Si & Bruton (1999) interviewed 51 joint-venture experts. The three main categories summarized by them in the field of knowledge acquisition in transitional economies (the particular example is China) are: 1) knowledge of governmental issues; 2) knowledge of culture, and 3) knowledge of the market (Si & Bruton, 1999, p. 84). The following table presents the foreign firms' major goals. In each category they are ranked according their importance:

<i>Rankings of Knowledge Acquisition goals of IJVs</i>	
Knowledge of Governmental Issues	• Understanding Government Behavior • Learning National Policies, Rules and Relevant Laws • Understanding the Partner's Economic System
Knowledge of Culture	• Learning more about the Partner Firm's National Culture • Learning the Negotiation Styles of the Partner's Nation • Gaining Knowledge of New Managerial Types and Styles
Knowledge of Market	• Gaining Knowledge of Partner's Market Characteristics • Gaining Understanding of Labor Resources • Gaining Understanding of Capital Resources • Learning New Technologies

Table 4: Major Knowledge Transfer Goals [source: Si & Bruton, (1999), p.84]

According to the RBV intangible assets like specific skills and know-how are much more difficult to imitate, because they are much more difficult to specify, mostly inseparable from the human capital and are not subject to patents, which can be bought. They are also imperfectly substitutable (Das & Teng, 2000, p. 42). Nevertheless, they are an important competitive advantage. The IJVs are the most suitable market entry mode for knowledge transfer. The partners are in constant collaboration and interaction with each other and this makes the whole process much easier and natural (Glaister, et al., 2003 , p. 85). Sometimes it might be an unconscious process, but having this intent from the beginning can substantially speed up the process (Glaister, et al., 2003). Learning orientation represents the managerial values focused on the capture, valuation and the intention to use certain information. M.A. Farrell (2011) finds strong support for their hypothesis that the higher learning orientation leads to a better business performance of the JV.

Another side of the learning perspective is the competitive part. Upon entering into a strategic alliance, one of the companies or both of them might be interested only in the internalization of

the other's knowledge and skills to the detriment of the other party (Das & Teng, 2000, p. 44). This could quickly turn into a "race". When all the needed capabilities have been acquired from the other partner, he might become needless and expendable. This is why great asymmetries in the learning capabilities and orientation might eventually destabilize the JV (Khanna, et al., 1998, p. 198). It is also expected that the foreign partner will show much greater aspiration for learning: an MNE would have experience on markets of a larger scale, thus would be accustomed to competitiveness. An MNE would also possess larger resources to invest and build the learning capacity it needs. And these capacities accelerate the learning process and increase the probability that the local partner just might not be needed in a certain moment (Kale & Anand, n.d.).

2.5 Local partner issues

It was already mentioned a number of times that the JV is a strategic alliance between two or more firms. This implies that both sides will take part into the management of the new entity. There are certain important aspects deriving from this fact. The company will have to take into consideration the decisions and desires of the other partner. This could create frictions in the different managerial points of view.

Madhok (1995) describes the management of interorganizational relationships as based on two main traits – opportunism (contract-centered approach) and trust (relationship-centered approach). The first one of them emphasizes on the individualistic, selfish and self-interested nature of the participants of the alliance. Each one of them is expected to try to maximize his own benefits, even if it is at the expense of the other partner. This increases the risk, and the costs respectively, of the enterprise since the firms will have to invest more in protective mechanisms. Therefore, a contract is needed, which will set certain rights and obligations for the participants in the JV. Nevertheless, in this case, in the absence of any other stimulus except the enforceability of the agreement, the firms would not do more than the required minimum for the success of the alliance (Madhok, 1995, p. 59). There is the need for something more than the purely economic stimulus, so that the company can function in a profitable way. The essential ingredient is namely the "trust". If the partners are distrustful to each other, this will not allow the bond needed for the

cooperation to develop. When the partner demonstrates willingness to cooperate and to share the resources needed for the successful functioning of the strategic alliance, the level of joint trust will increase (del Mar Benavides-Espinosa & Ribeiro-Soriano, 2013, p. 2). The benefits of the higher level of trust are obvious – it lowers the monitoring costs, leads to a faster problem solving competence, the partner tends to behave in a more predictable manner (Madhok, 1995, p. 60).

One of the variables influencing management and conflict-resolution styles is the cultural distance, especially in the case of the IJVs, where there is a constant close interaction of people from different countries. A great deal of misunderstandings can arise, when one of the partners does not know how to interpret the behavior of his foreign partner. All this can decrease the level of trust. Even more, higher cultural distance can prevent the implementation of an integrated system of management practices, which should unite the two teams (Ng, et al., 2007, p. 434). For instance, it is known that professionals from more individualistic cultures tend to choose direct and confrontational strategies, when there is a conflict of some kind. In other countries people concentrate on the long-term relationship between the partners. They are described as avoidant and accommodating. The Anglo-Saxon countries are a classical example for competitive and East-Asian countries for passive and collectivistic cultures (Pearson & Stephan, 1998, p. 68). Nevertheless, higher levels of trust can decrease the effects of different cultures.

Trust is impossible to achieve without a certain level of commitment. It can be defined as: “...taking the necessary measures to maintain the relationship by contributing the required staff, time and resources” (del Mar Benavides-Espinosa & Ribeiro-Soriano, 2013, p. 2). Each partner must show his willingness to invest the above mentioned assets in order to have good reason to expect the same from the other side and to achieve better results. The commitment of the affiliates is also found to have positive influence on the cooperative learning (how to manage the IJV) (del Mar Benavides-Espinosa & Ribeiro-Soriano, 2013, p. 5). A positive influence on this willingness between the two sides exercise the equal distribution of the profits of the JV, the longer period of cooperation, which is envisioned by the partners, avoid complexities and trust each other (Demirbag & Mirza, 2000, p. 7).

Another important issue is the division of control between the partners. A reliable control mechanism is needed for the successful operation of each firm. For decades there has not been a

clear opinion, which is the most important criterion for its valuation in a strategic alliance. There are two basic types of control – operational and strategic, but it is not very easy to define, which control mechanism is dominant – equity ownership, board representation, appointment of key personnel by the foreign partner, capital and non-capital resource contribution (Selekler-Göksen & Uysal-Tezölmez, 2007, p. 385). It would seem logical that the equity would be the leading one of them, since it refers to the origin of the capital. Even if it can assure the strategic control, it is very doubtful that this is valid also for the operational one. These are, for instance, the cases, where the one affiliate provides the investment, but is highly dependent on the technology, management and know-how competences of the other side. Probably the influence over the company's strategy and its implementation is a much more trustworthy (Demirbag & Mirza, 2000, p. 6). This means to exercise ability to influence your partner by using formal authority.

Kwon (2008) finds strong support for the factors, which increase the level of mutual commitment between the partners in the IJV. The strategic bond unites and gives perspective to the strategic alliance. In this aspect it is very important that the affiliates clearly allocate the responsibilities among themselves, so that there is ambiguity in the management and overlapping of duties (Glaister, et al., 2003 , p. 99). The partners must also make sure that they are compatible with each other and can contribute adequately to the success of the new enterprise. Last, but not least, they have to implement an efficient communication and monitoring policy, so that there is no information asymmetry (Kwon, 2008, p. 569).

3. Conclusion and hypotheses

From the mentioned above motives and factors it is obvious that the full acquisition and the equity joint ventures have a lot of similarities, being both in the group of the equity market entry modes. Nevertheless, the most significant difference between them is the shared ownership in the case of the IJV, which predetermines its functional specifics and applicability. The experience and the strategic goals of the investing company influence its decision how to conduct the entry. The conditions in the target country also play a significant role over this choice.

In order to verify whether the theoretical foundations and the rules, which can be derived from them, are applicable to the region of SEE and the energy sector in particular, the following conclusions are drawn. They will be compared to the real-life conditions and experiences of the two companies in Bulgaria and Turkey:

High-control market entry modes like the acquisition are associated with previous experience. It is important that the buyer has established certain practices and built the needed competences in order to be able to handle such deal by himself, since it is associated with a significant level of commitment of resources, time and efforts. The strategic alliance is preferable, when the investor would need help and guidance to enter the desired market:

Hypothesis 1: Past previous experience is associated with a preference for M&As over JVs;

Stepping on a new market, especially on one of a transition economy, is inevitably related to coping with the rules of this market – interaction with institutions and governments, struggling with local and other international competition. Therefore, someone who is going to share these risks with you and can serve as an mediator between the foreign investors and the local authorities, might be preferable than facing these challenges alone. In case of a failure this can minimize the losses:

Hypothesis 2: JVs will be preferred, when the risks and the uncertainty (political, institutional and economic) are high;

Hypothesis 3: The need for knowledge transfer will inspire the company to choose a JV;

The cultural distance is one of the risk dimensions of the new market. The requirements of the consumers are also shaped by their cultural background, their income and the trust that they are ready to grant the new entrant. A local partner can shorten the learning period, reduce the liability of foreignness and help build trust with the customers:

Hypothesis 4: Higher cultural distance is positively associated with JVs over M&As;

The competitive advantages of the firm also must be considered, when choosing the mode of entry. Patents, specific know-how or even corporate secrets must be properly protected. It is also more difficult to transfer it to local employees. Therefore, an acquisition might be a more suitable choice for this objective:

Hypothesis 5: The transfer of their specific proprietary assets requires an acquisition;

In fast growing markets with a high potential being the first entrant or one of the first might prove very beneficial, although it is associated with higher risks. Securing a larger market share before other competitors is vital in many cases. M&A being known for its speed can be preferable in this case. An IJV takes more time to build. The partners need additional time to adjust to each other and begin to function as a whole:

Hypothesis 6: A market with a high potential will inspire M&As;

The hypotheses can be summarized in the following table:

Presence of:	Acquisition	Joint Venture
Previous cross-border entry experience	yes	no
High-risk market and environmental uncertainty	no	yes
Need for knowledge transfer	no	yes
Transfer of specific proprietary assets	no	yes
High market potential	yes	no
High cultural distance	no	yes

Table 5: Factors and their positive influence over the choice of an entry mode

In the next part of the thesis each country and company will be described in various aspects at the time of and before the deal. For Bulgaria this will be the year 2005 and the years before and 2007

and before for Turkey. These aspects will be cultural, economic and political. A certain focus will be put also on the types of state regulations in these countries. The thesis will also provide a short description of VERBUND AG und EVN AG with their motives and objectives in the host countries.

Last but not least a series of interviews with involved members from both companies will be carried out. They will share their personal experiences from the processes and will fill in the gaps, which the public information could not, as long as it is not a corporate secret. These staff members will also be asked to fill up short questionnaires.

4. EVN AG and the M&A in Bulgaria

This chapter begins the empirical section of the thesis. A brief overview over the development of EVN AG, the business areas that it is involved in and its structure will help to understand better the company's goals, experiences and management vision. This will be done from the perspective of the years 2004 and 2005 in order to analyze the particular conditions that the company was subject to before and at the time of the cross-border market entry.

Of even greater significance is the description of the political, social and economic description and interpretation of the factors in Bulgaria at the time of the acquisition. These are the conditions, which shaped and led to the final decision to execute the deal. They will take place right after the overview of the company and will be the main focus of this chapter.

4.1 EVN AG in the period 2004/2005

This sub-section will briefly present the history of EVN AG, its core businesses, corporate strategy and some financial figures. The main objective is to derive knowledge for the company's strategic vision.

4.1.1 Historic evolution of the company

EVN has a long tradition in the energy sector. The roots of the company can be traced back to the establishment of the electricity grid and the power generation in Austria itself. In 1907 the Landeselektrizitätswerk was founded – a small electricity company in the Archduchy of Austria above the Enns, which was a part from the mighty Austro-Hungarian Empire. It built a hydroelectric power plant, which had to provide power for Sankt Pölten – nowadays, the capital city of the province Lower Austria in the Republic of Austria. After the First World War and the following political changes in 1922, the company was renamed to NEWAG (Niederösterreichische Elektrizitätswirtschaftsaktiengesellschaft) and the ownership was in the

hands of the provinces Vienna and Lower Austria. The main goals were the development of the electricity network in regions without access to electricity, the construction of electricity power plants and the generation of electricity. In the following decades NEWAG was renamed to Gauwerke Niederdonau AG and took over several independent electricity companies. After the Second World War and the following nationalization the province of Lower Austria became the sole owner of NEWAG.

As a result of the adoption of a new development policy in 1954 the Lower Austrian gas supplier NIOGAS was established. The founding members were again the province and the company under its control, NIOGAS. In a short period of time a distribution network for gas was created in the province of Lower Austria. The rapid increase of gas demand made Austria the first Western country to sign a contract with the Soviet Union for gas purchases. NIOGAS was among the first companies to offer supply of natural gas to the private consumers.

The merger between NEWAG and NIOGAS was considered already in the 1970's, but was not undertaken for tax reasons. After tax law changes the companies merged finally in 1986, forming a fully integrated company. They adopted also a new name, which has made it popular today – EVN (Energie-Versorgung Niederösterreich). Up to the end of the 1980s the ownership of the concern was public. After the passage of new privatization legislation in 1988, the company took advantage, and implemented two public offerings in 1989 and 1990. EVN was allowed to sell no more than 49% of its share, preserving the province of Lower Austria as the majority holder with 51%. With the accession of Austria to the EU in 1995 and the enlargement of the Union in the following years, EVN AG faced new business opportunities, of which it decided to take advantage in order to ensure the further growth and success of the company (EVN AG, 2014).

4.1.2 Corporate strategy and vision

Since 2001 the Austrian energy market became fully liberalized. The firm entered a local alliance – the “Austrian electricity solution”, to enhance its competitiveness. The company developed its business not only in the energy sector, but also in other public services – water, waste incineration, telecommunications and continued to grow ever since. EVN AG adopted a strategy

of expansion of its core energy business in Lower Austria and in the region of Central and Eastern Europe. The years after the investment in Bulgaria would further prove that. The concern will also enter Macedonia, Albania and Croatia. It is nevertheless true that the deal in Bulgaria would be the first major step of the company in the region of SEE. It did not have major previous experience in making business in this area of Europe.

Nevertheless, EVN AG had the confidence to embark on the quest for new market opportunities. As Figure 2 shows the company had a stable growing profit in the years preceding the acquisition:

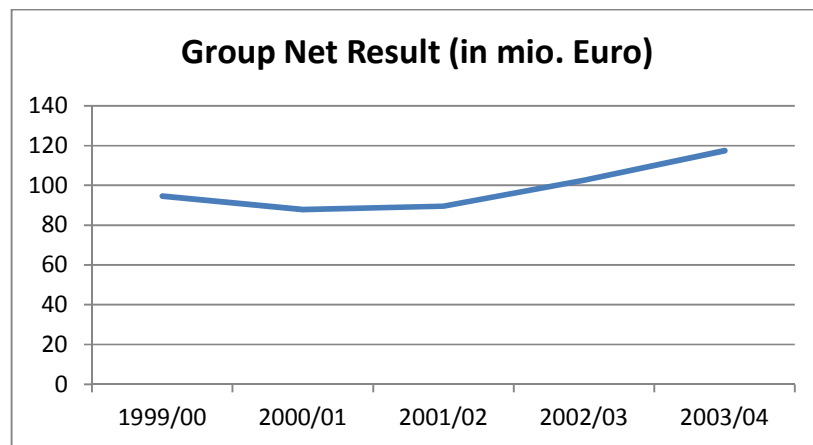


Figure 2: Group net result for the period [Source: Annual report 2003/04]

There were relatively stable tendencies for growth in Austria and the EU in general. The demand was increasing despite the favorable climatic conditions in the period. Therefore, electricity sales were also on the rise - by 8.1% on an yearly base 2003 /2004 to 10,442.4 GWh total sales (to end consumers and wholesale). This was possible due to the participation of the company in the power trading alliance, where it had arranged long-term price and production agreements to diminish the risk in its field of operation (Annual Report 2003/04, 2004). The table below depicts the progress in the trade quantities of EVN:

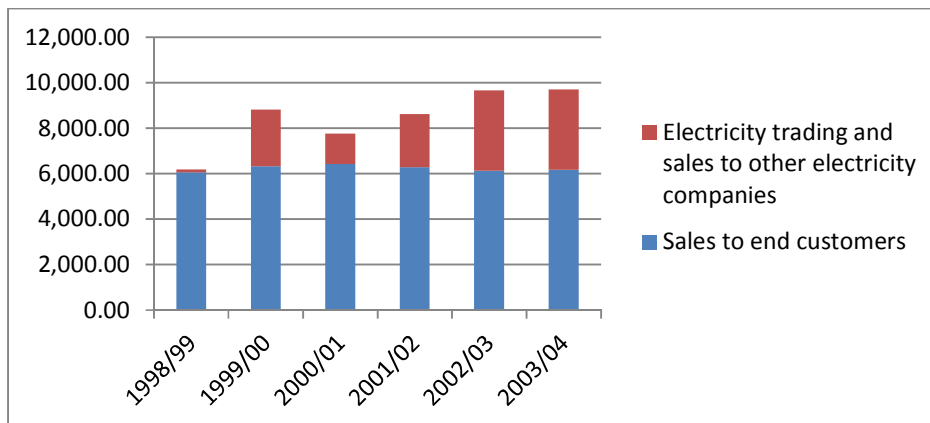


Figure 3: Electricity sales volumes (in GWh) [Source: Annual Report 2002/03 and Annual Report 2003/04]

In sum, EVN AG had a vision and a strategy of further growth – in other fields of operation and in other countries. The firm had been formed through an M&A and had some experience in this field. It had gained confidence from the previous successful years in its homeland, where it had secured its position on the market. As it will be discussed in the next sub-section there are other additional favorable country-level factors, which influenced the decision to enter the Bulgarian market at that time.

4.2. Bulgaria in the mid 2000's

This section will focus on the environment that EVN was about to enter in 2004-2005. It will first provide a short overview of the historical background and institutional environment in Bulgaria at that time. Consequently, the economic perspectives and cultural specifics of the country will be introduced. The section will end with the general conditions of the deal.

4.2.1 The transition in Bulgaria in the 1990's and early 2000's

The political and economic development in Bulgaria in the period, which will be analyzed, is a direct consequence of the historical changes that took place not only on the Balkans, but also in the whole region of Central and Eastern Europe. Bulgaria used to be a part of the Eastern Bloc and a socialist republic for almost 45 years. The demise of Communism that led to the fall of the “Iron Curtain” introduced a number of challenges to the country, many of which are problems even today.

In the period between the 1946 and 1990, the economy was centrally planned and the country was part of the Council for Mutual Economic Assistance (CMEA) – an economic and trade organization under the leadership of the Soviet Union. Unlike some of the East-European members, which in the 1970's and the 1980's tried to re-orient their trade to other partners, Bulgaria increased further its trade volumes with the Soviet Union. In the second half of the 1980's the share of the Soviet trade turnover in the Bulgarian economy grew to more than 50% (Dobrinsky, 2000, p. 582).

In the late 1980's with the decay of the USSR, the regime in Bulgaria decided to borrow foreign debt rather than adjust and modernize the economy. The gross foreign debt grew from 2.9 billion USD in 1984 to 10.7 billion USD in 1989. The disintegration of the CMEA caught the Bulgarian producers unprepared to face the western competition, revealing their weaknesses and leading to an inevitable economic crisis during the phase of the transition after 1990 (Mihov, 1999, p. 6).

Compared to the transition cases in the other Balkan states, the one in Bulgaria is probably the least violent case. There were relatively few cases of anomic violence and the efforts were towards a gentle transition. The start was good, but the development afterwards was weak (Agh, 1999). The principle of plurality was adopted as leading in all aspects of the future development – economics, politics, interests, types of property and viewpoints. The main economic objectives in the first years of the transition were “...wide-ranging price liberalization, opening up of the economy, abolition of central planning and free entry of private economic agents to the market as well as liberalization of foreign trade” (Dobrinsky, 2000, p. 583). These policies were inconsistent, because of the lack of public consensus on all of the matters and the disunited opposition.

Some scholars argue that the transition was effected not in the right order. The first objective of the process should have been to change the old system of values with democratic ones and reshape the thinking of the people. Only later the democratic institutions could have been built upon these foundations. In the case of Bulgaria this was done the opposite way. The common people were not prepared for the consequences of the democratization of the political system and the liberalization of the market. Having a Gini coefficient of income distribution in the 1980's between just 20 and 25 the society was ready to except some of the less glamorous sided of democracy like social classes, property and larger differences in the social status. This resulted in a poor efficiency and low trust in the new institutions (Todorov, 2003, p. 17).

Since 1989 the ex-communist Bulgarian Socialist Party (BSP) had been one of the dominating players on the political stage entering into coalitions with other left parties and groupings. It managed to save much of its positive public image as a competent government it the preceding decades. On the other side of the political spectrum was the anti-communist Union of Democratic Forces (UDF), which united political groupings and parties on the right. They represented the new vision, oriented towards the liberalization and the West. The Movement for Rights and Freedoms (MRF) served as a balancing power and protected mainly the interests of the ethnical minorities, primarily the Bulgarian Turks. The leadership of Ahmed Dogan the movement was represented in each National Assembly after the beginning of the transition.

The UDF took office between 1992 and 1994. It had to undertake market-oriented reforms, which proved to be unpopular among the people. The economic decline, the rise of the crime and unemployment diminished the initial enthusiasm of the voters. This is why in 1994 BSP won the elections presenting a political vision, which was supposed to protect the "Little Man" from the excesses of the free market. Nevertheless, it had to step down in the beginning of 1997 after the massive protest and strikes as a result of the collapse of the economy. The young Prime Minister Zhan Videnov could not show the political strength to put under control the desires for personal enrichment of the people surrounding him. In the period 1997-2001 under the leadership of the Prime Minister Ivan Kostov the alliance between UDF and the People's Union (PU) managed to

stabilize the economy, to achieve good economic growth and to develop the negotiations for membership in NATO and the EU (Harper, 2003, p. 336).

“In the beginning of 2001 the former Tsar of Bulgaria Simeon Saxe-Coburg-Gotha returned back to Bulgaria after 55 years of exile...” (Harper, 2003, p. 336) and proclaimed his intentions to take part in the elections that same year. He formed a movement after himself – National Movement Simeon II. He was euphorically welcomed and managed to win 52% of the votes. His political program concentrated on economic measures and the unification of the society behind common values. His government continued to follow the pro-western course of the previous one. The economic and political conditions continued to improve. Bulgaria became a NATO-member in 2004 and was intensely working to meet the requirements for EU-membership. Yet, some problematic areas remained – corruption, organized crime, health care. Nevertheless, Bulgaria seemed to be on the right course.

Year		1996	1998	2000	2002	2003	2004
Voice and Accountability	Estimate*	0.37	0.37	0.41	0.49	0.51	0.54
	P-Rank**	61.54	59.62	60.10	62.02	62.98	64.90
Political Stability and Absence of Violence	Estimate	-0.20	0.53	0.35	0.40	0.15	-0.02
	P-Rank	39.90	62.98	59.62	59.62	48.56	45.19
Government Effectiveness	Estimate	-0.31	-0.24	-0.04	0.20	0.11	0.19
	P-Rank	44.00	47.00	54.15	62.95	60.98	64.39
Regulatory Quality	Estimate	-0.12	0.08	0.20	0.55	0.63	0.67
	P-Rank	48.52	53.92	58.33	68.62	69.60	72.54
Rule of Law	Estimate	-0.46	-0.36	-0.23	-0.10	-0.19	-0.13
	P-Rank	34.92	37.32	44.02	49.76	46.41	49.28
Control of Corruption	Estimate	-0.78	-0.24	-0.21	-0.20	-0.07	0.10
	P-Rank	25.85	47.31	51.70	51.70	55.12	58.04

*Estimate of governance (ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance),

** Percentile rank among all countries (ranges from 0 (lowest) to 100 (highest) rank)

Table 6: The Worldwide Governance Indicators, Bulgaria, [Source: The World Bank, www.govindicators.org]

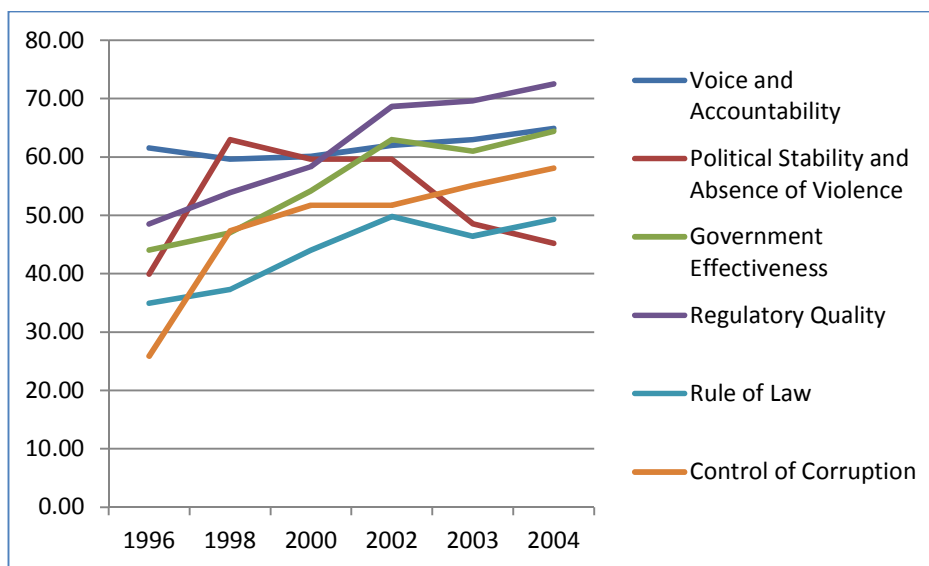


Figure 4: P-rank change of Bulgaria over the years [Source: The World Bank, www.govindicators.org]

According to the World Governance Indicators, a research data set summarizing the governance quality into six major dimensions by The World Bank, there has been an improvement in Bulgaria over the period 1996-2004, as depicted in

Table 6 and Figure 4 (Kaufmann, et al., 2013). It can be concluded that in the context of these indicators the institutional and governance quality in Bulgaria has been improving and giving certain signs that the country was on its way to stability in comparison to the previous years.

4.2.2 Economic crisis and privatization

As discussed in the previous section the 1990's were a turbulent period for the Bulgarian economy, which had to walk its way from being a command to a functioning market-oriented one. Generally, all post-communist countries in Central and Eastern Europe experienced difficulties during this transition, but they had managed to overcome them by the middle of the decade. Yet, for Bulgaria this was still an ongoing process in 2004, due to the political instability and the inconsistent and slow implementation of key reforms.

There were several devastating economic measures in the period 1991-1996. The unconditional financial subsidization of state-owned enterprises created was probably the biggest one. Lacking a long-term oriented perspective and strategy, a lot of the loans were not result-oriented and included illegal and corrupt practices. Their main goals were to fill a certain hole in the budget of the company and were not bound with any conditions regarding restructuring and efficiency improvement. A vicious circle was created, that resulted in further accumulation of debts. A lot of loans were issued to other unreliable clients as well, in consequence of which the banking system of the country had been drained. According to some rough estimates in the period from 1993 to 1995 the cumulative gross losses of the state sector amounted to about 50% of the average annual GDP (Dobrinsky, 2000, p. 588).

In 1996 the banking sector of Bulgaria inevitably collapsed under the weight of the bad loans. Since 1995 many banks had been experiencing problems with the liquidity. Several of them went into bankruptcy. This created a domino effect in the whole system. The country was plunged in hyperinflation (reaching over 500%), causing the devaluation of the national currency (the Bulgarian lev). Most of the depositors lost their savings. The society was deeply disappointed and expressed its discontent through massive protests in the yearly 1997.

Proving to be incapable of controlling the fiscal policy of the state, the government introduced in July 1997 a currency board by the International Monetary Fund. The Bulgarian lev (Bulgaria's national currency) was fixed at the rate of 1000 lev for 1 Deutsche Mark. The banks had to follow strict rules in terms of required reserves and risk mitigation practices. The budget deficit was also taken under control. Soon after that the economy began to stabilize (Mihov, 1999). The GDP was growing, the budget deficits and inflation were again under control and the unemployment was decreasing:

Year	2001	2002	2003	2004	2005
GDP , billion 2005 USD	23.04	24.13	25.45	27.16	28.9
Government gross debt, % of GDP	66.0	52.4	44.4	37.0	27.5
Harmonized Indices of Consumer Prices (HICPs) - Inflation		5.8	2.3	6.1	6.0
Unemployment, % of labor force	16.4	19.5	18.2	13.7	12.1

Table 7: Bulgaria, selected indicators [Source: Eurostat, International Energy Agency]

One of the main stabilization measures was the resumption and the acceleration of the privatization. It started actually in 1992, but until 1997 according to different estimations only about 5% to 7% of State enterprise assets were privatized. Another holdback was the fact that many of them were only partially sold to private entrepreneurs and the state continued to own different amounts of shares and to subsidize them. It was the economic crisis in 1996 (Figure 5) that set the ball rolling. The revenues from the privatization were perceived as a valuable source of foreign currency for the depleted reserves of the National bank. The high inflation during this period made the evaluation of the entities more difficult and it became easier for investors to acquire entities under their actual market value. The Ministry of Finance allowed companies to revalue their real assets except the financial ones. A lot of the enterprises became insolvent, which also accelerated the process (Miller & Petranov, 2000, p. 231).

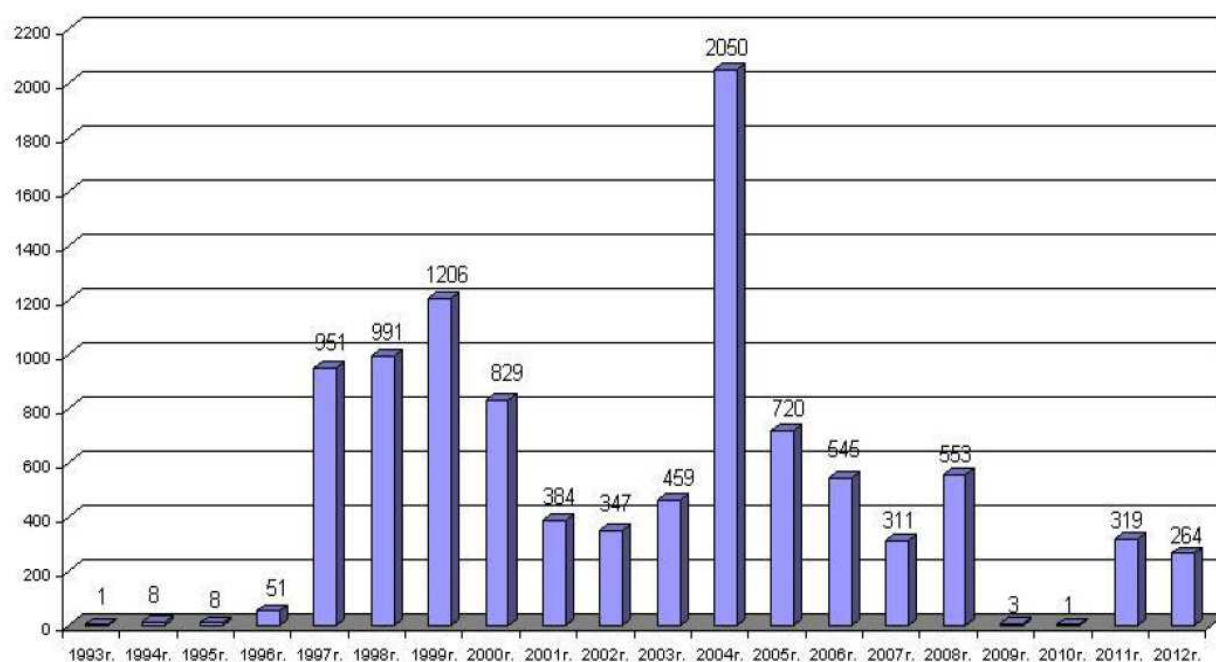


Figure 5: Privatization contractual agreements (in million leva) [Source: The Privatization and Post-Privatization Control Agency of the Republic of Bulgaria]

The beginning of the new decade was characterized by a rapid growth of the foreign direct investments (FDI) in Bulgaria. According to statistical data in the period 2001 – 2005 their share

as a percent of the GDP of the country almost tripled (from 5.8% in 2001 to 14.9% in 2005). The peak was reached in 2007 – 29.4% (Eurostat, 2014). However, the privatization was not the only source of inflow of foreign capital and investments. The low wages attracted many export oriented green field investments. Bulgaria had been an attractive destination primarily for European investors. The main FDIs in 2002 came from Austria (28%), The Czech Republic (13.9%), Greece (13.4%) and Germany (12.8%) (Petranov, 2003).

4.2.3 Cultural dimensions

As previously discussed in section 1.4.2.1, the comparison between the countries on a cultural level will be conducted through the Hofstede's approach and the index of Kogut & Singh. Figure 6 depicts the scores of the two countries on the scale from 0 to 100. The dimensions, which are taken into account, are Power Distance Index (PDI), Individualism (IDV), Masculinity (MAS) and Uncertainty Avoidance Index (UAI):

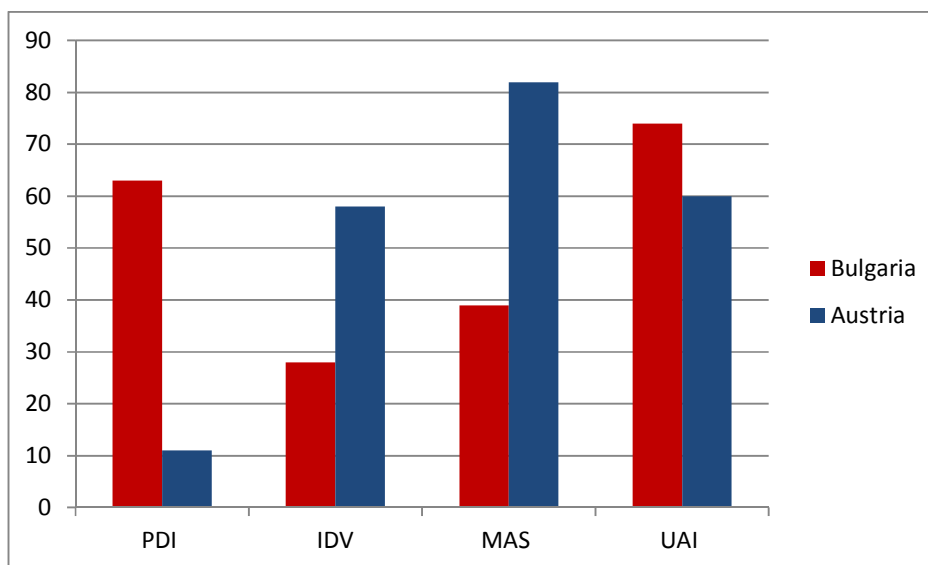


Figure 6: Country comparison [Source: The Hofstede Center]

It can be seen, that there are significant differences in almost every dimension. The PDI reveals that Bulgaria scores relatively high. People there are expected to accept hierarchal order and the higher standing people openly demonstrate their rank. The subordinates expect guidance from above and are less likely to be initiative in their work. They accept class division and these

societies are prone to totalitarianism. This assertion is historically supported. The modern Bulgarian state was established in 1878 after nearly 500 years of Ottoman rule. After the Second World War the totalitarian regime of the Bulgarian Communist Party ruled the country and the economic life centrally for little less than 50 year. It could be pretty much said that it was not until 1989 that the people in Bulgaria are learning how to exercise their democratic rights and business spirit.

Austria on the other hand has significantly lower power distance index. Independence, egalitarianism, accessible superiors, decentralization of power – these are the norms, which are expected to be found in an Austrian company. The strict control is not a priority and the attitude towards the higher managers is more likely to be informal. As it is obvious, the two countries have a very different management style, which is also confirmed in the interview with Mr. Werner Casagrande, former Project Manager in EVN at the time of the acquisition in 2004/2005 in Bulgaria.

On the next dimension, individualism vs. collectivism, Bulgaria's score is more than two times lower – 28 vs. 58, which defines it as a collectivistic culture. Long-term relationship, commitment to the family, loyalty as a high-valued virtue and preference for group-work are typical for this type as cultures. According to an EU-wide study, Bulgarian young people are most likely to live with their parents into their 20's and 30's – 52.8% of the men. And even if the tough economic conditions and the youth unemployment are to blame to a large extent, part of the percentage is still due to the national culture (novinite.com, 2014). Austria can be classified as an individualistic country with more pragmatic, business-oriented type of thinking, where individual goals, initiative and high personal achievements are promoted. Independence is valued and is expected from the employees.

With a score of 39 the Bulgarian society is a rather feminine one. Being better does not necessarily mean more success. The job is perceived more as a source of finance in order to live. In conflict situation, rather than being decisive, the consensus and negotiation are the preferable resolution methods. Austria's index in this dimension is also twice as high – 82, which is definitely a rather masculine society. Competition, confrontation and victory are seen as inseparable part of the successful professional. Managers are expected to be decisive and proactive. Conflicts are resolved directly.

The last index is the only dimension, in which it can be said that the two countries are similar. Both dislike uncertainty and ambiguity and try to avoid it whenever possible, because they bring them discomfort and anxiety. Strict following of laws and rules are an emotional need are supposed to reduce the risk in uncertain situations. A high uncertainty UAI is also associated with longer decision-making time, whenever thinking “outside the box” is required. Unorthodox ideas and behavior are avoided.

4.3 The parameters of the deal and first impressions of the Austrian acquisition team

As a part of its privatization program in 2004 Bulgaria announced its plans to make an auction for 67% of the stakes of seven electric power distribution companies (EDCs), which were going to be grouped in three regional packages: Western, Southeastern and Northeastern (Seelos, 2011). Five bidders took part in the auction and each one of them could acquire just one package. The price was the key criterion. The offers were the following:

Package/Bidder	EVN	E.ON	Enel	CEZ	PPC
Western	302.00	270.50	241.20	281.00	165.00
Southeastern	271.00	140.70	120.60	121.50	80.00
Northeastern	-	-	201.00	171.50	180.00

Table 8: Bids made by the competing companies (in million euros, Source "EVN in Bulgaria", p.7, Seelos]

EVN won the Southeastern region, which consisted of two companies – EDC Plovdiv and EDC Stara Zagora. The main characteristics of the area can be summarized in Table 9:

		EDC Plovdiv	EDC Stara Zagora	Total
Electricity customers	Number	866.679	628.967	1.495.646
Network	km	32.706	23.245	55.951
Sales volumes	GWh	3.647	2.921	6.568
Employees	Number	2.400	1.800	4.200

Table 9: Key figures [Source: Annual Report 2003/04, EVN AG, p.23]

The acquisition would definitely increase substantially the client base of the company. It would also be the first successful one in the region of CEE. As a competitive advantage EVN AG planned to use its higher purchasing power and thus achieve economies of scale. The company would also invest in the transmission grid, which had been neglected in the years before, in order to reduce the technical losses. Another major goal of the company was to improve the collections - as it later became clear, it was common that many households, firms and even public institutions. Centralization and reorganization of the branch system of the two acquired companies, coaching program of the Bulgarian managers and high control of the post-merger integration process were other measures to improve the performance of the new subsidiaries.

The negotiating team of the Austrian company quickly noticed several of the cultural differences predicted in section 4.2.3 Cultural differences. The high power distance and the highly hierarchal structure of the public institutions prolonged the making of the decisions in them and often resulted in unneeded bureaucracy. A lot of the employees were not motivated and pro-active and were concentrated on their direct tasks. In some cases the procurement in the EDCs was not conducted transparent enough due to informal relations (See Appendix 1).

Although the situation in Bulgaria was perceived as relatively stable in political and economic sense, the main concerns were from political nature. It was important that the country would stay on the right and predictable path – full liberalization of the energy market was yet to come, and the favorable economic reforms were to be completed (Annual Report 2003/04, 2004, p. 23). The economic and financial risks were considered to be of secondary importance and the cultural one ranked on the last place (See Appendix 1).

Nevertheless, EVN AG was ready to take these risks. It perceived Bulgaria as a high potential market, which could be further developed - the electricity consumption was higher than the

Europe's average, but the energy efficiency was much lower. The country was going to enter the EU soon, which would increase the stability and improve its international image.

4.4 Conclusions and personal remark for the acquisition of EVN AG in Bulgaria

When analyzing the conditions in the country and the type of the market entry mode of the company, there are several conclusions to be made. First, Bulgaria was not seen as a high risk country from the perspective at that time. Although it was still stabilizing from the difficult transition after the change of the political and economic system, there were several signs of optimism regarding the future of the country.

EVN had been trying to enter the region of CEE previously, and the opportunity it was trying to take in Bulgaria was not a spontaneous decision, but a part of a large-scale strategy. The new market share was large in terms of number of customers and area to be serviced. It had high growth potential. Yet a certain amount of investment was needed. There were certain types of risks, which could not be classified as high, also according to the perception of the company members, which were working on the successful implementation of the deal.

The cultural differences could not be disregarded. They could not be neglected, because they required a change of the approach of business making. The Austrian members of the staff had to adjust their negotiation style to the new environment. It became clear that a new more effective and proactive attitude had to be cultivated in the new subsidiary during the post-merger integration period through a monitoring and a coaching program. Apart from the investments, the new management style was probably the most important asset, which was to be transferred to the Bulgarian company (it includes restructuring and optimization of the structure and the costs of the entity) (See Appendix 1).

All this can be summarized in the following

Table 10 :

Decision making factor:	Presence in the current situation
Previous experience	no
High risk market and environmental uncertainty	no
Need for knowledge transfer	no
Transfer of specific proprietary assets	no
High market potential	yes
High cultural distance	yes

Table 10: Factor presence in Bulgaria

It should not be forgotten, that in the case of Bulgaria there were certain rules enforced by the Bulgarian Privatization Agency, which restricted the choice of market entry mode. In other words, it was not possible for the companies to choose other than an acquisition of shares, but for the purposes of this thesis this fact will be laid aside and the case is going to be analyzed, as if the company had chosen this entry mode by itself.

Comparing the benchmark from the hypotheses in

Table 5 with the results from the analysis of the conditions of the market entry of EVN in Bulgaria in

Table 10, it can be seen, that they match in three of the six assumptions (high risk and uncertainty, need for knowledge transfer and market potential) and in the other three they do not. Therefore, it could not be given explicit priority to one of the modes or the other. An assumption based on the interview with Mr. Casagrande is that the different decision making factors had different weight in the decision making process (See Appendix 1). For the M&A-team the cultural distance, for example, was less important than the political stability and the economic potential of the project. So after the more significant factors proved to fulfill the basic requirements, the acquisition prevailed as a choice.

5. VERBUND AG and the JV in Turkey

The chapter will start with a brief overview of the development of VERBUND AG, the business areas that it is involved in, and its structure. Next, the company's goals, experiences and management vision will be considered. This will be done from the time perspective of 2007 in order to analyze the particular conditions that the company was subject to before and at the time of the cross-border market entry. Again the main focus of the chapter will be on the specific conditions in Turkey, which shaped the dimensions of the deal.

5.1 VERBUND AG in 2007

This sub-section will briefly present the history of VERBUND, its core businesses, corporate strategy and some financial figures. The main objective is to derive knowledge for the company's knowledge and strategic vision.

5.1.1 Company history and evolution

The history of the company features the development of the whole modern power system of the Republic of Austria. Shortly after the Second World War the nationalization of important industries was a popular policy in Austria. In 1947 the "2nd Nationalization Act" was issued, which gave the public authorities the right to take over all electricity production and distribution companies. Only small-scale power plants and grids were allowed to be privately owned. Later the same year the so called Verbundgesellschaft, the predecessor of the modern VERBUND, was officially registered in the Commercial register of the Vienna commercial court under the name "Österreichische Elektrizitätswirtschafts-Aktiengesellschaft". The main tasks of this entity were to manage the shares of the Republic of Austria in special purpose and provincial companies, as

well as to supervise and coordinate the expansion and reconstruction of the national electric system.

The first years of the company were marked by funding shortages – in this industry the largest projects are traditionally subsidized by the state. Nevertheless, by the end of the 1940s major power plant projects were initiated, which had to provide the much needed electricity in the provinces of Tyrol and Carinthia. In the 1950s, thanks to the Marshall Plan, Austria continued with the construction of major projects. The Kaprun and Ybbs-Persenbeug power plants were celebrated as heroic achievements and the country was able for the first time to cover its own needs, rather than to depend on imports.

In the following decade the economy was making a tremendous progress. In the 1940s the average households consumed only about 140 KWh of electricity per year. Only in the 1960s did the consumption of electricity double, and Austria had to import it once more, although further large-scale power plants were finished. In addition, clean energy has been a priority for Austria and VERBUND. After the prohibition of nuclear power usage after a referendum in 1978, the company had to continue with the construction of hydro and water power plants. In the thermal power plants environmental protection mechanisms were installed. Nevertheless, VERBUND concentrated and developed its engineering competences in the field of hydro-power technology. Today around 2/3 of the electricity in Austria is generated from the power of the rivers.

A major significant change in the structure of the company came in 1987 after a modification of the 2nd nationalization law, which allowed partial privatization. In the next year 49% of the shares of VERBUND were sold on the Vienna Stock Exchange. The other 51% remained under the ownership of the state. In 1987 the company united in its structure the shares of the Republic of Austria in a number of other special entities from the power industry.

As the country joined the EU in 1995, it had to adjust its the energy market to certain liberalization requirements. VERBUND AG had to adapt to the new conditions after enjoying a state-protected dominant position for decades. This meant optimizing the costs and the structure and concentrating on one core business – electricity. The unbundling of the “production” and “transmission” sectors called for administrative and legal changes of the corporation. This process went smoothly, and VERBUND met the official full liberalization of the electricity

market in Austria in 2001 confident of its leading position in the market. The company expanded its business abroad as a result of a new corporate strategy (VERBUND AG, 2014).

5.1.2 Corporate strategy and vision

The strategy for the development of VERBUND in the mid 2000's was initiated in the previous decade. Realizing that the high production costs, inefficient corporate structure and the high level of indebtedness can never bring the desired continuous, sustainable growth, the management undertook a wide-ranging restructuring program, which was completed in 2006. Reduction of the staff by 50%, re-organization of internal processes, divestments and debt-clearing were only a part of the measures. New business-opportunities abroad were considered. The joint ventures in Italy, France and Greece, the subsidiaries in Germany, Hungary, Slovenia and Poland proved to be beneficial. Furthermore, the increase of the global energy prices and the electricity sales helped VERBUND register impressive results:

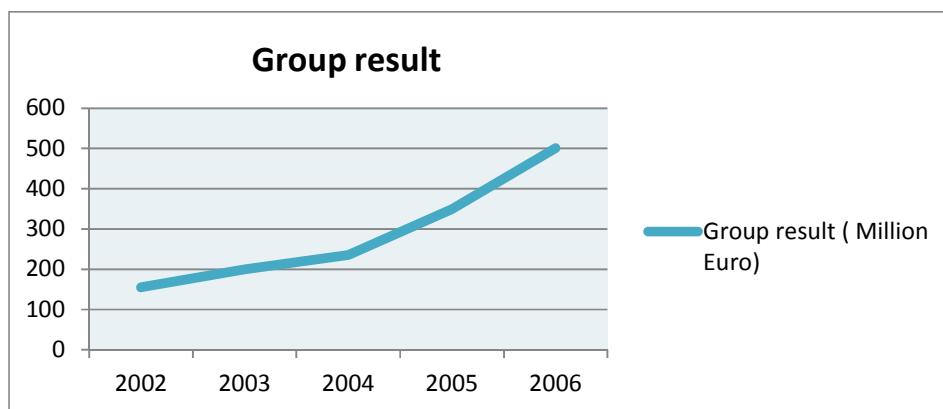


Figure 7: Group net result for the period [Source: Annual Report 2006/2007]

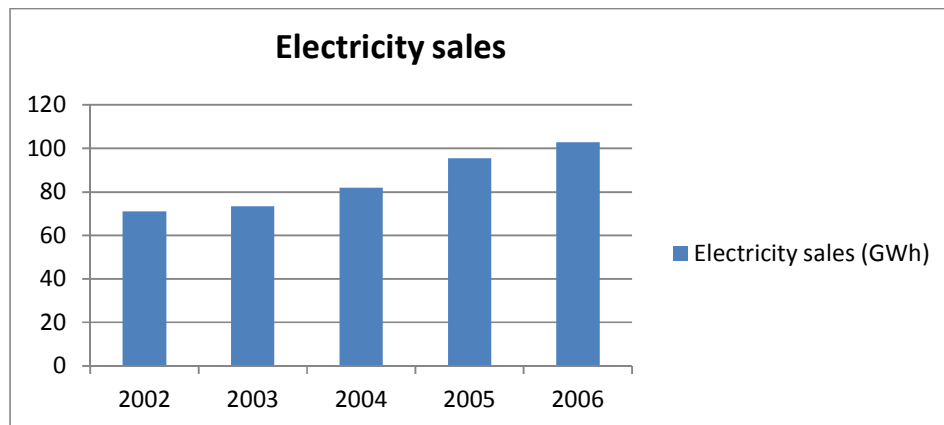


Figure 8: Electricity sales volumes [Source: Annual Report 2005; Annual Report 2006]

The focus of the new expansion strategy was put on high growth potential markets in SEE – Turkey, Macedonia and Romania were the main priority destinations and these countries were still in the beginning of the liberalization of their energy sectors. Over the previous years the company had established a certain cross-border market entry strategy. It had three main steps (VERBUND Annual Report, 2006, p. 40) :

- 1) Examine and analyze the market and its conditions;
- 2) Acquire a locally-based energy company;
- 3) Set up own generation capacities or secure electricity procurement in order to sell it on the local market;

In the case of Turkey the case of entering the market only by itself was not considered. From the very beginning the VERBUND looked for a suitable partner (See Appendix 2).

5.2 Turkey in 2007

This section is focused on the environment that VERBUND was about to enter in 2007. It will first provide a short overview of the historical background and institutional environment in Turkey at that time. Consequently, the economic perspectives and cultural specifics of the country will be introduced. The section will end with the general conditions of the deal.

5.2.1 Between Europe and the Middle East

The foundations of the modern Turkish state were put shortly after the First World War. It was in 1923 that the Ottoman Empire was officially replaced by the Republic of Turkey by a revolutionary group led by Mustafa Kemal Atatürk, who became the first president of the nation. The main goal of the new young and energetic leader was to modernize the multi-ethnic country in a Western fashion. Right after he seized power Mustafa Kemal implemented a number of radical reforms, most of which aimed to reduce the influence of the Islamic religion in the state governance and the everyday life of the ordinary people – all Koranic and religious schools were closed, the Islamic law was replaced by the parts of the law systems of a number of Western countries, the Arabic script was replaced by the Latin script, education became compulsory, Western-style dress were promoted, democratic multiparty elections were allowed and many others.

Although there were not massive protests against the so called “cultural revolution”, there was sometimes significant opposition from the side of religious leaders, mostly in the eastern part of the country. These revolts were also used by the Kurdish minority to gain certain level of autonomy since the Kurdish identity was repressed by the new Republic, which strived to preserve the territorial unity of the state. The army crushed the rebellion, some of its leaders were executed and the Kurdish identity was denied. Although the sultanate was abolished and democracy was introduced, the party of Atatürk – the Progressive Republican Party (RPP), political opposition was not allowed. The actual multi-party period began in 1950, when the Democratic Party (DP) won the elections and formed a government (Kasaba, 2008).

The army, along with RPP, has traditionally seen itself as a protector of the republic and the legacy of a secular (the separation of government from religious institutions). It has not hesitated to act even against the constitution and the basic principles of democracy, if it considers something as a danger for the national security. On a number of occasions the military has used its power and influence to intervene in the domestic politics. The tactics it uses can vary from issuing an ultimatum to political governments to operate in a manner set by it, as in 1971 and 1997, to direct assumption of power through coups – 1960 and 1980 (Aydin, 2005, p. 103) .

The traditional separation of the different social classes is associated with different political preferences. The normal and the upper middle class, which lives in the larger cities, most of all Istanbul and Ankara, which has easier access to education and work, demanding a better education, are other traditional supporters of the democratic and Kemalistic movement. But there is a large part of the population, which lives in poverty, does not have higher education. They are more prone to support the ideas of the political Islam (Kirisici, 2004, p. 40)

Taking into consideration this historic background it is easier to comprehend the political situation and possible trends, which at that time could have influenced the entry of VERBUND into the country. At that time, the Justice and Development Party (JDP), whose leader Recep Tayyip Erdogan, a former mayor of Istanbul became a prime minister in 2003 and holds this post up to the present day. The party was established in 2001 and although its ideology originally derived from the tradition of Islam, it managed to push away itself from this image and moved to the in support of “conservative democracy”. This was more or less the equivalent of the Christian democrats in Western Europe. The JDP claimed to be also pro-Western and pro-American. Its voters were mainly male from both rural and urban regions, whereas urban working women and housewives tended not to support it that much (Kasaba, 2008, p. 262).

The unstable economic growth was stopped by the economic crisis of 2001, when the Turkish lira lost a lot of its value to the United States Dollar and the GDP shrank by 5.7%. The country was governed by a coalition, which found itself in a difficult situation. The economic and political instability in the antecedent years served as a catalyst for the discontent of the people, who craved for stability and progress, and expressed it by stepping back from the traditional, better-known political formations. The JDP won the 2002 elections with vast majority. This enabled the party to form government by itself – since 1991 the country was governed by coalitions (Federal Research Division, 2013). Turkey managed to mark substantial economic success with a steady growth of more than 4% per annum. This is why in 2007 the party won the elections with a score of 45.5% of the votes. The following RPP had only just 21%.

Year		2002	2003	2004	2005	2006	2007
Voice and Accountability	Estimate*	-0.34	-0.12	-0.03	-0.04	-0.11	-0.09
	P-Rank**	41	44	48	48	45	46
Political Stability and	Estimate	-0.87	-0.81	-0.84	-0.60	-0.60	-0.82

Absence of Violence	P-Rank	20	24	20	27	27	20
Government Effectiveness	Estimate	0.04	0.04	0.04	0.19	0.16	0.30
	P-Rank	59	60	60	60	60	60
Regulatory Quality	Estimate	0.09	0.08	0.07	0.27	0.29	0.32
	P-Rank	57	55	57	61	59	62
Rule of Law	Estimate	-0.06	0.13	0.13	0.16	0.05	0.02
	P-Rank	50	56	58	57	55	55
Control of Corruption	Estimate	-0.71	-0.23	-0.17	-0.02	0.00	0.09
	P-Rank	32	50	51	57	59	60

*Estimate of governance (ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance),

** Percentile rank among all countries (ranges from 0 (lowest) to 100 (highest) rank)

Table 11: The Worldwide Governance Indicators, Turkey, [Source: The World Bank, www.govindicators.org]

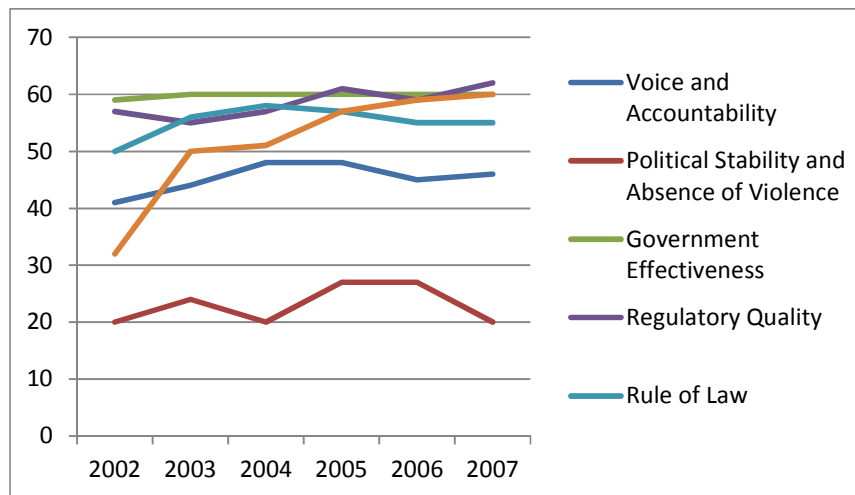


Figure 9: P-rank change of Turkey over the years [Source: The World Bank, www.govindicators.org]

Over the period from 2002 until 2007 Turkey does not register any significant progress in the development of the scores, although there is a slight improvement. This means that the situation in the country has not changed much over the time. If Turkey wants to join the club of the states in the EU, it should not neglect some important and needed reforms. The country is lagging in the development of its political and institutional development. Compared to the BRIC-countries, often given as an example of high potential economies, it is in just a little better position than India and China and still behind Russia and Brazil according to the Human development index.

5.2.2 Economic growth and potential

The potential of the Turkish economy is widely acknowledged. It was also recognized by the management of VERBUND AG as interesting, vast and with high growth potential, part of which lied also into the upcoming liberalization of the market. And yet, it is important to analyze the specifics and the foundations of this development.

Since the 1980s Turkey began a process of liberalization of the economy. This included reducing state subsidies and central prices determination, encouraging foreign investments through removing barriers for foreign trade, and interest ceilings, relaxing capital controls and expansion of the private sector. As a result, foreign capital flowed into the economy; cross-border trade flourished. The economy was growing rapidly with steady rates. Nevertheless, according to many scholars, the liberalization was not backed up by other needed macroeconomic reforms and regulatory policies. Turkey's boom and bust was accompanied by a number of inevitable cyclic crises – 1991, 1994, 1998, 2001 (Macovei, 2009, p. 5).

The last one of 2001 resulted in one of the most severe economic recessions in the history of the country. The Turkish lira depreciated by 115.3% against the USD and the real GDP dropped by 5.7%. The inflation, which traditionally had been high due to the undisciplined financial policy of the governments, rose to 68.5%. The interest rate of the government securities, one of the main sources of financing of the budget, scored the unprecedented 96.2% (Bakir, 2009 , p. 72). The banking sector was under severe pressure due to the large number of bad loans and the higher costs for inter-bank financing. At that time, as mentioned in the previous sub-section, the JDP won the majority of the votes of the scared and confused people, who wanted stability and security.

The new government undertook the so much needed reforms, which put order in the macroeconomics of the country without suppressing the economic progress. The IMF helped with a number of loans, which were bound to certain requirements for restructuring and reorganization. The measures included stabilization of the banking sector by implementation of international stability requirements, balancing of the central budget and deficit, tax reforms, reduction of the public debt to reasonable levels, cutting back of public investment in order to

keep the inflation under control (Macovei, 2009, p. 11). The stabilization program gave fast results, as it is visible in the following

Table 12:

	2001	2002	2003	2004	2005	2006	2007
GDP growth (per cent)	-5.70	6.16	5.27	9.36	8.40	6.89	4.67
CPI inflation	54.40	44.96	25.30	10.58	10.14	9.60	8.76
Unemployment rate	8.40	10.40	10.50	10.80	10.60	10.20	10.30
General government deficit/surplus (% of GDP and million EUR)	-23.9	-10.2	-9.0	-4.4	-1.2	0.8	-1.5
Foreign direct investment, net inflows (% of GDP)	1.71	0.47	0.56	0.71	2.08	3.80	3.41
Short-term debt (% of total reserves)	82.09	57.94	64.74	82.73	74.13	67.74	56.41

Table 12: World Development Indicators, Turkey [Source: The World Bank]

Thanks to the successful implementation of the macroeconomic stabilization program during 2002-2007 Turkey managed to get back on the fast growth track, mostly visible by the GDP indicators. The chronically high inflation, which is an inevitable part of this process, was limited to reasonable levels. The state budget restricted some of the expenditures and a lower deficit levels were gradually achieved. Turkey regained the confidence of the investors. The level of the FDI compared to the GDP, even though it was also constantly growing, was on the rise.

One of the key assets in a country is the population. Turkey has great potential, which is yet to be utilized. In 2007 the population of the country was around 69.5 million people. The growth rate, although in the last decades it has been steadily decreasing is around 1.2 - 1.3% p.a. The share of the people in the age range 15-64 years is 65.5%, out of them 17.7% are between 15-24 years (according to 2007 data). The EU-27 average, for instance, is 12.5% (The World Bank , 2013). And although 26% of the population lived below the poverty level, there is a new middle class on the rise, which is expected to demand and consume more with the further economic development of the country. Along with the features of the economy Turkey can indisputably be classified as a high-potential market.

5.2.3 Cultural dimensions

As previously discussed, a comparison between the cultural dimensions of Hofstede between Turkey and Austria will be conducted. Since each trait was already described in detail, the focus will be put only the major differences between just the two countries and all three altogether:

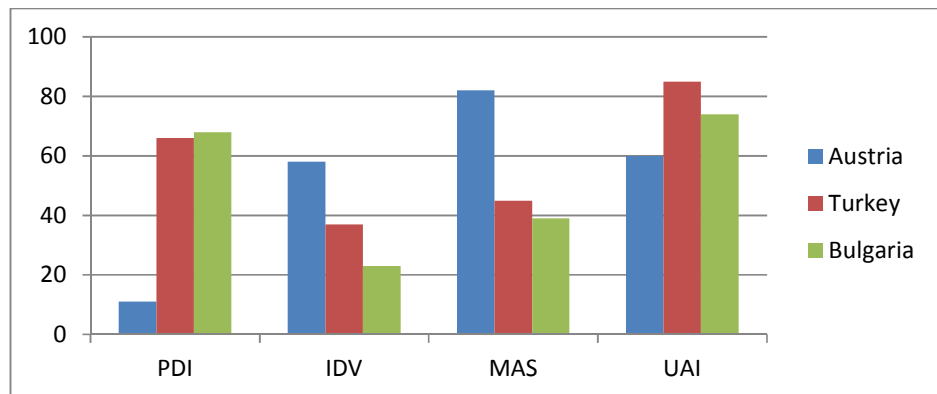


Figure 10: Country comparison [Source: The Hofstede Center]

As it is obvious from the figure above the same type of differences between Bulgaria and Austria are valid for the comparison between Austria and Turkey. The centuries of life together (Bulgaria was under Ottoman) rule for almost 500 years have left their mark. The similarities between the two South Eastern countries are obvious, although they are religiously and ethnically very different.

Mr. Reitböck, a member of the VERBUND-team, which was responsible for the deal, reported of none significant cultural differences in the negotiation process between VERBUND AG and the Sabanci Group. The Turkish partner had adopted very high corporate rules and practices, which were on a modern, international level. A lot of their employees had studied abroad and/or had international business experience. The negotiations with the local authorities were conducted by the Sabanci Group and the Austrian partners did not have personal impressions for the local cultural environment.

5.3 Parameters of the deal and personal experience of VERBUND AG into the new environment

With the rapid economic development of Turkey in the 1970's and the increase of the electricity demand, common power outages began to appear implying the need for reform and change of the whole state-owned energy sector. This meant liberalization, privatization and establishment of a state-regulator. The restructuring began in the mid-1980's, but the political inconsistency and the resistance from a number of public institutions, which were involved in power struggles among each other, led to the fact that the privatization remained limited due to the insufficient legal and institutional framework.

The first significant step towards the liberalization of the market came in 2001, when the Energy Market Regulatory Authority (EMRA) was established and a new energy law (Law No: 4628) was passed. A process of unbundling of the production, transmission and distribution functions of the Turkish Electricity Board (TEK), the Turkish national electricity company, was initiated (Çetin & Oğuz, 2011, p. 125). In 2004, a timetable for the privatization of public electricity companies and the liberalization, based on market principles, of the electricity activities was made by the public authorities. Although there was a certain lag in the fulfillment of the plan, a significant progress was noted.

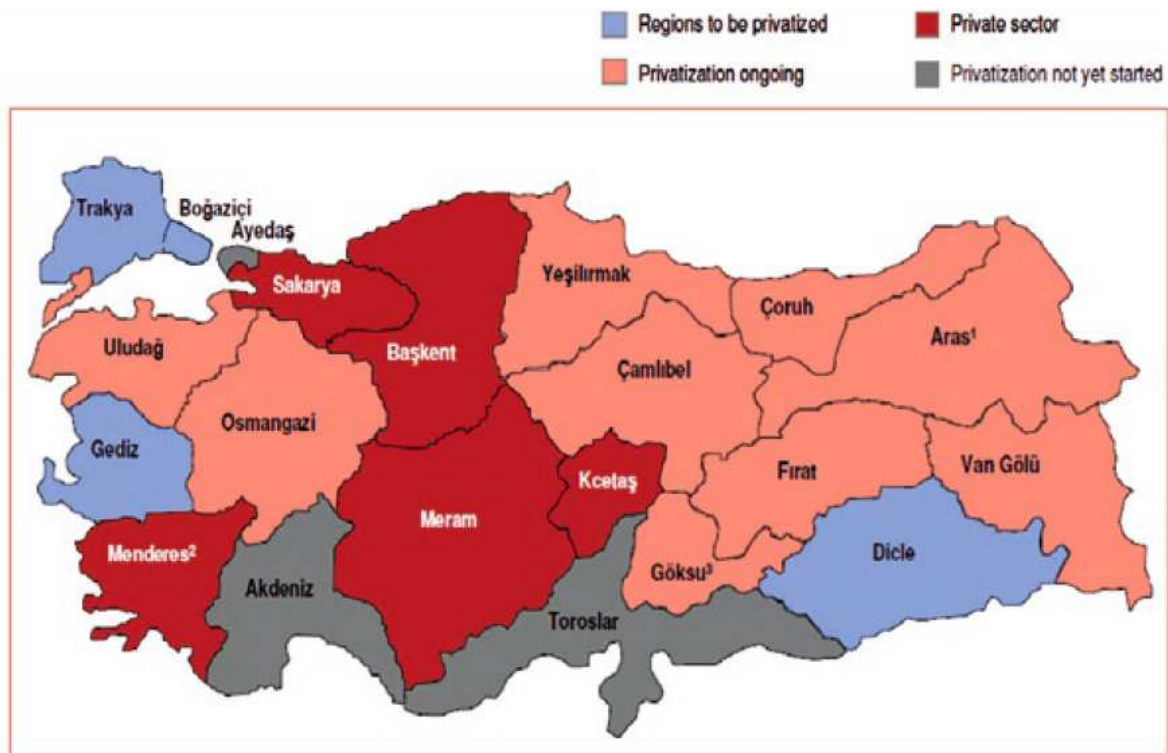


Figure 11: Privatization progress in Turkey in the electricity industry, 2009 [Source: Çetin and Oğuz 2011, 129]

A number of private companies stepped on a market, which was yet to be developed, although not all provinces were subject of privatization. Following the progress of the liberalization in Turkey VERBUND decided in the mid 2000's that it is already time to explore these opportunities, as it is mentioned in one press release of the Sabanci Holding, the eventual partner of the Austrian firm: "Sabanci and Verbund consider the Turkish electricity market as one of the most attractive emerging energy markets in Europe, offering considerable opportunities for sustainable growth on all levels of the electricity value chain" (Sabanci Holding, 2006). At the same time this opportunity represented possible, substantial risks, because there were no guarantees, what path this process might take and if the actions of the government, and the ones that might follow, would be contiguous.

VERBUND AG never considered entering the market by itself. It needed a partner with a profound knowledge of the local environment and language. Moreover, it was more eager to provide technical knowledge, particularly in the field of hydropower, than to overtake other

duties, like customer relations for example. This way valuable resources would be saved and the company would execute the duties, where it has the more expertise and experience. The Austrian investor conducted several negotiations with different potential local partners. In the end the Sabanci Holding was chosen. This is a leading Turkish and international conglomerate with an outstanding reputation and a wide scope of businesses – financial services, automotive, tire and reinforcement materials, chemicals, textile a.o. It controls over 50 subsidiaries, many of which are market leaders in their industry (see Appendix 2).

For the purposes of the IJV VERBUND bought 49.99% of the shares of Enerjisa – an energy company, which was 100% owned by the Sabanci Holding, at the purchase price of € 245.3 million. Afterwards a cooperation agreement with the Sabanci Holding was signed for joint management was signed. The Joint Venture's field of operation was planned for the regions Baskent, Sakarya and Ayedas. The partners stated the ambitious goal to achieve 10% share on the Turkish electricity market and to increase the production capacity tenfold to 5,000 MW by 2015 (VERBUND Annual Report, 2007).

The Turkish and the Austrian side had no major conflicts and disagreements on the future strategy of the IJV. The level of commitment and trust was high, which made easier the joint decision making. The common goal united the partners. The staff of the Enerjisa and the Sabanci Holding had the needed competences, skills and resource to execute their duties in the best possible way (see Appendix 2).

5.4 Conclusions and personal remark about IJV of VERBUND AG in Turkey

The market entry of VERBUND AG in Turkey with its environmental conditions has a number of very interesting issues. They can be summarized as it follows:

The company had previous experience in the field of cross-border market entry. It had successfully established subsidiaries in a number of other countries and was planning to continue with this expansion strategy, considering other potential markets. Although this was the first

major deal in the region of SEE, VERBUND AG had a vision and a strategy, based on market-entries in the past, how it should proceed. The negotiation team took into account the regional specifics and used the services of external advisors, already involved in the country.

The market was perceived as one with very high opportunities, which in the same time made the risks for the project worthwhile. The market was in process of liberalization and privatization for the last 20 years ago. The political environment was stable for the moment, but there were always certain signs of instability, as the history of the country had shown. Turkey had also a lot to do in order to improve the institutional environment, the income level and the citizen rights of the population. The currency risk was also present. Turkey was also not member of the European Union, which means that there is much less opportunity for an outsider intervention possible in case of unfavorable policies. Unlike Bulgaria, whose currency was tied to the Euro under the regulation of the Currency Board, the Turkish lira was traded free on the international markets. A financial crisis like the one in 2001 could significantly undermine the profitability of the investment.

The competitive advantages, which VERBUND had to offer, were the equal partnership and the substantial experience in the field of hydropower engineering. Turkey had a large unused potential for hydropower plants. However, this know-how cannot be classified as a special proprietary asset, but more as an investment and development potential.

Although the negotiation team from the side of VERBUND did not have any direct contact with the local authorities or people since this task was one that the Turkish side had to assume, according to the dimensions of Hofstede, Austria's culture and cultural perception differ a lot from the ones of Turkey. This was, namely, the role of the Sabanci Holding – to serve as an intermediary.

As it was done in the previous case in the following table the results are summarized:

Decision making factor:	Presence in the current case
Previous experience	Yes
High risk market and environmental uncertainty	Yes
Need for knowledge transfer	Yes
Transfer of specific proprietary assets	No
High market potential	Yes
High cultural distance	Yes

Table 13: Factor presence in Turkey

In the case of Turkey almost all decision making factors confirm the hypotheses. Only the first statement “Previous experience” and “High market potential” do not correspond to the initial suggestions. The final results of the study will be summarized in the following last section.

5. Conclusions and final remarks

The main purpose of this thesis is to compare the theoretical research work of different authors in the field of the M&As and IJVs and to derive the common factors, which predetermine the use of the one entry mode over the other. The analysis and the comparison of the different sources led to the formulation of six hypotheses. This was the starting point for the second stage - the empirical analysis, which followed afterwards.

This analysis has two specifics. The first one is that it was done in the region of South Eastern Europe. Although not very large in terms of area, this part of the continent is highly varied in the types of ethnic groups, history, economic and political development.. Therefore, each country must be analyzed separately and categorization for the whole region cannot be plausible. The thesis puts focus on two countries – Bulgaria and Turkey, neighbors that have many differences and some similarities.

Second, two big Austrian firms in the energy sector and their experiences are taken into account. The energy industry is very important for each country and for this reason it is heavily regulated by the government. In Bulgaria and Turkey it is yet to be fully liberalized and privatized. This introduces great opportunities, but also significant dangers in front of these projects, which demand substantial investments.

There are several conclusions to be made. In the case of Bulgaria, where EVN AG undertook an acquisition, the Hypotheses 2, 3 and 6 found practical support. The first two implied that in the presence of high market and institutional uncertainty and the need of knowledge transfer from a local partner the firm should prefer the IJV as an entry mode. In the situation of EVN in Bulgaria these factors were not existent. This suggests that the firm can choose an acquisition. Hypothesis 6 states, that in the conditions of a high market potential a more suitable choice is the M&A and Bulgaria was perceived as such.

Hypotheses 1, 4 and 5 were not supported in this case. The lack of previous experience in the field of cross-border acquisitions, the high cultural distance and the lack of specific proprietary assets to be transferred did not influence the decision of the management of the EVN AG to

choose the M&A over the JV. This possibility was not even considered as a possibility in the strategic plan.

The market entry of VERBUND AG and the choice to establish an IJV were supported by all statements (hypotheses), except of the first one. The country had higher institutional and economic uncertainty, the cultural distance was high, and therefore a local partner was chosen to reduce these risks, although the company had gained previous experience in the field of expansion strategies. There were not any particular assets, which had to be specifically protected. The potential of the market was indeed high, which contradicts the initial suggestion, but VERBUND was also one of the first foreign companies to enter the energy sector of Turkey in this scale. It could be said that this is a text-book example for factors, which impose the partnership as a required choice.

The thesis has also certain limitations. First, the number of the explored cases does not allow generalizing common principles for the market entry approach in SEE. It would be beneficial, if in further studies more examples are taken into account. EVN AG, for instance, had and still has subsidiaries in other Balkan countries like Croatia and Albania. Second, in the case of EVN AG in Bulgaria the market entry mode was predetermined by the conditions of the privatization. The international companies had to take part in an auction for the shares of regional electricity distribution companies. This limited the options to just one. In many countries with an ongoing liberalization of the electricity market the government determines strict conditions for the process since this is a very sensitive topic. Third, the qualitative research methods used in this thesis can be combined with quantitative ones in order to improve the precision of the results.

The unbundling and the liberalization of the energy and electricity markets is still an ongoing process and a question of present interest, especially in the EU. It is certain that there will be more and more utilities, which would try to take advantage of their competitive advantages and penetrate foreign markets that are liberalizing in the moment or seeking foreign investments. Therefore, more extensive researches would surely prove to be beneficial for understanding better the decision processes in the energy sector under the specifics of the given country.

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Abstract:

With the globalization of the business world today evermore firms are developing expansion strategies outside the boundaries of their home countries. The energy industry is no exception. With the ongoing liberalization and privatization of this sensitive sector new opportunities for cross-border market entry occur. The main objective of the thesis is to apply the theoretical rules for market entry choice in general to the specifics of the environment in South Eastern Europe and the energy industry. For this purpose two cases are analyzed – the acquisition of EVN AG in Bulgaria and the joint venture of VERBUND AG in Turkey.

The basis of this study is an extensive literature review of the existing theory on the factors that determine which market entry mode is preferable under different circumstances. This lead to the summary of six hypotheses. The qualitative analysis, combined with the personal impressions of specialists from the two companies shared in interviews, led to contradictable result. The case of Turkey supported most of the hypotheses about the joint ventures. The acquisition of EVN AG in Bulgaria supported only half of the assumptions with real-life facts. In conclusion it is to be said that in the regulated environment of the energy industry the companies are not always free to choose the market-entry mode by themselves. Not all factors are taken into account with the same weight. This is why this area would continue to be an interesting field for further researches.

Abstract:

Mit der zunehmenden Globalisierung der Weltwirtschaft entwickeln immer mehr Firmen Expansionsstrategien außerhalb der Grenzen ihrer Heimat. Die Energiewirtschaft ist keine Ausnahme. Mit der fortschreitenden Liberalisierung und Privatisierung dieses sensiblen Sektors ergeben sich neue Möglichkeiten für einen grenzüberschreitenden Markteintritt. Das Hauptziel dieser Master-Thesis ist zu prüfen, ob die theoretischen Annahmen für die Wahl der Markteintritt-Strategie in den Besonderheiten der Umgebung in Südosteuropa und der Energiebranche angewendet werden können. Zu diesem Zweck werden zwei Fälle analysiert – die Akquisition eines nationalen Energieversorgers durch die EVN AG in Bulgarian und das Joint Venture der VERBUND AG in der Türkei.

Die Grundlage der Studie ist eine umfangreiche Literaturrecherche über die Faktoren, die den Eintrittsmodus unter bestimmten Bedingungen bestimmen. Dies führte zur Formulierung von sechs Hypothesen. Die qualitative Analyse, kombiniert mit den persönlichen Eindrücken von Spezialisten aus beiden Unternehmen, führte zu widersprüchlichen Ergebnissen. In dem Fall von der Türkei wurde die Mehrheit der Hypothesen über Joint Ventures durch Fakten unterstützt. Der Erwerb der EVN AG in Bulgarien bestätigte nur die Hälfte der Annahmen mit realen Fakten. Abschließend ist zu sagen, dass die Unternehmen im regulierten Umfeld der Energiebranche nicht immer frei sind, ihre Markteintrittsstrategie selbst zu wählen. Nicht alle Faktoren werden mit dem selben Gewicht behandelt. Deswegen ist dieser Bereich auch weiterhin ein interessantes Feld für weitere Forschungen.

APPENDIX 1

Meeting: 22.11.2013, Time: 15:45, Minutes: 48

Participants: Werner Casagrande, Project Manager of HPP Gorna Arda AD, Bulgaria - a subsidiary of EVN AG; Dimitar Krumov

Top 1: The experts involved in the deal

In 2004 Mr. Casagrande was a Project Manager M&A in EVN AG. This was one of the first big deals for him, but had, nevertheless, already gathered some experience during the attempt of the company to get involved in projects in Romania, which proved to be unsuccessful for various reasons. One year earlier he participated in the acquisition of a company for wastewater treatment in Germany.

The core team in the pre-merger management process consisted out of approximately ten people that were both employees of EVN and external experts. On the side of the company the responsible professionals came from different departments – technical, commerce, legal, accounting, project management. The external help consisted mainly out of Austrian and local legal advisors, an investment bank and international accounting company.

Top 2: Strategic vision of EVN AG for the market entry and business in Bulgaria

The growth potential in terms of customer basis as well as of consumption per capita of EVN in Austria was more or less limited and the company believed its opportunities lie in other fields of business and abroad. It had considered different options in the region of CEE (Slovakia, Romania, Hungary), which at that moment were not pursued. The timing of the entry in Bulgaria was predetermined by the government at that time, which decided to privatize and auction 67% of seven energy distribution companies. The market entry mode was foreordained by the rules of the privatization.

Bulgaria was attractive for EVN for a number of reasons. The market had a high-growth potential – the level of income was much lower than the average in the EU and the energy consumption per capita was half of that in Austria. The Bulgarian economy was making headway after the tremendous crisis it was in the 1990's and there were signs of political stability. The government of the National Movement Simeon II was elected in 2001 with majority and was widely supported.

EVN, on the other hand, planned to use the competitive advantages it possessed to further develop the companies it was buying. It had a sufficient purchasing power to achieve economies of scale, e.g. in buying larger quantities of electricity meters, which it was planning to replace. The power grid suffered from technical losses, due to the lack of investments in the previous decades, and the illegal practices of manipulating the meters. Some customers were illegally connected and were not paying for their consumption. The structure of the two companies, that the Austrian electricity supplier was planning to buy, was highly decentralized. Many of the different branches had their own legal and accounting departments and own standards. EVN wanted to use its managerial experience to exercise higher control, to reorganize the branch system and consolidate the common departments in the head offices in Plovdiv and Stara Zagora (primarily HR, procurement, legal, accounting). It was also ready to invest in the renovation of the power grid.

In the pre-merger phase the team of EVN was using some similar in all other cases procedures. It made a Due Diligence, inspected sites, and did some assumptions and estimations for the future development of the acquired entity. Yet, the plan specifically for Bulgaria was worked out in detail during this process.

Top 3: Risks regarding the project

According to Mr. Casagrande there was not one single dominating risk, but it was more a bundle of risks. First, there was the planning risk – the market projections and development expectations could not take the direction they were expected to follow. Second, the stability of supply and the policies of the government were also not completely certain. In sum, the investment risk as a whole is the possibility that the investor might not operate in a predictable framework as he is hoping.

The process of the acquisition was smooth in overall. It was open, transparent and was done on a high institutional level. An international investment bank had to implement the deal and there was strict monitoring from the Privatization Agency of the Republic of Bulgaria. EVN was not confronted by any illegal practices.

Nevertheless, the company realized some of the dangers it could expect afterwards. As mentioned above, the level of the income was much lower than in the homeland of EVN and its main concern was that some of the clients might systematically refuse to pay its bills, as they have been doing so far – households, firms and even public institutions. This has never been considered in the Austrian market and was something completely new for EVN.

Top 4: Cultural differences and first contact with the Bulgarian reality

Apart from the fact that in Bulgaria the people do not nod, but shake their head, when they agree, there were several other cultural differences, which were quickly noticed in the process of the negotiations with the Bulgarian authorities. It quickly became clear that the structure in the public institutions was highly hierarchal. When there was no decision-maker, it could take weeks until a message was passed and some more weeks until it was returned. People were not willing or motivated to find a solution on an expert level, because there was fear in the public administration, that if you take a decision instead of someone higher-ranking, it could result in negative consequences. This is why employees, not only on public service, but also in private entities, were not proactive and were concentrated only on their own tasks. The insufficient coordination between the institutions and the bureaucracy also made negative impression.

The post-merger integration plan developed mostly over time. It was not concrete, but the Austrian investors knew exactly, that if they wanted the acquired enterprises to be competitive and successful, they had to implement some of their own managing style. A strict coaching program of the Bulgarian employees was conducted periodically and led by experts from Lower Austria. The services of an external advisor, who had to monitor and help to manage this process, were also used for some two years. The main goal was to transfer the EVN philosophy and management style in the Bulgarian subsidiary. Young Bulgarian professionals, who had studied

and worked abroad, were recruited in order to contribute to the introduction of proactive working style.

Please rate your concern for the following types of risks associated with international market entry projects:

Type of risk	5- extremely concerned	4	3	2	1 – not concerned
Financial		X			
Political	X				
Economical		X			
Cultural			X		

APPENDIX 2

Meeting: 16.01.2014, Time: 16:15, Minutes: 45

Participants:

Thomas Reitböck, Head of Projects and Transactions, VERBUND International GmbH;

Dimitar Krumov

Top 1: The experts involved in the deal

In 2007 Mr. Reitboeck was engaged in the Corporate Development Department of VERBUND. Together with the head of the department he was in charge for coordinating the acquisition of a 50% stake in the Turkish electricity company Enerjisa. At that time he had already gained valuable experience in the field of cross-border M&A. For a period of 5 ½ years he had been engaged with CA IB Corporate Finance GmbH – an investment bank involved in the CEE region. Since 2005 he was working in the Corporate Development Department of VERBUND. The core VERBUND team, which was executing the Enerjisa transaction, also included professionals from a number of other functions and departments of the company – mainly legal, controlling, technical, and energy market experts. In addition VERBUND also engaged international external advisors – an investment bank, a law firm, and technical advisers. Those advisers had international experience as well as an ongoing business practice in Turkey.

Top 2: Strategic vision of VERBUND for the market entry in Turkey

The market entry into Turkey was part of the international expansion strategy of VERBUND. By then VERBUND was already holding participations in Italy and France. The management perceived Turkey as a highly interesting, developing electricity market with an outstanding growth potential, which was yet to be fully liberalized.

For the Turkish market VERBUND decided to enter into a co-operation with a strong, local partner who has experience in dealing with state and regional authorities. VERBUND was looking for a partner with profound knowledge of the local conditions and procedures. In this

respect VERBUND considered different options and conducted interviews with a number of potential partners. Finally, Sabanci Group and VERBUND decided to enter into a partnership. Sabanci is one of the leading Turkish conglomerates doing business in different sectors in Turkey as well as internationally. Sabanci has an excellent market position, a solid financial strength and an outstanding reputation. As Sabanci is also operating in many countries outside Turkey it has implemented international standards and policies of doing business. The competitive advantage of VERBUND was the long-time know-how in the field of hydropower plant construction, maintenance and operation, as well as the company's trading experience in liberalized energy markets. VERBUND was also ready to offer an equal partnership (50/50) and the management was fully committed to the Turkish market and the development of the joint venture company.

Based on their vision and common expectations on the Turkish market Sabanci and VERBUND developed a long-term oriented strategy for their joint venture Enerjisa. Enerjisa was to become the leading integrated electricity company in Turkey aiming at a market share of 10% of the Turkish electricity market by 2015. The goal for generation was set to reach a capacity of 5,000 MW within this timeframe.

Top 3: Major risks regarding the project

There are several classes of risk that were recognized and considered in setting up the joint venture. First, the joint venture was exposed to the market risk – the Turkish energy market was still developing and was yet to be fully liberalized. The further steps of liberalization and the future development of the level of volatility and liquidity of the electricity market have been taken into account. Second, the political risk was also taken into account. Future regulatory policies and decisions could influence the successful development of the JV. This was one of the key reasons for VERBUND to enter into a co-operation with a strong local partner. Third, the currency exchange rate risk has been identified as key risk influencing the financial result of the JV and return on investment.

Top 4: Relationship between the joint venture partners

During the negotiation and setting up of the joint venture both partners demonstrated a high level of trust and commitment towards each other and a high willingness to cooperate. Based on their common expectations for key market developments they developed a business plan for Enerjisa which was characterized by the common goal to reach a 10% market share on the Turkish electricity market. In governing and managing Enerjisa they followed established corporate governance rules and key decisions were taken jointly. The Sabanci Group enjoys an excellent reputation in Turkey as well as internationally. Sabanci managers employed modern tools and processes of doing business. A lot of its employees can be characterized as open-minded and motivated with an international educational and business experience. Enerjisa itself is applying an open and transparent recruitment policy, and recruited most of its management and staff locally.

In overall, the negotiation process and closing of the deal were carried out smoothly. Due to the high commitment of both partners the acquisition and establishment of the JV could be executed successfully within the given timeframe.

Please rate your concern for the following types of risks associated with international market entry projects:

Type of risk	5- extremely concerned	4	3	2	1 – not concerned
Financial	X				
Political	X				
Economical		X			
Cultural			X		

Curriculum Vitae

Krumov, Dimitar



Ausbildung:

Universität Wien – Magisterstudium Internationale Betriebswirtschaft	Oktober 2011 – Februar 2014
Universität für National - und Weltwirtschaft, Sofia Bachelor Rechnungswesen	September 2007 – Juli 2011
91. Deutschsprachiges Gymnasium „Prof. Konstanin Galabov“, Sofia	September 2002 – Mai 2007

Praktika und berufliche Erfahrung:

Praktikum bei der Bulgarian Holding Company AG, Sofia, Bulgarien Rechnungswesen und Controlling	Juli 2013 – September 2013
Praktikum bei der Natsionalna Elektricheska Kompania EAD, Bulgarien Nationaler Stromversorger Bulgariens, Abteilung „Stromhandel“, Einblicke in folgende Bereiche:	Februar 2013
Praktikum im Ministerium für Industrie, Energie und Tourismus, Bulgarien Kundenservice-Berater, Mobiltel EAD, Sofia, Bulgarien	Juli 2012 – August 2012 August 2010 – Mai 2011
Praktikum beim Institut für Marktwirtschaft, Sofia, Bulgarien	Mai 2010 – Juli 2010

Auslandserfahrung:

Work and Travel Program in den USA, North Carolina	Juni 2008 – September 2008
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Sprachkenntnisse:

- Bulgarisch – Muttersprache
- Englisch – Verhandlungssicher – Cambridge Certificate in Advanced English (CAE)
- Deutsch – Verhandlungssicher – Deutsches Sprachdiplom, Stufe 2
- Russisch – Fließend – Zeugnis B1

EDV-Kenntnisse:

MS Word, MS Excel, MS PowerPoint, Adobe Photoshop

Persönliche Interessen:

Literatur, Filme, Sport, Wirtschaft

A handwritten signature in black ink, appearing to be 'D. Müller', written in a cursive style.

Wien, am 27.04.2014