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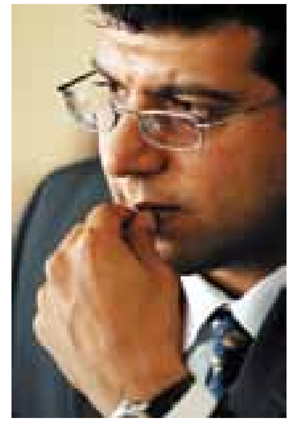
The Coming of Age of the Financial Crisis



Ilan Alon, *Editor*
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More than a year after the collapse of Lehman Brothers, the Great Recession is still looming large in the global economy. Unemployment and gold prices have hit recent highs, while FDI flows, trade and globalization have reached a nadir. A McKinsey and Company Global Survey of executives (Martin, 2009) reveals that (1) not all companies see a recovery by 2010, (2) most believe that the economy is still battered and that recovery will be slow, (3) many believe that globalization has stalled, and (4) commitment to free market economics will be lower than it was before the crisis. It seems as though every issue of the popular business press, such as *The Economist, Business Week, Financial Times*, and *The Wall Street Journal*, is filled with anecdotes and discussion of causal factors, contagion effect, particular industry impacts, and strategies for the new economic order. The previous issue of Insights dealt with some of the same issues as well.

As a supplement to the previous issue, this issue will examine (1) the ability of IB to contribute to the changing geopolitical and economic changes, especially in relation to institutional theory, (2) the impact of the financial crisis on the supply chain, (3) a comparative overview of the Spanish banking sector, and (4) the impact of the great recession on emerging EU economies.

The current global recession certainly exposed some warts in the global economic system and called into question some of the neo-liberal notions and assumptions of the Anglo-American economic system. It appears that some chapters in our international business books and, more importantly, in economic texts need to be re-written. The assumptions, economic incentive systems, systemic impacts, and regulatory influences must be re-examined. The crisis also highlighted what the international business discipline knew long ago: that economic, social and political systems need to be studied in contexts and that studying the contexts may be as important as the phenomenon itself. In international business, comparative, international and global phenomena are studies across time, space, national, ethnic, or group divisions.

In the first essay, Suhaib Riaz from the University of Ontario Institute of Technology suggests that international business can contribute to the understanding of the crisis and its consequences and in giving appropriate policy implications. The essay offers institutional theory as a particularly useful framework, as it takes institutional differences into account. The author also suggests that international business can be part of the solution by applying theories from a wide variety of disciplines to solve systematic problems. Studying variations across time and space is suitable for international business researchers. The current crisis can be studied as "time in context" across multiple levels.

One such level of examination can be the supply chain. In his essay on the impact of the financial crisis on the global supply chain, Robert Mefford from the University of San Francisco looks at the supply chain consequences. The tightening of credit in the financial sector meant that floating inventory and financing exports became harder. The just-in-time practice of multinational companies exacerbated the downward mobility of supplies, coined as the bullwhip effect. Shorter and fewer-tiered supply chains, such as the ones existing in service firms, were, therefore, less affected. Mefford's study shows how a crisis that started in one sector quickly spread to others, with a system wide effect on the supply chain.

Clearly, the industry most affected by the current financial crisis was banking, which is where the crisis started. But not all countries' financial systems were equally impacted. In fact, in some financial systems, the current crisis has given rise to their banks, relative to their previous world standing. Joaquín López Pascual and Yingying Zhang of CUNEF, Complutense University of Madrid, distinguish the banking sector of Spain from other shadow banking systems. Readers of their essay may be surprised to know that the Spanish and Chinese banks, and not American banks, are now among the top banks in the world. Why is it that Spanish banks were able to avert the financial crisis and, in fact, move ahead in global rankings? The answer, according to the authors, is found in the strict regulatory environment, competent risk management, lack of perverse incentives, control over leverage, and transparency.

The last essay in the issue examines the impact of the global economic crisis on the new EU member states. Kalman Kalotay from the United Nations Conference on Trade and Development and Sergey Filippov from Delft University of Technology examine the impact of the crisis on FDI flows, foreign subsidiaries, manufacturing outputs and exports, and public policies. As a result of the crisis, many subsidiaries in emerging markets have assumed new responsibilities extending beyond their original conceptions as pure export platforms, and their host governments have used this opportunity to push through needed upgrades of the industrial infrastructure for value-added activities. In the future, it is likely that more innovations will emerge from developing countries which are increasing their R&D and expanding their industrial capacity now.

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Exploring Institutional Realities: The Economic Crisis as a Time for IB to Lead

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The current economic crisis is a complex social phenomenon, several aspects of which go beyond national borders and also cross traditional academic disciplinary boundaries. While initial academic commentary in media has typically been grounded within the disciplinary boundaries of finance or economics, the complexity of the phenomenon requires broader investigation. International business (IB) scholars are known for dedication to the realities of phenomena, for investigation using multiple disciplinary perspectives, and of course, for focusing on phenomena beyond national borders. All these aspects are needed for proper examination of the crisis. In this article, I draw out a few insights on the unique position of IB scholars that can enable them to take a lead in the emerging academic discourse on the crisis and also invigorate broader interest in the IB approach to investigating business phenomena.

Stepping Outside the Box: Institutional Contexts across Space and Time

The current crisis, by drawing attention to the fallibility of existing institutions, can sharpen our arguments on how being within any one institutional framework could lead to cognitive biases. This could in turn lead to better appreciation of how different the phenomenon might be outside our system and what theories or methods might be appropriate for it. Stepping "outside the box" and accepting the reality of "other worlds" is easier when one's own taken-for-granted institutional system is in question. The current crisis could thus naturally lead to curiosity about other systems, and about how these systems compare and connect with the present one. With the cognitive blinkers off, it would be easier to appreciate a few IB truths on the boundedness of business activities by institutions that vary across space and time.

The attention to institutional differences across "space" or geopolitical borders in light of the crisis can spur several new initiatives for understanding the complex world we live in. In particular, more attention could be drawn to the new and multiple ways in which business phenomena across the world are interconnected yet different across borders (Dunning & Lundan, 2008). National government level, firm level and individual level cross-border interactions are more complex than before, not because the world is "flat" but precisely because it is not so. This leads to the idea that diversification of risk at the firm or investor level will have to take into account more complex interconnectedness across these multiple levels. Thus, the understanding of "distance across borders" and "risk" in IB studies might benefit from a re-examination in the context of the crisis. In this environment of interconnected transactions where risk across previously "uncorrelated" asset classes could become correlated at any point in time and extend across national borders, what is "distant" or "risky" could be seen through a new perspective taking into account the flows of capital, debt, assets, products and services, and in particular, financial interconnectedness in ways not envisioned earlier. Such investigation could complement earlier mainstream IB ideas on cultural distance and political risk.

The role of time in understanding business activities bounded by institutional frameworks could gain more prominence (North, 1990). The often unstated but assumed idea that institutional systems across the world are moving monotonically towards some sort of ideal over time is likely to be more contested. Cyclical views will gain prominence, with more cautious understanding of changes in financial and other institutions, which would be seen in the context of history. In this respect, recent suggestions on the importance of time in IB research (Eden, 2009) could help invigorate a new "time-as-context" set of works based on historical understanding of institutional development to provide better insights on business phenomena related to the crisis and beyond.

> *"The often unstated but assumed idea that institutional systems across the world are moving monotonically towards some sort of ideal over time is likely to be more contested."*

Institutional Idiosyncrasies and Challenges of Convergence

Further to the above points, space and time could be seen together as contexts for business activities. For example, the crisis helps focus attention on the fact that institutions vary across both space and time, and therefore institutional change is as idiosyncratic as institutions themselves. Research on business phenomena in the wake of the crisis in say, Eastern Europe, China, India or anywhere else, must consider the unique path-dependency and idiosyncratic nature of each country's institutional system as it evolves over time.

In particular, the assumption that the world is converging towards some sort of ideal American institutional framework and differences across nations are disappearing is contested by the varied causes and effects of crisis-related events across borders, suggesting the accuracy of semi-globalization or "spiky" arguments, rather than "the world is flat" simplicity (Ghemawat, 2003). For example, while excessive debt is part of the crisis phenomenon in the United States, high savings surpluses are the key issue in the Chinese context (Ma & Assche, 2009). Further, the normative idea that the reduction of institutional differences across the world and assimilation into a United States-centered model is desirable is also likely to be more strongly contested from within both the neoliberal capitalist worldview and critical theory perspectives. If this crisis shows us one thing most powerfully, it is that taking the existing neoliberal capitalism institutions in the United States as they exist at any point in time as absolute and working only within that system is far from reality. Instead, the creation or co-creation of institutional systems, the role of organizations in this process, and the differences in organizational forms and institutional frameworks across borders matter.

> "... *changes in the domestic markets of developed countries could provide opportunities for developing market firms to enter "value for money" segments* ..."

The range of voices on the pros and cons of various institutional arrangements is likely to widen on both sides of the existing neoliberal welfare-capitalism models, with Austrian economics and its arguments on minimal government roles gaining attention on one hand, and more socialist-leaning arguments on increased roles for government attracting new followers on the other. These increasing philosophical differences are likely to underpin debates in management on issues such as shareholder versus stakeholder management, corporate governance structures, the role of non-market strategies, business ethics, sustainability, responsible leadership, and so on. International business scholars could leverage their broader understanding of such issues gained through investigations across a wider range of economic, political and social contexts to provide insights from multiple perspectives.

Interconnectedness of Parallel Events across Different Institutional Environments

The simultaneous escalation of the crisis across national borders also helps focus attention on the timing of parallel events and their interconnectedness (or lack thereof) across borders. How could it be that while the major auto manufacturers in the United States (General Motors and Chrysler) were near collapse during the crisis, an Indian group (Tata) unveiled its most ambitious auto venture (Nano)? How would these two events, taking place in different space zones, interact over the longer term and impact each other in some other time-space zone? Would the shake-up in the United States' finance industry have any interaction with the micro-loan movement now or in the future? In other words, exploring whether and how businesses in different institutional frameworks could impact each other at some point in time, and indeed could impact "rules of the game" in each other's domains, deserves more attention and would be interesting for IB scholars to take a lead on.

These aspects would also form part of a forward-looking debate (Meyer, 2009), as business organizations try to make sense of where their next competitor or co-operator could come from in the changed post-crisis environment. For example, changes in the domestic markets of developed countries could provide opportunities for developing market firms to enter "value for money" segments, thereby creating competition or possibly co-operation opportunities for domestic firms (Williamson & Zeng, 2009). Similarly, off-shore service providers in developing markets might find new budget segments emerging in developed markets that they could cater to in the future. Further, experiences gained by developed countries' business organizations and NGOs in creating opportunities for lower-income, partly-employed or unemployed demographics in developing countries could be channelled back through reverse-knowledge transfer for solving emerging business and social problems in developed countries. For example, consumer and small-business financing models from debt-averse institutional environments along with micro-credit models tested in developing countries could be modified for business applications in the post-crisis economy. IB scholars' familiarity with such institutional contexts could allow them to take a lead on exploring these possibilities.

Organizational-Institutional Interplay

A renewed focus on institutional change in the context of the crisis could also draw more attention to the organizational-institutional interplay underlying such change (Riaz, 2009). When and how could business organizations become large enough and few enough in an industry to be "too big to fail", such that their failure could compromise institutional frameworks at the national and international level? The size and number of organizational players in an industry or institutional field and their interplay with institutions could be new topics of interest. Business organizations holding entire institutional frameworks "hostage" through their large size and broad scope of activities might not be a new phenomenon, but this deserves a fresh look in today's context. For example, more investigation is needed on how dominant financial industry organizations shaped the practices of risk evaluation, how risk across various asset categories became correlated during the crisis and eventually contributed to the failure of large financial players, and how such failure of oligarchies could pose systemic risk for national and international institutions.

Further, government intervention to support certain institutional frameworks through owning or supporting large businesses has existed throughout history (e.g., the East India Company) but deserves a revisit as well, in terms of the impact of such intervention on national and international institutions (e.g., United Kingdom's decision to invoke security laws on Iceland's banks; United States' bailout of major firms in the finance and auto industries). The new types of interactions emerging amongst private and public sector organizations and national governments would be interesting to explore in this respect. For example, how does the movement of professionals as institutional carriers (Scott, 2009) across the private sector and regulatory bodies (e.g., Wall Street banks such as Goldman Sachs, Securities and Exchange Commission, United States Treasury) impact the institutional frameworks at the national and international level? Attention to these aspects by scholars and policy-makers is crucial in the context of emerging dialogues between government and the financial industry, such as the recent appeal by President Obama to Wall Street for supporting regulatory overhaul, and a public admission by Goldman Sachs' Lloyd Blankfein on the industry's culpability. IB scholars could draw upon their insights from institutional contexts where such government-business interaction, oligopolistic competition, or other non-market factors are common, to contribute towards a better understanding of these emerging issues.

Multi-level Phenomena and Institutional Context

Exploring institutional realities could also provide insights into the multi-level nature of the phenomenon. For example, the behaviour of individuals during the crisis – that some have alluded to with accusations of greed and immorality—needs to be seen within wider organizational and institutional contexts. Thus, investigation of problems within the financial industry would need to shed light on the recruitment, training, incentives structures, and cultural aspects prevalent across the institutional field at national and international levels. Behavioural aspects of other key phenomena at the center of the crisis, such as the practice of debt, also need investigation and contextualization in terms of institutional frameworks. The practice of debt in its various forms varies across societies due to differing cultural-cognitive, normative and regulative institutional frameworks. The perception and evaluation of debt-related risk and the forms and extent of its acceptance at the individual, corporate, and societal levels need to be studied through multi-level and multi-disciplinary approaches that give due attention to individual behavioural aspects, but also take into account institutional systems and their historical trajectories across national borders. These issues are fertile grounds for research where IB scholars are uniquely positioned to take a lead.

Conclusion: Rigor and Relevance through Institutional Analysis

The above insights lead to a more general insight with respect to current debates on rigor and relevance in the field. Most of our business theories and methodologies are bounded within the existing North American systems, without due consideration that these systems themselves should be part of the analysis. With the reality of the crisis difficult to ignore, research traditions not taking into account institutional framework differences and changes across time and space could be more easily questioned in terms of their relevance. IB has led in relevance, and this is a time to lead functional areas mired in abstract theorizing and unrealistic assumptions to the complex realities inherent in social phenomena such as the crisis. It is therefore also a time to revisit the devotion to established theories and contest their claims through raw empirical evidence (Hambrick, 2007). Revisiting theoretical paradigms in today's context also means invigorating theories with concepts that speak directly to the space-time context as mentioned above, rather than considering such context only as an issue of generalizability of tests conducted in any one framework. IB, which has always recognized institutional differences across borders, should lead other functional area scholars to the realization of this reality and help in shaping new research trends in established functional areas.

The crisis could generate some fresh thinking on these lines and also draw us closer to understanding such complex social phenomena better by renewing our focus on multi-disciplinary, multi-level and cross-national analysis. Toward this end, IB scholars could leverage their understanding of varied institutional contexts to inform the emerging discourse in the post-crisis economy. This could be, in other words, an IB education moment that could place IB scholarship at the center of the business administration disciplines for quite some time.

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The Financial Crisis and Global Supply Chains

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The financial crisis which erupted in 2007 has already had profound effects on the global supply chains of multinational firms and will likely permanently alter some fundamental supply relationships. This essay explores what some of the consequences have been to date and speculates about future effects. Of course, the length, scope, and severity of the financial and economic crisis will determine how significant and permanent these impacts are, and it is impossible at this point in time to forecast this accurately. But in any case there have already been major developments in global supply chains that are likely to persist after the crisis ends.

Global trade is down by a third in 2009 from 2008 (*The Economist,* 2009), and the World Trade Organization (WTO) has forecast that global trade will fall by another 10% in 2009 (Jenkins, 2009). This is a very dramatic development as world trade has been on a continuous upward trajectory for many years. As globalization has rapidly advanced in the last two decades, it has provided a mechanism through global supply chains for localized economic disturbances to rapidly become global. The result has been that most countries are experiencing some negative effects of the drop in trade, with some nations and some companies being severely impacted by it. Just about every player in the global trade machine (banks, manufacturers, suppliers, service providers, transport and shipping companies) is experiencing consequences.

One of the first results of the financial crisis was the tightening of credit that is used to finance production and inventory of firms. This was followed by a sudden fall in demand for finished goods that quickly spread back through supply chains, affecting countless numbers of suppliers throughout the world. In China alone it is estimated that 67,000 factories have gone bankrupt (Green, 2009). Increased volatility in currency and commodity markets altered the cost and risk of global sourcing arrangements. Some countries responded with protectionist measures to promote exports and discourage imports. And many countries implemented economic stimulus packages that created and altered patterns of demand and supply.

The major consequences of the financial crisis as it affects global supply chains are primarily in three areas: financing problems, logistical problems, and cost effects. Permeating all three areas are heightened uncertainty and greater risk. This is leading many buyers and suppliers in global supply chains to refocus on stability and risk management, with less emphasis on cost reductions than prior to the crisis (Pisano-Ferry & Santos, 2009). These consequences and others of the financial crisis on global supply chains will be discussed in this essay.

Financing Problems in Global Supply Chains

It did not take long for the liquidity problems in the global capital markets to spill over to supply chains. Most buyers and suppliers in global supply chains are heavily dependent on their banks and the securities markets to provide them with working capital to finance production, inventories, and receivables. As the large global banks that provide trade finance experienced liquidity problems in 2008, they severely restricted credit to their corporate customers. The secondary market for trade credits also essentially dried up, further reducing funds. The trade finance gap has been estimated at $25-550 billion (Chauffour & Farole, 2009). Even companies with good credit ratings and strong balance sheets found themselves starved for liquidity. In response many firms cut purchases, reduced inventories, and lengthened payment to their suppliers. Of course, this exacerbated the crisis as demand and production fell and the suppliers were short of funds. The speed at which orders dried up and production was cut back was startling and affected companies around the world in extended supply chains. Increasingly firms are following *just-in-time* practices in regards to inventory, so cut-backs in orders were sudden and large with the uncertain demand environment. The *bullwhip effect* of a change in demand downstream in the supply chain being amplified as it moves upstream was clearly evident in the semiconductor industry which is global and involves hundreds of suppliers. A decline in demand for consumer electronics of 8 percent year-on-year in the US led to a fall of 20 percent in demand for chips for these products (Dvorak, 2009). This squeezed the cash flow of suppliers up and down the supply chain as everyone cut back production and tried to reduce inventories to conserve cash.

> *"Even companies with good credit ratings and strong balance sheets found themselves starved for liquidity."*

Some remedies for the financing problems of firms in global supply chains are evolving. One is for the companies with stronger balance sheets, often large MNEs that are usually the buyers, to extend financial assistance to their suppliers. This can be done in several ways including paying more quickly, making loans to suppliers, working with banks to facilitate trade finance, seeking import-export financing from government agencies, and even in a few cases taking equity stakes in suppliers (Milne, 2009a; Neville, 2008b). The suppliers themselves may factor receivables to obtain funds and seek assistance from banks and government agencies. The financial crisis threatens to reverse a recent trend towards more open-account financing in international trade. With increased counterparty risk and reduced liquidity, some firms are returning to traditional letter-of-credit trade financing (Neville, 2008a). More firms are seeking pre-shipment and inventory financing, and a few banks are providing this (Hawser, 2009).

Many firms are doing more careful financial risk assessment of their supply chain partners (Banham, 2009). This is both to prevent disruptions to their supply sources and to provide an early warning signal of potential problems. They can then determine whether to provide financial assistance or seek alternative, backup sources of supply. Few firms did this type of credit evaluation before, but the financial crisis has motivated many to undertake this activity. Cisco Systems was one of the few that previously had a program which, while designed to deal with disruptions to its supply chain due to natural and political disasters, was extended to assess the impact of the current financial crisis on its supply chain (Hoffman, 2008).

The Group of 20, meeting in London in April 2009, realizing the importance of international trade to economic recovery, obtained a commitment from its membership to provide $250 billion of trade assistance through import-export credit agencies and development entities. They also pledged to not increase protectionist measures, but some of the stimulus and corporate assistance programs of governments have been inherently biased toward domestic firms. Banks which have received government support have been pressured to increase their lending to local firms while stimulus programs have often contained "buy local" provisions. The long term effects on global trade of these measures remain to be seen.

"Banks which have received government support have been pressured to increase their lending to local firms while stimulus programs have often contained "buy local" provisions."

Logistical Problems in Global Supply Chains

The effects on global supply chains are not only financial. Many firms that have offshored their sources of supply have experienced serious disruptions in their ability to obtain materials and products. The sudden drop in orders in developed countries spread rapidly through global supply chains, resulting in severe cutbacks in production in the multiple tiers of the supply chain. In some cases suppliers failed due to lack of financial capacity to survive the sudden fall in orders. In other cases, they cut quality or lengthened delivery times in a desperate attempt to reduce costs. Some have had difficulty funding the purchase of materials, delaying fulfillment of orders. Inventories have been cut drastically along the supply chain (i.e., *destocking*), making it difficult to replenish supplies quickly (Milne, 2008).

These problems are exacerbated to some extent by the emphasis in recent years on cost reduction in supply chains. Much of the globalization of supply chains occurred because of a search for lower costs, which led to a shift of much production to developing countries. This inevitably lengthened supply chains, increasing response time and total inventory throughout the system. Many managers adopted lean practices of keeping inventories as low as possible in their firm. This system seemed to work well when the global economy was rapidly expanding, but some of its flaws are now becoming apparent such as single sourcing and inadequate inventories (*Logistics Manager*, 2009). The overemphasis on cost reduction, and lack of concern about increasing productivity and supplier collaboration and sustainability, have contributed to some of the current problems being experienced in global supply chains (Mefford, 2009).

Firms are responding in various ways to the disruption of supply chains caused by the financial crisis. There is more concern about supplier capability, both production and financial, with closer monitoring of the supply base (Smith, 2009). Although this has not happened much yet, there may be a shortening of supply chains with fewer links and sourcing at home or closer to home. The CEO of Phillips, Gerard Kleisterlee, says that he expects large companies to move away from far-flung global supply chains for both economic and environmental reasons (Tett, 2009). Countries in Eastern Europe are likely to benefit if European MNEs shift sourcing away from Asia, while Mexico and other Latin American companies will benefit if US and Canadian firms shift to closer suppliers (Milne, 2009b). This sourcing closer to home is sometimes referred to as *nearshoring*. Some firms may even consider *in-sourcing* or vertical integration to have greater control over their supply chain. For those firms continuing to outsource, there is likely to be more emphasis on predictability and reliability, instead of cost, in selection of suppliers (Smith, 2009).

Another likely consequence of the disruptions in global supplies will be closer coordination of the entire supply chain. This, in conjunction with better supplier selection and closer monitoring of supplier performance, will allow quicker and more accurate response to demand fluctuations and less of the bullwhip effect. The supplier too has an incentive to know more about its customers to prevent sudden cancellation of orders or payment problems. Both buyer and supplier have been incentivized to know each other better because of the financial crisis (Green, 2009). Improved information technology, especially supply chain management software and demand forecasting software, will facilitate this tighter linkage of the supply chain. However, with the current credit problems, many firms have cut back on investment, particularly IT investment, and this may hinder the desired better communication (Hoffman, 2009).

There also may be an increase in outsourcing the entire supply chain management process to a specialist firm like Li & Fung Group in Hong Kong, which can manage the whole process of procurement, production, logistics, and payment. Companies including Liz Claiborne, Talbots, Toys'R'Us, Timberland, and Sanrio are using Li & Fung to manage their supply chains; they just provide product designs and Li & Fung does the rest (Einhorn, 2009). The advantage of this approach is that it not only reduces the headaches and complexity of managing the chain but also takes advantage of the specialist firm's extensive knowledge of the supply base for an industry and its ability to quickly shift suppliers as conditions change. If the entire process is not to be outsourced, at least the logistics portion could be. Third-party logistics providers (3PLs) such as United Parcel Service (UPS) and Federal Express (FedEx) provide extensive management of the shipping process throughout the supply chain and may even provide in-transit financing in some cases (Hoffman, 2008).

A variation of the shortening of the supply chain approach is to keep the suppliers in the low cost developing markets but increase their economic viability by developing products and markets in their home countries. By increasing scale and scope and improving their financial resources, the MNE is developing their capabilities to be a more reliable supplier (Sodhi & Tang, 2009).

Cost Consequences on Supply Chains

Not all of the effect on cost has been negative in supply chains. Some commodity prices have fallen substantially since the crisis began, which lowers the cost of raw materials in the supply chain. Oil, iron ore, copper, and most agricultural products are among those commodities whose prices have fallen and are significant cost factors in many industrial products. This may be a short-lived effect but currently is beneficial to many firms. Some may choose to prudently hedge against future commodity price fluctuation via commodity futures, options, or swaps.

Exchange rates of many developing countries have fallen vis-à-vis the US dollar since 2008, resulting in another source of cost reduction to global firms sourcing from these countries. Fluctuating exchange rates also influence the attractiveness of countries as offshoring sites, and the result may be some shifting of suppliers to countries experiencing the greatest depreciation (e.g., to Mexico or Vietnam from China). How permanent these shifts in currency values are remains to be seen but ultimately may have an impact on sourcing and investment decisions. Heightened exchange rate volatility also introduces an additional element of uncertainty into global supply chains. This may discourage some offshoring decisions as well as increase the need for hedging. Hedging against currency changes can be either operational (e.g., diversifying supplier countries or markets) or financial (e.g., currency futures, forwards and options). However, the cost of financial hedges has risen and thye are more difficult to obtain for many firms due to the financial crisis (*The International Economy*, 2009)

Another cost benefit of the economic crisis has been a decrease in shipping costs. Container rates have fallen substantially along with shipping rates for other modes of transportation due to the drop in demand and thus shipping volume. This is compounded by a large increase in container ship capacity coming on line in the next few years that may result in reduced shipping costs persisting even as the global economic situation brightens.

Service Supply Chains

The last decade has seen a dramatic increase in offshoring of business processes such as call centers, software development, back office financial services, and other support activities. How have these supply chains been impacted by the global financial crisis? To date, the answer is that they have been impacted less severely than product supply chains. Imports of business, professional, and technical services to the US were 4% higher in the first quarter of 2009 than a year earlier (*The Economist*, 2009). Why are service supply chains being less affected than product supply chains? The answer may be in the basic nature of service supply chains, which are generally shorter with fewer tiers and thus are more closely linked to final demand than product supply chains. Being shorter means less of a communication lag with a demand change and a lessened bullwhip effect. Service supply chains are often much closer to true just-in-time systems with services being rendered as the work flows in rather than in large, infrequent batches or orders (e.g., processing of credit card applications in India occurs as the applications are received). Not all service supply chains are short or JIT of course, but it appears that enough are to mitigate the effects of the financial crisis. This does not mean that they are not affected by the crisis, however. They are experiencing the same shortage of credit as product chains and reduction in total business crimping their financial capacity and ability to expand. Some business process outsourcers in India are attempting to move into higher value-added, more complex IT projects that are longer-term and more stable (Srivastava & Hamm, 2009).

The Future of Global Supply Chains

Global supply chains are clearly under stress with the financial crisis. Firms involved in these supply chains are learning to adapt and adjust to the problems of liquidity and supply disruptions that have resulted. There have been some cost benefits of the crisis due to lower material and shipping costs, but the volatility of commodity prices and exchange rates has increased the uncertainly of future cost structures. Many of the consequences of these adjustments remain to work themselves out. If the crisis is short-lived then inertia is likely to set in, and many firms will revert back to their old supply chain practices. But some more forward-thinking firms may achieve permanent improvements in their supply chains as a result of the crisis. Some of the approaches discussed above hold such promise. These include a focus on more *rapid-response* supply chains that are tightly coordinated with quick response to changes in demand, short lead times, and lean inventory throughout the chain. There will probably be less emphasis on cost and more on reliability and flexibility in designing the supply chain. The future probably also foretells supply chain partners seeking a better understanding of each other's production and financial capabilities and closer monitoring of the supply chain by the dominant partner as well as better communication facilitated by improved supply chain software. Firms also may pay more attention to hedging some of the cost risks through diversification and financial derivatives. The firms that deal with the financial crisis strategically will emerge stronger (Meyer, 2009). By positioning the firm to deal with the next crisis with a tighter, more resilient supply chain they will have enhanced their global competitiveness.

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Banking Crisis: A Spanish Case in the International Horizon

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The financial crisis we are experiencing sometimes seems to perplex people. However, if we cast our minds back, a financial crisis, or more specifically, a banking crisis, is not a singular phenomenon occurring for the first time in our human history. As recently as the 1980s, massive lending followed by major defaults caused the Third World debt crisis triggered by the Mexican Weekend, and in the United States, the bankruptcy of many "savings and loans" resulted in a loss of over 150 billion dollars, most of which was covered by taxpayers (Cundiff, 2007). Japanese banking has also suffered from the deterioration of its banking system with a crisis that began in early 1992, when the problem facing the *Jusen* companies (housing loan corporations) was publicly recognized (Kanaya & Woo, 2000).

With regard to Spanish banks in the international horizon, their particular performance and the crises they have suffered may not be very familiar. The recent publication of *The Banker* with the ranking of the top 1,000 banks in the world in terms of profits may take some by surprise. The top five are all Chinese and Spanish: ICBC (China), China Construction Bank (China), Santander (Spain), Bank of China (China), and BBVA (Spain) (Torres, 2009). This essay examines how these banks have managed to be at the top of the worldwide profitability ranking in the current banking crisis, focusing especially on Spanish banking due to its success in the sector and given its comparative silence in international business.

International Banking Crisis and Spanish Crises

Past banking crises have demonstrated that they have the potential to ruin some banks, whilst others and their managers may occasionally be able to take advantage of crises to reform financial systems and strengthen their positioning in the post-crisis market.

In Europe, the Scandinavian banking crisis cost 2.8%–4% of their GDP. Barings Bank in the United Kingdom, Crédit Lyonnais in France, Napoli Bank in Italy and Banesto in Spain could also be added to this crisis list. At the beginning of the 21st century, the German bank crisis and the Argentinean one through the redollarization of frozen deposits in these countries caused the main banking crises.

Several variables could contribute to the crises and make financial firms go bankrupt. Difficulty in the economic environment may be the cause of the crisis, but bad management and fraud together with an absence of an appropriate preventive policy are the main contributors. Barings Brothers, founded in 1762, went bankrupt after accumulated losses in the futures market in Singapore by a trader called Nick Leeson, after more than 200 years of existence.

The current financial or banking crisis, which began in the middle of July 2007, is the most important one since 1929. The causes are multiple, but the weak regulatory framework, low level of risk management, perverse incentives, high and uncontrolled leverage, lack of transparency and greed among managers with excessive compensation packages are some of them.

Apparently, Spanish banks, along with Chinese ones, have performed well in terms of profitability in this worldwide banking crisis as a result of their singular strengths. The Spanish banking business model is fully integrated into the European and international model, unlike the Chinese one. Based on their prudent management, their feasible business model has made it possible to obtain profits in this difficult economic climate we are experiencing and to maintain a low level of bad debts and defaulting.

The persistence of the current crisis has been destructive for the international finance system and international banks. Efforts have been made to promote joint-initiatives by several countries, international organizations and forums to rebuild or restore confidence in the financial system.

If we look back at previous years' data, we can see that the rise of Spanish banks in the worldwide ranking has been gradual. In 2006, Santander and BBVA were already well-ranked in terms of assets according to Bankers Almanac, and they were the 13th and 38th largest banks in the world, respectively (Kase & Jacopin, 2005). An analysis of some recent banking crises shows that the good performance of Spanish banks in these critical times is not accidental. Studying banking in this country in further detail may provide some insights that will prove useful to other international banks and businesses. Based on Villasante (2008: 2), some characteristics of the Spanish banking system are shown in the Table 1, with further details in the next section.

Spanish Banking Industry and Their Leading Banks

The current positive performance of the Spanish banking industry could be attributed to the Banco de España's[1] demanding regula-

Table 1 Characteristics of the Spanish banking system

External factors:	
Institutional and legal framework (Effective supervision)	- Unconnected to the problems associated with subprime * No investment in toxic instruments * No vehicles besides supervised balance * No reputational risk when selling to clients
Internal Factors:	
Business model (Stability)	- Retail banking - Client-oriented - Highly competitive and efficient management with advanced technology
Financial results (Positive)	- Repeated high profitability - Real excess in capital and reserves - Low defaulting and very high coverage

tions and supervisions, its well-developed business model, and its appropriate risk management with prudence in incorporating some innovative financial products.

Spanish banking, without exception, has experienced several crises in its history. In the 1970s, Spain was in a period of political transition and its economy lived in a period of constant crisis with more than 27 banking crises from 1978 to 1985. However, only two banks went bankrupt (López Pascual & Sebástian González, 2008). They learned from these mistakes and the banking system was thoroughly transformed. This banking reform was characterized by processes of concentration, mergers and acquisitions, creating more powerful financial groups and enforcing the Banco de España's monitoring and control functions. These controls focus on prudential regulation in which a sound financial balance is required with a high percentage of own resources/capital, a low level of bad debts and high coverage for operations. Another example is the creation of the Spanish Financial Auditors' Association in 1970, which became one of the two leading associations of this kind in Europe (Kase & Jacopin, 2005).

As a result of banking crises, there was a series of mergers and acquisitions between 1987 and 1999. After all these internal reorganizations, Spanish banking realized that it was part of a global financial system instead of a domestic one, and that meant competing globally with other internationally competitive banks. Specifically, in 1986 and 1987, the theory that "marriage" between big banks was the best way to be prepared for the competitive business environment increased in importance. Consequently, the Unión Económica y Monetaria (UEM)[2] was established, and the competitiveness of Spanish banks has increased due to financial liberalization and significant technological development in recent years (López Pascual & Sebástian González, 2008).

Large banks resulting from international mergers and acquisitions are unavoidable in order to be internationally competitive. The maturing process of Spanish banking contributed to their competitiveness in the international sector, which led them to acquire banks in Europe, Latin America, the United States and Asia in the 1990s and 2000s. As a result, two mega-banks emerged in Spain after several operations with different phases: BSCH (Banco Santander Central Hispano, commonly called Santander) and BBVA (Banco Bilbao Vizcaya Argentaria).

The excellence of Spanish banks' management lies in their retail banking business model. To differentiate them from others, they are very much customer-oriented rather than product-oriented. The model has proved to be sound and profitable in the past. This managerial factor has centered on the accomplishment of anti-cyclic provisions. That is, the reserves of provisions could make it possible to gain time and continue to maintain profits and a healthy capital rate. This is a determinant factor, since it prevents Spanish banking needing to decide on management and investment controversies. The latter, in fact, has weakened the banking system in general, in both Europe and the United States.

Finally, appropriate risk management in incorporating innovative financial products has been fundamental for Spanish banks to avoid excessive investment in toxic assets, which is what has happened to other international banking systems. This prudence in their management to exploit certain types of financial instruments has proved to be effective and beneficial in the long-term, as currently witnessed. The ones that have benefited from this the most are two Spanish mega-banks, which have shown comparatively high profitability in their last periods.

International Expansion of Spanish Banking: The Case of BBVA in Asia

As mentioned earlier, the two high performing Spanish mega-banks, Santander and BBVA, have a wide-ranging international presence in different continents. Like most other Spanish firms' internationalization processes, their first attempts at international expansion were in the region of Europe and Latin American countries. Between 1995 and 2000, Spanish banks strove towards growth in the region of South America and to break into the European League (Kase & Jacopin, 2005).

As commonly understood, Spanish firms have strengths when entering European and Latin American markets due to their geographical proximity to the former and cultural similarity and historical social network advantage with the latter. Without exception, Spanish banks internationalize first in these two traditional markets. In this section, we take a more detailed look at one of these two mega-banks, BBVA, which became the second largest franchise banking group in South America by the millennium, after Santander and before Citibank.

As part of BBVA's ongoing internationalization process, the bank entered the US market in 2004 with the acquisition of Valley Bank of California through BBVA Bancomer. Later, in line with their strategy of entering the Hispanic segment of the US market, BBVA acquired Laredo National Bank in 2005, Texas Regional and State National banks in 2006, and Compass Bancshares in 2007. All these operations were part of BBVA's strategic plan to build a powerful retail banking network in the US, establishing a unique platform with 622 offices in 7 states to become the 19th bank in the US.

Consequently, BBVA had a strong business presence and economic impact, especially in the South American market and its related segment, but a relatively weak presence in the Asian market by the beginning of the 21st century. In order to fill the gap in this potential market, and given the relevance of its emerging economy, BBVA launched its strategic plan in the Asian market in February 2005, consisting of several office and subsidiary openings in Shanghai, Tokyo, Singapore, Taipei, Seoul, Sydney, Mumbai, and other first-tier Asian cities.

The reasons behind BBVA's internationalization process in Asia are basically the opportunities it represents: the largest continent, 60% of the world population, 25% of the world GDP, 23% of international commerce, and the main creditor in the world. Asia also contains the top recipient of direct foreign investment (China), one of the main investors (Japan), the first and the second country in the world for reserves, and the two most populated countries (China and India).

Despite these positive opportunities in presence, BBVA was aware of the challenges it would face: a not very uniform market, disparity in development among different countries, interventionism in political regimens, and protectionism in economic systems. In order to grow gradually, BBVA's strategy focuses on organic development based on profitable business. In the meantime, it has signed a strategic alliance agreement with CITIC Group, the third largest joint-stock commercial bank in China.

This partnership began in November 2006, as an important milestone in building BBVA's strategy in Asia, specifically in China. In this exclusive strategic alliance, BBVA simultaneously entered the China Mainland and Hong Kong markets through China CITIC Bank (CNCB) and CITIC International Financial Holdings Limited (CIFH).

In 2008, when the financial crisis forced many multinational banks to leave their initial Chinese investment planning, BBVA not only stayed, but also moved their investment forward to the second phase. In June 2008, BBVA agreed with CITIC to increase their stake in CNCB and CIFH to approximately 10% and 30%, respectively, with total required funds of 800 million Euros, which came to a total investment of 2 billion Euros.

The strengthened strategic alliance with their strategic partner, CITIC Group, allows the Spanish bank to capture superior growth opportunities in China with a limited financial investment. For BBVA, this alliance enhances their vision of creating short-term value and improved future potential for its shareholders, combining long-term business opportunities with immediate earning power.

Currently, BBVA has international coverage in 33 countries with more than 42 million clients, 7,500 offices and 100,000 employees, 70% of them outside Spain. One of the factors that contribute to its success is the combination of an excellent management of profitability and risk, and its growth, which drives sustainable development by value creation.

Some Reflections on the Crisis: Threat or Opportunity

We have seen that a crisis presents an opportunity to some banks, whilst for others it is totally destructive. Some hypotheses derived from this overview of the high-performing Spanish banking system are: due to the fundamental influence of the financial system in global business, a stronger regulatory system is needed to monitor and control this industry; the high performance of Spanish multinational banks (i.e., Santander and BBVA) is probably due to the essential retail banking model, which offers many more sustainable financial products and services with customer orientation; the virtue of prudence in banking management is critical for a bank's growth and survival, especially in this globalizing and highly dynamic business environment. This third reason may explain why most multinational banks withdrew their investment in China, while BBVA was able to seize the opportunity to enhance its presence in this potential market. According to Villasante (2008: 9), the differences between Spanish banking and shadow banking are summarized in Table 2.

Nonetheless, not everything is positive in the Spanish banking indus-

Table 2 Comparison between the Spanish banking system and shadow banking

Spanish banking	Shadow banking
Institutional and legal framework	
- Risks remain in supervised balance	- Not regulated or supervised
- High proportion of capital and reserves	- Not consuming own capital when supervised
- Liquidity management	- Not recognizing the commitment of the liquidity granted
Business Model	
- Retail banking	- Highly profitable
- Client-oriented	* Fewer costs
- Basic mortgages in commercial linkage	* High commissions
Management style	
- Prudent risk management	- Less strict in risk management
* If high risk, no sales	* Generated for sales
- Combination of long-term strategy with short-term delivery	- Profit-oriented

try in this crisis. There have also been factors that have affected it in a negative way, such as excessive loan lending and concentration on certain types of activities, specifically related to the real estate business. The Spanish government recently approved the Fondo de Reestructuración Ordenada Bancaria (FROB)[3] by Royal Decree on June 26, 2009, to strengthen the financial system for the post-crisis and to shorten the crisis period to boost economic development. There are many challenges in our international business environment. How to turn a crisis into an opportunity could be essential for the success of businesses with sustainable fundamentals; or in the words of Meyer (2009: 3), "how can business survive the crisis, and position themselves for the recovery whenever it may come?"

Endnotes

1 Banco de España is the central bank of Spain.

2 UEM literally means Economic and Monetary Union.

3 FROB literally means Fund for Ordered Bank Restructuring.

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The Global Economic Crisis and Foreign Subsidiaries in New EU Member Countries

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Introduction

THIS ESSAY EXAMINES THE IMPACT of the global economic crisis on foreign direct investment (FDI), with special reference to the new member states of the European Union (EU). It has to be emphasised that FDI has reacted to the crisis differently from portfolio investment, due to differences between the two. Although portfolio investment and FDI both entail ownership of shares, this ownership is fundamentally different. Portfolio investment is limited to minority participation (usually less than 10% of shares), and as a rule, it has no management influence and pursues purely financial interest. Therefore, it has short-term or temporary time range. On the other hand, FDI implies major or even full ownership and strong management influence (Dunning & Lundan, 2008).

Similarly to domestic firms, foreign subsidiaries are at jeopardy as the crisis unfolds. However, unlike any domestic firm, a foreign subsidiary is a unique object of analysis due to its dual nature – being a part of an MNE network and a host national economy. Moreover, a recent stream of literature on subsidiaries of MNEs has emphasised a significant heterogeneity of subsidiaries. Therefore it is not surprising that the response to the economic crisis will depend not only on the industry and host economy, but even more on the type of a given subsidiary.

It may be argued that more attention should be paid to the subsidiary evolution, a process whereby the already established subsidiaries gain new functions and competences. Events following the outbreak of the global crisis provide some empirical evidence to this argument, as certain subsidiaries in new EU member states expand their functions even during the global economic turmoil.

Crisis and FDI Flows in Europe

The year 2008 marked the end of an upward trend in global FDI. As the crisis unfolded and corporate and project finance were weakening, equity investment and foreign direct investment alike came under pressure. Many planned takeovers were put on hold and greenfield projects postponed as the financing got harder and business prospects gloomier. Existing projects also came under pressure, especially in terms of employment levels.

According to an estimate that UNCTAD released in April 2009 (UNCTAD, 2009), global FDI inflows were estimated to decline by about 15% in 2008, to $1.7 trillion. At the "epicentre" of the crisis, developed countries suffered from a fall of FDI by 25% in 2008, compared to a decline of 15% globally, and an increase of 7% in developing countries and a growth of 24% in South-East Europe and the Commonwealth of Independent States. Evidence for the new EU member states remains mixed. The growth of FDI inflows continued by 34% in Romania, 8% in Hungary and 3% in the Czech Republic, while a fall in FDI inflows was recorded in Poland (-28%). The current new members of the EU used to rely heavily on FDI inflows for economic restructuring in their period of economic transformation the 1990s; presently, they still depend on foreign investors in their development strategies, trying to attract FDI in higher value-added industries and functions.

Heterogeneity of Foreign Subsidiaries

Contemporary academic research on subsidiaries and subsidiary management places a great deal of emphasis on heterogeneity. The extant body of research on subsidiaries has employed several typologies of subsidiary roles and strategies. Based on White and Poynter (1984), it is possible to distinguish between subsidiaries in terms of product scope (product line extensions and new product areas), market scope (range of geographic markets available to the subsidiary) and value-added scope (range of functions performed by the subsidiary – development, manufacturing, marketing) (Papanastassiou, 1999; Pearce, 1992).

The main tenets of this typology are well applicable to the case of the new EU member states as evidenced by relevant reports and data sources (cf. Hunya, 2000; Kalotay, 2006; Szanyi, 2006; UNCTAD, 2003, etc.). This literature proves that currently, subsidiaries with higher value-added, such as R&D laboratories (which are mostly immune to the crisis) are relatively rare, although growing in number. Market-seeking subsidiaries are probably the most frequent, especially as a result of large privatisation deals, under which large local market-oriented units became foreign owned without necessarily being deeply integrated in the corporate networks of the new owners. These subsidiaries might suffer in the crisis, especially in societies where the local consumer purchasing power declines (e.g., in the Baltic States and Hungary). Efficiency-seeking ("export platform") units are also frequent, present not only in the manufacturing industries (automotive, electronics and garments) but also in export oriented services (such as shared services centres). Some of these subsidiaries again can suffer from the crisis if their international demand is declining, and if the crisis coincides with the existences of excessive productive capacities (e.g., in the automotive industry). In turn, the crisis can provide new business opportunities for the cost-efficient locations of new EU members in export oriented services.

How export platforms have been affected by the crisis can be detected from output statistics available for industries in which foreign subsidiaries dominate or are the only players. The former is true for the manufacturing output and exports of new EU member countries, the latter for most of their transport machinery and equipment exports (Table 1); Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Slovakia and Slovenia all show very similar decline in industrial output (over 20%), in exports (over 20%) and in the exports of the transport industry (over 40%).

Table 1. Year-to-year changes in manufacturing output and exports, selected countries, February 2009

Country	Change in manufacturing output (%)	Change in manufacturing exports (%)	Change in the exports of transport equipment (%)
Bulgaria	-24.3	-39.2	-41.0[a]
Czech Republic	-23.4	-22.2	…
Estonia	-32.7	-26.0	-54.0
Hungary	-26.1	-30.4	-48.1
Latvia	-24.3	-29.3	…
Lithuania	-17.9	-21.8	-31.9
Poland	…	-24.8	-25.7
Romania	-14.5	-15.9	…
Slovakia	-28.2	-31.0	…
Slovenia	-24.1	-25.1	-42.3[b]

Source: Authors' calculation, based on national statistics.
[a] Machinery and transport equipment.
[b] January 2009.

As one example of the social effects of the crisis, in Hungary, various major job cuts affected the subsidiaries of foreign MNEs over the six-month period November 2008–April 2009. The export-oriented subsidiaries of the car, electronics and garment industries (especially Suzuki, Foxconn, Jabil Circuit, Linamar, Sanmina SCI, Levi's and Bosch), as well as the local market-oriented subsidiaries of foreign banks (Raiffeisen, Intesa Sanpaolo) were the most affected by downsizing. Compared to foreign subsidiaries, local firms engaged less in job cuts. Despite this generally negative picture, it is notable that the total size of massive downsizing remained relatively limited, especially compared to the generalized increase in unemployment, carried out by small and medium-sized enterprises. It does not mean however that the impact of plant closures would be negligible in terms of lost demand for local supplies and lost purchasing power of employees, especially in smaller localities where the foreign subsidiary used to be a major source of employment.

Prospects: Subsidiary Evolution and Business Services

While the output of foreign subsidiaries (and hence inward FDI) is in general contracting both worldwide and in new EU member countries as a result of the crisis, some subsidiaries are expanding their activities. The growth and evolution of subsidiaries in new EU member states can be split into two forms. Firstly, there is a conventional evolutionary path of subsidiary whereby the functional scope is being increased and competences are being enhanced. The global economic crisis does not seem to hamper such development for certain subsidiaries. Secondly, the global economic crisis provided new opportunities for new EU member states. By capitalising on their competitive advantages such as lower costs of workforce, flexible tax regimes and geographical proximity to important markets, these countries strengthen their investment attractiveness and competitive positions. These two scenarios deserve a closer look.

The organic growth of certain subsidiaries continued in the times of crisis. A case in point is the Czech subsidiary of Honeywell, a major US MNE producing a variety of consumer products, engineering services, and aerospace systems. In December 2008 this Czech subsidiary announced the creation of a research centre for aircraft engines within three years. At the same time the company intends to expand production of aircraft-engine components in the Czech city of Olomouc and is planning to hire 400 additional engineers for its R&D lab in Brno. Honeywell plans to transfer a total of 700 jobs from its aircraft engine production operation in Phoenix, Arizona, to the Czech Republic and Mexico. Moreover, the company also wants to expand its development centre in Brno, in order to be able to test various types of turbine engines. When this process is complete, the company's most comprehensive testing centre for new-generation turbine engines will be located in the Czech Republic, employing

1,100 people. This is a case whereby a subsidiary is moving from a pure export platform status towards elements of a product mandate.

As demonstrated, the impact of the global financial crisis has been strongly felt in the automotive industry. Its impact, however, has been moderate in other industries. A case in point is shared services centres. For example, since the early 2000s, new EU member states started emerging as prospective locations for business process outsourcing (BPO), a form of outsourcing that involves the contracting of the operations and responsibilities of specific business functions (or processes) to a third-party service provider, as well as off-shoring (near-shoring) of corporate business functions. National investment promotion agencies have been very enthused about this development and are attempting to support it, since it reflects the national strategies of transformation towards the knowledge-based economy.

As for shared services, new centres were opened in Hungary in 2009 (Vodafone, 3M, Alstom, Christian Dior). Similar developments can be observed in Poland: in February 2009, Unilever (Netherlands/United Kingdom) opened its first global product development centre in Central and Eastern Europe in Poznan.

By their nature, projects of this kind are less capital-intensive than manufacturing projects. A much more important indicator of success is the number of new jobs created, since they contribute to employment. Besides, these jobs are preferred to those in manufacturing/assembly, since they are more knowledge-intensive and require higher qualification. The most important advantage of these subsidiaries in the context of the crisis is that they do not seem to be affected by the downturn. On the contrary, certain developments such as the devaluation of local currencies further increases the cost advantages located in the EU member countries.

Public Policies

The FDI downturn has created a major policy challenge for governments worldwide, and in new EU members in particular. As FDI inflows are declining, and some foreign MNEs are even divesting, people are losing their jobs at foreign subsidiaries, and fiscal revenues are dwindling, there is a pressure on host-country governments to compete more efficiently and more aggressively for their part from a shrinking cake. All this has had to be done against the backdrop of a need for a macroeconomic "quick fix", increasing the temptation to recourse to protectionism and economic nationalism. However, effective and sustainable FDI policies require measures that avoid "beggar-thy-neighbour" solutions. In the context of investment promotion, the challenges are to find new priorities (for example, replacing the automotive industry), and new measures (including a rethinking of the system of subsidies which in the current form has been to little avail in stopping job losses). In the countries in transition in particular, questions are raised of whether policies to attract FDI and benefit from it have been sufficient and the right ones from the point of view of desirable outcomes and resistance to crises. The uneven record of FDI and the negative effects of the crisis indicate that there is a need for a stronger link between better investment promotion and industrial policy. The relationship between the quantity and the quality of FDI needs to be better understood, especially in the context of the crisis.

While policies aimed at initial attraction of FDI flows (including investment incentives) have spread around the world, and to economies in transition in particular, policies targeting already established subsidiaries of MNEs remain rare. However, recent research (e.g., Costa & Filippov, 2008) has underlined the extension of FDI policy toward subsidiary development as a viable strategy to bring benefits to the national economy. Subsidiary development should have a twofold goal: retaining foreign subsidiaries and contributing to their evolution. Naturally, this calls for the subsidiaries' embeddedness into national economic and innovation systems.

Focus on the existing subsidiaries in the time of global economic downturn may be a winning strategy. It is evident that in the current conditions it will become even harder to compete for new FDI flows. On the other hand, new investment may come from subsidiaries' reinvested earnings and expansion of operations, leading to investment multiplicator and spillover effects in the national economy. Focus on foreign subsidiaries does not imply alienation of domestic firms or preferential treatment of subsidiaries. It is rather a set of policy measures complementary to the strategy of national economic development.

In new EU member states in particular, the crisis should accelerate policies aimed at upgrading their production base to higher value-added activities, especially in the form of investment in knowledge and innovation, and support to R&D function of foreign subsidiaries.

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