

# Emerging multinationals: the case of Hungary

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## Abstract

*Foreign direct investment from transition countries to other transition countries have evolved quickly, especially after 2000. Hungary is one of the leading countries among (former) transition economies in outward foreign direct investments (OFDI), both in terms of per capita stock of OFDI or in terms of stock per GDP. First we present the most important characteristics of Hungarian OFDI (evolution in time; most affected sectors: concentration in services and extractive sectors; host countries: concentration in the surrounding countries/regions; dominance of privatisation related versus greenfield/brownfield).*

*Second, in order to identify differences in motivation compared to (O)FDI from developed countries, we establish four distinct groups of Hungary-based foreign investors on the basis of company case studies. (We prepared case studies for the following companies: Dunapack (paper industry), Richter Gedeon (pharmaceutical industry), Videoton (electronics and automotive industry) and Onlinet (software industry), each belonging to one group of Hungarian foreign investors. However, we refer to data and company characteristics of the two biggest investors, MOL (oil industry) and OTP (banking) as well.)*

*We show how FDI by these four groups adds up to the total stock of Hungarian-originated FDI abroad. These four groups differ not only in terms of sector, size and controlling owner, but also in motivations of investing abroad, all which we show in detail. We then compare these characteristics with results of research on the character of emerging country multinationals.*

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## Introduction

FDI home countries are usually developed economies, however, recently, a growing number of companies from emerging and developing economies has become MNCs. Though most recently, the dominant global player in OFDI among developing countries is without doubt Asia (Sauvant, 2008), former transition economies are also becoming important home countries for emerging multinationals: there are more and more companies, which invest abroad, though their share in world FDI is still marginal (Svetlicic, Jaklic, 2006) Hungary is among the leading foreign investor countries in former transition economies. The paper shows how Hungarian outward foreign direct investment (OFDI) evolved over time, what its main characteristics are and how Hungarian investor companies can be characterised. In the final part of the paper, we make a comparison on the basis of our analysis, with other emerging country MNCs, using the features analysed in detail in Aykut and Goldstein (2006).

### 1 OFDI from Hungary

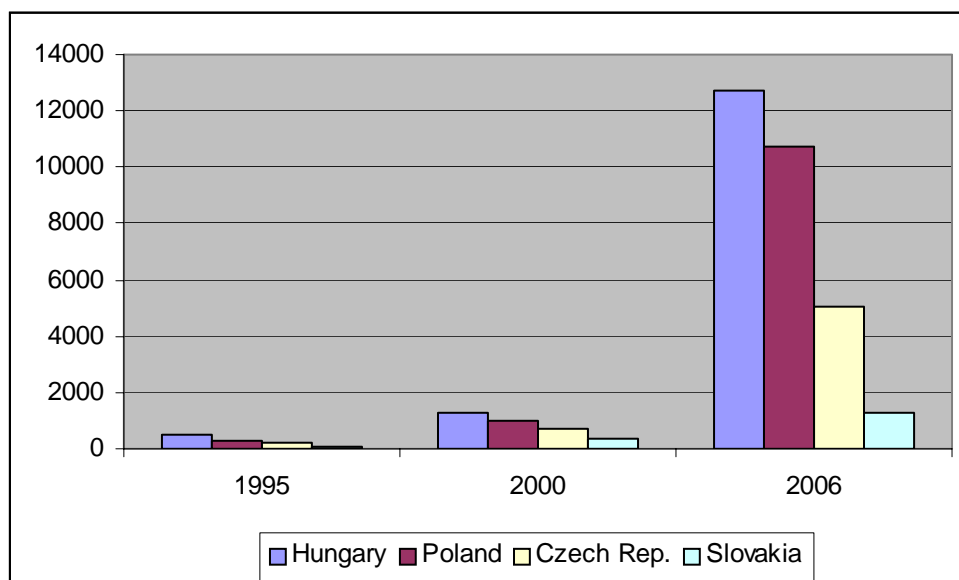
Foreign direct investments from transition countries have evolved quickly, especially after 2000. Hungary is one of the leading countries among (former) transition economies in outward foreign direct investments (OFDI), both in terms of per capita stock of OFDI or in terms of stock per GDP. In this chapter we show the most important characteristics of Hungarian OFDI.

#### 1.1 International (regional) comparison

Hungary is one of the leading capital (FDI) exporters of East-Central Europe (together with Estonia and Slovenia as far as per capita OFDI is concerned.). At the end of 2006, the OFDI stock reached USD 12.7 billion, while the same indicator for Poland was USD 2 billion less and that of the Czech Republic less than half of the Hungarian data.

Hungary has been in leading position in the region since the beginning of the nineties, i.e. from the starting of the transition period. However, its lead diminished over time: the Polish OFDI stock was only slightly more than half of Hungarian OFDI stock in 1995, while in 2006 this ratio surpassed 85 per cent. However, the Czech OFDI stock was half of that of the Hungarian, and in 2006, only 40 per cent of it.

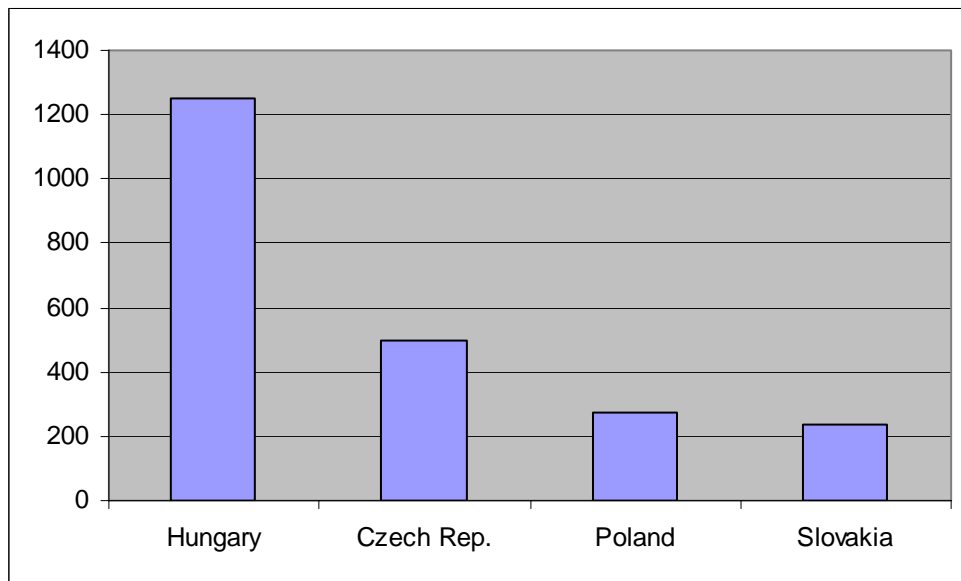
**Graph 1 FDI outward stock (USD millions)**



Source: UNCTAD 1997, 2007

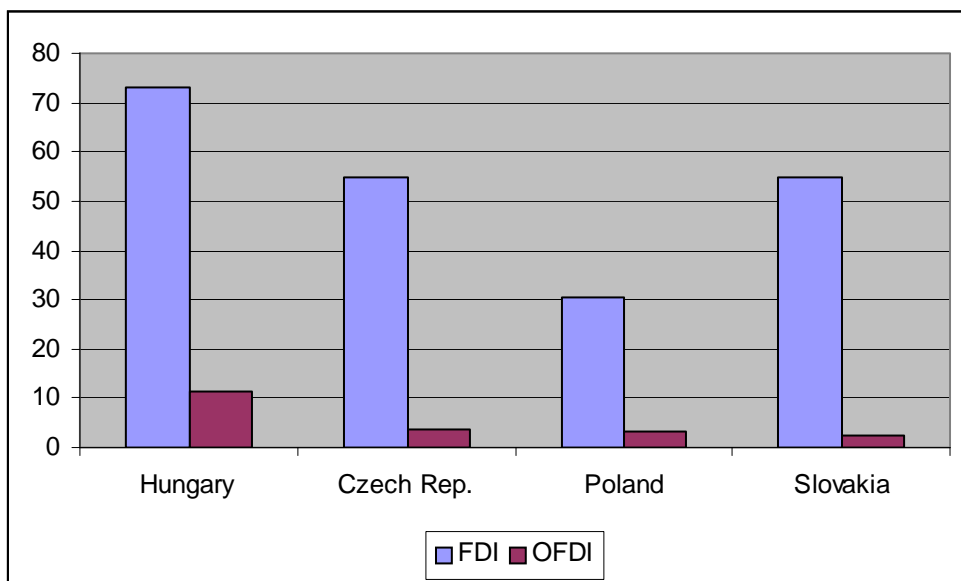
However, these numbers show little about the real extent of internationalisation through OFDI. Real comparisons can be made on the basis of per capita OFDI or OFDI/GDP indicators. According to these indicators, Hungary's leading position in the region is even more pronounced. On a per capita basis, the Hungarian indicator was two and a half times that of the Czech Republic, and four and a half times that of Poland and Slovakia. According to the OFDI/GDP indicator, the difference is even bigger: Hungary owns three to five times higher indicators than the other three countries.

**Graph 2 FDI outward stock per capita (2006, USD)**



Source: UNCTAD 2007

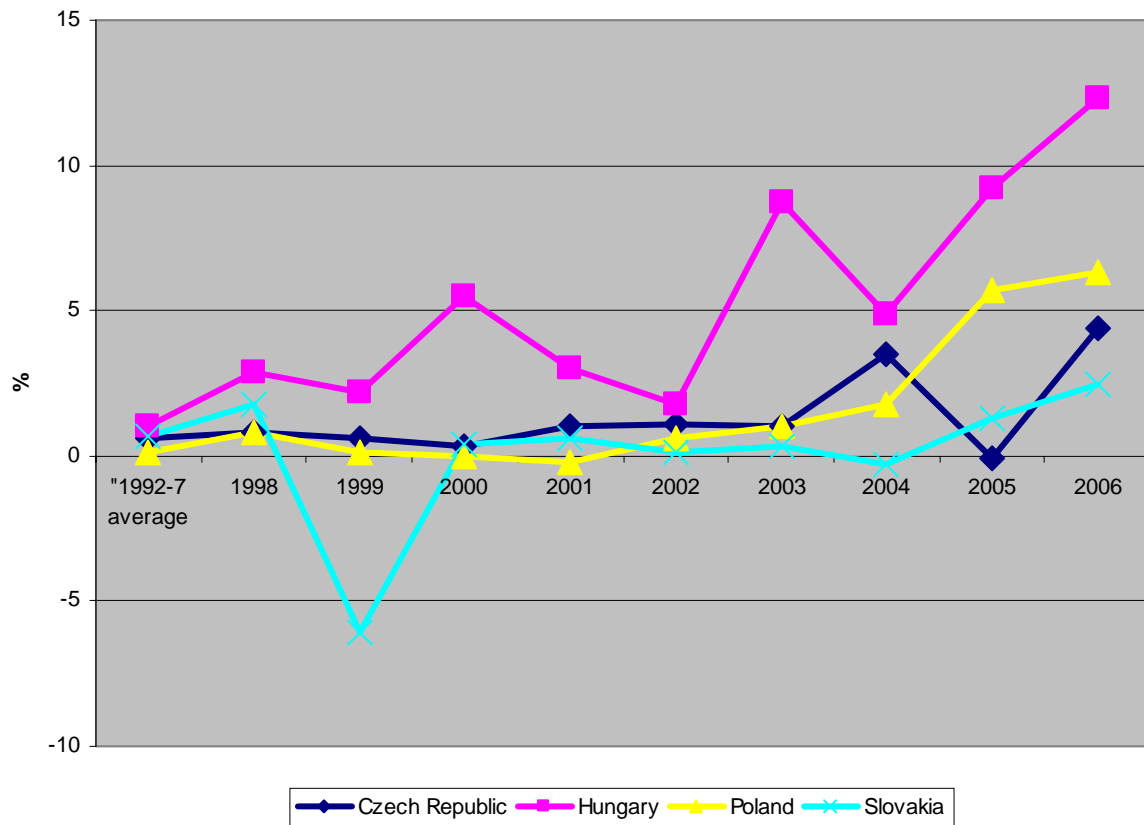
**Graph 3 FDI and OFDI stock as a percentage of gross domestic product (2006)**



Source: UNCTAD 2007

As it can be seen, Hungary, similarly to inward FDI, started to invest capital abroad much earlier than its regional counterparts. The regulatory and overall business environment started to be favourable for FDI and OFDI much earlier than in the other three countries.

**Graph 4 Annual OFDI flows as a percentage of GFCF, 1992-2006**



Source: UNCTAD, WIR, 2003 and 2007

Similarly, as the percentage of gross fixed capital formation, Hungary “spent” the highest share of its investments abroad during the whole period. The share of OFDI in GFCF climbed as high as 12 % in 2006. Poland increased this indicator gradually starting from 2002-3, Slovakia from 2004, while in the Czech Republic, 2000 can be the starting year with a high volatility, especially in 2005.

## 1.2 Main characteristics of Hungarian OFDI

Hungary started to invest capital abroad in bigger amounts starting from the mid-nineties. The first “jump” in OFDI flows occurred in 1997 and then in 2000. While the period between 1997 and 2002 can be characterised with an around 500 million euros annual outflow, starting from 2003, except for 2004, annual outflows exceeded 1 billion euros, representing a high amount even compared to FDI inflows in these years.

**Table 1 Annual flows and stock of FDI from Hungary, 1995-2007, million euros**

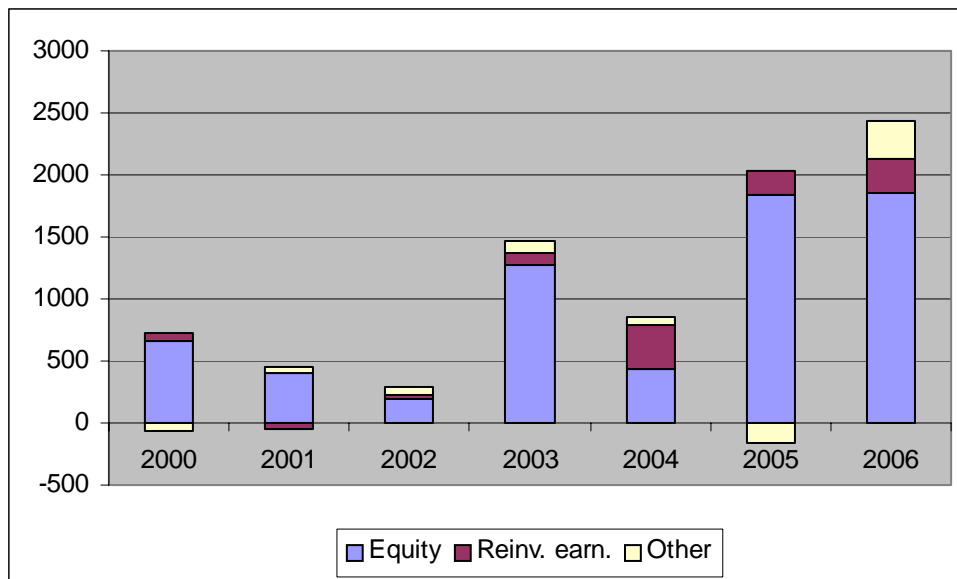
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Equity	236,1	-0,8	265,5	234,7	252,2	664,8	409,4	190,8	1280,6	425,9	1837,3	1916,8	1801,2
Reinvested earnings	234,7	-2,1	6,0	-6,3	-19,9	63,5	-49,2	28,0	76,9	397,1	95,5	697,2	869,1
Other capital	-150,4	0,5	131,3	16,8	2,4	-63,9	38,3	76,8	105,8	69,1	-155,9	308,7	333,7
Total flow	320,3	-2,4	402,9	245,2	234,7	664,4	398,5	295,7	1463,3	892,1	1776,9	2922,7	3004,0
Stock at the end of the year	216,9	213,7	586,5	671,8	915,5	1375,5	1762,7	2067,8	2782,3	4412,1	6622,2	9248,0	12456,0

Source: Hungarian National Bank

At the end of the nineties, Hungary-based, formerly state owned companies, privatised through the stock exchange, became important international (regional) players, when they started to get involved into privatisations in the neighbouring countries. That is also the main reason why Hungarian OFDI is so volatile: one or two privatisation projects push annual outflows to higher levels in certain years. To name a few examples, more than half of the record high 2006 OFDI outflow was connected to OTP (Hungarian bank), which acquired two Serbian, one Russian, one Ukrainian and one Montenegrin bank, and raised the base capital of its Romanian affiliate. In 2000, 65 per cent of the total outflow is related to the acquisition of the Slovakian Slovnaft by MOL (Hungarian petrol company) and to the acquisition of a Czech hotel by Danubius (Hungarian hotel chain). In 2001, MATAV (Hungarian Telecommunications Company) acquired the Macedonian state-owned telecom company, which transaction represented around 75 per cent of the total annual outflow. Another important characteristic, on the basis of the above examples is that Hungarian OFDI is closely related to privatisation deals in neighbouring or geographically closer countries.

In terms of the composition of outflows, the typical pattern characterizes Hungary: from countries in the first stage of OFDI, equity investments dominate, as it is true for Hungarian OFDI until now. However, in the second stage of OFDI evolution, reinvested earnings and other capital (basically credit transactions between the parent and the affiliate) gradually become more and more important. This phenomenon can be explained by the fact, that as foreign affiliates become more established over time and start producing profit after a few years of losses, companies extend capacities in the foreign country, and this can be the most easily done from profits produced there. First signs of stepping into this second stage of OFDI are present in the Hungarian case, because it can be seen, how the reinvested earnings component, and to a lesser extent, other capital component of OFDI become more and more important starting from 2003.

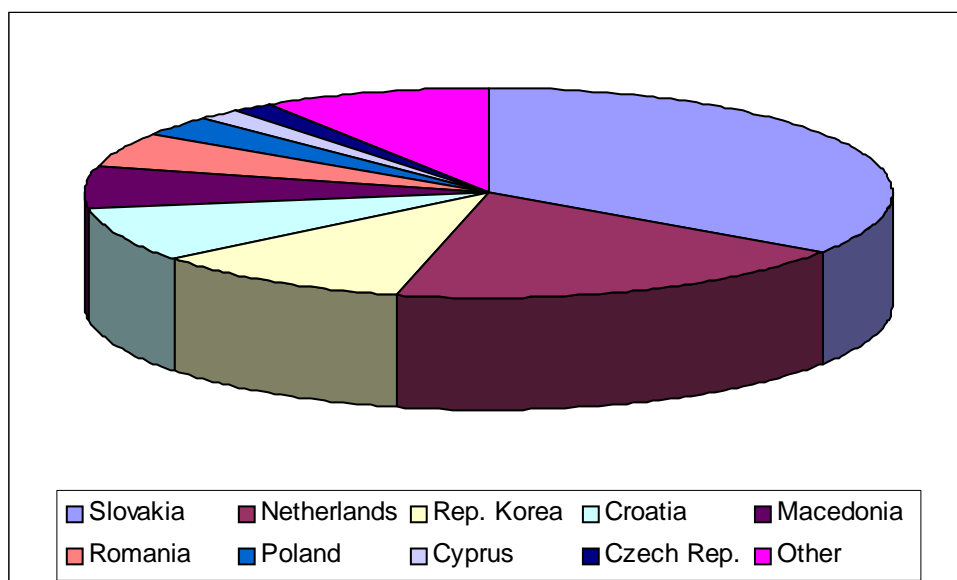
**Graph 5 Composition of OFDI from Hungary (million euros)**



Source: National Bank of Hungary

In terms of the most important country targets of Hungarian OFDI, neighbouring or geographically close countries dominate, with 59 per cent share in the total stock of Hungarian OFDI. The Netherlands and Cyprus are assumed to be on the list because of their special role in financial flows. In South Korea, in 2006 a bigger project was realised by a Hungarian affiliate of an MNC, which put the country among the top destinations of Hungarian OFDI.

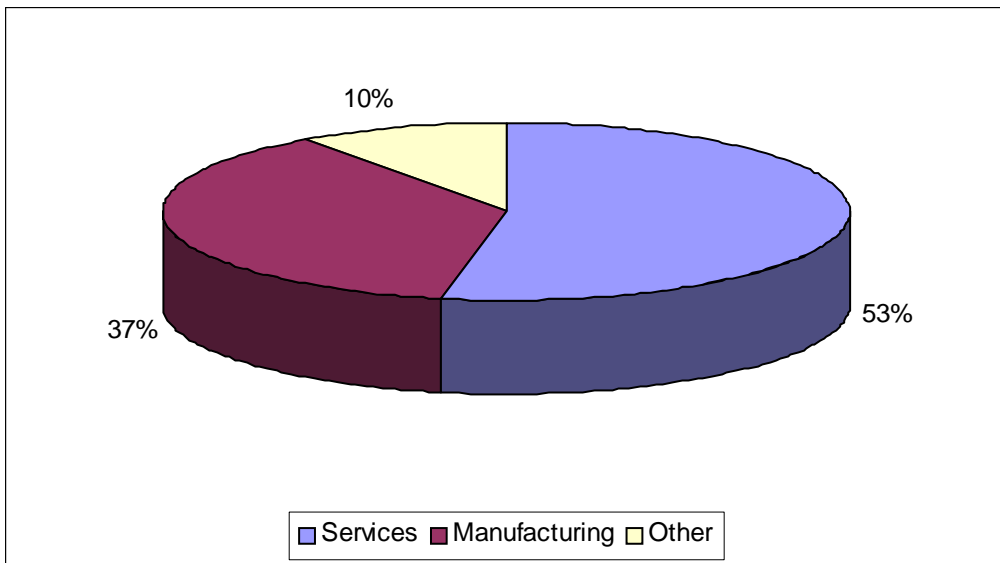
**Graph 6 FDI outward stock by countries, 2005 (%)**



Source: National Bank of Hungary

According to the sector composition of OFDI, services dominate with 53 per cent of total OFDI at the end of 2006, while manufacturing represented 37 per cent. This is also due to a few big projects, especially in the services, sector, as it is indicated later in the paper.

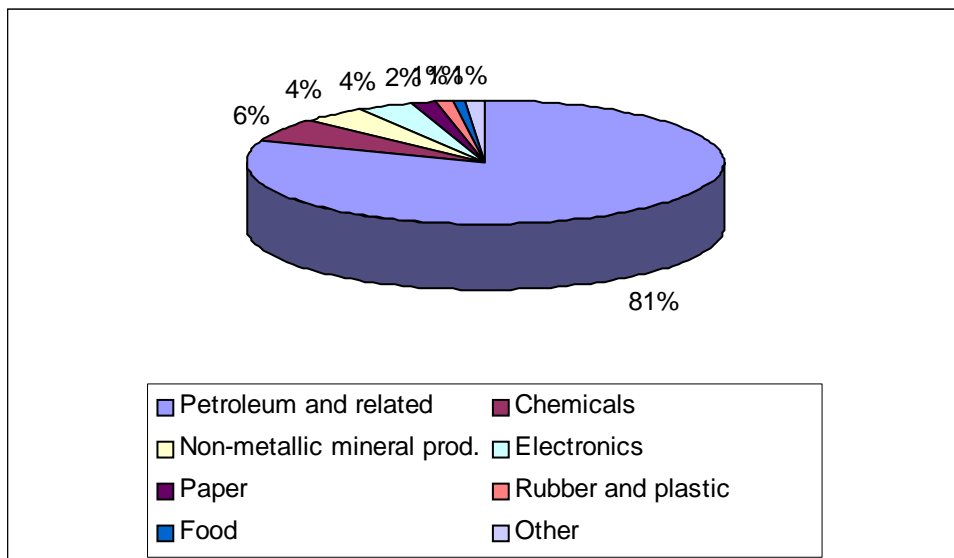
**Graph 7 FDI outward stock by sector (%)**



Source: National Bank of Hungary

Inside manufacturing, the overwhelming majority of investments can be attributed to the petrochemical industry (basically MOL), 6 per cent to the chemical sector (mainly pharmaceuticals), 4-4 per cent to the non-metal mineral sector and to electronics, 2 per cent to the paper industry and 1-1 per cent to rubber/plastic, food and other sectors.

**Graph 8 FDI outward stock in manufacturing by sector, 2005, %**

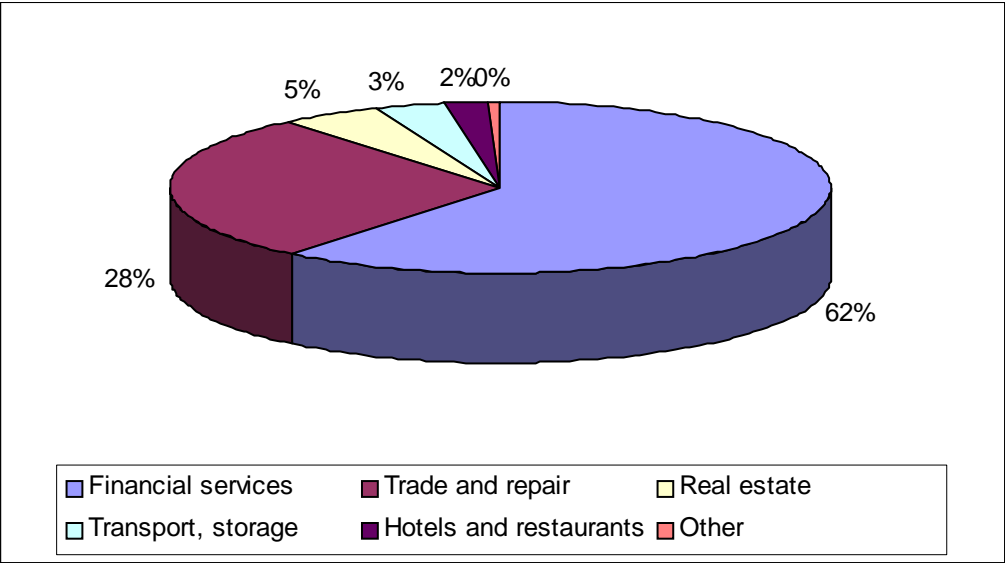


Source: National Bank of Hungary

In services, there is also one dominating sector: financial services, which are, similarly to manufacturing, also connected to the activities of one company: OTP. 62 per cent of services OFDI was realised in the financial services sector at the end of 2006. Besides financial services, trade and repair (28 per cent of services OFDI) is an important sector target of OFDI, in many cases companies establish their trade representatives abroad, but besides that, there are important investors in retail trade as well. Moreover, OFDI in real estates represent 5 per cent of total services OFDI stock, hotel and restaurants: 3 per cent (Danubius Group), and transport: 2 per cent.

According to our estimation, the two biggest investor companies, MOL and OTP may account for as high a percentage as 60 % of total OFDI from Hungary.

**Graph 9 FDI outward stock in services by sector, 2005, %**



Source: National Bank of Hungary

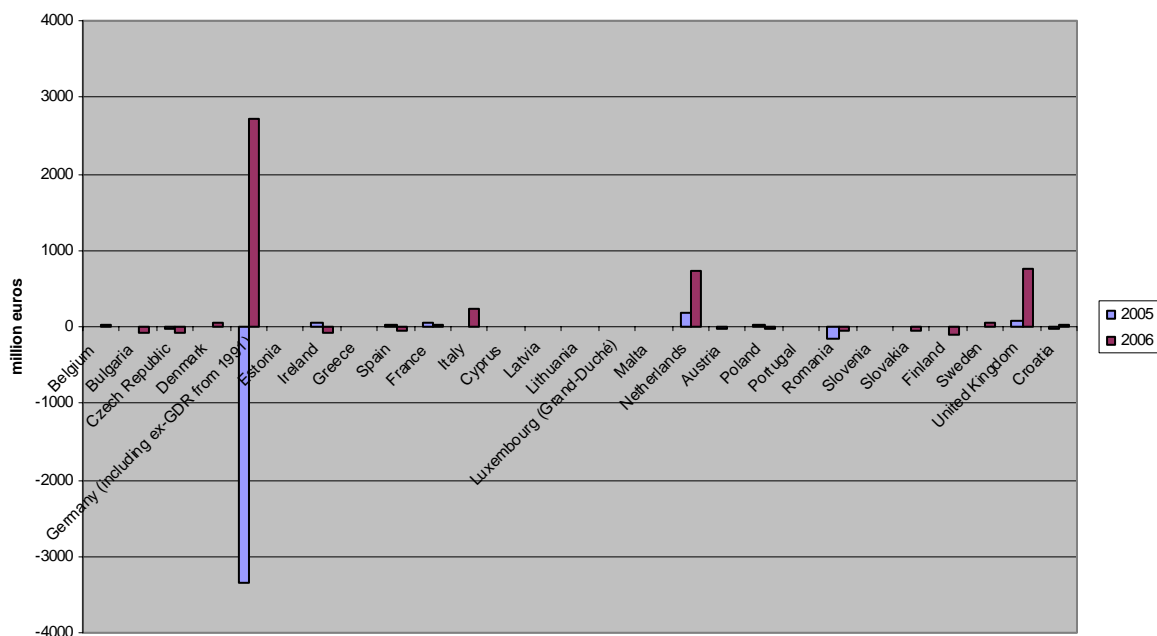
Overall, Hungarian OFDI started to grow and reach high levels at the turn of the century. Its main targets are geographically proximal countries, and it is concentrated sectorally to a great extent: in manufacturing to the petrol sector, in services to financial services. This concentration can be explained by the fact, that there are a few big investors, responsible for the biggest projects. On the other hand, these big projects usually are connected to privatisation deals in other countries of the region, thus Hungarian OFDI can be characterised as privatisation-related. This latter phenomenon plays an important role in the annual fluctuations of OFDI flows.

One last remark must be made concerning the reliability of data: having a look at mirror statistics reveals how unreliable OFDI data are, especially in German-Hungarian relations. Graph 10 illustrates the difference between the data from the two sources. Comparing Hungarian reported statistics (in balance of payments) and mirror statistics from EU partner countries and Croatia (which is an important destination of Hungarian OFDI), substantial differences are revealed, especially in the following relations: Germany, the Netherlands and United Kingdom. It is even more problematic, that for the EU-27, the sum of differences by country amounted to 3 billion euros in 2005 and to 6 billion euros in 2006. There can be various reasons for the differences between reported and mirror statistics, though in this case,



the differences are too big for explaining them with the usual time lag or reporting problem factors. (The data problems concerning emerging country OFDI are discussed in Aykut, Goldstein, 2006.)

**Graph 10 Differences between reported and mirror statistics on Hungarian OFDI annual flows, 2005-6 (million euros)**



Source: Eurostat data

*Note: no data available for mirror statistics from Belgium, Greece and Portugal (2005), Cyprus, Latvia, Lithuania, Luxemburg, Malta (2005 and 2006)*

## 2 Company case studies

When analysing development in Hungarian OFDI, it is important to concentrate on company level data and information, because companies realise for investment abroad – and not countries. (Though the business environment for inducing companies to invest abroad is country – and maybe sector - specific.) Moreover, company level analysis is useful for Hungarian OFDI, because – as we have seen it – it is concentrated to a great extent; a few companies are “responsible” for the overwhelming majority of OFDI.

### 2.1 Company with foreign participation investing abroad: Dunapack

Dunapack is a Hungarian paper industry company with long tradition. It produces paper products and packaging material. The company’s activity expands from wood pulp manufacturing through collection of waste materials to the production of paper and packaging products. Its privatisation process started in 1990, when the Austrian Prinzhorn group acquired shares in the company, which reached 100 per cent in 1995. The Hungarian affiliate’s share in the total production of the group is one third, the paper branch is managed in Austria, while the packaging material branch in Hungary. The company at present is one of the biggest companies in the CEE region in the paper-based packaging material branch. It

employs 1300 employees, and the company is 125<sup>th</sup> in terms of net sales, 108<sup>th</sup> in terms of profit among Hungarian companies. The company is the market leader in Hungary: it represents around 60 per cent of the total paper production of the country. It is an important supplier to affiliates of MNCs in Hungary (Nestlé, Unilever, Henkel).

Dunapack started its regional acquisitions at the mid-nineties, and it is now among the most important Hungary-based companies investing abroad. As a precedent, it is important to note, that the Austrian Prinzhorn group (a family owned company) appeared in the CEE region at the beginning of the nineties. Its main motive was market-seeking (partly the Hungarian market, partly the market created by affiliates of MNCs started to operate in Hungary), and the main target country was Hungary. One reason for investing in Hungary was the specific high transport cost of the packaging product, because the production must be located in a 200-250 km's proximity of the companies supplied in order to react quickly to specific needs. Dunapack, after a restructuring and modernisation of production after privatisation, became the managing centre in the CEE region for the production of packaging materials, due to its growing market share, lower compared to Austria production costs and advantageous (close to new markets) geographic position. These factors explain why further investments in the CEE region were realised through the Hungarian affiliate. The main motive again is market seeking, because neighbouring countries do not have the demanded capacities in producing paper based packaging materials, while demand – partly due to the activities of foreign owned companies in these countries – is rising quickly.

The appearance on a new market follows the same pattern. First, the company establishes a commercial affiliate. This can be done with low costs and risk, and the affiliate is able to discover the local market. The affiliates employ local experts, who know the local business environment well, and who can discover market opportunities. In the last ten years, such commercial affiliates were established in all neighbouring countries (Austria, Slovakia, Ukraine, Romania, Serbia, Croatia and Slovenia), and geographically proximal countries, such as the Czech Republic, Poland and Bulgaria. When local turnover reaches a certain threshold level, Dunapack establishes a local production unit as well. This happened in five of the above listed countries. All were planned to be carried out in the framework of privatisation, but because of the lengthiness and cumbersomeness of privatisation in some of the countries in question, only one production affiliate was connected to privatisation.

**Table 2 Dunapack's foreign production affiliates at the end of 2007**

Name of the company	Country	Year of establishment	Share of Dunapack (%)	Mode of entry
Dunapack Rambox	Romania	1996	100	Greenfield
Dunapack Ukraine	Ukraine	1998, 2007	100	Greenfield
Eurobox Polska	Poland	2000	100	Greenfield
Dunapack Rodina,	Bulgaria	2002	98	Acquisition
Valoviti	Croatia	2003	100	Greenfield

Source: Annual Report of Dunapack

There are two main reasons why the Prinzhorn group realizes its internationalisation in the region through Dunapack: first, because the Hungarian affiliate is in key position in the production of paper-based packaging materials, and second, because of the specificities of the product, where proximity to consumers/buyers is important.

## **2.2 Investor company, privatised through the stock exchange: Richter**

The pharmaceutical industry has a long tradition in Hungary, with four leading companies. All the four companies are privatised; three of them with dominant foreign ownership, and the shares of the one we refer to in our paper were introduced in the Budapest stock exchange. It has a dispersed ownership structure, basically with no controlling owner. (Table 1) 25 per cent of the shares is owned by the Hungarian State through ÁPV Zrt.

**Table 3 Ownership structure of Richter Gedeon joint stock company (31.12.2006)**

<b>Owners</b>	<b>Voting capital (%)</b>	<b>Base capital (%)</b>
Domestic owners	<b>35.55</b>	<b>35.51</b>
- ÁPV Zrt	25.08	25.04
- Local governments	0.33	0.32
- Legal persons	7.68	7.67
- Private persons	2.46	2.48
Foreign owners	<b>64.45</b>	<b>64.37</b>
- Legal persons	64.43	64.35
Of which: Bank of New York	13.61	13.59
Of which: York	0.02	0.02
- Private persons		
Own stocks	0.00	0.12
<b>Altogether</b>	<b>100.00</b>	<b>100.00</b>

Source: Annual report 2006

Richter Gedeon is the biggest pharmaceutical company in Hungary, and it is one of the biggest manufacturing companies. In 2006, according to net sales, it was the 27<sup>th</sup>, according to own capital, the 4<sup>th</sup>, according to exports, the 14<sup>th</sup>, according to the number of employees, the 10<sup>th</sup>, according to operating profit, the 4, and according to before-tax profit, the 5<sup>th</sup> company in Hungary.<sup>1</sup> It employs 8600 employees. In international comparison, it is a medium-sized pharmaceutical company, however, in the CEE region; it is among the biggest pharmaceutical companies. If its plans of merger with the Polish Polpharma will be realised and of the acquisition of a Russian pharmaceutical company, it will become the leading company in the CEE region.

The company's strategy was based on domestic investments between 1992 and 2007. Its internalisation can be cut into three stages. In the first stage, between 1992 and 1998, the company concentrated on the establishment and extension of its trade representative network. Joint ventures established during this period served the aim of exporting to new markets or maintaining exports in old markets. In the second stage, between 1998 and 2002, the company started to acquire companies in the CEE and CIS region, which are important export markets of the company. In the third stage, between 2002 and 2007, the company started to fit its new affiliates in the company structure, and consolidate the new structure. Besides investment and capacity extensions in the CEE and CIS regions, it established a joint venture in India with Themis Medicare Ltd, in order to extend its capacities and improve its competitiveness.

**Table 4 Foreign affiliates of Richter Gedeon at the end of 2007 (in production)**

Name	Country	Share of Richter Gedeon (%)	Mode of entry

<sup>1</sup> Figyelő TOP 200, (2007)

ZAO Gedeon Richter-RUS	Russia	100.00	Greenfield
Gedeon Richter Romania S.A.	Romania	99.19	Acquisition
GZF Polfa Sp. Zo.o.	Poland	70.11	Acquisition
Richter Themis Ltd.	India	51.00	Joint venture
Gedeon Richter UA V.A.T.	Ukraine	98.10	Acquisition
Biowet Drwalew S.A.	Poland	69.86	Acquisition

Source: Annual report 2006

Financing of these investments was realised from own resources after 1998. The most important motive of internationalisation is market seeking. The company always had a strong export orientation, which reached 70 per cent in terms of export/sales in 2006, and surpassed 80 per cent last year – due to problems in the domestic market. However, more recently, the cost reducing, and efficiency seeking motive has also appeared, as it is obvious from the case of the Indian joint venture.

### 2.3 Medium-big sized Hungarian investor company: Videoton

While before the transition period, activity in the electronics sector was negligible in Hungary; by now it is one of the strongest growing sectors of the economy. (Actually, the overall growth of manufacturing is likely to be driven by the growth of the electronics sector.) Growth rates of output surpassed significantly manufacturing averages after 1995, and the increase in employment was also higher than the manufacturing average. The dynamic growth of the sector is mostly due to foreign direct investments, carried out by IBM, Flextronics, Nokia, Philips, and Samsung, to name only a few of them. The (relatively) unskilled labour intensive nature of the production, carried out in companies in Hungary can be indicated by the fact that the share of white-collar employment in this sector, though increasing, but is still below the manufacturing average. The sector is strongly export-oriented (exports in total sales close to 90 per cent) and strongly concentrated in terms of the number of companies.

Videoton was founded in 1938. At present the company employs 9000 workers, which is a result of a gradual reduction of employees. Its consolidated turnover at present is 273 million euros. It has been built on the ruins of a big state-owned company, which was bought by Hungarian individuals in the framework of privatisation in 1992, and it followed a specific strategy. Before 1998, it carried out mainly assembly-type activities, and extended its capacity by acquisitions in Hungary: in Kaposvár, Jászberény, Törökszentmiklós, Kunhegyes, Salgótarján. However, due to the relative increase in costs (especially labour costs) in Hungary; it was forced to change its strategy. After 1998, according to the new strategy, the company's aim was to become a full contract manufacturer. That includes using locally developed, own technologies to a greater extent, financing inputs more from own resources and carrying out engineering activities. In order to realise the new strategy, first, investments were realised in the domestic company, second, assembling and OPT were relocated into another country in the region: Bulgaria, with lower labour costs by buying a company there (1999). As a result, at present the company is the largest in its segment in the region, and is among the TOP 10 in Europe and TOP 30 worldwide. It is serving a wide variety of end markets for the automotive, consumer electronics, household appliances, IT, office equipment and telecommunication industries. It is a supplier among other to Alcoa Fujikura, Valeo, Visteon, Delphi, Sony, Philips, Matsushita, TGI, Electrolux, IBM, Hewlett Packard, Brother Industries, Texas Instruments, Ascom, 3M-Quante. Besides manufacturing, it provides

services to its customers as for example design and engineering, logistics, distribution, quality assurance, project management, technology material procurement and financing and engineering services. Due to the strategy of the company, currently Videoton is able to take four different roles: financial investor, professional strategic partner, R&D partner and traditional manufacturing partner. Starting from 2005, new sectors (green-energy, healthcare) were put in the list of Videoton's activities. The company continued to acquire local companies in related sectors and activities. (E.g. in 2006 it gained 55% share in KVJ Művek Zrt., which is a direct supplier of Suzuki in the field of stamped sheet metal parts and sub-assemblies, and deals with manufacturing packaging systems which make the delivery of parts and components in the automotive industry easier.)

The company acquired the Bulgarian company (DZU AD in Stara Zagora) partly to keep its partners who subcontract labour-intensive production processes to the company, partly to build up a regional CM strategy. The cost-reducing, efficiency seeking motive is obvious, because, according to the company's homepage: Through our presence in Hungary and Bulgaria we can provide the cost level of China with the proximity of Europe to our partners. The Bulgarian company carries out the following activities and uses the following technologies: machining, plastic injection moulding, sheet metal processing, electronic and mechanical assembly, tool design and manufacturing.

#### **2.4 Small-medium sized Hungarian company: Onlinet Ltd.**

Onlinet Ltd was established in 2001, by three Hungarian private persons, IT professionals. Its main activity is software production and software consultancy. It is a small company, at present it employs 43 people, and its sales in 2006 reached 2.4 million euros. In 2007, the company was one of the fastest growing technology companies in Europe, according to Deloitte-Touche Report. It developed a specific product (queue management system or customer directing system). These QMS and Kiosk solutions are used by banks, telecommunication companies, public utility companies and public institutions or other companies with a customer service. In 2004, the company extended its list of activities by introducing the distribution of Uninterruptible Power Supplies (UPS) used in industrial environments and others dedicated for Small Office and Home, which are used in hospitals, office buildings, shopping malls, manufacturing plants, educational and governmental institutions. After its establishment, the company grew dynamically in terms of output, sales and starting from 2005, also exports. Big Hungarian banks, affiliate banks, telecom companies are among others the buyers of their product. While exports represented only 5 per cent of total sales in 2006, its growth rate surpassed 10 per cent starting from 2005. The company wants to expand abroad, at present it has subsidiaries in Russia (St. Petersburg, Moscow - 2006), Romania (Bucharest - 2006), Bulgaria (Sofia - 2007), England (London - 2007) and this year it plans to open an office in Poland, and maybe in Ukraine. Moreover, the company is about to sign a contract with a partner company located in Africa, which would guarantee easy access to 35 African and 8-10 Middle Eastern countries. Onlinet's aim is to have at least 15 subsidiaries by 2010. This mainly means the opening of local offices. Inside the new location, they deliberately look for cooperation with local partners. According to the managers as it is written in Budapest Business Journal: "There is always a great deal of mistrust of newcomers in this region. Therefore, it was crucial to be recommended by someone that is accepted in that area. This was the reason that, in Russia, we first appeared in St. Petersburg and only later in Moscow: Our partner was well-entrenched in that town."..... Moreover, "According to the owners, most of Onlinet's profits will come from (foreign) daughter companies: These companies installed about 500 systems in Hungary during a six-year period, while they were able to manage more than 100 systems installed just within one-and-a-half years in Romania."

## **2.5 Special cases? Outward FDI and relocation**

Outward FDI can be connected to relocation, when Hungarian owned companies relocate their manufacturing or services activities to other countries. When a foreign owned company relocates from Hungary, then this transaction is statistically registered on the FDI-side (as minus). Up till now, relocations of activities of foreign owned companies dominate by far, though there are some cases of Hungarian companies relocating their production to neighbouring countries in order to reduce costs.

The UNCTAD (2003) survey for the preceding period January 2002 and June 2003 found five cases of large relocations from Hungary, including Flextronics (production of X-box), IBM Storage Products (production of hard disc drives), TDK, Philips (production of cathode-ray TV sets), Visteon. They all had a considerable job market effect, resulting in a job loss of 3700 in the case of IBM and 1000 in the case of Flextronics. However, all these relocations were registered in the FDI part as negative inflows. In another study, considering smaller projects as well, Hunya and Sass (2005) in the period between July 2003 and September 2005, found altogether 65 clear-cut relocation cases, of which 7 represented relocations from Hungary. Where do firms relocate from Hungary? According to their survey, countries of destination are usually lower cost countries further to the East. Romania stands out with 3 cases, and further four such countries are represented with one case each. The main driving force of the foreign investor is “rationalisation” and concentration of production for a larger regional market to one production site. Production concentration may be the reason for having Austria on this list<sup>2</sup>. Which sectors are affected by relocations from Hungary? Companies, listed in UNCTAD (2003), belong to the electronics and automotive sectors. Companies that relocated production from Hungary during the ICT crisis did not close down their Hungarian sites but either transferred other activities to Hungary (Philips) or maintained their less labour intensive capacities there and even relocated there some production related services (IBM). In Hunya, Sass (2005), two of the seven cases were realised in the labour intensive footwear-textile-clothing sector, and one-one case affected automotive, electronics, chemical, food and machinery sectors. Altogether, the automotive, electronics and clothing sectors seem to be the most affected. It is mainly US (3 cases) and German (2) MNCs, which relocated their production from Hungary. While in the period in UNCTAD (2003) a few thousands of jobs were relocated from Hungary, mainly to China, Ukraine and India, in the period analysed by Hunya, Sass (2005), no big job losses were recorded, the two biggest relocations affected only less than 400 jobs in Hungary.

The above short description concerns relocations recorded in the FDI part of statistics. In OFDI, cases are much rarer. In the above mentioned case studies, it is mainly certain companies in the third and the fourth groups, which relocate their most labour intensive activities abroad in order to reduce costs and improve competitiveness. However, the share of this type of OFDI in total OFDI is very low (partly due to the dominance of investment abroad by companies in the first and second group.)

## **3 Four groups of Hungarian foreign investors**

Many studies analysed the emergence of multinational companies from countries outside the developed country group, which is a recent though strengthening phenomenon. Among these home countries, (former) transition economies can be found as well. As far as the literature

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<sup>2</sup> Kraft Foods Inc. (USA) closed down its factory in Hungary in January 2004, and transferred its production to its Austrian and Slovakian plants.

concerning the theory of outward internationalisation is concerned, dynamic models, such as the Uppsala model and the investment development path model are describing a process, in which a country's net investment position depends on its level of economic development. According to Dunning and Narula (1998), country specific factors influence this relationship, when economic structure, institutions, government policy etc. influence the net investment position of the country in question. The IDP model can explain outward FDI from (former) transition economies. (Andreff, 2002) The New Members of the European Union are between the second and third stage of the IDP, indicating a negative net investment position. However, as the cases of Estonia, Hungary or Slovenia show, one should expect in the near future a move towards the fourth stage and a speeding up of the IDP. (Svetlicic, Jaklic, 2006, Kalotay, 2002)

On the basis of company case studies and various previous analyses, especially in Antalóczy (2001) we established four distinct groups of Hungarian investors abroad. As a first group, the foreign owned affiliates of MNCs, operating in Hungary, invest abroad – which is called in the literature “indirect” FDI (see e.g. Svetlicic and Jalkic, 2006, Altzinger et al., 2003, Andreff, 2002). In this case, various reasons – e.g. accounting considerations, sector or product specificities, specific knowledge of the Hungarian affiliate or lack of profitable investment opportunities in Hungary – explain why FDI is realised through the mediation of the Hungarian affiliate. (Companies with foreign participation became established and turned their production profitable first in the first mover for FDI of the CEE region, Hungary, which provided one of the main sources of outward FDI (i.e. investments abroad by companies registered in Hungary).) To this group belong the following companies: T-Com-Matav (the Hungarian affiliate of Deutsche Telekom, through which the Macedonian telecom company was acquired), the Austrian Prinzhorn Holding (owner of the Hungarian Dunapack company, see more details in the case study) or Axel-Springer (the German company owns various magazines, journals and newspapers in Hungary and acquired further such companies in neighbouring countries through its Hungarian affiliate). However, on the basis of the individual deals' data, we estimate, that the share of indirect OFDI can not exceed 15 % of total OFDI from Hungary.

In the second group, big formerly state-owned Hungarian companies can be found which at present have no controlling owner, because they were privatised through the stock exchange. Their management's main motive is to gain market shares and to become regional MNCs, and their mode of entry is mainly through privatisation in the geographically proximal countries, though some smaller greenfield investments are also present, in some cases in faraway countries. OTP (bank), MOL (petrol company), Richter (pharmaceutical company), and Danubius (hotels) belong to this group. This group is responsible for the overwhelming majority of Hungarian OFDI, according to our estimations, based on sectoral OFDI data, this group represents more than two thirds of Hungarian OFDI. Here two transition-specific factors (Svetlicic and Jalkic, 2006) can be traced; both are connected to the privatisation process. The first one is the method of privatisation, via which the management of these companies got into a strong position, having no controlling owner. The second privatisation-related element is, that the main channel of internationalisation of these companies is through taking part in the privatisation process of other (former) transition countries.

#### Box MOL and OTP – the two biggest foreign investors in Hungary

The overwhelming majority of Hungarian OFDI (about 60 % according to our estimation, shared more or less equally by the two companies) is represented by two companies: MOL and OTP:

MOL is one of the leading companies in Central and Eastern Europe in petrol and gas production and distribution, and this is the largest company of Hungary in terms of its turnover, operating profit, exports and own capital, while according to the number of employees, it is the fourth largest company. On the basis of the indicators of efficiency it is among the leading European companies of the sector. It has a dispersed ownership, due to the fact, that it was privatised through the stock exchange and there is no controlling owner. 32.1 % of the shares are held by foreign institutional investors, 20.2 % by the Austrian ÖMV. Further share owners retain less than a 10 % share. Among these, it is important to note, that OTP bank owns 9.4 % of the shares, while 7 % is in the hands of the Czech CEZ. One piece registered voting preference share of the series „B” with a par value of HUF 1.000 that entitles the holder thereof to preferential rights as specified in the present Articles of Association. The „B” series share is owned by the Hungarian Government.

In 2008, MOL had a majority ownership of 13 foreign affiliates. The most important is the Slovakian Slovnaft. MOL owns 25 %+1 shares of the Croatian INA (and it aims at increasing its share). In December 2007, MOL concluded an agreement about a strategic alliance with the Czech energy company, CEZ, and established a joint venture for joint investments in gas power stations in Central and Eastern Europe. Other affiliates of MOL include companies in Asia, the Middle East and Africa, which are smaller in size and deal with extraction. Other European affiliates deal mainly with distribution and wholesale and retail trade. (These are located in Oman, Germany, Pakistan, Yemen, Austria, Kazahstan, Romania, Austria, Slovakia, Russia, Serbia, Slovenia). Thus, the main aim of MOL is to become a leading regional company in its sector, a leading regional multinational. Foreign investments, established by MOL follow a gradual strategy. Its first two affiliates were established in the neighbouring Romania and Ukraine in 1994, through greenfield investments, which were followed by other greenfield investments in other neighbouring countries. However, there was a clearcut change in the company strategy in 2000, when it decided explicitly that its main aim is to become a leading regional multinational. Since then, privatisation-related acquisitions dominated instead of greenfield investments, and the size of foreign projects became bigger. (Shares of Slovnaft and INA were acquired after 2000.) As part of the new strategy, it also acquired a majority stake in the leading Hungarian petrochemical company, TVK, thus established a basis for an integrated petrochemical company. Through its foreign greenfield investments and acquisitions, MOL became an interesting and valuable target for acquisitions itself, which induced the Austrian ÖMV to launch a series of “attacks” for acquiring further shares in MOL. This fight seems to be over now with the official disapproval of the European Commission for ÖMV’s inimical steps.

OTP is Hungary’s leading bank, it is the determining financial institution in Hungary as far as retail banking is concerned. It is a universal bank. Its overall market share in Hungary is estimated to exceed 25 percent. It owns the highest number of ATMs and branches in Hungary. It was privatised through the stock exchange, in three “tranches” (1995, 1997 and 1999) which resulted in a dispersed ownership, including foreign and domestic financial and private investors, which own more than 90 per cent of total shares. As a result, there is no controlling owner.

OTP is a strictly regional player. It started its “shopping spree” in the region after its privatisation was finished in 2001. The same year it acquired a Slovakian bank, though this is one of the affiliates of the bank, of which it may be get rid this year because its performance remained below the expectations with less than 3 % market share. (Similarly, the Serbian affiliate may be sold later this year, however, the sales revenues most probably will be spent either on further acquisitions, or on a capital raise in the other affiliates.) Besides Serbia and Slovakia, OTP affiliates are located in Bulgaria, Croatia, Ukraine, Romania, Russia and Montenegro. In terms of market shares, the Montenegrin bank is a market leader, and the



Bulgarian bank also has a relatively high market share: almost 14 per cent and is a market leader in the country. At present, OTP bank is eyeing a further away target: Unibank of Azerbaijan, which is the second largest bank of the country.

Source: newspaper articles and websites of the companies ([www.mol.hu](http://www.mol.hu) and [www.otpbank.hu](http://www.otpbank.hu))

The third group consists of companies, which are owned by Hungarian private persons, companies or other investors and they are medium to big sized. The main motivation of their internationalisation is cost reduction, thus their main motive is efficiency seeking. In certain cases, market seeking motives are present as well. The most prominent companies in the group are Videoton, Jász-Plasztik, KÉSZ Ltd., Pharmatrade, TriGránit.

The fourth group contains small and medium sized, Hungarian owned companies, which do not “venture” far away, usually establish their small-sized production facilities in the other side of the border, in many cases in territories with Hungarian minorities in Slovakia or Romania. The case of the Onlinet Ltd. presented here, is more an exception than a rule in the fourth group. Usually, these small companies are not operating in a high tech segment of a sector. Though this group may seem small, but according to Svetlicic and Jaklic (2006), about 10 per cent of Hungarian OFDI can be represented by smaller sized investors.

As far as the various characteristics of these four groups are concerned, the following can be stated about them (besides nationality and size, which was already mentioned in more details in the previous section), alongside the factors analysed in Aykut and Goldstein (2006).

Geographical targets of the investments indicate also the nature of firm specific advantages. As the main targets of investments are countries in the region with similar or lower level of development compared to Hungary, this indicates that the investing companies have a relatively weak competitive position. Even if the investment is realised outside the region, it is rare that it would be taking place in a more developed country. (For this latter, the case of Onlinet, which is operating in a high tech niche and opening a subsidiary in England is a good example.) The regional preference can be explained not only by the nature of firm-specific advantages, but also with the following location specific factors, which act as location advantages: geographical proximity; historical, cultural and minority ties; previous trade relations and knowledge of the market. Another important attracting factor may be the less intense competition: in countries, which started their transition period (and privatisation process) later, there is a first mover advantage connected to an earlier market presence, as can be the case for OTP buying a Montenegrin bank (group 2) or T-Mobile buying the Macedonian telecom company. It is also true, that for emerging multinationals it is typical that they invest predominantly in their own regions (Sauvant, 2008, p. 7; Aykut and Goldstein, 2006, p. 16) thus they can be classified as regional multinationals as opposed to global multinationals. (Aykut, Goldstein, 2006) However, the same authors state, that there are signs that certain emerging country multinationals are venturing beyond their immediate region. This is also true for emerging multinationals of Hungary (see e.g. the case of MOL or Richter), though the size and importance of these investments is dwarfed by regional OFDI.

Sectors are an important distinguishing factor for group 2 and group 3. In group 2, companies traditionally strong sectors, privatised through the stock exchange are affected. In group 3, companies in those sectors can expand internationally, in which technically there is a possibility of “cutting up” the production process and separating the labour-intensive processes from the overall process, e.g. in electronics, car industry and related supplier sectors. In that respect, there is a certain divergence in Hungary from the pattern of emerging

multinationals, which are highly concentrated in the services (infrastructure) and extractive sectors. (Aykut and Goldstein, p. 17)

As far as the mode of entry is concerned, it seems to be specific for group 2, where there is a clearcut domination of privatisation related acquisitions, especially for larger projects. In groups 3 and 4, while both entry modes are present, due to the limited financial means and to the smaller size of projects, greenfield investments are slightly more frequent. As Andreff (2002) already observed in 2002, while in the nineties greenfield projects dominated, mergers and acquisitions became the dominant entry modes among emerging transition country multinationals, especially if breakdown according to the invested amount is analysed (and not the number of projects).

Corresponding to the findings of Aykut and Goldstein (2006), p. 21, the internationalisation of Hungarian MNCs happens relatively early in corporate life, using a narrow window of opportunity, connected to privatisation opportunities in the region, especially for group 2, and for group 3 and 4, being a first mover in the countries or regions concerned. For group 1 companies, this problem is less relevant, because expansion decisions are usually taken in the foreign parent company.

As we found, technological innovation as a source of company specific advantage can be present only in group 1 (“indirect OFDI”) or group 3 or 4 (especially small sized high tech companies). It is, however, more common in all four groups, that organisational innovation is the source of that advantage. However, as it is stated in Sauvart, 2008, for emerging multinationals the bottleneck from the point of view of performing successfully in a foreign market is in many cases not finance or technology, but first of all specific human resources, which are able to manage international expansion and operations. Andreff (2002) in his econometric study also calls the attention to the possibly exaggerated role assigned to technology in the case of transition country multinationals. This also underlines the importance of organisational assets, which Hungarian MNCs successfully expanding and operating in the region won without doubt.

As far as the main motive of the investment is concerned, in stage 1 of internationalisation, the market seeking motive is expected to dominate. This is true for groups 1 and 2, as we could see from the company case studies. In groups 3 and 4, the market seeking and efficiency seeking motives can be both present. In group 2, e.g. in the case of the already mentioned Jászplasztik, not only keeping or augmenting market shares is the essence of the market-seeking motive, but rather following the customer: the main reason why Jászplasztik established an affiliate in Slovakia was that the company which it supplies, the Korean Samsung, grounded a company there. On the other hand, in the case of Videoton, efficiency seeking motives dominated when its Bulgarian affiliate was established through an acquisition. As it was already noted by Svetlicic and Jaklic (2006), asset augmenting type of FDI is basically missing from the outward FDI of the New Member States of the EU, including Hungary.

Various company strategies lay behind the foreign investment of these companies. As we saw, for group 1 (“indirect” FDI), there can be various company specific reasons for further internationalisation through a foreign affiliate. It is more interesting for group 2, 3 and 4 companies to seek for the most important strategic motive. This can be, as we saw, strengthening the management’s position by becoming a regional multinational company with important strongholds in many countries. This latter aim (becoming an important player in another country of the region) can be realised by exploiting a first mover advantage (mainly group 2). In group 3 and 4, cost reduction by using foreign locations with lower (labour) costs or by exploiting economies of scale can be an important strategy. On the other hand, group 3 or 4 companies may follow their domestic partners to a foreign country (usually suppliers or

other clients) or may exploit a first mover advantage. In some cases, specificities of the product allow group 3 or more often group 4 companies to apply a niche strategy.

Hungarian emerging multinationals' strategy is influenced to a great extent by the business environment of their home country. It is especially important from the point of view of group 2 companies, for whom internationalisation is part of a defensive strategy, the main aim of which is to strengthen the company's and the management's position. Paradoxically, as these companies expand, they become a more and more attractive acquisition targets.

Table 5 summarizes our findings alongside the above listed factors.

**Table 5 Summary table of the four OFDI groups**

Groups	1	2	3	4
Companies: nationality of owner and size	Foreign owned	Listed on the stock exchange	Medium-big sized Hungarian	Small-medium sized Hungarian
Geographical targets of investment	Relatively close countries	Relatively close/neighbouring, in a few cases far away developing target countries	Relatively close/neighbouring	Neighbouring
Sector	Various, product specificities are important in some cases	Financial services, petrochemicals, pharmaceuticals, hotels dominate (these are the four leading companies' sectors)	Electronics, textile-clothing, plastics, metal working, timber etc. (various manufacturing sectors)	Various manufacturing and services sectors
Mode of entry	Greenfield, in some cases M&A	M&A (mainly privatisation) dominant, very few greenfield	M&A, greenfield	M&A, greenfield
Stage in corporate life	Early	Relatively early	Relatively early	Relatively early
Technological or organisational innovation?	Technological (intangible asset of the MNC)	Organisational	Organisational (in niches technological)	Organisational (in a few cases technological: ICT)
Main motive	Market seeking, (some cases: efficiency seeking)	Market seeking (strengthening of the company's – and its management's – position)	Efficiency and market seeking	Efficiency and market seeking
Strategy influenced by home country business environment/state-owned?	Only in some cases and in terms of no profitable reinvestment opportunities	Yes (strengthening of the management's position)	Yes (rising labour costs)	Yes, partly (rising labour costs, shortage of labour, tax burden)

## **5 Hungary-based emerging MNCs**

We showed, how Hungary excels among the Visegrad countries in outward foreign direct investments. Because of the earlier start, there are now a considerable number of “emerging MNCs” in Hungary, though, as we indicated, the structure of OFDI in terms of the number of companies investing abroad is very concentrated. Two companies: OTP in banking and MOL in petrochemicals represent at least 60 % of the total OFDI stock of Hungary, according to our estimations based on sector data.

In order to show the very “diverse” picture of companies investing abroad, we presented four groups, which, besides some common characteristics, differ from each other. Common characteristics are, that all companies invest predominantly in neighbouring or geographically close countries, usually in the CEE (and in some cases in the CIS) region. This indicates former economic ties and cultural proximities as well as the relative risk aversion of these “newly born”, young MNCs. The main mode of entry is also similar in the four groups: M&A (in many cases connected to privatisation) is clearly preferred; greenfield companies are established in special cases. On the other hand, there are differences in motivations, strategies of these company groups.

Because of the highly concentrated nature of Hungarian OFDI, we could show, that the dominance of group 2 investors results in the fact that the main motive is a defensive one: for formerly state owned companies, privatised through the stock exchange and thus having no controlling owner, regional expansion is a mean for strengthening the company’s and its management’s position.

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