The Practice of Economic Action

Foreign Direct Investment Attempts in Central and Eastern Europe[1]

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Nina Bandelj

Department of Sociology

University of California, Irvine

nbandelj@uci.edu

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Abstract

While substantial scholarship has advanced a sociological understanding of economic processes and institutions, little attention has been devoted to scrutinizing the model of action underlying this research. Drawing on the evidence of foreign direct investment (FDI) attempts by Western firms in Central and Eastern Europe, I argue that to understand socially embedded economic action in situations of high uncertainty a practical actor model has more empirical utility than the commonly assumed rational actor approach. Empirical evidence shows that decision-making in FDI cases is not merely a matter of rational efficiency maximization but is structured by social forces: business connections, personal ties, cultural conceptions, struggles for power and broader institutional environment. These social forces provide not only the constraints on instrumental rationality but, more importantly, contribute to substantive and procedural variability in action, extending it beyond profit-maximization and means-ends calculation that lie at the core of rational actor assumptions of neoclassical economics. The paper ends by specifying scope conditions for the practical actor model and its empirical utility in advancing our understanding of economic processes.

Introduction

Recent studies in economic sociology have theoretically advanced and empirically substantiated the social underpinnings of economic processes by arguing that markets and economic transactions are embedded in, or constrained and enabled by, social networks, cultural understandings and political institutions (for review see Smelser and Swedberg 1994). These analyses have focused on identifying the social forces that structure economic activity but have been less concerned with advancing a model of action consistent with the emphasized social character of economic processes. Some economic sociologists, primarily those working in the network perspective, largely rely on the assumption that economic and organizational actors are rational profit-maximizing agents and that social relations in which they are located are efficiency enhancing (e.g. Granovetter 1985; Uzzi 1996, 1997, 1999; Gulati and Gargiulo 1999). Other scholars doubt the preeminence of efficiency concerns in guiding economic outcomes, highlighting the importance of goals such as firm survival or legitimacy (Fligstein 1996, 2001). Most often, however, in sociological analyses of economic processes the underlying model of action is underspecified, much less scrutinized.

Using qualitative evidence of foreign direct investment (FDI) transactions, I argue that to understand socially embedded economic action in situations of high uncertainty a practical actor model has more empirical utility than the commonly assumed rational actor approach. Empirical evidence shows that decision-making in FDI cases is not merely a matter of rational efficiency maximization but is structured by business connections, personal ties, cultural conceptions, power struggles and broader institutional environment. These social forces provide not only the constraints on instrumental rationality but, more importantly, contribute to substantive and procedural variability in action, extending it beyond profit-maximization and means-ends calculation that lie at the core of rational actor model proposed by neoclassical economics.

What Guides Foreign Direct Investment Transactions: Economistic Perspective

Foreign direct investment (FDI) is investment made by a company in the investor country into a foreign, host country. It can take a form of acquisition of already existing host firms, fully by a foreign company, or in partnership with domestic firms by forming joint-ventures. Foreign investors can also establish new companies in the host country, known as greenfield investment.

Previous research, primarily conducted by economists and business scholars, has been mostly concerned with why and how investor firms decide to undertake direct investments abroad. Stephen Hymer (1976 [1960]), one of the first scholars who studied these issues, claimed that firms are motivated to increase their profits by exploiting their inherent advantages in other countries. These, so called, ownership advantages include access to patented technology, specific management or marketing skills and ownership of brand names. There are several ways in which firms may exploit their inherent advantages. Besides direct foreign investment, firms may also export their products and license their technology. In Hymer's framework, firms choose between options on the basis of their relative profitability.

Transaction cost economics (e.g. Williamson 1975, 1985) assumes that companies are primarily interested in lowering transaction costs, so when trade or licensing are too costly forms of internationalization, firms choose FDI. Transaction cost economics has also been used to explain multinationals' FDI entry mode choice, such as joint-venture, greenfield investment or acquisition of existing companies (Sun 1999). The theory predicts that multinationals will use the entry mode that minimizes transaction costs.

Although often not explicitly stated, the above predictions of firm behaviour with respect to foreign direct investment decisions rest on a specific understanding of economic action (of actors' motives, orientations toward action, and the contexts in which they act) drawn from classical and neoclassical economic theory, which assumes that economic actors are rational utility-maximizing agents.

Rational Action Model

The model of action advanced by neoclassical economic theory presupposes that economic actors are independent in their decision-making, that they possess perfect information in conditions of perfect competition, have fixed preferences and preference ordering which fulfils the condition of transitivity.

According to this model, the primary objective (or the end goal) of economic actors is to maximize profits. To do so, actors gather information about all possible courses of action that would help them achieve their goal. They determine the costs and revenues associated with each course of action and decide on the one that maximizes profits. In the case of foreign direct investment, profit-maximizing economic actors figure out that investing outside of their home country yields more profits than investing domestically. Moreover, comparing all possible foreign investment locations and modes of entry, they are able to choose the one, which objectively maximizes their profitability. Actors follow a logical means-ends approach and make decisions deductively by determining their goals, evaluating the potential strategies to reach goals based on the information at hand and choosing the optimal alternative that minimizes transaction costs.

Bounded Rationality

While rational action model is widely accepted as a theoretical framework, many scholars find that actual business decision-making significantly deviates from the model's assumptions, recognizing that limited cognitive capacities prevent economic actors from synoptic rationality. These limitations were first conceptualized in 1957 by Herbert Simon who proposed that economic actors are boundedly rational.

> "The limits of rationality have been seen to derive from the inability of the human mind to bring to bear upon a single decision all the aspects of value, knowledge, and behavior that would be relevant. The pattern of human choice is often more a stimulus-response pattern than a choice among alternatives. Human rationality operates, then, within the limits of a psychological environment" (Simon 1957: 108).

People do not possess perfect information, know all action alternatives, nor the exact outcome of each, and they lack a complete preference ordering for those outcomes. This limits the extent to which agents can make a fully rational decision and they are forced to make decisions not by "maximizing" but by "satisficing", i.e. finding satisfactory instead of optimal solutions to problems.

While this perspective revises the rational action theory, it nevertheless presupposes that people make decisions on the basis of a clear means-ends schema; they know their goals, know which means bring out desired ends and can evaluate alternatives (albeit poorly) to select the one that they find satisfactory. Thus, in Simon's conception of bounded rationality there still exists an assumption of an objective utility maximizing function that optimizes the actor's utility within constraints. It is just that subjectively, because of cognitive limitations and imperfect information, the actor cannot know it. A clear implication, as proposed by Simon, is that if the computational capacities of the human mind improved, we could make rational decisions.

Practical Action Model

Stimulated by insights of ethnomethodology and cognitive psychology's focus on classifications, representations, schemas and scripts in guiding action, neoinstitutional theory in organizational analysis questioned the usefulness of a monolithic model of (boundedly) rational action (DiMaggio and Powell 1991). Ethnomethodology, work of Harold Garfinkel in particular, emphasizes the role of routines, conventions and "practical reason" in guiding action. Actors in everyday life are practical and largely follow routines. If the sphere of economic life and business is just another realm of social life, preoccupation with economic actor's intentionality (and rationality) as implied by the rational action model may be unwarranted. In addition, the affective and evaluative dimensions of action may be intimately bound up with cognition (DiMaggio and Powell 1991: 22). Moreover, actors may envision a variety of alternatives as plausible strategies (logics) of action since what is conceived to be rational depends on the intersubjective interpretation of a situation and is not given objectively. Consequently, neo-institutionalists conceive of a variety of *rationalities* rather than a single rationality in economic action (Dobbin 1993, 1994a, 1994b). The multiple rationalities view suggests that even in cases of business decision making, we should broaden our understanding to include a variety of possible goals of economic action, not only profit maximization. Substantively, actors can be rational by maximizing their utility in a variety of ways. Hence, we should think about rationality as substantively variable.

The practical action model also builds on the philosophy of pragmatism and a view that action is not only contingent on the situation but that the “situation is constitutive of action” (Joas 1996:160):

> “In order to be able to act, the actor must pass judgment on the nature of the situation. Every habit of action and every rule of action contains assumptions about the type of situations in which it is appropriate to proceed according to the particular habit or rule. In general, our perception of situations already incorporates a judgment on the appropriateness of certain kinds of action. This explains why situations are not merely a neutral field of activity for intentions, which were conceived outside of that situation, but appear to call forth, to provoke certain actions already in our perception. (Joas 1996:160)

Action then is not merely geared toward specific ends (i.e. is teleological) but is creative, as activity itself is a source of ends. Joas’ notion of creative rather than teleological action uncovers the potential ambiguity in the relationship between means and ends which is the basis of rational action model. Rational action (and bounded rationality for that matter) presupposes that the relationship between means and ends is clearly defined in a means-ends schema. Goals are know a priori. On the basis of goals (ends), the best alternative strategy (or means) is identified, which will allow an actor to accomplish his or her goals. However, in actual situations, especially in conditions of high uncertainty, people often cannot know in advance what the consequences of their actions will be, so an optimizing strategy cannot be easily identified. Moreover, if situations themselves are constitutive of action, then it is possible that the goals and strategies of action (i.e. both ends and means) are modified during the process of action itself. In certain cases, both ends and means can emerge out of the situation and are not given prior to it, as assumed by rational action. Applying this to economic action in cases of foreign investment, this framework suggests that business actors engage not merely in procedural rationality, but in a variety of other types of action, whereby the means and ends are not clearly identified prior to the action process nor are they necessarily stable during this process. Hence, economic action can be considered *procedurally variable*.

In sum, the practical actor model as outlined above specifies two sources of variation overlooked in the traditional profit-maximization rational action framework. First, it highlights the possibility of substantive varieties of rationality allowing for goals other than profit maximization. Second, it uncovers procedural variation in the logic of economic action, going outside the clearly defined means-ends calculations. The next two sections take each of these sources of variety in turn.

Substantive Varieties of Rationality

While the traditional economic account privileges the understanding that economic actors strive to maximize profits, there may in fact be several other equally likely and legitimate goals of economic action, comprising different substantive varieties of rationality. Fligstein makes one proposition; to replace "profit-maximizing actors with people who are trying to promote the survival of their firm" (2001: 17). Firms may also explicitly target earnings, shareholder value, market share, or the highest surpluses, as was the case for socialist firms, and not simply the highest profits. Moreover, when states act as economic actors, they may aim at political power and/or job protection.

In the case of foreign direct investment, decisions could also be informed by value rationality, whereby certain investment locations, like a country to which one maintains affiliate ties, will be preferred on normative grounds and convictions that one should do good for that country. In certain cases of East European émigrés or their children investing back to their home countries, economic action may have ideological basis, such as playing a role in building capitalism after the fall of communism. Moreover, firms may not be uniform coherent actors and different coalitions within them may promote different, even conflicting goals. Or individuals can hold several different motives simultaneously.

Overall, this makes it clear that not all market activity should be seen as profit-maximizing. Hence, the conception of economic action should allow for substantive varieties of goals and preferences.

Procedural Varieties of Action

Any substantive variety of rationality can be subsumed under the rational action perspective, which treats goals and preferences as exogenous. As a matter of fact, in the formulations of rational action that go beyond allocative efficiency within a market setting, a claim that an act is rational does not refer so much to its substance as it denotes its procedural means-ends logic. The means-ends schema implies internal coherence whereby actors have stable preferences and clear fixed goals and they decide upon the means in a way that maximizes their utility, whatever their utility function may be.

However, the influence of politics, cultural understandings and social networks on economic activity can fundamentally shape the procedural logic of action, breaking the neat means-ends calculations. Political or ideological interests may lead people to strongly identify with certain strategies of action or solutions to problems, so that they may not be able (willing) to switch to alternatives, even when those are more cost efficient. In such cases, means to act are independent of action goals, and goals are often identified only as a consequence of committing to certain means.

Often, organizations cannot be treated as unitary actors where agreement on organizational goals and strategies to pursue them is straightforward. In cases where there is a lot of internal conflict about what goals the company should pursue, different coalitions can push their preferred strategies as equally plausible. The alternative that is selected is not superior based on the means-ends calculation but because it has more political support. Sometimes, political preferences will induce identification with certain strategies of action, so that these will dictate the choice of goals (reversing the means-ends schema). A position that domestic ownership should be preserved and foreign ownership rejected, without regard whether this is cost efficient for the firm or not, exemplifies such politically charged circumstances where ideology plays an important role.

Moreover, shared cultural understandings (or lack thereof), which develop during the course of action between transaction partners, often create emotionally charged circumstances, which may compel actors to change their initial goals or modify their preferences. Likewise, new information that comes to actors via their social networks may induce them to change their preferences when the process of action is already underway. All this suggests that social forces, which shape action, not only constitute actors' preferences and goals but also affect their stability.

In addition, different types of economic processes in different temporal and spatial contexts have to deal with more or less environmental uncertainty, such as changes in legal and political environment or economic crises. In conditions of uncertainty, the straightforward means-ends schema will be less likely retained, as actors in their response to environment will often change their preferences, goals or strategies to reach them. Their final goals will likely be articulated during the process of action itself. And goals that they reach at the end of the transaction may not be what they wanted in the beginning.

Two Illustrations of FDI Transactions in Eastern Europe

To illustrate the varieties in substantive rationality and varieties in procedural action in foreign direct investment decision-making, let's consider two cases that describe the experiences of investor firms from the West pursuing investment opportunities in Central and Eastern Europe. The information is based on case evidence collected by Estrin, Todd and Hughes (1997) in their study of multinationals in Central and Eastern Europe. For each case, Estrin and colleagues interviewed several managers in both investor and host companies. They asked general questions about the FDI transactions, and they were not primarily interested in the process of decision-making. They didn't directly ask respondents to recall how exactly the decisions of where to invest were made, so there is less chance that respondents substantially reconstructed the processes that happened in the past. The fact that organizational decision-makers tend to post-factum rationalize the events that happened when their attention is brought to the process is an obvious methodological disadvantage involved in interviewing.[2]

Case of British Vita's Investment in Poland

British Vita, a multinational chemical company based in the UK established a wholly owned subsidiary in Poland. Reflecting back on the initial stages of the transaction, managers listed a few reasons why the company decided to invest in Eastern Europe. First, the company wanted to follow its German customers. Second, the company was interested in lowering their production costs and third, they felt that they could successfully operate in Eastern Europe because of their experiences in establishing subsidiaries all over the world, including Africa.

In Eastern Europe, the company chose to invest in Poland. In fact, several of the company's major German customers moved their sites to Poland and Vita's subsidiary in Germany "helped to bring home to senior management the profitable opportunities opened up by the fall of the Berlin Wall and the opening up of Central Europe" (Estrin et al. 1997: 167). When asked to describe the reasons for their choice of Poland as the investment site, the managers listed the size of Poland's market, and the fact that several of Vita's major customers established companies in southwest Poland, in what is the old Germanic part of the country. In addition, the company was able to purchase two main raw materials used in their production from companies in Poland, one of them located next to the facility that Vita established.

Vita also had to decide on the mode of investment. The company wanted to have 100 percent control because they had bad experiences with joint ventures in Africa and Canada. They didn't want to have to negotiate about the way the business was run. However, Vita had problems finding a company for

[2] Post-outcome estimates by subjects of their pre-outcome judgments are closer to the outcomes than their pre-outcome judgments were, something known as the knew-it-all-along effect. When actors look back they rationalize their action, so it seems as if they employed teleological rationality to achieve it. When looking back actors can't avoid but to include the information acquired during the process in the information set out of which a decision is made, resulting in a hindsight bias in economic expectations (Kolzl, Kirchler and Rodler, 2002).

outright acquisition. For the locations they considered, the Polish Ministry of Privatization insisted that the Polish sides retain significant shares. The company was searching for several months, and even considered joint-ventures (despite their original resistance to that option). However, they could not find any factories that they considered suitable for their production. “Vita gradually convinced itself that, despite the recent corporate emphasis on growth by acquisition, this was not the right strategy for it in Poland. However, this did not lead it to drop out of the Polish project, because management felt that it still retained sufficient expertise to attempt a greenfield development” (Estrin et al. 1997: 171).

Looking for a greenfield investment site was not without problems. The company had to deal with a vast Polish bureaucracy and waited for all the documents about land registration and ownership from Warsaw for eight months. Vita also had problems with the local authorities about the electrical supply for the company. “This was only resolved in the end by a threat on Vita’s part to pull out from the deal” (Estrin et al. 1997: 172). Vita certainly did not expect all these administrative problems which delayed their entry into the market substantially.

So how was Vita’s decision to establish a new subsidiary in Poland made? As a multinational company, Vita’s overall strategy was to look for opportunities globally. However, it seems that the specific locations were not carefully chosen in advance but considered in turn, as the opportunities arose, largely responding to the practices of the firms in their network. It seems that the company started thinking about possibilities in Poland because their customers went there. The fact that they were also able to get raw materials close by was an additional advantage that made Poland a satisfactory alternative, even though the company didn’t evaluate any other Eastern European countries in detail. The company was satisficing rather than maximizing (Simon 1957).

In addition to investing in Poland, the company had an already established preference to enter the market via an acquisition based on its previous experience. However, during the process, Vita modified its initial goals because of the circumstances it encountered, which were not anticipated in advance and were more costly than initially anticipated. The decision process was very incremental. As suggested by

Mintzberg (1978) strategies emerged in practice and the decisions carried out were not the same as the intended strategies (see also Hickson 1987).

Lycett and Danubius Case

Lycett Industries is a medium sized company in the steel fabrication industry, based in the United Kingdom. One of its main owners and managing director is Robert Armitage. In 1990s, Armitage thought that the company needed to enter new markets and search for lower-cost production sites, and he believed that Central and Eastern Europe would be an appropriate place to reach these objectives. He also thought that continental customers would be more willing to place orders with a firm based in Eastern Europe than in the UK. Overall, he was of the opinion that the metal fabrication industry would slowly move out of UK altogether.

To look for a suitable production site in Europe, Armitage's approach was not very methodical and cost effective. He personally traveled around Poland, then Czechoslovakia and Hungary for about two years in search of the site. Once he saw some possibilities in Eastern Europe, he decided that Lycett would not need to acquire a whole existing company, but only a part of it, since this would involve less restructuring. He didn't seem to consider establishing a greenfield investment as a possibility.

"The determining factor in the choice of a Hungarian site seems to have been that the division of the Danubius [Hungarian site offered] was the most appropriate for Lycett's needs. However, Armitage also believed that Hungary offered the most stable political environment, with no threat of a return to communism. He also felt Budapest to be at the center of Europe, with good communications. Finally he noted the strong engineering tradition. It is unclear how many of these points were correct, or were really influential in the decision in practice. Armitage has since said 'If I were to do it again, I would go to Poland or Slovakia'" (Estrin, Hughes and Todd, 1997: 118-119).

It would seem that the justifications that Armitage provided for the choice of the Hungarian location were rather post-factum rationalizations. It may be more appropriate to view his decision as arising out of a set of circumstances and as a by product of his search strategy (or lack thereof). As it turns out, Danubius was a division of Ganz shipbuilding group which was actively searching for a foreign partner for several years. Danubius saw foreign direct investment as an opportunity to get capital needed for restructuring and a way to clarify the relationship with the mother company Ganz with regard to ownership of land and buildings. In search of a foreign partner, the management of Danubius distributed pamphlets describing the firm at Hungarian embassies abroad, including in London. This is where Armitage learned about Danubius. He established a good relation with a person working at the Hungarian embassy in London who arranged a visit to Danubius. This contact person ended up on the Lycett Danubius board after the investment transaction had been made. It is likely that Armitage continued to pursue the Hungarian location so seriously because of the rapport that he developed along the way with the contact person. At the same time, by being a local, this person was well positioned to facilitate the negotiation process.

On the other side, the managing director of Danubius part of Ganz thought that Lycett was a good partner because his interest was the greatest among the three companies that were interested in investing, and Danubius was impressed with the quality of the sample made for it by Lycett. Other local managers thought Lycett was the right partner because it brought big orders from important customers. None of the managers mentioned the importance of the price that Lycett was willing to pay for Danubius, and the fact that after a careful analysis of all possibilities, the cooperation with Lycett had the most advantages and the least disadvantages, proving to be the most optimal for Danubius. In fact, the price started to be discussed only after the top management of the main company Ganz agreed to sell to Lycett. At this point, the negotiations started with two Hungarian state agencies which between them held a 100 percent share of Ganz. In the end, one of the two agencies, State Holding Company, sold its shares to Lycett, enabling it to acquire a 70 per cent stake in Danubius. The other agency, the State Property Agency, “never actually made a decision on the matter of whether to sell, and indeed refused to talk about the price at all because it had not taken a decision in principle about weather or not the firm should be sold” (Estrin, Hughes and Todd 1997: 120).

In this case, Robert Armitage, the key decision maker did not seem to have any clear strategy for the East European investment, except for the fact that he believed that going to Eastern Europe was a good idea for several reasons. (Of course, he reported on those after the fact, which leaves a possibility that the reasons listed were somewhat reconstructed in hindsight.) Compared to the other two cases presented, it is also important to note that Lycett was a smaller company without FDI experience. In fact, FDI in Eastern Europe was a novel practice for the company and the company engaged in it with a very general objective in mind, but without clear goals and thus best means to reach them. As “relocations are an unprecedented step into the unknown” (Hickson 1987: 171), the UK company - in fact, its CEO by traveling around - was discovering their goals during the search process and by responding to the circumstances as they arose.

On the other side, the Hungarian firm was looking for a foreign partner because they saw it as an opportunity to get investment capital and simultaneously independence from their mother company. For this company, getting a foreign partner was considered a plausible option because during the privatization process, the Hungarian government promoted FDI as a privatization strategy, as opposed to other alternatives, such as management employee buyouts, as was the most frequent case in Slovenia, for example.

Danubius’ method of search for a foreign partner - putting together a pamphlet about their firm and distributing them at various locations, including at Hungarian embassies abroad – may seem an awkward method; after all it took two years for them to find a partner, but this was the practice, in which they engaged. In the end, it was clear that they didn’t decide on a partner that offered the best price for a share of their firm, as economic theory might predict, because the price was only negotiated after the company had already decided on Lycett as the investor.

Logic of Decision-Making Practice

The evidence from these case studies does not align well with the textbook definition of business decision making in which firms, as unitary rational actors, first identify a goal, then search for pertinent information, then evaluate alternative strategies and finally select the one which maximizes their utility.

It is very obvious from the cases described above that firms' decision-making cannot be considered outside of the social context in which it occurs. Especially in FDI transactions (which are by definition exchanges between two parties), the decisions about investment locations and modes of entry that investor firms make (or don't make) are substantially influenced by the decisions made and actions taken by target firms. These may proactively initiate investment transactions or even reject FDI offers. In addition, the decision making process is also modified by the influence of third parties, such as national governments or local authorities. Actually, in foreign direct investment transactions in Eastern Europe, which are simultaneously ways of privatizing state-owned enterprises, the state authorities will be always more or less implicated. In addition, actors outside of the investor and target firms who act as mediators in the transactions can play an important part in influencing the realization of FDI attempts.

Investment attempts in Eastern Europe are complex processes because of the uncertainties they involve, the multiple stakeholders they implicate, and the time they take to realize. The actors involved in FDI transactions in Eastern Europe, as anyone else, have imperfect information and cognitive limitations in making rational decisions – they are boundedly rational. In addition, they may have unstable preferences which shift as events develop. In fact, because of high levels of uncertainty and political and cultural embeddedness of economic action in Eastern Europe, actors often also have unclear goals.

So how are the decisions in such circumstances made? Nutt (1984) examined ways in which ideas were sought to make decisions and found that in about half of the cases, actors were looking back to the practices that they or others have used in the past and, in the other half of the time, actors were actively searching for new ideas and innovating. Likewise, in the FDI cases presented here, the more experienced players, such as the multinationals, used the strategies of action that they have used in the past when undertaking foreign investments, or at least they drew from those experiences to form preferences (such as in the case of British Vita's decision to avoid joint-ventures). On the other hand, firms, which were relatively non-experienced with FDI, lacked a toolkit of practices and had to improvise or engage in what often seemed like a trial-and-error behavior (as in the Lycett case).

Overall, actors made their choices in an incremental step-by-step manner, responding to the circumstances in which they found themselves. Often, as people made one decision, path-dependency kicked in that was difficult to reverse. Once British Vita decided to invest in Poland, they persisted with this decision, even though they encountered a great number of obstacles on the way, in which they had to substantially modify their mode of entry strategy. It also took much longer than expected for the process to complete. It may also be the case that some decision makers along the way identified emotionally with the alternative chosen (i.e. going to Poland) and thus had problems in shifting to a more effective means for solving a problem (March 1994). Likewise, it may be speculated that because Robert Armitage developed a good contact with a person working at the Hungarian Embassy, who was very much pushing for the transaction to realize, that he overestimated the potential benefits of that cooperation. Let's remember that in hindsight, this person regretted his choice, and the financial performance of the company showed the negative consequences as well. Based on this evidence, I suggest that the fact that emotions and irrational beliefs influence economic processes should not be considered an anomaly but incorporated into the model of economic action.

Based on these observations, I suggest that the process of decision making in FDI attempts can be best understood as *practical action* whereby reasoning is infused with unreflective routine following, emotional reactions, normative commitments, imagination and improvisation. Practice is not wholly consciously organized (Bourdieu 1980). It is not random or purely accidental but, as one thing follows from another, practice happens. Bourdieu uses the metaphor of social life as a game to exemplify the improvisational aspects of practice. First, all games have rules and they determine, what players can and cannot do. Second, games are learned through explicit teaching as well as experientially in practice. Accordingly, most people depend on their social competence, their own experience, or their practical sense of logic rather than an analytical model when they are engaged in social practices.

Understanding decision-making as a practice, also suggest that the means and ends (teloi) of FDI attempts are not fixed at the beginning of transactions – instead they emerge out of the situation, so that action is non-teleological (Dewey 1922, 1939, Joas 1993, 1996). This goes contrary to the rational action postulates of given and fixed goals, conditions, constraints, and preferences. Thinking of action as non-teleological doesn't mean that actors are not intentional. They do act to reach some goals, but these goals are either articulated during the process of action or they are substantially transformed during the process of action. An end, to which actors arrive at the end of the transaction, may not be what they wanted in the beginning. This processual nature of decision-making also implies that preferences are unstable - what satisfies the actor at the end of the transaction may not be what would have satisfied him or her at the beginning.

Case evidence also showed that sometimes the goals of transactions are relatively undefined or underspecified. Robert Armitage wanted to do something in Eastern Europe but he didn't know exactly what the company's strategic goal should be. This became clear only as he had begun traveling around the region. We could say that his goals were articulated as a consequence of the fact that particular search strategies were used. Means then determined the ends, which goes against the rational action assumption of coherent means-ends schema, where identification of ends precedes the choice of means.

On the whole, practical actor model relaxes the assumptions of rational choice:

a) organizations are not necessarily unitary and independent in determining their objectives,
b) ends and means are not necessarily fixed and stable,
c) situations are not necessarily certain and actors do not have complete information;

In addition, practical actor model views:

a) decision-making as practice in which actors respond to the particularities of specific situations,
b) these situations as embedded in social networks, cultural understandings, distributions of power and institutional arrangements, and

c) these social forces as not only exerting constraints on actors but constitutively shaping their understandings of possibilities available to them and the criteria with which to evaluate them.

It is important to acknowledge that the practical action model may be a more empirically useful framework for understanding FDI in Eastern Europe than rational action because foreign investment is a highly complex economic process and Eastern Europe is a highly uncertain social environment. Certainly both the type of economic process that actors engage in as well as the environment in which decisions take place will determine whether practical actor model has empirical utility.

More generally, whether organizations are more or less engaged in means-ends calculations to satisfy their goals (i.e. instrumental rationality) depends on:[3]

a) goals of action: how clearly they are defined a priori and how stable they are during the process of decision making,

b) means to reach goals: how uncertain they are a priori and how stable they are during the process of decision making,

c) participation of actors involved: how unitary organizational members are, how many parties are involved, how clear it is who can make decisions and what the decision makers' preferred ways are of handling situations

d) time constraints: how quickly decisions need to be made, what is their perceived urgency and how much time can decision makers devote to them.

Uncertainty, ambiguity and complexity allow for improvisation and ad hoc behavior. More politically charged circumstances, with more players that have different incommensurable stakes, lead to power struggles. Stronger personal commitments lead to emotional reactions. Time constraints lead to less deliberation, more improvisation and ad hoc decision making. FDI transactions in Central and

[3] In this discussion we should keep in mind that synoptic rationality is impossible and even if actors engage in consistent and internally coherent means-ends calculation, they have limited cognitive abilities and can be only boundedly rational (Simon 1957, Kahneman 1994).

Eastern Europe are complex transactions, with multiple stakeholders in uncertain environments. According to the above criteria, these are the circumstances which are least conducive for means-ends calculation.

FDI Attempts in Eastern Europe as Socially Embedded Practical Action

> "Foreign investment in Central and East European countries is based too much on emotional prejudices and daily political needs and is far from rational economic considerations." (Dunning and Rojec 1993: 12)

This paper is motivated by an observation that the above quote captures the empirical reality of FDI in Central and Eastern Europe and the task of an analyst is to provide an explanation that best captures its complexities. I argue that we should understand foreign direct investment transactions in Central and Eastern Europe as an economic process shaped by social forces: social networks, cultural understandings, power distributions and macro institutional arrangements. This perspective shifts the focus from a firm as a coherent isolated unit calculating profitability to the social embeddedness of economic transactions, whereby a variety of substantive rationalities and a variety of procedural logics are possible.

Any situation in which economic actors act is more or less structured by its network, cultural, political and institutional characteristics. In making their decisions, organizational actors draw on their business connections and personal ties. They rely on their cultural understandings and sympathies. They use their political alliances and vie for power. And they do so in the context of institutional arrangements. These social forces do not merely regulate economic activity by placing a constraint on rational action. Rather, they inherently constitute actors' understandings of economic strategies and goals and enable the evaluation of alternatives that these actors conceive as plausible.

Such a framework doesn't align well with the standard conception of rational action, which presupposes profit maximization as the ultimate goal and only one objectively best set of means/strategies to reach it. Rather, *economic action is substantively variable*. Actors are socialized into culturally defined and institutionally legitimized goals to be sought, such as profits, shareholder value, surpluses over which they have control, or job security for employees; and they confer utility when these goals realize. Actors are also socialized into culturally available and collectively considered as (in)appropriate means to reach those goals, such as using a break-even analysis, relying on personal ties or seeking advice of fortune tellers. Power struggles and institutional arrangements influence which (or whose) goals and strategies are going to be (or can be) pursued. In sum, means and ends of economic action are socially, culturally, politically and institutionally defined.

The social embeddedness of FDI transactions in Central and Eastern Europe substantively determines:

a) what should be pursued as valued objectives (e.g. profits, firm survival, job security…),

b) what the preferences are resulting from these broad objectives (e.g. investing abroad, getting a foreign partner, downsizing), and

c) what the strategies are to reach those goals (e.g. relying on network ties for information, conducting formal analyses of costs and benefits, advertising the company as an investment location by distributing pamphlets).

Because of the all-encompassing definition of rational action accepted today, all these means and ends can be understood as rational as long as they are part of coherent means-ends calculations. Altruistic behavior and morally good action are rational because they can have utility ascribed to them. Relying on sympathies and notions of fairness are ways of maximizing individual utility. While such an expansive definition of substantive rationality doesn't have much explanatory power, it is logically solid.

Nevertheless, there is one aspect of the rational action framework that the present analysis challenges directly: the procedural aspect of rationality, i.e. the consistency of means-ends schema, clarity of goals and stability of preferences. I argue here that we should release the assumption that business decisions necessarily abide by the coherent means-ends calculations. Rather, as FDI decision making shows much of the economic activity in uncertain environments should be understood as a social practice and economic actors as practical actors who make their decisions by interpreting and responding to the particular situations in which they find themselves, relying on their cognitive but also habitual, affective and evaluative dimensions of action. Economic processes involve complexities and uncertainties which are a property of the environment and not only perceived by individuals because of their cognitive limitations.

Thus, economic actors cannot always make decisions within a procedurally rational means-ends framework, i.e. having a priori clear goals, defined, rank-ordered and stable preferences, deciding on means a priori by weighing costs and benefits, ultimately selecting the alternative that will objectively minimize transaction costs. The analysis of FDI transactions proposes that *economic action is procedurally variable*.

The social embeddedness of economic transactions implies a variety of logics of action:

a) actions were goals are articulated as a consequence of the choice of means (commitment based action)
b) actions where ends articulated at the beginning are not the same as ends achieved in the end because goals change during the process (situationally contingent action)
c) actions where both ends and means evolve during the process of action itself (improvisation or innovation).

When, due to social embeddedness of economic action, actors politically identify with certain strategies/means prior and regardless of goals, and when they allow their preferences to change based on the presence or lack of shared understandings between transactors, the assumptions of stable goals and preferences cannot be upheld. When, because of environmental uncertainties, due to legal changes, political instability, or external economic shocks, actors change their goals and shift their preferences responding to the particularities of given situations, the coherent means-ends calculation breaks down. In the uncertain, politically and culturally charged environments of Eastern Europe in which actors undertake complex and involved foreign investment attempts, the above is very likely. An investigation of FDI in Eastern Europe thus gains explanatory power if we relax the assumptions of profit maximization and means-ends calculations, and instead adopt a practical action framework that explicitly incorporates the social embeddedness of economic life.

Admittedly, organizational attempts in the transition societies of Central and Eastern Europe may have a particular character. However, the implications this analysis has for the prevailing understanding of economic processes as rational means-ends calculations, should not be dismissed due to their temporal and spatial uniqueness (i.e. volatile post-socialist Eastern Europe) or the peculiar nature of the economic process under scrutiny (i.e. complexities of foreign direct investment). Rather, analyses of economic phenomena generally could benefit from examining the variability in substantive goals as well as procedural logics of economic action. The task of future research is to apply this approach to other economic processes in other environments and to identify the conditions that sustain certain substantive and procedural varieties of economic action over others.

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