The Emergence of Multinational Firms from Eastern Europe in Austria

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Introduction

Leading multinational enterprises (MNE) in Central and Eastern Europe Countries (CEEC) “are about to establish themselves as prominent players” in the global investment arena, says the World Investment Report 2001 (UNCTAD, 2001). For most of the top 25 non-financial MNEs foreign activities grew faster than domestic activities in 1999. Transportation, petroleum and natural gas, and pharmaceuticals are the leading sectors for outward investment. However, FDI is not a one way road. Every outward FDI of a home country resembles an inward FDI from the viewpoint of the host country. Our paper presents in particular this host country perspective.

Austria has been chosen primarily since it is an important EU host country (Altzinger 2001, Bellak 1996, 1998) to the transition countries. While the host country perspective normally includes aspects like the welfare effects, employment and output effects as well as competition effects, data limitations and the fact that outward FDI by CEECs is still a quantité négligeable from the host country view do not enable us to do a representative survey of inward investments originating in CEECs. The objective of this paper therefore is more modest: We highlight the emerging structural patterns of inward FDI from CEECs in Austria. In particular, we ask what type of activities of MNEs from CEECs is located in Austria.

To this end we present the overall quantitative dimension of Austrian inward FDI originating in CEECs in a comparative perspective. Major structural differences emerge when such FDI is compared to FDI originating in the EU. In addition, several characteristics of the parent companies and their Austrian affiliates are discussed. Our main results concerning the activities of the affiliates contrast sharply with the observations made on outward FDI of CEECs in other transition countries (see Jaklic and Svetlicic, 2002). While CEECs’ outward FDI in other CEECs are partly market related and partly production related (i.e. of a strategic asset- and efficiency-seeking type), FDI directed towards Austria is mainly of a market servicing nature. The geographical orientation of outward FDI of CEECs is also reflected in the structure of activities of the CEEC affiliates in the EU and the other CEECs.

The first part of the paper ("Conceptual Background") distinguishes two main types of CEECs’ inward FDI in Austria and presents one case-study for each type. The following two sections ("The Aggregate Perspective", "The Firm Perspective") highlight the macro-economic perspective and the micro-economic perspective. There is a short concluding section.
**Conceptual Background**

The main purpose of this subsection is to create a general classification scheme of outward FDI from CEECs. Previous research (e.g. Antaloczy, Éltető 2001; Bellak, Altzinger 2001; Jaklic and Svetlicic 2002) suggest two dimensions to be responsible for variations in the activity, conduct and performance of affiliates. Figure 1 presents four general cases of outward FDI from CEECs grouped by these two dimensions. The first classification criterion is *ownership* and the second is the *geographical direction of the investment*. Since we are interested in the host country view of Austria, cases 1 and 3 will be discussed in greater detail and examples of firms will be presented, while cases 2 and 4 will be mentioned only briefly for the purpose of putting the first two cases in perspective.

*******Figure 1 about here*******

*Ownership* may be an important cause of variations among groups of firms for a number of reasons. Since we are primarily concerned with the type of activities pursued in the foreign affiliate, we ask whether the affiliate in Austria is *indirectly* owned by a Western parent firm via a CEEC firm or *directly* owned by a CEEC firm:

- **Direct FDI**: A direct FDI from CEECs is an affiliate which is owned by a parent company, which is located *in the CEEC* itself (Case 3: Slovenia, Case 4: Hungary in Fig. 1).
- **Indirect FDI**: While the FDI we observe may *originate in a CEEC*, in the case of indirect FDI it is owned by a parent company *in a third country* (Case 1: Germany, Case 2: Austria in Fig. 1).

The second dimension, viz. the *geographical direction of the investment* also affects the type of activity, since East and West locations differ by location factors they offer. Consequently, the intra-firm division of labour will lead to a geographical dispersion of activities driven by the optimum combination of the given location advantages with the various firm specific advantages. Affiliates will be assigned differentiated roles: Regional specialisation of activities of a CEEC affiliate in Austria will therefore differ from that of affiliates in other CEECs:

- **East - East FDI**: "Eastern" locations offer market opportunities for CEEC firms, with some possibilities for low-cost production in lower developed CEECs.
- **East - West FDI**: "Western" locations are primarily sophisticated markets in the viewpoint of CEEC firms, rather than serving asset-seeking or rationalising purposes.

We maintain that all cases of outward FDI from CEECs fit into one of those four cases. Of course, there may be some more complicated “real world” cases. Two examples are presented below.

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**Box 1**

**Gorenje - "direct FDI"**

Gorenje (Slovenia) was founded in 1950 starting production of white goods in 1958. Already in the early sixties Gorenje started its expansion abroad with first exports to Germany. In the seventies Gorenje continued with its expansion in Europe establishing a sales promoting affiliate in almost every “western” European country. Gorenje is majority-owned by domestic shareholders. The production of white goods is the core activity of the company, but it is also
engaged in furniture production, machine construction and in the service sector. About 60% of the group sales are made in “western” Europe (Northern and Central Europe, South-Western Europe, and the UK), as the German market is the biggest and most important one for Gorenje. Overall Gorenje employs about 7,200 people with sales of EUR 612 mn and a net profit of EUR 14 mn in 2000. Gorenje has a 4% market share in the household appliances market in Europe.

**Affiliate companies and international involvement**

Gorenje has 34 affiliates of which 10 are in Slovenia, 10 in West Europe, 7 in South-East Europe, 5 in CEECs and 2 overseas. Already from the geographical distribution of affiliates the importance of the “western” market can be presumed. In this case we find a direct “east” – “west” (Gorenje Slovenia – Gorenje Austria) connection, an “east” – “east” relationship (Gorenje Slovenia – Gorenje Zagreb, Croatia) and also a very interesting direct “east” – “west” (Gorenje Slovenia – Gorenje Austria – Gorenje Skandinavia) and “east” – “west” – “east” (Gorenje Slovenia – Gorenje Austria – Gorenje Poland) connection due to the positioning of a supervisory holding company in Austria.

**Activities in Austria**

Besides the holding company which is located in Vienna, with the purpose of supervising most of the affiliates abroad, Gorenje is one of the few CEEC investors with a production plant in Austria (Freistadt). The most important factor of success of Gorenje is the combination of kitchen furniture and household appliances. There is no single player on the Austrian market offering and marketing this integrated solution. Also, the flexible supplier policy of Gorenje is a key to success allowing Gorenje to find the best supplier in terms of price and quality. Just-in-time supplies and production are also a part of Gorenje's policy minimising the storage time.

Synergy effects are derived from partners (furniture production) in Slovenia and in the Czech Republic for common purchases within the group. Skilled and reliable labour is a central prerequisite for being successful in such a demanding market.

Surprisingly, involvement of the Austrian affiliate in foreign markets is very low. Exports amount to only about 3% of sales, all directed to Germany and Switzerland. This is explained firstly by the fact that all neighbouring countries’ markets are already served directly by a local affiliate of Gorenje. Secondly, more important there is no agreed rule within the Gorenje group and the furniture producing sector, which would clearly determine the export markets for the single furniture producing units. Intra-firm trade with the parent company is very low as basically no products are exported to Slovenia and only a minor share of imports stems from the parent company in Slovenia.

Although Gorenje Freistadt is practically not involved into export activities it was involved into the process of setting up Gorenje Kuchyne – Czech Republic, the second affiliate of the Gorenje group with production abroad. Gorenje Freistadt provided the production system, the IT solution, know-how and also personnel. Gorenje Kuchyne produces kitchen furniture in the lower price segments for the home market exporting about 15% of production mainly to Slovakia.

Finally the effects of EU expansion have to be mentioned as Gorenje Freistadt hopes for better access to CEE markets and to move to higher price segments on the Czech and the Slovak market.
Box 2

Holcim (formerly Hirocem) - "indirect FDI"

Holcim Slovakia is an example of an indirect FDI, directed to Austria. Hirocem a.s. was founded in 1992 as a successor firm of the traditional cement producer in Rohoznik (Western Slovakia). Already in 1992 the Swiss multinational Holderbank acquired a 6.34 percent stake in the company through its financial holding “Breitenburger Auslandbeteiligungs GmbH”. In 1996 Holderbank reached a majority ownership in the Slovak cement producer. As the Holderbank group changed its name to Holcim, Hirocem followed in 2000. The new investor brought rationalisation, financial strength and quality management supporting further expansion of the company.

Today Holcim is the market leader in cement and concrete production on the Slovak market. During 2000, Holcim Slovakia employed 1,100 people with sales of about EUR 69 mn reaching a profit after tax of EUR 3 mn. The key success factor of Holcim Slovakia is the technology. Holcim Slovakia has an 18.5% market share on the European market of white cement. Only one tenth of all European cement producers are able to produce this commodity. Beyond a high market share on the CEE markets, Holcim Slovakia has a considerable market share on the German and Swiss markets. Holcim Slovakia is able to produce every kind of grey cement and in the future plans to concentrate on white cement and to increase customer satisfaction through accurate and in-time supplies. Production of plastic rocks used for concrete is planned to be continued.

The biggest competitors for Holcim Slovakia on the European market is the Danish group Aalborg and a cement plant recently built in Turkey (low transport costs, transport by ship). Other important factors of success of the Holcim group in Slovakia are a decentralized management, a comparably risk averse strategy with stable profits, combined with an advanced level of internationalisation.

Affiliate companies and international involvement

Holcim Slovakia secures its success through a wide net of affiliate companies and cooperation with market leaders in related business fields (see Figure 2). The biggest producer of concrete in Slovakia is Slovbeton running 12 concrete plants with a transportation reach of 30 km each. Transport of cement is realised by a joint venture with an experienced partner from the Czech Republic (Muska s.r.o., Prague). In southern Hungary supplies are organised with local affiliates of the Holcim group.

***********Figure 2 about here

Activities in Austria

The close market of Austria is served by the wholesale affiliate Cemroc. Another joint venture was formed with the “Austrian Wopfinger Stein- und Kalkwerke Schmidt und Co”. A financial holding company was established in Austria, which is supervising the production of dry mortar and cladding materials in Slovakia. Here we observe a very rare kind of relationship between “west” and “east”. This includes not only a “west” – “east” (BAB – Holcim Slovakia) relationship and an “indirect east” – “west” (Holcim Slovakia – Cemroc
The Aggregate Perspective

Data on inward FDI in Austria are collected in an annual survey.\(^1\) We have to note that these data comprise only investments of an amount of EUR 72,670 or above. Therefore (many) small companies with a lower amount of investment are not included in the sample, i.e. establishments with the main purpose of selling and distributing goods.\(^2\)

Figure 3 presents the development of total inward FDI stocks (measured by total capital invested) to Austria for the period 1989 to 1999. Austrian inward FDI from CEECs increased from EUR 34.5 million in 1989 to EUR 108.3 million in 1999. Since this change has been similar to the overall increase of inward investment the share of inward investment from CEECs by total investment remained always below 1% (0.31% in 1990 and 0.79% in 1993). Also, the number of employees of these affiliates remained rather modest (between 550 and 800).

***********Figure 3 about here

In comparison with Austrian inward investment from the EU inward FDI from CEECs show three particular features, namely (i) high capital-intensity, (ii) low labour-intensity and (iii) large sales per employee, which are best explained by the industrial structure of the affiliates.

Figure 4 shows the sectoral distribution of the affiliates from CEECs by the number of investments and Figure 5 shows the distribution by total capital invested.\(^3\) By far the largest numbers of affiliates are trading firms and only very few are manufacturing firms. Additionally, a few affiliates are holding companies and financial outlets (banks etc.). The sectoral structure measured by total amount invested contrasts strongly with this picture. In 1999 financial and holding companies have covered nearly 85% of total capital invested. Therefore, the capital-intensity by sector differs sharply. Capital-intensity was EUR 2 mn in 1999 on average, it was EUR 8.2 mn for holding companies and EUR 10.3 mn for financial-sector affiliates, respectively. It is obvious that the trading sector dominates measured by numbers of affiliates, whereas holding companies and finance are the two most important sectors when measured by total capital invested.

***********Figure 4 about here

***********Figure 5 about here

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\(^1\) The data set was provided by the Austrian National Bank, ’International Balance of Payments Division’. We are grateful to Mr. Rene Dell’Mour for his support.

\(^2\) Based on talks with CEECs - trade delegates and managers of the CEECs affiliates in Austria we are inclined to presume that such establishments play an important role of CEECs economic activities in Austria. However, it remains a lack of empirical evidence on that issue.

\(^3\) This part of the descriptive analysis is restricted to the period 1994-1999, because the data of the Austrian National Bank are available at the NACE-classification only since 1994.
An other feature of inward FDI from CEECs is the huge intra-firm trade deficit of the Austrian affiliates. The main reason for the deficit is certainly the large number of trade affiliates. In particular this feature seems to be a well-working mechanism to facilitate the integration of transition economies and their companies into the EU.4

Also the structure of motives of inward investors from CEECs emphasises the importance of trade, finance and holding companies. Although the motives for FDI (weighted by nominal capital invested) show the importance of market access (38%), the most important motives are “others” (60%). Again, this pattern can be explained by the industrial structure. Since holding companies and the finance sector account for more than three quarters of total investment the “other” motives dominate this picture clearly. All other motives (taxes, procurement and labour costs) do not count at all for inward investors from CEECs.

The majority of the affiliates from CEECs are small or medium-sized firms. More than 80% of the affiliates have less than 20 employees. There is not a single affiliate from CEECs with 500 employees or more.

Finally, the regional breakdown by home countries (see Figure 6) shows clearly the importance of those CEECs which are adjacent to Austria. The sharp increase of Slovenian affiliates in 1991 is due to the dissolution of the former Yugoslavia, i.e. of the transformation of former Yugoslav into Slovenian affiliates. However, the number of Slovenian affiliates decreased considerably later on. An increasing number of new affiliates during the very recent period (1996-1999) have been established by Slovakian and Czech parent companies.

***********Figure 6 about here***********

The regional distribution of the CEEC affiliates in Austria stresses the importance of geographical proximity. While on average the share of affiliates from CEECs is only 1.8% per province, this share is up to 10.4% in Carinthia (which is adjacent to Slovenia) and 10.2% for Burgenland (which is adjacent to Hungary). Hence, some kind of “regional clustering” seems to be developing.

The Firm Perspective

We sent a short questionnaire to 210 foreign-owned affiliates in Austria where the investor firm is located in a CEEC. The purpose was to develop ideas about the activities of these affiliates in Austria and the importance of these tasks for their parent companies. Yet, the survey brought an unexpectedly low response rate (14 firms), despite it has been followed by a telephone campaign, which unfortunately did not increase the response rate to representative levels. The low response rate may be explained by the fact that new affiliates are usually „under-staffed”, that they are not used to or are extremely cautious to give information to outsiders. A caveat regarding the generality of the results must therefore be emphasised. Nevertheless, the picture emerging largely matches the information presented in the previous section.

The answers of the responding firms are summarised below. We start with the motives for the investment in Austria, then continue with a description of the investing firms (affiliate in the case of an indirect and parent firm in the case of a direct FDI) in the CEECs (including

4 It should be mentioned here that the evidence for Austrian FDI in CEECs shows exactly the same pattern (see Altzinger 2001).
their degree of multinationality), followed by the main characteristics of the Austrian affiliate. This is followed by a discussion of the main activities of the Austrian affiliate and supplemented by additional information on ownership and other key characteristics.

Motives

In most cases, Austria has been chosen because of its market potential. Combined with other information, Austria has not been chosen as a "test case" for EU markets, even if "developing new export markets" ranks third. Also, Austria could have been chosen just due to its proximity to the parent firms and the importance of its local market. Two motives, namely "central location of Austria" and "logistics", which are important location factors particularly tied to "wholesale" are also highly important.

While "unimportant motives" provide basically the mirror image of important motives, the extremely high ranking of sourcing of inputs or human capital is a differentiating factor from other inward FDI in Austria received from EU countries. Yet, it again fits the wholesale activities.

The relatively high unimportance of the motive of "developing new export markets" stated by the affiliates in Austria and the little co-operation between CEECs' affiliates and Austrian firms explains why the former seem to act more as "islands" in Austria with few local linkages. Thus, the motives revealed by the Austrian affiliates reflect the evidence shown on the aggregate level in the previous section.

Parent firms

The parent firm is not necessarily located in the capital city of the CEEC. The affiliates in the sample belong to three large parent companies (> 1000 employees); 3 medium sized companies (500 - 1000 employees); 6 small companies (< 500 employees) and 2 where size was not available. On average, the parents employ 2,723 employees, but excluding the three largest, the average drops to 306 employees. The investments of the largest firms, which are already MNEs, are to be distinguished from those of smaller firms, where size as an ownership advantage does not apply.

The number of affiliates gives some indication of the degree of multinationality of the parent firms, although the information is limited without additional indicators on size or activity. According to the figures, the investing firms include one large MNE (> 1000 affiliates); one medium MNE (> 10 affiliates); and 12 regional firms (1-10 affiliates).

Activity of Affiliates and Trading Patterns

The sample of affiliates consists of 6 old firms (set up prior to 1989) and 8 young firms. Only one CEEC parent firm has a large affiliate, all others are small affiliates with an average employment of 5.5. Thus, all affiliates are service firms. As to the activities in Austria, the "wholesale" category has been stated by some respondents, with the parent company typically being an exporter of manufactured goods. The manufacturing sector is clearly dominated by the metal industry in a wider definition (5 firms), while the rest of the sector consists of three large multinationals and two firms in other industries. At first glance, this reflects a dominance of traditional heavy industrial sectors. The product range of these firms suggests,
however, that these firms are partly specialised niche producers. The service sector firms include one “old” investor and three of the most mobile firms (data processing).

The question on the activities of affiliates in Austria complements the industrial distribution. Besides trading, there is some value-added activity in the software industry. The only explanation why these affiliates were set up in Austria then is proximity to customers. One possible motive, which could be revealed by the parent companies only, is that these affiliates might be used to build up contacts with Austrian firms investing in CEECs, so that the East-West business would eventually turn into an East-East business. This would underline other results (see Jaklic and Svetlicic, 2002), namely the (re-)orientation of CEECs’ firms to investing in CEECs’ markets.

Since the majority of affiliates are wholesalers, the regional sales structure is of particular importance. The majority of firms serves the Austrian market only. Only two affiliates have already served EU markets to a substantial extent. Three affiliates are substantially engaged in other CEECs, where probably other affiliates are located. The motives of the investment might yet be to develop the affiliate into a regional hub for the EU markets. Where a low share of EU markets in total sales already exists, this might be a promising strategy (5 firms). To a large extent, this depends on the geographical location of other affiliates and their competence.

**Other important characteristics of the responding affiliates and their parent companies**

By ownership, one third of the parent companies is locally owned, one third is owned by firms from other CEECs, which means that their Austrian affiliate is an indirect FDI. The remaining third shows regionally dispersed ownership, i.e. owners from several countries like joint ventures between a CEEC firm and a West European partner. From case study evidence and newspaper articles we nevertheless assume, that a much higher proportion of parent companies of CEECs’ affiliates in Austria is actually owned by a EU or Swiss company – be it a holding company or an operative parent company.

**Concluding Remarks**

This paper assesses the role of Austria as an important EU host country of inward FDI from CEECs. As has been shown by several other scholars (Jaklic and Svetlicic, 2002; UNCTAD 2001) the dominant share of total outward FDI of CEECs has been allocated to other CEECs. Therefore, it is of particular interest to what extent and in what respect inward investment from CEECs to the EU differs. While it is too early to provide a comprehensive assessment of the impact of inward FDI from CEECs, neither on home nor on host countries, a few structural features which may be important determinants of the future growth path of FDI (Dunning and Narula, 1996; Blomström and Kokko, 1997) were shown.

The total amount of inward investment from CEECs in Austria is still very low (less than 1% of total inward investment) but grew in absolute numbers since 1989. In particular, capital invested and number of employees per investment are much lower in comparison to inward FDI from the EU. There are only ten employees per affiliates on average. Most of the

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5 In some cases, we dealt with Austrian firms which are owned by CEEC nationals. We excluded such firms, since they are not affiliates of a CEEC-parent company by definition.
investment (measured by numbers) is concentrated in trade with huge sales per investment and large intra-firm deficits from the Austrian perspective. Measured by capital invested the most prominent industries are finance and holding companies. Not surprisingly, 65% of total numbers of investment comes from the two most developed transition countries Hungary and Slovenia. Within Austria, the regions of Carinthia and Burgenland attract the larger share of inward FDI from CEECs.

Although the amount of FDI is low, these patterns indicate that such investment has facilitated the integration of CEECs into the EU at least for two reasons. Firstly, a large part of this investment has been made in the trading sector and thereby improved the trade performance of the CEECs. We have to note that these trading affiliates are often outlets of manufacturing parent firms. Therefore, the intra-firm trade balance is favourable from a CEEC's perspective. Hence inward FDI in Austria is at least one step in the preparation for the upcoming EU enlargement. Secondly, the establishment of several holding companies in Austria (mainly in the Viennese region) is indicative of the fact that Austria is a favourable location for headquarter services and may be a bridge for the integration into the EU. Both features are the main location advantages of Austria. However, specific ownership advantages of parent companies are prerequisites for such investments. The two case studies presented in this paper have emphasised this fact.

With regard to the proposition that the domination of inward FDI in transition countries affects their outward FDI, there are no remarkable differences between the so-called "indirect" outward FDI from CEECs and the direct outward FDI by a CEEC-owned firm. While there may exist different patterns with regard to other CEEC markets, there is no evidence for Austria that direct and indirect investors from CEECs differ.

We conclude that CEEC investments in Austria, no matter whether they are direct or indirect and irrespective of the particular home countries they originate in (i) do not particularly affect the acquisition or upgrading of ownership advantages (competitiveness) of the investing firms; and (ii) are of mainly market-oriented nature, although mainly concerning the local Austrian market with some links to other EU countries (through their holding companies); and (iii) efficiency-oriented FDI by CEEC firms are an exception.

Since there seems to be a lack of knowledge of market opportunities in EU markets, this implies that CEECs should strengthen their agencies (whether public or private and whether new or on the basis of existing networks) in the EU markets to channel through information about key markets to their firms at home.

For Austria as a host country the responsibility towards its neighbouring countries should be reflected in an open-door policy (see Altzinger 2001), not least because Austria profited substantially from the opening of the CEECs so far.

Future research should try to capture the phenomenon of outward FDI from CEECs in EU markets on an empirical basis by broadening the range of firms and industries studied and increasing the number of EU-host countries included.

We do not believe that a new theory or paradigm is needed to explain the outward FDI from CEECs, but that the dynamic approaches such as the "level of development path"-model should be enriched by including more micro-foundations for the macro-phenomena studied. The possibility to study the conduct and behaviour of firms which are in clear contrast to "Western MNEs“ might provide new arguments, not least with regard to less developed countries than the CEECs are at present.
References


UNCTAD (2001), World Investment Report, New York
Figures and Tables

Figure 1: Four Cases of Outward FDI from CEECs

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Figure 2: Structure of HOLCIM
Figure 3: CEECs Total Capital Invested and Number of Employees

Source: Austrian National Bank.
Figure 4: Sectoral Distribution of Affiliates, 1994-99 (by numbers)

Source: Austrian National Bank.
Figure 5: Sectoral Distribution of Affiliates, 1994-99 (by total capital invested, EUR mn)

Source: Austrian National Bank.
Figure 6: Number of Affiliates by Home Countries

Source: Austrian National Bank.

Note: SK = Slovak Republic, SI = Slovenia, P = Poland, H = Hungary, CZ = Czech Republic.