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[Field Research]

# Central Eastern Europe's Pattern of Industrial Development and Regional Structure in Market Distribution

Dae-Sung Seo\*

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## Abstract

**Purpose** – Transnational corporations (TNCs) have influenced drastic changes (financial services, manufacturing, labor, technology transfer) in Central Eastern Europe (CEE). This paper examines the indirect changes in the CEE pattern of industrial development and market distribution.

**Research design, data, and methodology** – Over 25 years, neighboring (or rival) countries competed to attract TNCs as a double-edged strategy for privatization and debt reduction. Through their experience attracting foreign direct investment (FDI), many countries started to reflect aspects of national capitalism. Countries also began to realize in 2010 that TNCs sought to enter markets with more favorable conditions for export-oriented manufacturing.

**Results** – The analysis reveals that TNC investment strategies were aimed at eliminating local competition to acquire industrial "brown fields" to convert into "green fields." CEE countries have since strengthened their national systems and the support of large-scale state-owned enterprises and small and medium-sized start-up enterprises.

**Conclusions** – CEE has changed based on industrial development and a regional structure of TNC market distribution and associated government policies. The pattern toward flexible markets gives countries the ability to further their economies.

**Keywords:** CEE, Market Distribution, Consumption, Transition, FDI, Competition, Pattern Changes.

**JEL Classifications:** N93, N94, R12, O32.

## 1. Introduction

The article deals with the CEE' market distribution change. There started from the restructuring of industry development since

the transition and the existing patterns in local industry, all of which implemented "1st-round" reforms (market liberalization & small-scale privatization) in 1990-92. So the countries of the Eastern Europe and the Baltics are to compare performance measures across all three rounds, the gradually challenging 2nd-round and 3rd-round. They have embarked with varying degrees of intensity (large-scale privatization, enterprise restructuring & financial sector reforms). Initially, it suffered from the progress in "the 2nd-round" reforms in 1996, which include large-scale privatization and enterprise restructuring, which has been slower. In order to circumvent exactly this problem and to raise their own finance budget from abroad that would not add to the external debt, they focus on the following manner. Hungary has put the emphasis on their comprehensive privatization programs on sales of majority stakes to strategic (often foreign) investors, mainly in cash. Estonia has in some cases combined the sale of majority stakes to a strategic investor with sales of minority stakes for mass-distributed vouchers.

We can realize that CEEC was to show the different results. That means particularly because it extracted some benefits of mass participation while escaping the problems that are associated with fully diluted ownership. Privatization of small enterprises was implemented in many countries in the very early phases of the reform (including Albania, the Baltic States, the Czech Republic, Hungary, Kyrgyzstan, Poland and the Slovak Republic).

The privatization of farms has reached an advanced stage in many countries in 1996, the most of agriculture is now in private hands in Albania, Armenia, Bulgaria, Czech Republic, and Hungary. Much of the existing capital equipment and production methods are unsuitable for smaller-scale agriculture, which further slows the effective privatization and restructuring of agricultural production.

## 2. Costs and benefits between the state and firms

### 2.1. Background of ownership and governance patterns

Ownership and governance patterns, identify the governance

\* Assistant Professor, Sungkyul University, Gyeonggi-do, Korea.  
 Tel: +82-31-467-8413. E-mail: dais3s@gmail.com.

structures that have emerged as a result of the different privatization processes followed in the Czech Republic, Hungary, Poland and Russia. A privatized firm with dispersing outside ownership by individual voucher holders did not have the same governance structure as the firm with a core outside owner (a foreign investor). The most common issues were the insufficient domestic capital and delayed privatization. The Czechoslovakia participated in more than 70% people of them in which the 1st voucher privatization was performed in 1991.

<Table 1> Outcome of CEE's restructuring

|         | Reactive restructuring                                                                               | Deep structuring                                                                                             |
|---------|------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| Czech   | High - in IPF(investment privatization funds) - other domestic outsider-owned and state-owned firms. | Highest - in foreign-owned and lowest in insider-owned firms.                                                |
| Hungary | High - in all types of companies.                                                                    | Higher - in foreign-domestic outsider-owned and de novo firms.<br>Lower - in insider- and state-owned firms. |
| Poland  | Significant - labor shedding in state-foreign owned firms                                            | High - in foreign-owned and de novo firms, uneven - in domestic outsider- and insider-owned firms.           |
| Russia  | No difference - across types of firms                                                                | Little deep - restructuring across all types of firms                                                        |

Source: IBRD (1996).

Whereas, in Hungary and Poland, foreign firms hold minority stakes in de novo (newly-created) firms. Outside ownership has been a striking feature of the Hungarian privatization process, the feature also characterizes the de novo firms. When it comes to the ownership, the Czech does not distinguish the de novo firms, which would be mostly included in the insider-owned group.

<Table 2> Estimated share of the new private sector and the unofficial economy in GDP (1995)

|                                    | Eastern Europe | Baltics | CIS excluding Central Asia |
|------------------------------------|----------------|---------|----------------------------|
| New private sector in official GDP | 37.5 %         | 46.7%   | 21.7%                      |
| Unofficial economy in total GDP    | 19.0%          | 22.9%   | 44.8%                      |

Source: IBRD (1996).

In the face of strong resistance from enterprise insiders, the successive Polish governments opted for a multi-track approach to privatization .It was operated as a shock therapy to particular

policy leadership in Poland. At that time, Czech was expanding the voucher privatization. Hungary enhanced incentives for attracting FDI.

## 2.2. Dual balance: National capitalism and Miracle manufacturing by FDI

IFIs((international financial institutions) tried to cooperate with the successful case of CEE, Because of the need for public cost to attract TNCs. Initial Politicians were presenting various forms of state capitalism, and wanted to give them a fair chance with the advent of the national bourgeoisie and the mid-class.

By the late 1990s Czech was falling behind Hungary & Poland. Even Czech welcome to foreign capital inflows, but because it should be not be more preferred them to domestic capital. Czech caught up with them by providing tolerance of incentives and expansion of services to TNCs. Also because in the initial reform period, even nearly unstable case as liquidation of debt and then mostly have already paid the debt.

The most important commodity remaining controlled finally in all countries is energy. During the oil shocks of 1973-74 and 1979-80, even if most of them have not yet completed the process of liberalisation, they made it especially for electricity. In CIS the energy efficiency is over 4 times lower than in the Western Europe, they recognized that the estimates of the unofficial economy and unrecorded output were larger for the CIS than for CEE. MOL, a notable exception is the oil and gas company, where it initiated significant Board changes in February 1999.Through the State Property Agency (APV Rt) appointed prior to privatisation under the previous government. E.g. the savings banks OTP, & telecommunications company MATAV, & pharmaceuticals maker, Richter, & a property company, Hajogyari Sziget Vagyonkezelezo Kft.

Especially those connected to Western trade and industry, SOE(A state-owned enterprise) managers became another impact group possessing valuable experience with the international operating skills by the mixed formal or informal, the state or market strategies. Here was Hungary who consisted a secondary privatization method as MEBOs favoring the most managers of state-owned firms more than works. Poland's FDI incentive had not lower than in Hungary, but it was to take a double strategy of debt reduction for the stable. In this process, in case of Hungary MEBOs contributed more strongly to the emergence of new propertied holding class.

## 3. Type of industry development and micro-economic changes

### 3.1. Competitive manufacturing between V4

Reconstruct and the organization of Visegrad by approaching foreign capitalist-driven development according to the accession of the EU was generalized there. It's similar with that in the

past 19c because they experienced the prosperity built by foreign-oriented development. This competition has been strengthened by the EU. Integrated the role of 'hub-and-spoke' hub and support and increased dominance of TNCs.

Those appeared in Austria-Hungary monarchy and the Soviet era's history, regional cooperation framework turned into national competition. Since the oil price shock, it has had a Détente. However they got to going deeper the technology gap between the East and West, and tried to being some welfare countries from the changes in the 1970s-80s, all CMEA trade were encouraged to form a new division of labor as switched localization, internal industry, labor, technology transfer, know-how. Hungary produced bus and Pharmaceuticals, the former Czechoslovakia and Poland manufactured heavy chemical industries and vehicles. All 3 countries produced competitively the various electronics and computer goods.

### 3.2. Breaking and remodeling Rivalry

CEE tried to overcome the limit of the spoke economies such as unsatisfied demand, long transportation time, lower quality, lack of production differentiation and customer service. As a result of reduced production and employment in a reasonable overall state-owned enterprises, it was mainly achieved through the financial assistance of the deficit reduction and strengthening corporate restructuring. Even if Hungary's Law on Bankruptcy was enacted on 22 October 1991, later the government had no longer enforced companies with overdue liabilities to declare

bankruptcy, and allows a qualified majority of creditors to decide on an out-of-court restructuring.

Weak laws of the government impeded improvements in corporate governance. The bankruptcy process needs substantial improvements, although there has been a significant increase in declared bankruptcies (by 62% to 2,022 cases) in 1998.

In 2004, the only two countries to have had consistently high levels of bankruptcy filings over the past 3 years were Hungary and Poland. It was the most common industrial system with the exception of some large-scale industry. Because more effectiveness in attracting TNCs were complex industry that has been handed down from the past. EEs could rely on the relative abundant and appropriate human capitals, but they has caused regional competition between 4 countries in the region which was similar to the profile of the product.

## 4. Miracle industry trends

### 4.1. BRICs or Viesgrad

The complex activity manufacturing sector has created 1/3 to 2/3 of foreign capital Investment. In 2007, the top 10 car manufacturers and hundreds of suppliers focused on CEE for. They produced the 3 million various products, which amounted to 15% of the European production. Before the global crisis in 2008 it had estimated that the market share would rise to 20% of the region. There were some miracles between small or large

<Table 3> Privatization and corporate bankruptcy (1990~1996)

|         |                                                                                                         |                        | 1990 | 1991 | 1992   | 1993        | 1994  | 1995  | 1996  |
|---------|---------------------------------------------------------------------------------------------------------|------------------------|------|------|--------|-------------|-------|-------|-------|
| Czech   | mass voucher privatisation- IPF<br>(70%/GDP)                                                            | Bankruptcies filed     |      |      | 350    | 1098        | 1816  | 2393  | 2990  |
|         |                                                                                                         | Bankruptcies completed |      |      | 5      | 61          | 290   | 482   | 725   |
|         |                                                                                                         | Reorganisations        |      |      | 0      | 1           | 2     | 2     | 6     |
|         |                                                                                                         | Liquidations           |      |      | 5      | 60          | 288   | 480   | 719   |
| Hungary | direct sale to domestic & foreign investors: domestic private companies, managers /foreigners (60%/GDP) | Bankruptcies filed     |      |      | 14,060 | 1.<br>8,229 | 5,900 | 6,461 | 7,477 |
|         |                                                                                                         | Reorganisations        |      |      | 4169   | 987         | 189   | 145   | 80    |
|         |                                                                                                         | Liquidations           |      |      | 9891   | 7242        | 5711  | 6316  | 7397  |
|         |                                                                                                         | Bankruptcies completed |      |      | 1302   | 1650        | 1241  | 2276  | 3007  |
|         |                                                                                                         | Reorganisations        |      |      | 740    | 510         | 90    | 21    | 9     |
|         |                                                                                                         | Liquidations           |      |      | 562    | 1140        | 1151  | 2255  | 2998  |
| Poland  | mass liquidation / voucher privatisation (since1995)-workers /managers (60%/GDP)                        | Bankruptcies filed     | 151  | 1327 | 4349   | 5936        | 4825  | 3531  | 3118  |
|         |                                                                                                         | Reorganisations        | 2    | 76   | 688    | 665         | 596   | 465   | 375   |
|         |                                                                                                         | Liquidations           | 149  | 1251 | 3661   | 5271        | 4229  | 3066  | 2743  |
|         |                                                                                                         | Bankruptcies completed | 29   | 305  | 910    | 1048        | 1030  | 1030  | 984   |
|         |                                                                                                         | Reorganisations        | 1    | 8    | 98     | 179         | 235   | 287   | 173   |
|         |                                                                                                         | Liquidations           | 28   | 297  | 812    | 851         | 795   | 743   | 811   |

Source: IBRD (1997).

emerging countries. FDI outwards let Visegrad countries low when compared to BRICs countries especially Russia. As to investing in green field, BRICs especially China and India were much higher than Visegrad countries.

The difference between the both BRICs and Visegrad was remarkable miracle industries which tended acquisition-investment on an existing industry (Brown field) as for local-based or hub of TNCs. CEE came to lead the export-oriented development and growth on transnational complex industries. This was because, unlike the BRICs countries, it was the conversion of the production factors in successful structural micro-aspects rather than macro-economic aspects or meso-things.

The other reason was negative effects of TNCs' choice and competition for a cost saving. The successful industry fact was resulted in such as automotive, machine, device, equipment, electrical and electronic products, chemicals, pharmaceuticals as rebuilding the new industrialization for export.

It was a clear comparative advantage like low wages, a large amount of local purchasing power, well-equipped infrastructure,

and the different levels on GDP. They were similar as an investment motive for TNCs such a global system of production and transnational distribution. Some issues have appeared the finance of government in CEE due to support TNCs. The corporate tax rate of GDP for 1995-2007 was significantly lower, more than 3% in Slovakia, and 2% Hungary and 1.5% in Poland. Czech was also a little wide, but declined.

When compared between BRICs and Visegrád Four with the government debt and household consumption, the economy and consumption of V4 group has grown and their debts also increased steadily for 25years. While BRICs consumption has increased and debt is small. Both groups have been experiencing constant increases in consumptions of GDP whether an inward FDI was small or large. This means that Government debt and the external debt would have rather affected urgently household consumptions than foreign capital on the consumer market.

<Table 4> Exposure to the global crisis (mid to late-2000s)

|           | Financial /real estate FDI, 2005-7(2003) | Manufacturing FDI, 2005-7(2003) | Current account, 2007(2003) | External debt, 2007(2003) | Extension of credit to private sector, 2007 | Share of FX loans within banks' household loans 2008(2003) | General Govt' balance, 2007(2003) |
|-----------|------------------------------------------|---------------------------------|-----------------------------|---------------------------|---------------------------------------------|------------------------------------------------------------|-----------------------------------|
| Estonia   | 60.6(36.5)                               | 14.4(16.9)                      | -17.8(-11.3)                | 119.3(71.8)               | 285.0                                       | 82.4(66.6)                                                 | 2.6(1.7)                          |
| Latvia    | 46.5(38.8)                               | 8.8(15.6)                       | -22.3(-8.2)                 | 135.4(84.0)               | 221.9                                       | 87.4(58.4)                                                 | -0.4(-1.6)                        |
| Lithuania | 25.6(23.1)                               | 36.2(31.1)                      | -14.5(-6.9)                 | 76.9(44.8)                | 263.2                                       | 61.6(29.2)                                                 | -1.0(-1.3)                        |
| Bulgaria  | 38.1(28.2)                               | 17.8(34.8)                      | -25.4(-5.1)                 | 107.6(67.2)               | 250.2                                       | 29.8(5.6)                                                  | 3.5(-0.9)                         |
| Romania   | 31.2(16.1)                               | 34.1(50.9)                      | -14.4(-5.8)                 | 48.5(37.6)                | 261.3                                       | 58.7(29.3)                                                 | -3.1(-1.5)                        |
| Czech     | 31.1(25.7)                               | 36.1(41.9)                      | -2.6(-6.3)                  | 44.4(38.2)                | 233.6                                       | 0.1(0.7)                                                   | -1.6(-6.6)                        |
| Hungary   | 30.9(27.0)                               | 35.7(45.7)                      | -6.9(-9.4)                  | 96.8(61.6)                | 144.1                                       | 70.2(5.0)                                                  | -4.9(-7.2)                        |
| Poland    | 32.6(28.2)                               | 33.9(35.9)                      | -2.8(-2.5)                  | 54.8(49.5)                | 194.2                                       | 39.8(29.7)                                                 | -1.9(-6.3)                        |
| Slovakia  | 24.4(26.5)                               | 48.0(35.8)                      | -4.8(-4.3)                  | 52.7(39.5)                | 134.2                                       | 2.8(0.5)                                                   | -1.9(-2.8)                        |
| Croatia   | 55.1(26.2)                               | 23.0(34.9)                      | -7.5(-6.3)                  | 77.6(66.3)                | 136.4                                       | n.a.                                                       | -2.5(-4.8)                        |
| Slovenia  | 36.5(27.9)                               | 37.1(48.5)                      | -4.8(-0.8)                  | 100.6(52.5)               | 190.8                                       | n.a.                                                       | 0.5(-2.7)                         |

Source: The world bank (2015).

<Table 5> V4 and BRICs's External Debt and Consumption since the global crisis

|          | Govt debt (2014) /External debt (GDP, 2013) | House Consumption (GDP, 2012) | Inward Capital (2010) | Project value of Green field(2005.4~2011.5) | Outward Capital (2010) |
|----------|---------------------------------------------|-------------------------------|-----------------------|---------------------------------------------|------------------------|
| Hungary  | 79.2/ 115.3                                 | 54.30                         | 91.9                  | 45.7                                        | 20.7                   |
| Poland   | 57/ 72.6                                    | 61.42                         | 193.1                 | 109.8                                       | 36.8                   |
| Czech    | 42.57/ 63.4                                 | 50.55                         | 129.9                 | 34.0                                        | 15.5                   |
| Slovakia | 54.6/80.4*                                  | 56.69                         | 50.7                  | 41.3                                        | 2.8                    |
| Brazil   | 56.80 /19.86                                | 62.62                         | 472.6                 | 180.9                                       | 192.5                  |
| Russia   | 13.72 /19.2                                 | 49.09                         | 423.1                 | 255.5                                       | 433.6                  |
| India    | 67.72 /20.78                                | 60.28                         | 197.9                 | 363.8                                       | 92.4                   |
| China    | 22.40 / 9.51                                | 34.78                         | 578.8                 | 615.1                                       | 297.6                  |

Source: World Bank and Hungarian Central Statistic Office (2015). \*2014

#### 4.2. Advantage of latecomer

Slovakia was the late comers among CEE after the separation of the Czech Republic. While growth was starting to spur privatization of the remaining large state-owned enterprises and had joined the Eurozone in 2009.

In addition, the government began to sale 66% stake for the two international airports to several KDHC in the majority of Bratislava and Košice. They supported the inflow to future industry's FDI for a more diverse field introduced newly investment incentives and contributed to job creation, especially in areas of poor environment. The Slovakia's government by a latecomer is actively moved to trying to attract TNCs with generous incentive programs and tax reduction as compared to other regions.

#### 5. Advent of the market distribution periods after the financial crisis

As well as CEE countries, mostly in southeastern Europe and the Baltic countries have improved the value of existing products. TNCs moved in the way of new high-value exports, the width of the competition is expanded to other southeastern Europe (the Balkans) and the Baltic States. The global financial crisis was brought here on the following situation. Hungary, at 96.8 (61.6)% of external debt (government) was the highest among Visegrad countries, except for Lithuania and the Baltic countries and lower than in Croatia Balkan countries. However, manufacturing FDI in Hungary was higher than in other regions, including Visegrad to 35.7 (45.7)%.

After the financial crisis, Visegrad 4 have come structural reform agenda and revived the market distribution. The largely for-

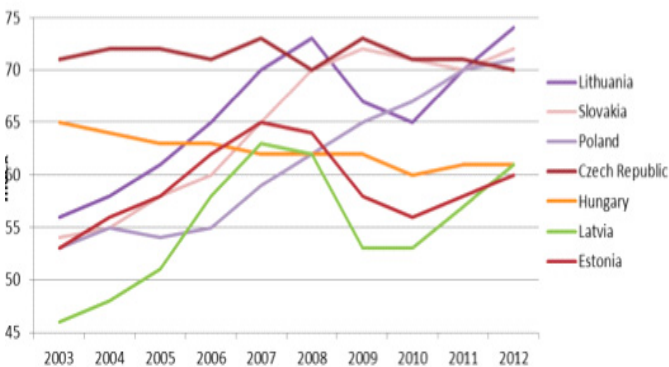
<Table 6> Corporate Rankings - based on sales (Hungary and Czech: 1billion HUF, CZK)

| 2012 | Countries | Company                           | Industry                                           | Ownership (Equity Cap)                              | Net Turnover |
|------|-----------|-----------------------------------|----------------------------------------------------|-----------------------------------------------------|--------------|
| 1    | Hungary   | MOL (Oil)                         | Oil, Energy                                        | State owned (2,247)                                 | 5,522        |
|      | Czech     | ŠKODA AUTO                        | Automobiles                                        | Volkswagen International Finance N.V. (100%, 160.0) | 262.6        |
| 2    | Hungary   | Audi                              | Automobiles                                        | Audi (961)                                          | 961          |
|      | Czech     | ČEZ                               | Electricity                                        | State owned (70%, 636.1)                            | 215.1        |
| 3    | Hungary   | GE Infrastructure                 | Engineering                                        | GE (531)                                            | 1,395        |
|      | Czech     | RWE Transgas                      | Oil, Gas                                           | RWE Gas International B.V. (100%, 87.6)             | 181.1        |
| 4    | Hungary   | MVM                               | Power, Energy                                      | State owned(620)                                    | 767          |
|      | Czech     | AGROFERT                          | Agrochemical, farm machinery, agriculture and food | Andrej Babiš (100%,96.2)                            | 132.5        |
| 5    | Hungary   | Samsung Electronics               | Electricity                                        | Samsung (181)                                       | 713          |
|      | Czech     | UNIPETROL                         | Chemicals                                          | POLSKI KONCERN NAFTOWY ORLEN S.A. (63%, 50.6)[      | 107.3        |
| 6    | Hungary   | E.On                              | Natural gas, Energy                                | Germany Electric power, Eon (30)                    | 699          |
|      | Czech     | FOXCONN CZ                        | Consumer electronics                               | Foxconn Holdings B.V. (100%, 16.7)                  | 105.1        |
| 7    | Hungary   | Tesco                             | Retails                                            | Tesco (289)                                         | 608          |
|      | Czech     | Hyundai Motor Manufacturing Czech | Automobiles                                        | Hyundai Motor Company (100%, 48.5)                  | 92.6         |
| 8    | Hungary   | Magyar Telekom                    | Telecomm                                           | German Telecom (607)                                | 289          |
|      | Czech     | ALPIQ ENERGY SE                   | Power, Energy                                      | Alpiq Central Europe AG (100%,10.4)                 | 81.5         |
| 9    | Hungary   | Bosch                             | Automobile part & Service                          | Bosch service(159)                                  | 580          |
|      | Czech     | ČEPRO                             | Oil, Gas                                           | State owned (100%, 16.7)                            | 66.4[        |
| 10   | Hungary   | E.On                              | Oil, Energy                                        | nationalized in 2013(281)                           | 570          |
|      | Czech     | Barum Continental spol            | Automobile Tire                                    | Continental Holding France Sarl (70%, 31.6)         | 53.8         |

Source: HVG (2013)., Czech Investment (2014).

eign-owned banking sector has weathered after the global crisis well, although credit to the private sector shows little growth and lending standards remain tight. The economic recovery needs to become better established to improve financial conditions, and cooperation with local supervisors may need to be strengthened, including through the new framework.

Key targets in the municipal and environmental infrastructure sector are the establishment of multi year incentive-based tariffs to stimulate investment and efficiency improvements. The fine-tuning of service contracts allowed greater private-sector participation, the improvement of governance and the limiting of political interference. In the transport sector there appeared still too few good examples of successful public-private partnerships (PPP), while concession policies and full commercialisation of the railways has yet to be achieved in most cases.



Source: Eurostat (2014).

<Figure 1> The comparison of the real personal consumption between Visegrade Group and Baltic states (EU 28 average= 100)

Visegrád group is private consumption are lower than the EU average but rapidly growing when compared to the Baltic and other neighboring countries. It can be seen that the increase in private consumption. Slovakia, Poland, Czech Republic, except in Hungary, they can achieve a high consumption group with similar Lithuania. Although Hungary is a situation that investment in research and innovation in higher than most other Visegrád three countries, it do not connect the market distribution to the national consumption. The consumption of their domestic foreign people rather than help to do them. But they still has high potential for growth in consumption, Poland has increased personal consumption expenditure as innovative research and development. Those durable products and distribution have been the driving force of economic growth.

## 6. Conclusion & Implication

During 25 years, EEs has suffered the pain of a big change. It was close to the physical distance between the local elements by the TNC operating. TNCs in the Northern European countries did not invest the Baltics in neighboring with such Sweden & Finland, but in Hungary, Nokia (Finnish mobile phone maker) and Swedish (Electrolux appliances) have established R&D facilities and large-scale production plant in Hungary far from the own regions. This phenomenon was not normal case similarly when compared to the neighboring countries and shared regional culture. These multinational companies had in mind that the market of V4 is likely to be extended to the eastern Caucasus and Western Balkans. They have invested on Visegrad 4 countries further. As corporate investment strategies will be faster into a integrate CEE like V4. V4 have become their own pattern changes according to industrial development and the regional structure in market distribution by TNCs or government policies. V4's pattern changes toward flexible regional markets make them help to grow in own economies.

CEE has distinct differences in the privatization scheme, but, they has the need for collaboration forward among Visegrade countries through mutual competition, which TNCs can be accessed variously in the market distribution. Through cooperation with other TNC, CEE will be influential in the region, as transnational corporations rather than privatization of large state-owned enterprises. Because the new pattern changes in CEE now are to be formed in one market distribution of the V4 group and to be extended for the eastern Caucasus, Korea should go make it for only V4in cooperation with the TNC within CEE on a market convergence and ICT development toward market expansion.

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