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FDI in Central Europe

edited by
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Editorial: FDI in Central Europe

Literature offers numerous concepts, models, and theories explaining foreign direct investment (FDI) inflows and outflows. The most popular classification of these theories divides them into three groups (Kilic *et al.*, 2014): macro-level theories, micro-level theories, and development theories, which combine elements of both macro- and micro-level theories (Wach & Wojciechowski, 2014; Wojciechowski, 2013).

Macro-level FDI theories include capital market theory, dynamic macroeconomic theory, exchange rate theory, economic geography, gravity approach, and institutional analysis, among others. Macroeconomic theories treat FDI as a form of capital flow between different economies in the world, attempting to explain the motivations behind, and determinants of, FDI. Micro-level FDI theories include firm specific advantage theory, oligopolistic markets theory, the theory of internalisation, and eclectic theory, among others. Microeconomic theories are elaborated from the point of view of multinational companies. These theories try to explain why multinational companies choose FDI rather than other entry modes like exporting or licensing. Development theories of FDI (mixed theories) include product life cycle theory, Japanese FDI theories, and five stage theory, among others. Recently, different theories of behavioural economics have emerged in the economic theory of FDI, including network approach (Hosseini, 2005). New perspectives on FDI include the dynamic capabilities perspective, the evolutionary perspective with its core Scandinavian model (U-model), and the integration–responsiveness perspective called the I–R paradigm (Prahalad & Doz, 1987).

Based on the above-mentioned approaches and concepts, numerous studies have been conducted around the globe. In the previous issues, the research field of FDI appeared in almost each issue (Wojciechowski, 2013; Owczarczuk, 2013; Patnaik, 2013), thus, we decided to dedicate an entire issue to this very crucial topic for the economy, including, of course, all economies of Central and Eastern European countries. Various authors have empirically proven that membership in the EMU and the EU, taxation differences, and common borders have a significant influence on the stock FDI concentration in certain cases. Investment motives among the V4, as well as the size and dynamics of outward FDI, have undergone significant changes in the last decade (Wach & Wojciechowski, 2014; Marona & Bieniek, 2013).This issue presents six papers, including five studies dedicated to the region of Central Europe, especially the Visegrad Group.

Wojciech Zysk and Sławomir Śmiech from Cracow University of Economics (Poland) try to empirically verify the influence of FDI on foreign trade in all four Visegrad countries.

Jacek Klich, also from Cracow University of Economics (Poland), tries to answer the question of whether the Visegrad countries' membership in the European Union has changed something in terms of FDI inflow into the Visegrad countries after 2004.

Magdalena Rudnicka from Wrocław University of Economics (Poland) elaborates on the characteristics of service offshoring in Central and Eastern European countries with special attention to the V4.

Magdolna Sass and Andrea Éltető, both from the Hungarian Academy of Sciences (Hungary), as well as Katalin Antalóczy from Budapest Business School (Hungary), analyse outward FDI from Hungary and discuss the emergence of Hungarian multinationals using a case study method.

Robert Marciniak from the University of Miskolc (Hungary) presents an interesting outlook on global shared service trends in the markets of Central and Eastern European countries (CEEs).

Last but not least, Adam Marszk from Gdańsk University of Technology (Poland) presents a very brief, but interesting overview of the main theoretical concepts linking economic integration and foreign direct investment.

Krzysztof Wach
Editor-in-Chief

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The Influence of Foreign Direct Investment on Foreign Trade in the Visegrad Countries from 2001 to 2011

Wojciech Zysk, Sławomir Śmiech

A B S T R A C T

Objective: This paper is an attempt to settle the controversy around the motives connected with investing in the Visegrad countries and the verification of the hypothesis that FDI makes a significant impact on V4's foreign trade.

Research Design & Methods: The relationship between the value of foreign direct investment in V4 countries in 2001-2011 and the geographic structure of trade in two directions: exports and imports, will be examined. The paper includes an analysis of the influence of FDI on foreign trade (the linear gravity model was used).

Findings: FDI strongly influences the volume of Polish, Slovak and Czech exports and imports; only in the case of Hungary does FDI not stimulate foreign trade, the value of imports and exports is correlated with value of FDI inflow, as far as statistics are concerned, there is a significant inter-dependence between the inflow of FDI to V4 countries and the geographical and commodity pattern of their foreign trade.

Implications & Recommendations: The scale and structure of FDI in the V4 requires further study. It is also important to examine the number and value of greenfield investment projects, as well as mergers and acquisitions (brownfield investment).

Contribution & Value Added: This article attempts a holistic approach to the relationship between capital inflows in the form of foreign direct investment (FDI) and foreign trade of the host country, both export and import.

Article type:	original research paper
Keywords:	foreign direct investment (FDI); international trade; gravity model; Visegrad countries (V4)
JEL codes:	P45, F21, F10p

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Contribution share of authors is equal and amounted to 50% each of them.

Suggested citation:

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INTRODUCTION

The international movement of capital, especially foreign direct investment (FDI) and the consequences of the inflow of this capital for the host country, is an issue that provokes a lot of studies, disputes and discussions. In the era of globalization and internationalization, dynamic international capital flows make an impact on the elements of the economic structure of many countries in the world. Foreign capital that has been flowing from the beginning of the 1990s into the Visegrad countries (Poland, the Czech Republic, Hungary and Slovakia; V4) has affected the mentioned economic processes. It is generally acknowledged that the inflow of foreign direct investment accelerates the economic development of host countries, but there are also concerns about its actual and continuous impact on creating the conditions for sustainable economic growth. Positive effects dominate in the evaluation of foreign direct investment; however, the potential and real risks and costs should be taken into account. These issues are particularly important in the case of the Visegrad countries, where there has been a significant increase in investment in recent years, especially after their accession into the European Community in May 2004. Figures 1, 2, 3, and 4 present the inflow of capital in the form of FDI into Poland, the Czech Republic, Hungary and Slovakia in the period between 1990 and 2011.

The Visegrad countries compete with each other in attracting foreign investors. Taking advantage of that potential, the pace of economic development and investment attraction, the Visegrad countries use a variety of investment incentives. Individual countries depend on attracting foreign capital, which contributes to the activation of regions, provision of jobs, and an opportunity to work with local partners, at the same time making an impact on local economic development. It is important to note - and this issue will be given a clear focus in this paper - that capital inflows affect the foreign trade of the host country, both for exports development, but also for the development of imports. This paper presents an attempt to settle the controversy around the theme of investing in Visegrad countries and the verification of the hypothesis that foreign direct investment has a significant impact on the V4 countries' foreign trade.

Polish[1], Czech, Hungarian and Slovak membership in the European Community in 2004 (the so-called impulse accession) encouraged decisions to invest capital in the form of FDI (including reinvested earnings) by foreign companies (including TNCs), and this process made a strong impact on the development of exports and imports. The integration processes of the European Community brought a number of benefits to the countries in the region (Zysk & Śmiech, 2013):

- an increase in foreign trade (due to the trade creation effect and trade diversion effect),
- an increase in the profitability of exports (lower transaction costs after the abolition of customs duties and the cost of crossing the border),

[1] The issue of the relationship between FDI flows and changes in Polish foreign trade in the previous period (1993-2002) is described in Zysk (2012).

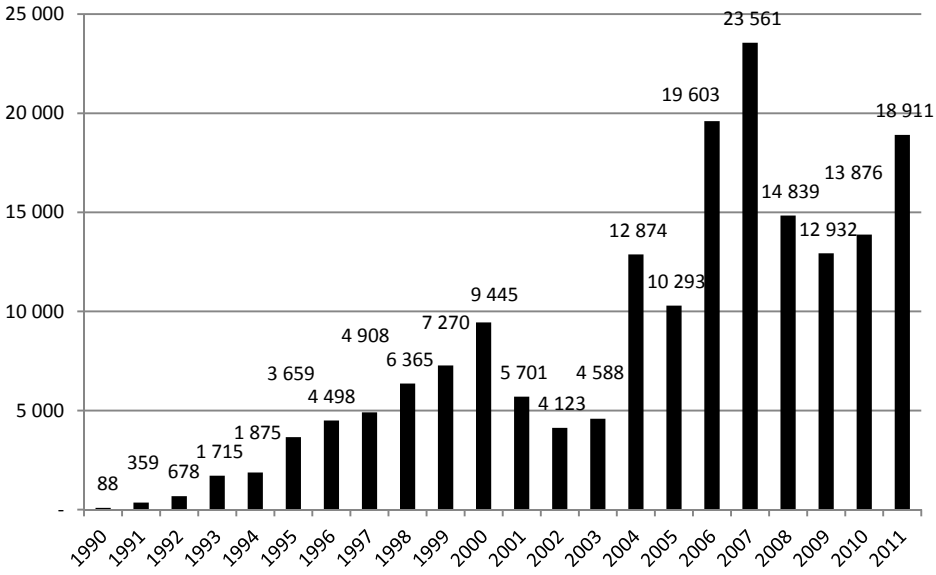
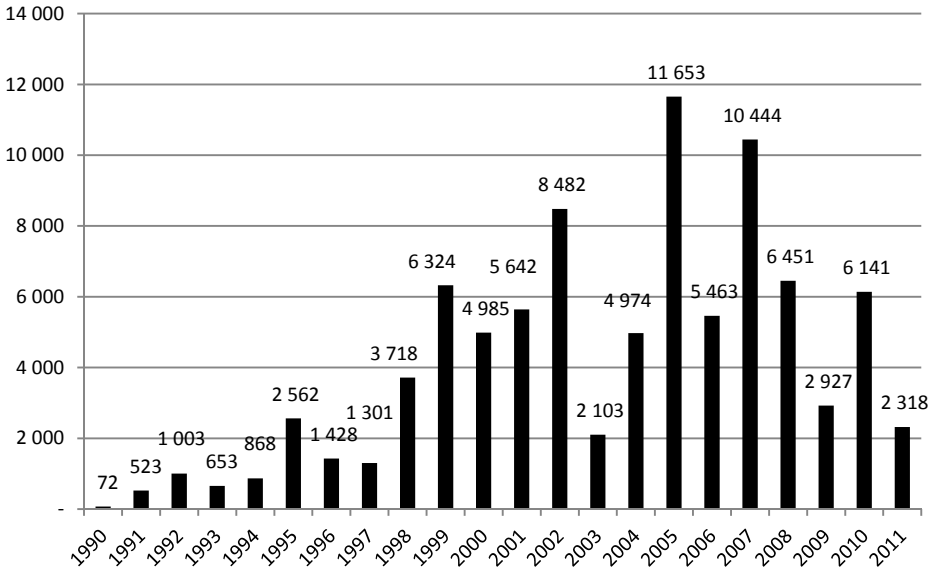


Figure 1. Inflow of FDI into Poland, period 1990-2011 (millions of USD)
Source: own calculation based on OECD data Retrieved on December 29, 2013 from http://stats.oecd.org/



*1990-1992 estimations based on the date for Czechoslovakia
Figure 2. Inflow of FDI into the Czech Republic, period 1990-2011 (millions of USD)
Source: own calculation based on OECD data Retrieved on December 29, 2013 from http://stats.oecd.org/

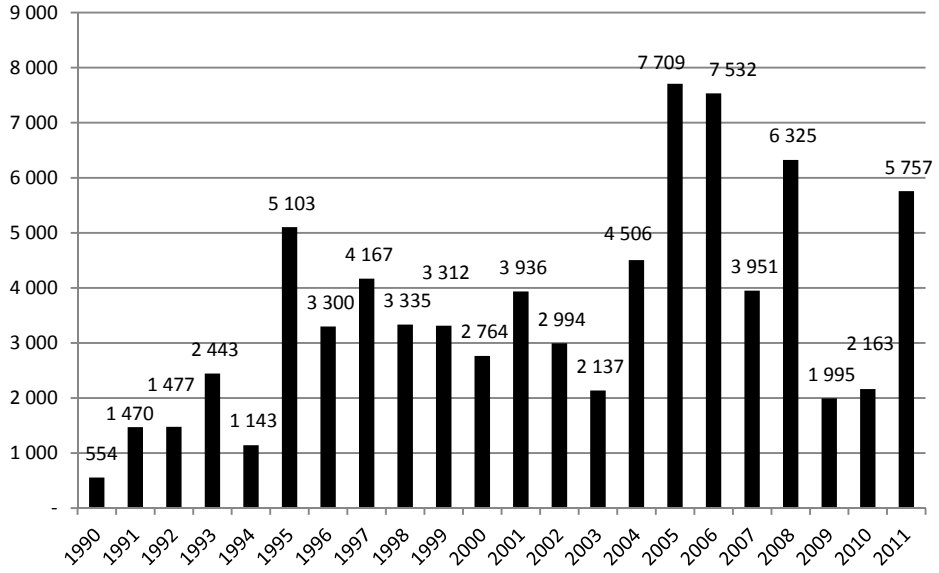
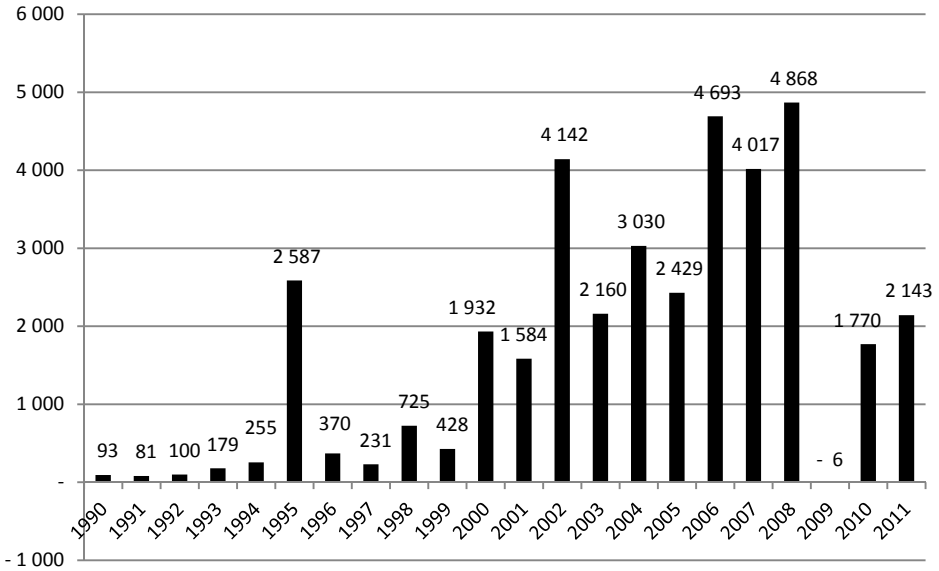


Figure 3. Inflow of FDI into Hungary, period 1990-2011 (millions of USD)
Source: own calculation based on OECD data Retrieved on December 29, 2013 from http://stats.oecd.org/



*1990-1992 estimations based on the date for Czechoslovakia
Figure 4. Inflow of FDI into Slovakia, period 1990-2011 (millions of USD)
Source: own calculation based on OECD data available at <http://stats.oecd.org/>. [29 December 2013].

– the influx of new technologies and management methods,
– the inflow of capital in the form of FDI (in both greenfield and brownfield investment).

The relationship between the value of inflow of foreign direct investment in the period 2001-2011, and the geographic structure of foreign trade in our country in two directions: export and import were examined. The hypothesis that inflows of FDI to the Visegrad countries influence Polish, Czech, Hungarian and Slovak foreign trade was verified with the use of the gravity model. Taking into account the heterogeneity of countries and time periods, several specifications of the gravity model were considered. We used random and fixed-effect panel models. There were several outliers in the sample. In order to limit their influence on the analysis results, a resistant regression (least-trimmed squares) was used. The results obtained in this case characterized a typical investor's country and typical periods.

LITERATURE REVIEW

World literature presents numerous studies on the relationship between capital inflows in the form of foreign direct investment and elements of the economic structure, along with foreign trade - including exports and imports. Table 1 shows examples of a synthetic summary of the selected studies' results focused on this subject.

Table 1. Summary of research results focused on the interdependence of FDI and the elements of the economic structure, including foreign trade

Reference	Subject	Country, period	Conclusions
Jayachandran, & Seilan (2010)	A causal relationship between trade, foreign direct investment and economic growth.	India, 1970-2007	The results of the Granger causality test showed that there is a causal relationship between the examined variables. Economic growth, trade and FDI appear to be mutually reinforcing under the open-door policy.
Makki & Agapi, (2004)	Impact of foreign direct investment and trade on economic growth.	66 developing countries, 1971-2000	FDI, trade, human capital, domestic investment are important source of economic growth.
Alfaro, Chanda, Kalemli-Ozcan & Sayek (2004)	Various links among foreign direct investment, financial markets and growth.	41 countries, 1982-1999	The empirical evidence suggests that FDI plays an important role in contributing to economic growth. The level development of local financial markets is crucial for these positive effects to be realized.
Weresa (2001)	The impact of foreign direct investment on Poland's trade with the European Union	Poland, 1990s	The FDI's impact on Polish trade can be seen as its contribution to export creation. Moreover, externalities caused by trade and FDI inflow are influencing Polish specialization patterns.

Cieślik (2009)	Relationship between the volume of trade and foreign direct investment in Poland.	Poland	FDI contributes positively to the development of international trade between Poland and OECD countries. In contrast, it seems that incomplete specialization H–O model better explains Poland's trade with the OECD countries.
Al-Iriani & Al-Shamsi (2007)	Foreign Direct Investment and Economic Growth in the GCC Countries	six countries comprising the Gulf Cooperation Council (GCC), 1970-2004	Results obtained from a heterogeneous panel analysis indicate a bi-directional causality between FDI and GDP in the panel of the GCC
Sridharan, Vijayakumar & Chandra Sekhara Rao (2009)	Relationship between foreign direct investment (FDI) and growth.	BRICS countries, 1996-2007 for Brazil, 1994-2007 for Russia, 1992-2007 for India, 1999-2007 for China and 1990-2007 for South Africa	The existence of a long-term relationship was traced and the test result revealed that the growth leads FDI bi-directionally for Brazil, Russia and South Africa and FDI leads uni-directional growth for India and China, respectively.
Kutan & Vuksic (2007)	Foreign direct investment (FDI) outlays on exports	12 Central and Eastern European (CEE) economies, 1996 -2004	Empirical results indicate that, for all countries in our sample, FDI has increased domestic supply capacity and hence exports
Zysk (2012)	Foreign capital and foreign trade in Poland. Pre-accession period	Poland, 1993-2002	FDI influences geographical and commodity structure of Polish foreign trade to a high extent, FDI strongly influences the volume of Polish exports and imports, the value of imports is correlated with the value of FDI inflow to a higher extent than with the value of export.
Zysk & Śmiech (2013)	Foreign direct investment and foreign trade in Poland.	Poland, 2004-2011	FDI influences Polish foreign trade, strongly influences the volume of Polish exports and imports, the value of imports is correlated more with the value of FDI inflow than with the value of exports.
Ambroziak (2012)	Impact of foreign direct investment (FDI) on intra-industry trade (IIT).	Visegrad Countries (VCs) (the Czech Republic, Hungary, Poland and Slovakia), 1995-2008	The obtained results confirmed that FDI in the VCs stimulated not only Vertical IIT, but also Horizontal IIT.
Hunya & Richter (2011)	Mutual trade and investment, Visegrad countries before and after their EU accession	Visegrad Countries, 1999-2007	Foreign investors coming into VCs from the EU-15 and other advanced countries were the real engines of revival in mutual trade.
Hanousek, Kočenda & Maurel (2010)	Productivity spillovers.	28 emerging European markets (transition economies), 1995-2008	Specific spillover channels (absorption capacity, R&D, education, institutions) do not report the evidence of knowledge spillovers from FDI. In contrast, the importance of backward and forward linkages in producing spillovers is strongly acknowledged.

Source: own study.

METHODOLOGY AND DATA ANALYSIS

The impact of direct investment relative the size of the imports from the country of the investor and the exports to the country of the investor was assessed with the gravity

model[2]. In its form, the basic gravity model, introduced by Tinbergen (1962), assumes that the volume of trade between countries is proportional to the size of their economies, measured by the size of GDP, and is inversely proportional to the distance between these countries. There are many extended versions of the basic gravity models, which allow for the assessment of additional hypotheses (e.g. the influence of the common border, a common language, and membership in a trade organization). This study presents some assumptions inferring that the volume of foreign trade (import and export) depends on: the GDP of the trade partners (constant prices), the inflows of foreign direct investment value, and the distance between the capital city of Warsaw, Prague, Bratislava and Budapest, and the capital city of the country of the investor (and at the same time the export/import partner). Given these assumptions, the analyzed model took the following form:

$$Y_{ijt} = a_0 GDP_{it}^{a1} DIST_{ij}^{a2} FDI_{ij}^{a3} e^{\delta} \quad (1)$$

where:

Y_{ijt} is the volume of imports to one of the Visegrad countries in the year *t* from country *i* , or export from one of the Visegrad countries in the year *t* to country *i* ,

GDP_{it} stands for the gross domestic product in country *i* and the year *t*,

FDI_{ij} denotes the cumulative volume of foreign direct investment from country *i* to one of the Visegrad countries in the year *t*,

$DIST_{ij}$ signifies the distance between the capital cities of countries *i* and *j,* δ - the error term, while $a1, a2, a3$ represent the parameters.

The estimation of the parameters model requires logarithm transformations and creates certain problems. The most significant amongst them is the heterogeneity among countries and zero trade flows. The comparison of methods of estimating parameters in gravity models can be found in the work of Santos & Tenreyro (2006). Assumptions adopted for the construction of the sample in the study allowed us to avoid the problem of zero trade flows. The estimation of parameters was conducted with the use of random panel models. We also presented (as a robustness check) the result of fixed models (two-way effect), and the resistance regression model. In this study, the following constraint modeling is applied:

1. the sample period is 11 years (annual data for the years 2001-2011),
2. variable import, export, FDI inflows, real GDP are measured in millions of USD,
3. the geographical distance in kilometers (transport costs between V4 countries and the studied countries approximated using parameter geographical distance between the capital cities, and 33 countries that were surveyed),
4. the output sample consisted of 33 countries, with 11 observations for each country: the period 2001-2011, a total of 333 observations.

[2] The value of trade between any two objects is proportional (other things being equal) to the product of the GDP of both objects, and decreases with increasing distance between countries - it is the gravity model of trade. The reason for the adoption of such a name is an analogy to the law of gravity discovered by Newton: the attraction between two objects is proportional to their masses and decreases with increasing distance between them.

RESULTS AND DISCUSSION

Individual equations of models were constructed for the export from Poland, the Czech Republic, Hungary and Slovakia to the investor's country, and individually for the import from the investors' countries to Visegrad countries. Parameter estimates of individual models were compared in tables 2, 3 and 4. Table 2 presents the results obtained using robust regression.

Table 2. Results from robust regression (lts) for V4 countries

Variables	Poland		Czech Republic		Hungary		Slovakia	
	Export	Import	Export	Import	Export	Import	Export	Import
const	22.85	25.344	23.92	22.77	25.73	23.41	21.76	23.30
FDI	3.72e-05	1.68e-05	6.44e-06	1.91e-06	4.60e-07	2.45e-07	2.48e-06	9.41e-07
GDP	0.856	0.808	0.686	0.847	0.810	0.939	1.088	0.955
DIST	-0.958	-1.265	-1.07	-1.043	-1.391	-1.255	-1.247	-1.338

Source: own calculations with R CRAN

In this case, the parameter estimates are made for a typical pair of countries during the typical time periods. The results are not encumbered by the presence of outliers. First, we note that the signs of all coefficients are consistent with our expectations - in particular, the positive value of the parameter obtained at variable GDP, and negative value of the parameter at the DIST variable in both equations, for exports and for imports. Positive values are finally standing at the FDI variable for both equations: the import and export equation. At the same time, the values of these parameters are at least 4 orders of magnitude lower than for the other variables in the model. It is worth noting that FDI seems to have a stronger impact on exports than on imports. Evidence for this can be seen in the higher values of the parameters in all countries for the export equation than the import equation. As in the case of robust regression, the calculation of standard errors of parameter is not possible, estimates cannot be assessed whether the impact of FDI on the volume of bilateral exports and imports is important. It is also difficult to assess whether the impact of FDI on exports is actually greater than on imports.

Table 3. Results from two-way fixed model for V4 countries

Variable	Poland		Czech Republic		Hungary		Slovakia	
	Export	Import	Export	Import	Export	Import	Export	Import
	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)
FDI	**-0.02** ***(0.004)***	**-0.017** ***(0.040)***	-0.003 *(0.553)*	0.002 *(0.733)*	0.003 *(0.377)*	-0.005 *(0.157)*	-0.010 *(0.222)*	**-0.020** ***(0.006)***
GDP	0.07 *(0.089)*	0.048 *(0.305)*	**0.078** ***(0.020)***	-0.025 *(0.538)*	**0.156** ***(0.000)***	-0.038 *(0.460)*	0.045 *(0.397)*	**-0.090** ***(0.045)***

Source: own calculations with R CRAN

Table 3 presents the results obtained in the two-way fixed effect model. Significant results (at 5% levels) are bolded in the above table. Because the variable DIST is constant (in time), it was not included in the model. In interpreting the results of this model, it

should be remembered that (although this has not been presented here) the constants characterizing the specific effects of pairs of countries (importer-exporter) and the impact of a given year were estimated in the model. Both constants can make a big contribution to the explanation of trade between the host country and the countries of the capital outflows. First, it may include such volatile conditions as cultural similarity (linguistic, religious, moral), the occurrence of the same diaspora trading tradition, signed trade agreements, membership in international organizations, demand for goods produced in the country, the prices and quality of goods for commerce, ease of transaction (physical distribution, trade restrictions, customs duties), the similarity of cultural and historical traditions, the way of conducting transactions, etc. The second constant (characterizing the year) will, in turn, represent the relevant variables in trade (exchange rate in both countries trading with each other or plant production, crops are not fixed in subsequent years). Parameter estimates for the two variables of FDI and GDP are statistically significant only for the two countries surveyed. In the case of Poland, FDI significantly and negatively affects the volume of trade (exports and imports), while in Slovakia, FDI has a negative impact on imports. A similar situation occurs in relation to the second variable, GDP, which has a significant and positive impact on exports to the Czech Republic and Hungary, negative and significant in the case of Slovakia. Such results are hardly in line with expectations. It seems, therefore, that the specific characteristics of trade between the host country and the country of the outflow of capital, the impact of which has been described in the context of fixed effects, are dominant with respect to FDI and GDP.

Table 4. Results from random effect models for V4 countries

Variables	Poland		Czech Republic		Hungary		Slovakia	
	Export	Import	Export	Import	Export	Import	Export	Import
	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)	coef (*p-value*)
const	**26.06 (0.000)**	**23.39 (0.000)**	**23.58 (0.000)**	**21.40 (0.000)**	**24.08 (0.000)**	**22.98 (0.000)**	**22.87 (0.000)**	**21.07 (0.000)**
FDI	**0.057 (0.000)**	**0.031 (0.004)**	**0.029 (0.000)**	**0.028 (0.000)**	0.003 (0.540)	-0.005 (0.228)	**0.069 (0.000)**	**0.042 (0.000)**
GDP	**0.743 (0.000)**	**0.648 (0.000)**	**0.750 (0.000)**	**0.616 (0.000)**	**0.751 (0.000)**	**0.466 (0.000)**	**0.763 (0.000)**	**0.544 (0.000)**
DIST	**-1.358 (0.000)**	**-0.875 (0.000)**	**-1.085 (0.000)**	**-0.671 (0.000)**	**-1.132 (0.000)**	**-0.764 (0.000)**	**-1.148 (0.000)**	**-0.713 (0.000)**

Source: Own calculations with R CRAN

Table 4 demonstrates the results for random effect models.[3] Similarly to the robust regression models with parameters of the characters, all variables are in accordance with the expectation. This means that FDI and GDP (business partners) stimulate the volume of imports and exports. A barrier to trade is, in turn, the distance between the capital cities. It is worth noting that the parameter estimates are statistically significant for

[3] Haussmann test statistics performed for each particular model suggest that random models are more suitable then fixed effect models.

almost all models and variables. The only exception is the assessment of FDI in the equations for imports and exports in Hungary. Comparing the results for models of export and import in different countries, we can see that all countries have higher (per module) values for exports than for imports. In particular, the average effect of GDP on export when GDP changes across time and between countries by one unit is between 0.743 (Poland) to 0.763 (Slovakia). Similar changes of GDP result in average increases of import by 0.466 (Hungary) to 0.648 (Poland). The situation is similar in the case of FDI. When FDI changes across time and between countries by one unit, then export increases between 0.029 (the Czech Republic) and 0.069 (Slovakia). When imports are taken into account, the effect of FDI is between 0.028 (the Czech Republic) and 0.042 (Slovakia).

CONCLUSIONS

The aim of the analysis was to examine the relationship between capital inflows in the form of foreign direct investment (FDI) and the foreign trade of the host country, both export and import (export-oriented and import-oriented level). As part of the analysis, three types of panel models were built, i.e. two-way fixed effect models, random models and robust regression models. Most of the results show that FDI significantly affects the size of the mutual trade between the country of investment and the investor's country. The analysis allowed us to draw some specific conclusions. First, the results obtained within the framework of two-way fixed effect models show that trade is largely determined by specific factors other than the size of GDP or FDI. Secondly, the results obtained show that FDI inflow is usually more export-oriented than import-oriented. Thirdly, the results for the robust regression models show that for typical countries, typical periods of FDI are not a strong determinant of foreign trade between countries of capital outflows in the form of foreign direct investment (FDI) and the host country. This is evidenced by the parameter estimates in the regression equations resistant (robust regression) for the variable FDI that is three orders of magnitude smaller than in the case of a group of random models. Comparison of the results of the impact of FDI on bilateral exchanges for each country shows its heterogeneity. Slovakia is a country where FDI is the strongest determinant of foreign trade. The smaller impact of FDI on bilateral exchange was recorded for Poland and the Czech Republic. Hungary, however, proved to be a country in which FDI had no impact on either the export or import. These different results may be explained by several factors. Among these, as first and foremost should be counted: the type of direct investment, the structure of import and export, the export and import rates (the share of or a particular direction of foreign trade in the creation or distribution of national income).

The use of traditional tools such as gravity models shows that the change in the level of foreign investment affects the level of imports and exports in a similar way. Hungary was the only case where the collected data does not allow for the conclusion that FDI in general affects export and import. In our opinion, the reasons for this phenomenon may be as follows: rapid changes in Hungarian currency (HUF) exchange, FDI disinvestment processes (for the 33 countries analyzed in this research, in 11 cases disinvestments were noted), and the fact that in our model we have assumed bilateral export/import relationships – maybe Hungary has different buyers than investors.

Hence, we do not find these results dependable. Assuming that the compound is tested for common objects and typical periods:

- the value of exports is correlated with the value of FDI inflow to a higher extent(5 results) than with the value of imports (2 results),
- two results displayed a similar impact,
- in the case of one country (Hungary) we have not found correlation between inflows of FDI and the value of exports and imports.

The scale and structure of FDI in Visegrad countries requires further study. It is also important to examine the number and value of greenfield investment projects, as well as mergers and acquisitions (brownfield investment). It should also be noted that in addition to testing the same value of FDI, it is important to focus on the structure of these investments, as well as horizontal and vertical investments. In the described Visegrad Group countries (V4), the phenomenon of capital investment in service centers, resulting in the development of business process outsourcing (BPO - Business Process Outsourcing or SSC - Shared Service Centers), should be also examined. But these are not capital-intensive investments, and make little impact on the country's foreign trade development in the host country.

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Foreign Direct Investment in the Visegrad Countries after 2004: Have the Visegrad Countries' Membership in the European Union Changed Something?

Jacek Klich

A B S T R A C T

Objective: The purpose of the paper is to identify the volume and dynamics of FDI in the Czech Republic, Hungary, Poland and Slovakia (V4) after their full accession to the European Union.

Research Design & Methods: The following hypothesis is tested: the Visegrad countries' membership in the European Union has not resulted in higher increases of FDI in these countries. The methodology is based on the concept of Investment Development Path (IDP) and Net Outward Investment position (NOI) of a country. The most current data (as of 2012) on FDI is derived from UNCTAD. The literature available in ScienceDirect and EBSCO has been reviewed.

Findings: The whole concept of IDP should be revisited. Possible changes should lead toward adopting a broader perspective encompassing the idiosyncratic economic structure of countries, as well as the heterogenous nature of FDI.

Implications & Recommendations: It seems to be necessary to redefine a fourth stage of IDP and to revise the criteria for classification into certain stages to avoid discrepancies in attributing particular countries to certain stages. Further conceptual work is needed with respect to the whole IDP model.

Contribution & Value Added: The paper extends Gorynia's, Nowak's & Wolniak's analysis on IDP in V4 countries by six years (i.e. from 2007 till 2012) and allows a preliminary assessment of IDP to V4 countries after their full membership to EU to be made.

Article type:	research paper
Keywords:	foreign direct investment (FDI); Visegrad countries (V4); international capital movement; sector patterns of FDI
JEL codes:	F210

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INTRODUCTION

In 2012, foreign direct investment (FDI) inflows decreased in all three major economic groups − developed, developing and transitional economies, though at different paces. In developed countries, FDI flows fell by 32% to 561 billion USD - a level last seen almost ten years ago (UNCTAD, 2013, p. 38). The majority of European Union (EU) countries and the United States experienced significant drops in their FDI inflows.

Outward FDI from developed economies declined by 274 billion USD in 2012, accounting for almost the entire fall in global outward FDI (UNCTAD, 2013, p. 38).

The Czech Republic, Hungary, Poland and Slovakia (hereinafter: Visegrad countries or V4 countries) are classified as developed countries; thus, it could be interesting to inquire how the complicated situation on international markets over the last couple of years influenced FDI dynamics in the V4 countries.

Inspired by Gorynia's, Nowak's & Wolniak's paper (2010) dealing with – among others – the timeframe and conditions of moving from investment development path (IDP) stage one to stage two, and then issues determining the advance towards IDP stage three[1] in respect to Central and Eastern European countries, we want to link V4 countries' membership to the European Union with the empirical study by Gorynia, Nowak & Wolniak[2] and to ask whether the V4 countries membership in the EU has led towards higher increases in FDI in these countries. Consequently, the hypothesis that the V4 countries' membership in the European Union has not resulted in higher increases in FDI is being tested here, forming the main goal of this paper.

The paper is organized as follows: after the literature review indicating the main streams of analysis of FDI to V4 countries, the method and materials used in the empirical part of the paper are presented. The results and discussion related to the positioning of V4 countries in the appropriate stages of the Net Outward Investment (NOI) path are then presented, followed by conclusions and few recommendations regarding the further development of the IDP model.

LITERATURE REVIEW

Considerable flows of FDI to V4 countries started in the early 1990s. The inflow of FDI to V4 countries over the last twenty years has been analyzed from various perspectives showing differences in the dynamics, geography and industry patterns of FDI to the countries at hand (Nowak & Steagall, 2002).

Due to space limitations, in this short review of the literature[3] only two issues are raised. The first issue refers to the overall assessment of FDI to V4 countries. There is

[1] Stages of IDP are presented in item 3 below.

[2] The empirical study by Gorynia, Nowak & Wolniak ends at 2006 and thus covers only the first two years of the V4 countries' membership in the EU. The analysis presented in this paper covers eight years of the V4 countries' membership in the EU.

[3] Due to the space limitations, the literature review is scaled (limited) basically to the V4 countries with just a few exceptions and covers mainly papers published after 2004. ScienceDirect (Elseviere) and EBSCO were searched using all of the keywords indicated above, plus "Ivestment Development Path". The search was limited to the period of 2004 until present and to the: abstract, title and keywords field. The selection process

a wide array of literature implying a positive influence of FDI on the V4 countries' economies (Pelinescu & Radulescu, 2009; Mutascu, Hetes & Miru, 2010; Nucu, 2005; Zámborský, 2012; Onaran, 2008; Kornecki, 2008; Ambroziak, 2012), to mention just a few.

Along with this, one may find papers presenting less unequivocal findings. Herrmann & Jochem (2005) found that the net effect of FDI on the trade balance in V4 countries was ambiguous.

Onaran & Stockhammer (2008) estimated the effect of FDI and trade openness on average sectoral wages in the manufacturing industry in the V4 countries for the period 2000-2004 and utilized a cross-country sector-specific econometric analysis based on one-digit level panel data, and concluded that FDI had a positive effect on wages, but only in the short run (in the medium-run the effect of FDI turned negative). Kravtsova, in her latest empirical analysis (2014), shows that although engagement in exporting and foreign ownership is generally perceived as being beneficial to individual firms and the economy as a whole, in the case of Hungary (which is perceived as a leader in attracting FDI) the effect of such an open policy toward FDI on the Hungarian economy remains unclear. The issue of business friendly policies in theV4 countries was also addressed by Rugraff (2008). Examining the efficiency of the V4 countries' FDI policies by evaluating the spillover effects of foreign investment, he concluded that the "TKC model" (i.e. used in Taiwan, Korea and China), built on strong state intervention in the industrial structure and in the industrial guidance of FDI, has been more efficient in terms of the creation of competitive indigenous firms than the business friendly model implemented in the V4 countries. Kravtsova's and Rugraff's findings correspond with those of Sass (2004).

In this context, one may mention Kuti's (2005) conclusions, according to which FDI has played a substantial, though contradictory role in the modernisation of Hungary.

The second issue refers directly to IDP as a core element of this paper. Although papers and other publications on IDP are present in the literature, there are fewer sources on IDP in the V4 countries. This group consists of works by (Boudier-Bensebaa 2008; Kayam & Hisarciklilar, 2009; Durán & Úbeda, 2001; Durán & Úbeda, 2005; Narula & Guimón, 2010; Fonseca, Mendonça & Passos, 2007; Gorynia, Nowak & Wolniak ,2010; Gorynia, Nowak & Wolniak, 2007, and – most recently - Stoian, 2013).

Boudier-Bensebaa (2008) undertakes a comparative analysis of IDP in the whole region of Central and Eastern Europe (including V4 countries) and the European Union of the 15 old member states. She concludes that the net outward investment position (NOI) of the V4 countries places them in stages one or two of the IDP, while that of the EU countries points to stages four or five. She draws attention to the fact that data on FDI stocks and GDP does not cover all the factors affecting FDI and development. In the FDI sphere, non-equity forms of investment are omitted. As for the effect on FDI, besides GDP, elements such as EU accession, globalisation and the transformation process

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consisted of three stages. In the first stage, all of the 127 articles (altogether) indicated by ScienceDirect and EBSCO were looked through and those not fitting with the research topic were rejected. In the next step, each summary of all the remaining articles (98) was read. Then, based on the summary content, 72 papers were identified for *in extenso* reading. In the *References* section, only the most relevant sources are indicated.

should also be taken into account. This EU accession issue from Boudier-Bensebaa's recommendations has led us to pose the question indicated in the subtitle of this paper.

Gorynia, Nowak & Wolniak (2010) elaborated on the IDP trajectories of six Central and Eastern European countries: Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovakia. Earlier, they did similar analysis for Poland (Gorynia, Nowak & Wolniak, 2007). They classified the V4 countries as belonging to stage two and indicated a paradox in respect to Poland, which being the least developed among V4 countries, appeared to be closest to the point of evolution into the more advanced stage three of the IDP (Gorynia, Nowak & Wolniak, 2007, p. 14).

Stoian (2013), analyzing outward FDI from 20 Central and Eastern European countries (including V4 countries), comes to the conclusion that IDP's main propositions remain valid and can explain the drivers of FDI outflows: they are positively associated with both GDP *per capita* and inward FDI. She also highlights the importance of accounting for home country institutional factors when investigating the determinants of outward FDI. Although Stoian claims that IDP still possesses its explanatory power, a vast majority of authors try to improve it (including Dunning who introduced IDP as a research tool in the early 1980s and is cited by all the above-mentioned authors). An example of such an interesting attempt is Kayam's & Hisarciklilar's (2009) proposition to use fluctuation function obtained from the general solution of an exponential function reflecting a continuous compounding process. It has extra properties that help capture the idiosyncratic shape of IDP and gives parameter estimates that facilitate the interpretation of the stage a country is at. This, in turn, seems to be a key solution to be acknowledged in the literature's ongoing problem with the adequate (i.e. precise enough) classification of a given country to a given IDP stage.

MATERIAL AND METHODS

Theoretical Framework

This paper is planned as an extension and further elaboration on Gorynia's, Nowak's & Wolniak's paper (2010) on the investment development path (IDP) trajectories of V4 countries. Consequently, Investment Development Path (IDP) theory[4] was used as a theoretical foundation.

IDP theory can be interpreted as an extended form (Kayam & Hisarciklilar, 2009) of the conditions for the internationalization of firms at the macro level to explain the dynamic relationship between foreign direct investment (FDI) and the level of development of a given country (Dunning cited in Narula & Guimón, 2010). The IDP model analyzes how patterns in FDI respond to changes in the ownership (O), location (L) and internalization (I) - advantages of firms and countries.

The ownership advantage (O) of a firm depends on its relative competitive advantage, such as patents and licenses, and on its access to raw materials and/or

[4] The term "theory" is of a purely conventional nature in this paper. Although it is used in the literature (Fonseca, Mendonça & Passos, 2007) it is very often referred to as a "concept" (Gorynia, Nowak & Wolniak, 2007), "model/paradigm" (Gorynia, Nowak & Wolniak, 2010); "framework" (Narula & Guimón, 2010), "approach" (Kayam & Hisarciklilar 2009) or "paradigm" (Boudier-Bensebaa, 2008).

markets. Location advantages (L) belong to the host country and are defined as factors increasing its attractiveness for FDI such as geographical proximity, labour market specifications (for example skill base, wages) and infrastructure. The internationalization advantage (I) indicates the advantage that the firms plan to exploit themselves rather than sharing or selling to other firms through arms-length contracts (like, for example, franchising) (Kayam & Hisarciklilar, 2009, pp.63-64). The IDP consists of five stages[5] which may be observed in most countries (Figure 1).

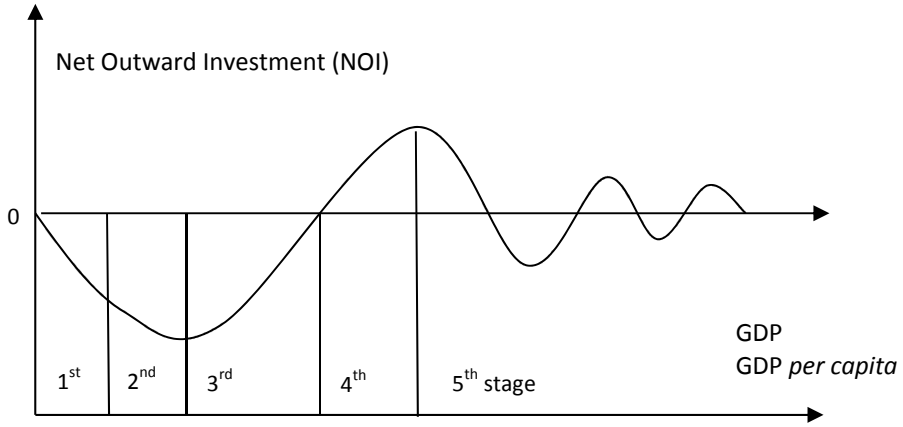

Figure 1. The pattern of the Investment Development Path (IDP)
Source: adapted from Dunning & Narula (1996) cited in: Fonseca, Mendonça & Passos (2007, p. 4).

Along these stages, the O, I, and L advantages of a country's firms – compared to those of other economies – change, making a country evolve from the position of inward direct investor to outward direct investor.

IDP theory states that a country's net outward investment (NOI) position (measured by the difference of outward and inward foreign direct investment stocks) changes as it develops, where the level of development is measured by gross domestic product (GDP) and GDP *per capita*.[6] The relationship between NOI and development is illustrated in Figure 1.

At stage one, the L advantages of the host country are assumed to be insufficient to attract FDI, and, therefore, FDI inflows are a result of natural assets. As would be expected, local (domestic) firms have not developed O advantages to be in a position to invest abroad, which results in minimal (if any) outflows. At that stage NOI is small and negative.

At stage two, outward investment remains small (or negligible), but the inflows increase as the size and purchasing power of local markets grow. Local (domestic) firms have certain O advantages, but these are still insufficient to generate more FDI outflows than inflows, which results in decreasing NOI but at a slower rate than in stage one.

[5] The first version of the direct IDP proposed four phases. The fifth one was introduced in 1993 (Durán & Úbeda, 2005, p. 124).
[6] Some authors use gross national product (GNP), see Narula & Guimón (2010).

Stage three is characterized by a decrease in the growth rate of FDI inward stock accompanied by an increase of outward stock which leads toward a growing NOI position. At the end of stage three, inward and outward FDI stocks are equal.

Stage four means that outward FDI stock is greater than inward FDI stock and the gap between them is growing. At that stage NOI is positive and growing. Stage four terminates when NOI reaches the maximum (in relative terms) level.

The last stage, stage five, begins when NOI starts to decrease.

Data

Data from UNCTAD statistics was used and organized in a way corresponding to that in Gorynia's, Nowak's & Wolniak's paper (2010). Since the authors ended their analysis on 2006, in this paper data up to 2012 was collected and the adequate indices were calculated. All the data (excluding population data) is shown in Tables 1 to 6.

Table 1. NOI and GDP of the Czech Republic in the years 1993-2012

Year	NOI USD million	GDP* USD million	NOI/GDP	NOI *per capita* USD	GDP *per capita* USD	NOI *per capita* (previous year=100)	GDP *per capita* (previous year=100)
1993	-3 242	39 264	-0.082	-313	3 797	100.00	100.00
1994	-4 247	45 631	-0.093	-411	4 411	131.31	116.17
1995	-7 005	57 786	-0.121	-677	5 589	164.72	126.71
1996	-8 074	64 895	-0.124	-782	6 283	115.51	112.42
1997	-8 686	59 464	-0.146	-842	5 767	107.67	91.78
1998	-13 571	63 863	-0.212	-1 319	6 206	156.65	107.61
1999	-16 854	62 166	-0.271	-1 641	6 053	124.41	97.53
2000	-20 906	58 803	-0.355	-2 040	5 737	124.31	94.78
2001	-25 956	64 376	-0.403	-2 537	6 292	124.36	109.67
2002	-37 196	78 425	-0.474	-3 642	7 678	143.56	122.03
2003	-43 003	95 293	-0.451	-4 214	9 339	115.71	121.63
2004	-53 499	113 977	-0.469	-5 241	11 165	124.37	119.56
2005	-57 052	130 066	-0.438	-5 576	12 713	106.39	113.86
2006	-74 824	148 374	-0.504	-7 282	14 440	130.60	113.58
2007	-103 851	180 479	-0.575	-10 046	17 458	137.96	120.90
2008	-100 643	225 427	-0.446	-9 666	21 651	96.22	120.02
2009	-111 022	197 187	-0.563	-10 588	18 805	109.54	86.86
2010	-113 581	198 947	-0.570	-10 762	18 850	101.64	100.24
2011	-107 355	217 077	-0.494	-10 117	20 458	94.00	108.53
2012	-121 266	195 971**	-0.618	-11 376	18 384	112.44	89.86

*current prices and current exchange rates; **estimation

Source: own calculations based on Gorynia, Nowak & Wolniak (2010). Data from UNCTADstat.

Periodisation

In order to verify the hypothesis from the pre-EU accession period, the last eight year period (1996-2004) was defined. The rationale behind this is twofold. Since the analyzed period of V4 countries as full members of the EU is eight years (2004-2012), it is reasonable to compare this eight year period to the last eight year period before the V4 countries' accession to the EU. Additionally, since FDI dynamics were highest during the

Table 2. NOI and GDP of Hungary in the years 1990-2012

Year	NOI USD million	GDP* USD million	NOI/GDP	NOI *per capita* USD	GDP *per capita* USD	NOI *per capita* (previous year=100)	GDP *per capita* (previous year=100)
1990	-411	36.500	-0.011	-40	3.515	100.00	100.00
1991	-1.948	34.106	-0.057	-188	3.289	470.00	93.57
1992	-3.265	38.010	-0.085	-315	3.667	167.55	111.49
1993	-5.406	39.378	-0137	-522	3.799	165.71	103.60
1994	-6.868	42.374	-0.162	-663	4.090	127.01	107.66
1995	-11.026	45.574	-0.241	-1.065	4.402	160.63	107.63
1996	-13.017	45.931	-0.283	-1.260	4.444	118.31	100.95
1997	-17.321	46.533	-0.372	-1.680	4.513	133.33	101.55
1998	-19.949	47.952	-0.416	-1.940	4.663	115.48	103.32
1999	-22.336	48.255	-0.462	-2.178	4.706	112.27	100.92
2000	-21.590	46.386	-0.465	-2.112	4.537	96.97	96.41
2001	-25.851	52.721	-0.490	-2.535	5.171	120.03	113.97
2002	-34.124	66.383	-0.514	-3.357	6.528	132.43	126.25
2003	-44.831	83.538	-0.536	-4.420	8.237	131.67	126.18
2004	-55.549	101.926	-0.544	-5.490	10.074	124.21	122.30
2005	-53.300	110.322	-0.483	-5.279	10.927	96.16	108.47
2006	-67.785	112.533	-0.602	-6.727	11.167	127.43	102.20
2007	-78.148	136.102	-0.574	-7.767	13.528	115.46	121.14
2008	-70.411	154.234	-0.456	-7.009	15.353	90.24	113.49
2009	-79.067	126.663	-0.624	-7.882	12.627	112.46	82.24
2010	-70.152	127.967	-0.548	-7.005	12.778	88.87	101.20
2011	-60.419	138.714	-0.435	-6.044	13.877	86.28	108.60
2012	-68.816	126.785**	-0.542	-6.898	12.709	114.13	91.58

*current prices and current exchange rates; **estimation

Source: own calculations based on Gorynia, Nowak & Wolniak (2010). Data from UNCTADstat.

first years of the post-communist transformation processes (due to the low base in 1990 and in 1993 in respect to the Czech Republic and Slovak Republic), such a time period was set to make the comparison between the increase of inward and outward FDI, as well as NOI, before the V4 countries' accession to the EU more justifiable.

The year 2004 is counted for both time-periods, since the V4 countries' full membership in the EU began on May 1, 2004.

RESULTS AND DISCUSSION

As indicated in Tables 1-4, all four countries noticed an increase of NOI between 2004 and 2012. The biggest increase (measured by the volume of NOI in USD in 2012 divided by its volume in 2004) was in the Czech Republic, followed by Poland, then Slovakia, and Hungary (2.27; 2.07; 1.98 and 1.23 respectively). The increase of NOI *per capita* in the period 2004 -2012 (measured by the volume of NOI *per capita* in USD in 2012 divided by its volume in 2004) mirrored the increase of NOI in USD and was the highest in the Czech Republic and then in Poland, Slovakia and Hungary (2.17; 2.08; 1.87 and 1.26 respectively).

Table 3. NOI and GDP of Poland in the years 1990-2012

Year	NOI USD million	GDP* USD million	NOI/GDP	NOI *per capita* USD	GDP *per capita* USD	NOI *per capita* (previous year=100)	GDP *per capita* (previous year=100)
1990	-14	64.550	-0.0002	-0.3	1.692	100.00	100.00
1991	-337	83.705	-0.004	-9	2.188	3000.00	129.31
1992	-1.269	92.326	-0.013	-33	2.408	366.66	110.05
1993	-2.109	94.122	-0.022	-55	2.450	166.66	101.74
1994	-3.328	108.425	-0.030	-87	2.819	158.18	115.06
1995	-7.304	139.062	-0.052	-190	3.614	218.39	128.20
1996	-10.728	156.684	-0.068	-279	4.072	146.84	112.67
1997	-13.909	157.154	-0.088	-338	4.086	121.15	100.34
1998	-21.296	172.902	-0.123	-554	4.499	163.91	110.11
1999	-25.051	167.802	-0.149	-653	4.371	117.87	97.15
2000	-33.209	171.276	-0.193	-866	4.466	132.62	102.17
2001	-40.090	190.421	-0.210	-1.046	4.970	120.79	111.29
2002	-46.864	198.179	-0.236	-1.224	5.177	117.02	104.16
2003	-55.728	216.801	-0.257	-1.457	5.668	119.04	109.48
2004	-83.404	252.769	-0.329	-2.182	6.613	149.76	116.67
2005	-84.569	303.912	-0.278	-2.214	7.955	101.47	120.29
2006	-111.390	341.597	-0.326	-2.916	8.944	131.71	112.43
2007	-157.091	425.129	-0.369	-4.114	11.132	141.08	124.46
2008	-140.213	529.423	-0.264	-3.671	13.863	89.23	124.53
2009	-155.895	430.912	-0.361	-4.082	11.282	111.20	81.38
2010	-171.195	469.799	-0.364	-4.482	12.299	109.80	109.01
2011	-148.539	514.115	-0.288	-3.888	13.457	86.75	109.42
2012	-173.079	487.528**	-0.355	-4.530	12.759	116.51	94.81

*current prices and current exchange rates; **estimation

Source: own calculations based on Gorynia, Nowak & Wolniak (2010). Data from UNCTADstat.

When comparing the increases of NOI after the V4 countries became EU member states to the period 1996-2004, one may conclude that they were smaller. The highest increase of NOI (measured as stated above) between 1996 and 2004 was recorded in Slovakia, followed by Poland, the Czech Republic and Hungary (respectively: 14.55; 7.77; 6.63 and 4.27). As can be expected, the increase of NOI *per capita* was the highest in Slovakia, followed by Poland, the Czech Republic and Hungary (14.50; 7.82; 6.70 and 4.36 respectively).

The comparison of NOI increases during the eight years before and after EU accession shows that the increase between 1996 and 2004 was considerably higher. This, consequently, may support the argument that eight years of membership in the European Union did not result in higher increases in FDI in the V4 countries. This goes for both inward and outward FDIs (see Tables 5 and 6).

Between 1996-2004, the increase of inward FDIs (measured in USD million) was the highest in Slovakia, followed by Poland, the Czech Republic and Hungary (respectively: 13.78; 7.57; 6.80 and 4.64). Between 2004-2012, the biggest increase of inward FDI was in Poland, followed by the Czech Republic, Hungary and Slovakia (respectively: 2.66; 2.38; 2.12 and 1.98). Although one may observe diminishing increases in FDI over the whole analyzed period 1990-2012, the increase during the period 1996-2004 was considerably higher than in 2004-2012.

Table 4. NOI and GDP of Slovakia in the years 1993-2012

Year	NOI USD million	GDP* USD million	NOI/GDP	NOI *per capita* USD	GDP *per capita* USD	NOI *per capita* (previous year=100)	GDP *per capita* (previous year=100)
1993	-493	13.497	-0.036	-92	2.530	100.00	100.00
1994	-731	15.615	-0.046	-137	2.918	148.91	115.34
1995	-1.158	19.587	-0.059	-216	3.652	157.66	125.15
1996	-1.863	21.157	-0.088	-347	3.938	160.65	107.83
1997	-1.847	21.389	-0.086	-343	3.976	98.85	100.96
1998	-2.512	22.378	-0.112	-467	4.156	136.15	104.53
1999	-2.882	20.473	-0.140	-535	3.801	114.56	91.46
2000	-6.415	20.403	-0.314	-1191	3.787	222.62	99.63
2001	-7.407	21.109	-0.350	-1375	3.918	115.45	103.46
2002	-11.679	24.463	-0.478	-2168	4.540	157.67	115.88
2003	-20.629	33.271	-0.620	-3829	6.176	176.61	136.04
2004	-27.101	42.178	-0.642	-5030	7.828	131.37	126.75
2005	-28.848	47.896	-0.602	-5351	8.884	106.38	113.49
2006	-37.047	55.796	-0.663	-6864	10.338	128.28	116.37
2007	-45.632	74.966	-0.608	-8441	13.867	122.97	134.14
2008	-47.476	94.268	-0.503	-8767	17.409	103.86	125.54
2009	-49.385	87.234	-0.566	-9103	16.080	103.83	92.37
2010	-46.950	87.072	-0.539	-8642	16.027	94.94	99.67
2011	-47.083	96.000	-0.490	-8655	17.647	100.15	110.11
2012	-51.403	91.729**	-0.560	-9439	16.843	109.06	95.44

*current prices and current exchange rates; **estimation

Source: own calculations based on Gorynia, Nowak & Wolniak (2010). Data from UNCTADstat.

As far as outward FDI is concerned, between 1996-2004 the highest increase was noticed in Hungary, followed by the Czech Republic, Slovakia and Poland (22.71; 7.5; 5.92 and 4.56 respectively). In the period between 2004-2012, the outward FDI increase was the highest in Poland, then in Hungary followed by Slovakia and the Czech Republic (17.17; 5.77; 4.07 and 4.03 respectively). It is worth noting the high volatility in the increase of outward FDI in Hungary and in Poland, which gives an interesting point of departure for discussion about the stages of the Investment Development Path V4 countries are currently on.

While V4 countries' membership in the EU did not result in a higher increase in FDI to these countries (both inward and outward), it should be indicated that a higher increase in GDP (measured in USD million, current prices, current exchange rates) was observed in Slovakia and in Poland (respectively: 2.17 against 1.99 and 1.92 against 1.61). The same goes for an increase in GDP *per capita*: 2.15 against 1.98 for Slovakia and 1.93 against 1.62 for Poland.

In the Czech Republic and Hungary, increases in GDP after 2004 were slightly lower. In respect to the Czech Republic, it was 1.76 versus 1.72, but in Hungary it was considerably lower (2.22 versus 1.24). These tendencies in GDP were also mirrored in respect to GDP *per capita*.

Table 5. Inward FDI* to V4 countries in the years 1990 (1993) – 2012 (in USD million)**

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Czech Republic	-	-	-	3.423	4.547	7.350	8.572	9.234	14.375	17.552	21.644	27.092	38.669	45.287	57.259	60.662	79.841	112.408	113.174	125.827	128.504	120.569	136.442
Hungary	570	2.107	3.424	5.576	7.087	11.304	13.282	17.981	20.746	23.381	22.870	27.407	36.224	48.340	61.567	61.110	80.153	95.469	88.003	98.803	90.641	84.457	103.557
Poland	109	425	1.370	2.307	3.789	7.843	11.463	14.587	22.461	26.075	34.227	41.247	48.320	57.872	86.755	90.877	125.782	178.408	164.307	185.202	215.639	198.196	230.604
Slovakia	-	-	-	642	897	1.297	2.046	2.083	2.920	3.228	6.970	8.125	12.437	21.773	28.185	29.595	38.567	47.713	50.416	52.537	50.284	51.293	55.816

* FDI stock is the value of the share of their capital and reserves (including retained profits) attributable to the parent enterprise, plus net indebtedness
** USD at current prices and current exchange rates
Source: UNCTADstat. Available from:<http://unctadstat.unctad.org/TableViewer/tableView.aspx> [28 January 2014]

Table 6. Outward FDI* to V4 countries in the years 1990 (1993) – 2012 (in USD million)**

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Czech Republic	-	-	-	181	300	345	498	548	804	698	738	1.136	1.473	2.284	3.760	3.610	5.017	8.557	12.531	14.805	14.923	13.214	15.176
Hungary	159	159	159	170	219	278	265	660	797	1.045	1.280	1.556	2.166	3.509	6.018	7.810	12.368	17.321	17.592	19.736	20.489	24.048	34.741
Poland	95	88	101	198	461	539	735	678	1.165	1.024	1.018	1.157	1.456	2.144	3.351	6.308	14.392	21.317	24.094	29.307	44.444	49.657	57.525
Slovakia	-	-	-	149	166	139	183	236	408	346	555	718	758	1.144	1.084	747	1.520	2.081	2.940	3.152	3.334	4.210	4.413

* FDI stock is the value of the share of their capital and reserves (including retained profits) attributable to the parent enterprise, plus net indebtedness
** USD at current prices and current exchange rates
Source: UNCTADstat. Available from:<http://unctadstat.unctad.org/TableViewer/tableView.aspx> [28 January 2014]

To summarize based upon the above, one may conclude that the hypothesis has been positively verified.

CONCLUSIONS

The results – apart from showing that membership in the EU has not led to an increase in the dynamics of both inward and outward FDI to V4 countries – bring our attention to the problem of positioning the V4 countries in the five stages of NOI.

Based upon the value of NOI in Tables 1-4, one may conclude that Hungary entered stage three of IDP in 2009. As for the Czech Republic, Poland and Slovakia, the situation is slightly ambiguous. Assuming that 2012 – as indicated earlier – was exceptionally tough for FDI, and that NOI for 2012 may be considered an exception, one may maintain that all of these three countries entered stage three of IDP in – respectively: 2010, 2010, and 2009.

If the above assumptions remain valid, one may conclude that the Czech Republic, Poland and Slovakia have made progress since - according to Gorynia, Nowak & Wolniak (2010) and Boudier-Bensebaa (2008) - Hungary had been considered as reaching stage three of IDP earlier.

Consequently, these findings considerably extend those by Gorynia, Nowak & Wolniak (2010) and Boudier-Bensebaa (2008).

There are, however, some limitations which have to be acknowledged. First and foremost, IDP should be considered in a broader context (Narula & Guimón, 2010). For example, NOI should be confronted with the OPI index (Gorynia, Nowak & Wolniak, 2010, p. 16). It is highly probable that a slightly different picture could emerge. An estimation of the negative influence of the global financial crisis of 2007 on FDI to V4 countries could be equally important. Second, even sharing Stoian's (2013) positive opinion about the considerable explanatory power of Dunning's IDP, one may not only repeat after Durán & Úbeda (2001) and Boudier-Bensebaa (2008) that it is necessary to redefine the fourth stage of IDP, but also to revise the criteria for classification into certain stages to avoid discrepancies in attributing particular countries to certain stages. Third, further conceptual work is needed with respect to the whole IDP model, especially concerning the various econometric models which should successfully address the idiosyncratic economic structure of these countries.

The V4 countries' membership in the European Union has not resulted in the speeding up of dynamic FDI in these countries (with respect to both inward and outward FDI). Despite this, V4 countries have already moved to stage three of IDP.

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The Scale and Characteristics of Services Offshoring in the Visegrád Countries

Magdalena Myszkowska

A B S T R A C T

Objective: The paper aims to outline the current position of V4's as destinations for services offshoring activities, analyse the extent and patterns of service exports and service-based FDI, and to determine their potential as offshoring locations.

Research Design & Methods: The paper is divided into six sections. Following the introduction, the 2nd section provides the theoretical background and gives an overview of the definitions of services offshoring. The 3rd and 4th sections examine trade data in order to find evidence of enhanced offshoring-related service activities in V4's. The 5th section studies the current and future position in the global services offshoring market of the CEECs. The final section contains research conclusions.

Findings: In the last few years, the CEECs have become an important location for services offshoring; there has been significant growth in the participation of this region in the global services offshoring market. Trade statistics confirm the assumption that expanding export in other business services and ICT services was associated with the growing importance of the V4 countries as offshoring locations.

Implications & Recommendations: Service offshoring is already a large and fast-growing industry in V4's, and there are emerging opportunities for extending it even further, individually and as a group, building on their past successes in exports. The main threats that V4's face are related to other CEECs that will seek to penetrate further into the nearby Western European market.

Contribution & Value Added: The results will contribute to the increase of knowledge of the society about one of the most crucial processes in the contemporary global economy. It is expected that offshoring will spread, embracing new and more advanced business processes. Hence, this phenomenon demands further analyses.

Article type:	research paper
Keywords:	Central and Eastern Europe (CEE); international outsourcing; offshoring; service-based FDI; service trade; Visegrád countries (V4)
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INTRODUCTION

The relocation of services is a phenomenon parallel to the phenomenon of relocating industrial processes from developed to developing countries with low operational cost. Central and Eastern European (CEE) countries play an important role in both types of relocation processes. In the last couple of years, relocation processes experienced rapid growth; a trend especially noticeable in the case of the new EU member states from the CEE, which began to act as host for this type of investments. However, their share in attracting such activities has been dwarfed by China in manufacturing and by India and certain developed countries, such as Ireland, Canada, and Israel, in services.

Knowledge of the development of services offshoring is limited, as a result of the lack of appropriate data and research tools. There is no doubt, however, that – especially after 2000 – production, value-added, employment, foreign direct investments and export levels rose noticeably in the CEE countries (in particular in the Czech Republic, Poland, Romania and Slovakia) as a result of offshoring.

As there are no readily available statistical indicators for measuring the extent of services offshoring in the V4 or the relative position of the countries in this process, the analysis is based on indirect measures. Following a widely applied methodology (UNCTAD, 2004), two service categories are suitable for evaluating the size of trade in offshorable services: 'computer and information services' and 'other business services.'[1] Their sum is assumed to cover the great variety of services that may potentially be affected by offshoring.

This attempt at estimating the scale of offshoring is based on a three-tier approach. Firstly, on the basis of the balance of payments (BOP) statistics, the occurring trends in relation to the size and structure of the services sector that can result from increased levels of offshoring were identified. An assumption was made that an increase of service export levels in the host country is a consequence of the fact that a positive decision regarding relocation has been made. Trade data derived from the BOP statistics gives a good approximation allowing the identification of trends in those services that can be regarded as offshorable[2], helps identify the geographical direction of relocation processes within the region, and also highlights the shifts in country level performance in terms of attracting offshored services.

Secondly, services offshoring data for the V4 countries will be extracted from the available official foreign direct investment (FDI) statistics, especially since according to estimates, so-called captive offshoring amounts to about two-thirds of the total value of offshoring worldwide. Traditionally, FDI is categorized either as horizontal (demand/market driven) or vertical[3] (cost driven). Market-seeking investors establish a subsidiary in the host country to provide services for the local market and are usually attracted by specific market attributes. For vertical investors, the most important motive

[1] These two categories are also referred to as 'IT services' and 'ITC-enabled services', respectively.

[2] Since the BOP statistics also contain services other than those subject to offshoring, the data they contain should be treated as indicating the upper level of the phenomenon (WTO, 2005).

[3] Vertical investments are relatively new phenomenon within service sector and result mainly from the advances in technology, which made the fragmentation of the value chain possible.

of investing abroad is taking advantage of the local resources. These companies offshore only particular service functions – usually administration (back office functions), finance, human resources, payroll services, logistics, customer care, knowledge services and R&D. Such investments are commonly referred to as shared service or contact centres.[4]

In the case of vertical investment, the majority of the services are immediately exported. These services are highly export-oriented and their export intensity is also very high (around 100%). That is why trade data gives the most relevant proxy for calculating the extent of the offshoring of these activities. Therefore, the growth of vertical investments in the service sector also leads to increased export levels for services (Gal, 2013).

Determining the actual extent and patterns of service offshoring requires a combination of quantitative and qualitative research. Hence, the statistical data is augmented with data from alternative sources (mostly expert analyses), which can be useful in spotting new phenomena that are not yet picked up by official statistics or that are being picked up with great delay.

THEORETICAL BACKGROUND

There have been many attempts at defining offshoring, hence one is bound to discover some differences between them when analysing the subject. Since offshoring is often treated coextensively with outsourcing, it is important to always precisely define these two notions and the relations between them. In practice, to simplify matters, the dominant approach in the literature is to categorise the main notions and their synonyms, taking into account the location (inside or outside a country) and the ownership of production resources (insource – outsource). The scope and type of offshoring and outsourcing are often defined additionally, resulting in notions such as nearshoring, concurrent sourcing, multisourcing or backshoring/deoffshoring.

In this paper, the definition from the World Investment Report (UNCTAD, 2004) is used (Table 1), which defines offshoring as the transfer and localisation of a part of a business process outside the country to the places where these can be serviced by foreign divisions of the company (*captive offshoring, intra-firm offshoring*) or by independent companies (*offshore outsourcing*). The notions of captive offshoring and offshore outsourcing relate to the company's decision of selecting a subset of the services they offer and relocating these to their foreign division (affiliated trade) or to a third-party provider abroad (unaffiliated trade), respectively.

Offshoring and outsourcing are also defined as trade phenomena that describe the directions of the trade flow (Table 2). There are three scenarios when offshoring can occur (Małuszyńska, 2013):

1. The company partially relocates services to its foreign divisions (Arrow 1).

[4] Shared service centres usually deal with back office and corporate functions supporting subsidiaries of the company abroad. Contact centres on the other hand deal with front office - customer facing - activities and serve the customers either within a particular region or globally.

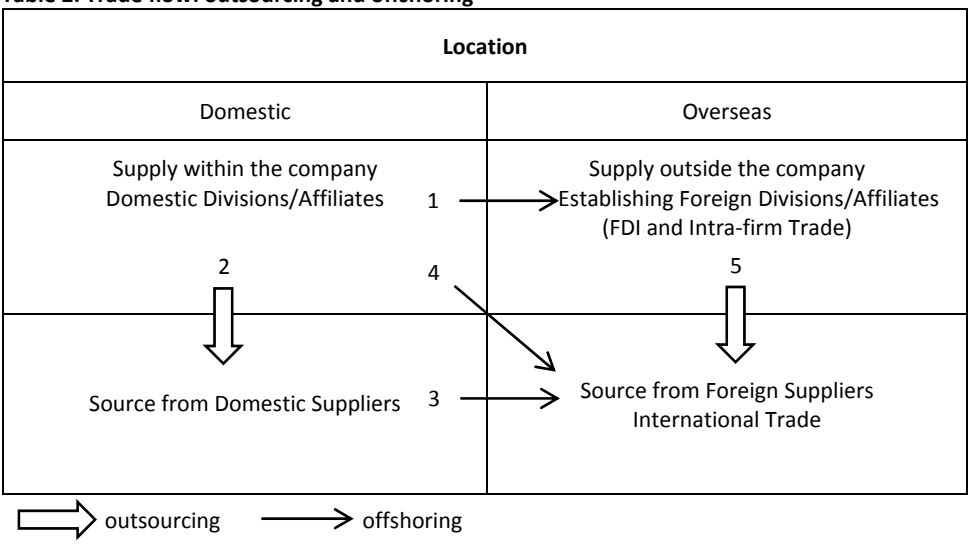
2. The company that has been outsourcing its services to a third-party service provider (Arrow 2) in the home country changes the provider to a foreign one (Arrow 3).
3. The company decides to relocate production to an independent company abroad (Arrow 4).

Table. 1 Offshoring and outsourcing permutations

Location of production	Internalized production	Externalized production „OUTSOURCING"
Home country	Production kept in-house at home	Production outsourced to a third-party service provider at home
Foreign country „OFFSHORING"	Production by foreign division/affiliate (*intra-firm/captive offshoring*)	Production outsourced to third-party provider abroad, which can be: a local company, a foreign affiliate of another TNC (*offshore outsourcing*)

Source: (UNCTAD, 2004).

Table 2. Trade flow: outsourcing and offshoring



Source: adopted from (Sako, 2005, p. 6) quoted in (Małuszyńska, 2013, p. 22).

Captive offshoring and outsource offshoring, as integral elements of the process of production fragmentation, are considered to be certain forms/types of (re)location, understood as the transfer of a part of services between countries, manifesting itself as direct international investment flows and international service flows within one organisation or between unaffiliated companies with separate capitals[5] (Radło, 2006).

[5] Without an indication whether or not it is accompanied by stopping or limiting production or downsizing in the country of origin.

From the point of view of the type of the relocated services, we can distinguish *inter alia:*

1. information technology offshoring (ITO) – covering the process of creating, support, programming, security and the processing of business transactions,
2. business process offshoring (BPO) – covering services related to business processes, that is, finance and accounting services, human resources, legal services, analytic services, market analysis, data processing, etc.; if the business processes require specialized knowledge such as legal advice or market analysis, the offshoring of such services is often described as knowledge process offshoring – (KPO).

It is important to note that services offshoring is a very dynamic process, in which the list of services considered to be viable for relocation grows rapidly. However, this also means that the research and statistics in the field are quickly becoming outdated.

SERVICE EXPORTS OF THE V4 COUNTRIES

When analysing the current service trade patterns of the CEE countries, it is of utmost importance to remember that the starting level for these countries' growth was very low. The previous economic system left the region with huge structural imbalances and a severely depressed service sector. Consequently, a wide range of services, particularly business-related ones, were either non-existent or not developed according to Western standards (Ghibutiu & Poladian, 2009).

The export of services has grown significantly in the V4 region since 2002 (Figure 1). In comparison to 1995, the level of service exports tripled in 2008. The share of the V4 in global service exports is modest (2,09% in 2012[6]), illustrating the still-low service export capabilities of these countries, although their growth rate is higher than the global or EU average. In absolute terms, Poland is the top service exporter (37897 mln USD), followed by the Czech Republic (22106.32 mln USD), Hungary (20392.12 mln USD) and Slovakia (7158.07 mln USD). When measuring their services trade integration as a percentage of GDP[7], Hungary is the country with the highest level of this indicator (14.5%), while Poland is the lowest (7.1%)[8].

The majority of V4 exports in services are directed at the EU market (around 70%)[9], which suggests that centres provide services mainly for their customers or subsidiaries in Europe (Fifekova & Hardy, 2010).

The V4 countries are now not only exporting more traditional services, such as transportation and travel, but also more modern and skill-intensive services, such as financial intermediation, computer and information services, and legal and technical support. Skilled jobs performed by accountants, programmers, designers, architects,

[6] In the individual V4, the respective shares ranged between 0.17% in Slovakia and 0.9% in Poland.
[7] This indicator has the advantage of removing the effect of differences in the size of the V4 countries.
[8] Figures provided on the bases of the data of Eurostat BOP Statistics retrieved on January 4, 2014 from: <http://epp.eurostat.ec.europa.eu/portal/page/portal/balance_of_payments/data/database>.
[9] EU-15 customers purchased 57% of CEE service exports in 2010.

medical diagnosticians, and financial and statistical analysts are increasingly outsourced by firms in developed countries.

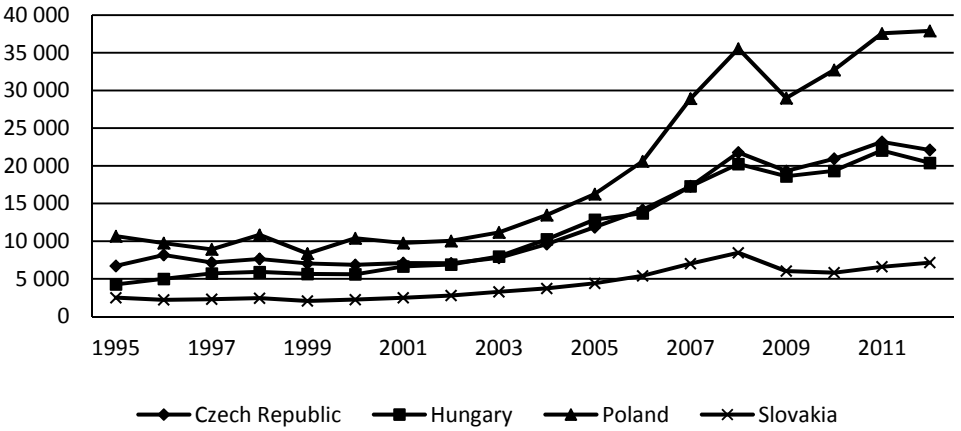


Figure 1. Total services exports of the V4 countries in the years 1995 - 2012 (in mln USD)
Source: OECD Statistics retrieved on January 18, 2014 from: http://stats.oecd.org/index.aspx?queryid=166

The striking fact about the sector share of service exports in the V4 countries is that traditional services still dominate over all other services (including offshorable services). Over 60% of service exports relate to travel and transportation, followed by business services. Out of these three sectors, the growth rate of business service exports was the most dynamic one (Table 3).

Table 3. The structure of services exports in the V4 in the years 2004, 2008 and 2012 (in %)

Industries	Czech Republic			Hungary			Poland			Slovakia		
	2004	**2008**	**2012**	**2004**	**2008**	**2012**	**2004**	**2008**	**2012**	**2004**	**2008**	**2012**
Total services	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Other business services	**15.6**	**25.5**	**25.6**	**24.1**	**28.3**	**31.4**	**13.9**	**22.7**	**26.2**	**16.7**	**17.2**	**21.4**
Computer and information	**1.3**	**6.7**	**9.3**	**3.4**	**5.8**	**6.3**	**1.9**	**2.5**	**6.5**	**3.3**	**3.4**	**7.1**
Transport	28.6	24.8	23.3	12.6	19.6	21.4	31.5	31.0	29.6	40.0	34.5	28.6
Travel	44.2	35.6	32.0	36.8	29.7	23.9	42.6	33.1	28.9	23.3	31.0	32.1
Financial	3.9	0.7	0.0	2.3	1.4	0.6	0.9	1.7	1.0	3.3	1.7	0.0
Communications	2.6	2.7	2.3	2.3	2.9	1.3	1.9	1.7	1.4	3.3	3.4	1.8
Personal, cultural recreation	2.6	0.7	1.2	10.3	5.1	6.9	0.9	0.4	1.0	3.3	1.7	1.8
Construction	1.3	2.0	3.5	1.1	2.9	1.9	4.6	5.4	3.7	3.3	1.7	3.6
Insurance	0.0	0.7	1.2	0.0	0.0	0.0	0.9	0.4	1.0	0.0	0.0	0.0
Royalties and licence fees	0.0	0.0	1.2	4.6	4.3	5.7	0.0	0.8	0.7	0.0	1.7	0.0
Government services	0.0	0.0	0.0	1.1	0.7	0.6	0.0	0.4	0.0	0.0	0.0	0.0
Services not allocated	0.0	0.7	0.6	1.1	0.0	0.0	0.9	0.0	0.0	3.3	3.4	3.6

Source: Own calculation based on Eurostat BOP Statistics retrieved on January 4, 2014 from http://epp.eurostat.ec.europa.eu/portal/page/portal/balance_of_payments/data/main_tables

The data collected from Eurostat BOP Statistics illustrates the increased tradability and large export intensity of the so-called offshorable services, i.e. business services and computer and information services. Between 2001 and 2012, their share within total

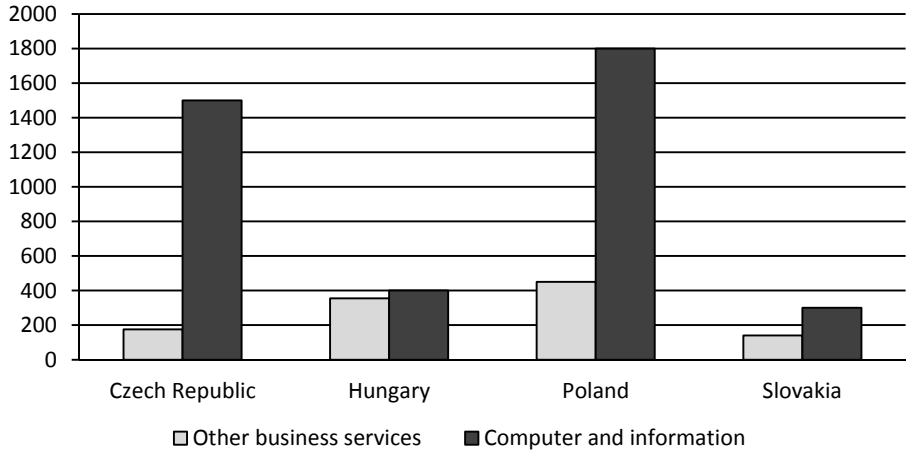


Figure 2. The growth of offshorable service exports in the V4 in the years 2001-2012 (in %)
Source: own calculation based on Eurostat BOP Statistics retrieved on January 4, 2014 from http://epp.eurostat.ec.europa.eu/ portal/page/portal/balance_of_payments/data/main_tables

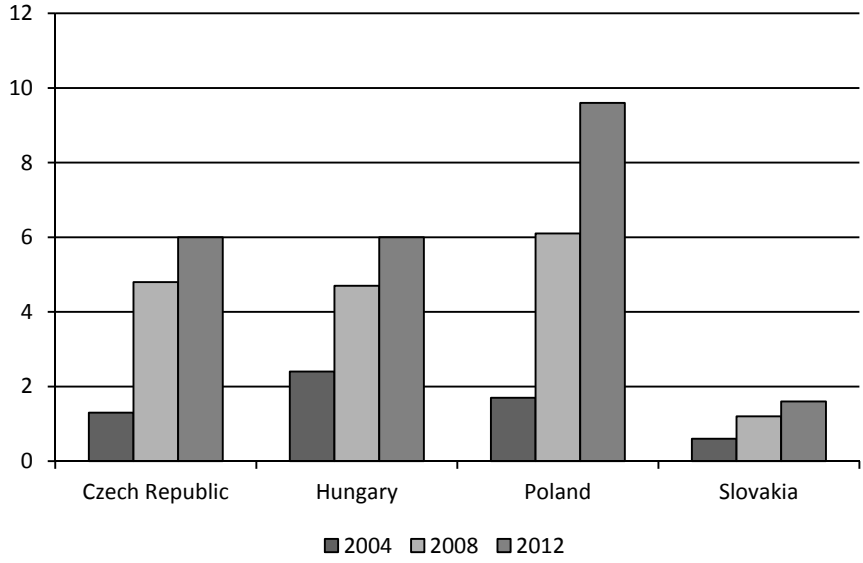


Figure 3. The offshorable service exports in the V4 in the years 2004, 2008 and 2012 (in 1000 mln EUR)
Source: Eurostat BOP Statistics retrieved on January 4, 2014 from http://epp.eurostat.ec.europa.eu/portal/page/ portal/balance_of_payments/data/main_tables

service exports grew steadily from 17.5% to 34%. It should be noted that Poland and the Czech Republic experienced the highest growth (see Figure 2).

The total value of these two service subcategories in the V4 was equal to 23.2 mld EUR in 2012. The overwhelming dominance of business services (an average of 85.3%) in the period 2001-2012 is striking. In absolute terms, Poland is the largest trader, followed by Hungary and Czech Republic (Figure 3).

The above service trade statistics support the preliminary assumption that offshoring generates expanding exports in particular service categories, namely business services and computer and information services. However, it is obvious that not all kinds of trade are connected to the offshorable services. The data does not show the true extent to which the offshorable service exports are provided by offshorable service centres, nor do they distinguish between the different forms of offshoring (Gal, 2013).

SERVICE-RELATED FOREIGN DIRECT INVESTMENT IN CEE

In the CEE countries, the range of services expanded rapidly as a result of the ongoing economic transformation; all this happened in alignment with the worldwide structural shift towards service-based foreign direct investment. In the Czech Republic, Hungary and Poland, foreign investments in the service sector became dominant by the late 1990s, but the boom started in 2000, when service-related FDI reached almost 60% of the total FDI in the region (Figure 4). Since 2000, the share of service sector FDI in total FDI flows was 70% in the Czech Republic, 55% in Hungary, 60% in Poland and 40% in Slovakia. Overall, the tertiary sector received more than 60% of the foreign capital inflows into the V4 region (Fifekova & Hardy, 2010).

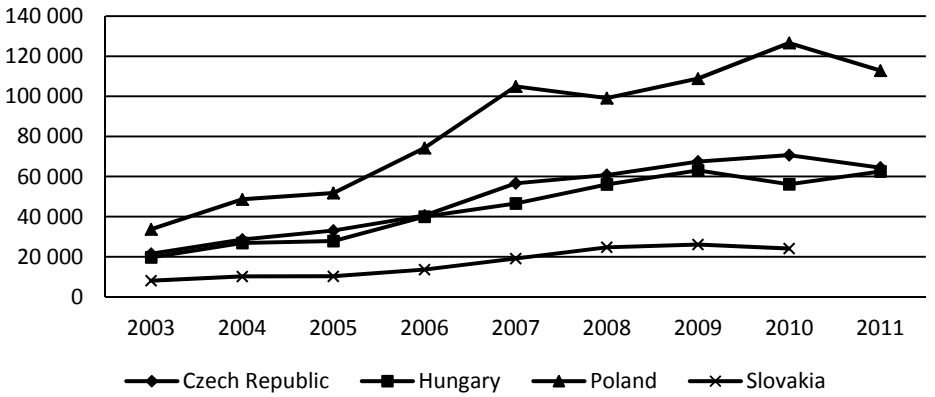


Figure 4. Service sector FDI stocks in the V4 countries in the years 2003 – 2011 (in mln EUR)
Note: data from 2011 for Slovakia were not available.
Source: OECD Statistics retrieved on January 20, 2014 from http://stats.oecd.org/Index.aspx?DataSetCode=FDI_FLOW_INDUSTRY

The structure of service-related FDI in CEE countries reoriented in line with international trends. From 1990 onward, the huge unsaturated service markets and lack of competition in CEE countries constituted an opportunity for horizontal investments, even though the political situation was unstable and the business environment

unfavourable[10]. In the first decade of the transformation[11], the majority of incoming service FDI was concentrated in trade, transport, communication, financial intermediation, real estate, business activities and other infrastructure services (Fifekova & Hardy, 2010).

After 2000, the composition of FDI flows started to change; there has been a shift from markets seeking horizontal business service investments to vertical business service investments. Divergence from the traditionally dominant FDI receiving service sectors was compensated for by the increasing share of investments into business activities, which can be observed especially in case of the Czech Republic and Poland (Fifekova & Hardy, 2010). As a result of the changing composition of FDI, the V4 countries have found themselves competing with other destinations to attract business services with high value-added activities.

The first business service projects in the CEE region mainly involved so-called back-office functions (finance, invoicing), which are less complicated and do not involve direct contact with the client. In the next stage, front office (customer facing) activities were transferred to the region, and the process continues with more value-added and skill-intensive activities. While Poland, Hungary and Slovakia attract a wide range of service activities, investments in the Czech Republic mainly specialise in IT-related activities (Sass & Fifekova, 2011).

The Czech Republic and Hungary are the group leaders when it comes to attracting service FDI. Poland, owing mainly to its size, usually surpasses all the other countries in terms of absolute FDI inflow, but nevertheless usually falls behind when per capita terms are taken into consideration. Slovakia lags behind in terms of both absolute and relative service sector FDI inflows and attracts the least amount of high value-added investment among the V4 countries (Sass & Fifekova, 2011).

The share of V4 countries in the global business services FDI is very low. The region is lagging far behind Asia (India being its powerhouse in that respect) and Western Europe, but it shows growing potential. It seems justifiable that service investments in the V4 countries are driven by the foreign investor's desire to gain access to skills and a business environment comparable to home country conditions, while taking advantage of relatively lower operational costs (Fifekova & Hardy, 2010).

THE GROWING IMPORTANCE OF CEE COUNTRIES IN THE GLOBAL OFFSHORING MARKET

Globally, the offshoring industry is expected to grow by 10% annually through 2020, reaching 1.6 billion USD (1.3 billion EUR) annually (McKinsey Global Institute, 2013). By 2011, IT and business services in the form of captive offshoring and offshore

[10] The investment incentives were not aimed at services companies at that time as the government realized that these firms are entering the market anyway being driven by market access rather than decreasing costs.

[11] A shift from centrally-planned economy towards market economy required an introduction of various – previously unavailable – services to satisfy the market needs. In the first years of transition, a wide range of service categories could not be provided locally, due to lack of expertise and skills, but also owing to shortage of capital and week telecommunication infrastructure.

outsourcing were provided in more than 120 countries in the world[12]. India[13], Brazil, Russia and China are considered the most attractive sourcing destinations for ITO and BPO. This is mainly because of the scale of services, available skills, and the maturity achieved with regard to offshoring activities. Forecasts, however, indicate that in the next few years these countries' share will be decreasing in relation to other expanding locations, including Central and Eastern Europe[14] (Oshri, Kotlarsky & Willcocks, 2011).

In the last few years, the CEE countries have become an important location for services offshoring, not only from a European perspective, but also worldwide; there has been significant growth in the participation of this region in the global services offshoring market. At the moment, the CEE countries have approximately an 8% share of global services offshoring. Currently, there are about 1000 centres with foreign capital operating in business and IT-related sectors, employing 270-300 thousand individuals with 20% yearly growth (Górecki *et al.*, 2013). A distinct majority of them are investments by companies from Western Europe.[15] Major European corporations, after targeting Asian locations[16], are now looking towards CEE to meet their nearshoring[17] requirements. V4 countries, offering closer proximity to the supplier, fewer time zone differences, and lower transaction costs, are especially significant nearshore destinations for Western European clients.[18]

In terms of ITO/BPO services, the market is growing as CEE countries become more westernised and the quality of life in these countries moves towards those of Western European countries. However, CEE may be more attractive for BPO than ITO because they provide excellent general education, but do not graduate IT students at anywhere near the pace that India does. Furthermore, local CEE demand for software and IT-related products and services is expected to continue growing, which means that Western European companies already present in the region are able to take advantage of their good access to such markets (Oshri, Kotlarsky & Willcocks, 2011).

The CEE offshoring industry is also well-positioned to fill demand for higher value-added services, as the recent growth in offshored R&D and engineering services in the region indicates. Even now, CEE service centres typically compete in terms of skills and not in terms of scale, offering higher value-added services than competitors in other countries that focus more on high-volume transactional processes. Globally, there is growing demand for more sophisticated services such as R&D and big data analytics. CEE offshoring centres may also be able to compete for relatively untapped offshoring

[12] As per The Hackett Group there are 4 900 service centres operating globally, with 52% of them located in Europe.

[13] The position of leader is still held by India, with approximately 40% of the market.

[14] CEE offshoring industry is growing at twice the rate of India's sector (McKinsey Global Institute, 2013).

[15] Companies from Germany, United Kingdom, Austria, Norway, Sweden and Netherlands most frequently opt to move their services to nearshore locations, rather than somewhere offshore.

[16] The costs of offshoring to traditional locations, such as China and India, have exploded in recent years and are starting to match the costs of many CEE countries.

[17] Nearshoring means relocating service activities to a foreign, lower-cost country that is relatively close in distance and within the same continent or time zone.

[18] The study of Carmel & Abbott (2007) identifies three major global nearshore clusters: one cluster of 20 countries surrounds North America, and another 27 countries (including CEE) form a cluster around Western Europe. The third smaller cluster lies in East Asia.

markets, such as public sector services, health, media, and utilities. There is also growing demand from small and medium-sized enterprises, which are expected to drive 40% of increasing growth through 2020 (McKinsey Global Institute, 2013).

Another option for CEE offshoring companies is to move up the value chain by positioning themselves as the coordinators of a broad network of offshoring services for clients. The CEE centres would experience the evolution from transaction centre to centres of excellence, from servicing single processes to influencing and transforming global ones, from service provision for individual European countries to multicultural melting pots.

Among the CEE countries, Poland and the Czech Republic stand out as having notable market potential. Poland is attractive as both a captive and outsourcing location. It is also a strong nearshore destination for Western European. Current estimates state that there are 400 service centres[19], belonging to nearly 300 investors and employing 110 000 individuals[20] (Górecki *et al*., 2013). The range of services is increasing in terms of the types of processes, geographic scope and market sectors. Simple transactions are being displaced by complicated tasks requiring high employee competence and knowledge.

Poland's offshoring industry has enjoyed great support from the local and national governments. It also benefits from country's size and resources. The Polish educational system is closer in quality to EU‑15 schools than those of other nations in the region, and its large population provides a deep talent pool. Poland has also withstood the crisis better than countries such as Hungary, and it still has significantly lower labour costs than the Czech Republic, Slovakia, and Hungary. As a result, it continues to attract new business, winning 40 out of 46 large offshoring deals in the region in 2012 (McKinsey Global Institute 2013).

The Czech Republic also has a strong position in the CEE offshoring market[21]. It is in second place after Poland, offering the most attractive education system, and data and intellectual property security and privacy among all the CEE countries. The latest research shows that on the Czech market there is a minimum of 200 centres which employ around 50 000 individuals. The growth rate of the industry has accelerated during last 3 years and next year is expected to increase by over 20% (Drygała & Colantonio, 2013).

While nations worldwide increasingly compete for a share of this significant and rapidly increasing offshore market, the V4 countries must continue to work at staying on the CEE podium, regarding successes achieved in other CEE countries and the increasing competition in terms of governmental incentives or infrastructure.

[19] Including shared service centres, business process and IT outsourcing centres, research and development centres (R&D).

[20] The Polish offshoring market is growing at an average rate of 20% per year.

[21] It is important to note that the high level of investment into the offsorable service sector in the Czech Republic is linked to the fact that in general, the Czech Republic continues to be a CEE leader in terms of FDI.

CONCLUSIONS

The tradability revolution in services has resulted in a rapid surge of transfers in service activities. Within the CEE region, especially the V4 countries could use their potential to reach a strong position on the global map of services offshoring. These countries achieved the highest levels of progress in terms of modernising their service industries and witnessed a rapid shift towards services. Trade statistics confirm the assumption that an expanding export in other business services and computer and information services is associated with the growing importance of the V4 countries as offshoring locations. During the last decade, the CEE particularly benefited from the worldwide structural shift towards service-based FDI. The region shows growing potential and might attract many investors looking to establish shared service or contact centres, as well as more recent initiatives in the form of knowledge process offshoring or research & development.

In the last few years, the CEE economies have developed a globally competitive offshoring industry. The region built its attractiveness primarily around its nearshoring advantages[22] arising from the combination of the availability of skilled labour and strong language skills, low costs, favourable business and stable political environments, well-developed infrastructure, and geographical and cultural proximity to Western Europe.

It seems that for all the V4 countries, their biggest problems are related to the competition of the remaining CEE states, as they all try to further penetrate the nearby Western European market. In the CEE region, many countries are in the position to emulate V4's offshoring success. Bulgaria and Romania are close to Poland in terms of employee qualifications; these countries are also characterised by significant cost advantages in comparison to Western Europe and share cultural and geographic proximity to major European customers. Despite all this, in the coming decade there will be opportunities for the V4 countries, individually and as a group, to build on their past successes in exports.

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[22] Nearshoring represents a major way in which CEE countries can compete with India for market share. Within this context, nearshore might be presented as a reaction to the main offshore destination – India, which is viewed as "farshore," a very distant destination, many hours to travel, many time zones away, and a very different culture.

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Outward FDI from Hungary: the Emergence of Hungarian Multinationals

Magdolna Sass, Andrea Éltető, Katalin Antalóczy

A B S T R A C T

Objective: Hungary is a leading outward foreign investor among the new member states of the European Union. Our research question is what those factors are which enabled Hungarian companies to expand abroad successfully.

Research Design & Methods: Our methodology is based on company case studies of the leading investors and other randomly selected companies with foreign investment.

Findings: Our main findings include the specific ownership advantages (OA) of privatised companies, with links to their heritage from the pre-transition period.

Implications & Recommendations: For companies established after 1990, OA is more similar to that of "traditional multinationals." Second, we make a link between "virtual indirect" investors and this specific OA, showing how the strong position and specific knowledge of the management are interrelated in developing and changing the OA.

Contribution & Value Added: On the basis of our research, the policy dimension concerns, first of all, the role of increasing local competition due to increased investments by foreign multinationals. This enables a few local companies to enhance their level of competitiveness to such level where they themselves will be able to become successful foreign investors. Second, highly innovative companies in small market niches are able to internationalise successfully even in the post-transition environment. Fostering R&D is thus an important tool for trade and investment policy as well.

Article type: original research paper (case studies)
Keywords: FDI; outward foreign direct investment; Hungary
JEL codes: F21, F23

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INTRODUCTION

Hungary is a leading outward foreign investor among the new member states of the European Union. It started to invest abroad earlier than other countries of the region, and thus the overall stock of OFDI and per capita OFDI is usually higher than in other Central and Eastern European (CEE) countries. Our study concentrates on the ownership advantages (OA) of these firms and the changes made to them which enabled them to become (regional) multinationals (MNCs).

Our paper's main aim is to show what factors enabled Hungarian companies to expand abroad successfully – and thus result in a significant stock of outward FDI at the macroeconomic level. Our methodology is based on company case studies of the leading investors and other randomly selected companies with foreign investment. The remaining part of the paper is organised as follows: First, we show the theoretical framework and a short review of the literature for our analysis. Second, we briefly describe the methodology used in this initial phase of the research. Third, we present the company case studies. Fourth, we briefly compare ownership advantages of our company cases with those of "traditional" and emerging multinationals. The final section presents our conclusions.

LITERATURE REVIEW

We rely on two strands of literature. First, our analysis focuses on the notion of ownership advantages (OA), which enable companies to invest abroad successfully. Second, we also relate our research to the literature on emerging multinational companies (EMNs), which delineate the distinguishing factors between "traditional" and emerging MNCs.

The eclectic paradigm of Dunning (1993) is a summary of theories, which builds partly on the theory of internalisation (Buckley & Casson, 1995) and transaction costs (Williamson, 1975). The three elements of the OLI-paradigm are: ownership, locational and internalisation advantages. These advantages explain foreign direct investments, i.e. for a foreign direct investment to be realised, all three of these advantages must be in place. The investing company must have ownership and internalisation advantages, while the host country must possess locational advantages.

As some authors argue, the OLI paradigm explains the investment of multinationals from developed countries well, but it is less relevant in the case of EMNs (Contessi, 2010). EMNs are very heterogeneous and do not seem to possess OA, for example, in the form of strong global brands. Some EMNs even have "adversity advantages": they are able to handle relatively disadvantageous local conditions in less developed countries that would otherwise scare off investors from advanced countries. On the other hand, certain EMNs invest abroad just to obtain OA (Aulakh, 2007; Mathews, 2006). Ramamurti (2012) argues that EMNs have to have OA; however, these are different from the ones of developed firms or "traditional" MNCs. Such OA can be the understanding of emerging market needs, functioning in difficult circumstances, etc., which obviously differ from the characteristics and abilities of "traditional" MNCs. Certain authors point to the fact that with time EMNs will develop similar OA to the developed MNCs (Lessard & Lucea, 2009).

According to another strand of literature, firms in less developed countries may also have OA. The heterogeneity of firms is highly relevant in the case of EMNs. Productivity and efficiency can depend on the form of FDI or internationalisation (Nocke & Yeaple, 2008). Highly productive firms coexist with less efficient ones within one country. This heterogeneity is related to the comparative ownership advantage framework (Li Sun, Peng, Ren & Yan, 2012) that says that although country A may be less developed than country B, certain companies in certain industries in country A can be superior in some fields (design, marketing, research, etc.) to their counterparts in country B. This can then lead to country A's firms' successful investment in the more developed country B.

The specific nature of EMNs has led certain researchers to revise previous theoretical frameworks. For example, instead of the OLI framework Matthews (2006) elaborates the "LLL framework" that he considers more relevant in the case of "Dragon" (i.e. Asia-Pacific) MNCs. The three letters mean Linkage (acquire resources externally), Leverage (exploit the resources stemming from linkages) and Learning (becoming more effective).

The literature on EMNs is large, but analyses are generally made on firms in the BRIC countries, while MNCs originating from CEE are analysed much less often. These "transition country multinationals" fit neither in the traditional theories of advanced MNCs, nor in the theories of EMNs (Svetlicic, 2004). CEE countries are somewhere in between the developed and developing countries. The example of Hungary and Hungarian MNCs is a good illustration of a "middle-developed" economy and its companies, which invest larger and larger sums abroad.

MATERIAL AND METHODS

In the present phase of our research, we rely on company case studies, for which the information is obtained from the balance sheets, websites of the companies and articles from specialised newspapers and journals. We selected six Hungarian-controlled companies which invested abroad. We tried to include companies of all sizes and firms from those sectors, in which significant foreign investments were realised. Of course, partly due to the low number of companies in the sample, it cannot be representative, but taken as a kind of "pilot" before conducting a research on a larger sample, it can provide important insights regarding our research question, namely what factors enabled Hungarian companies to successfully invest abroad.

Case studies can serve as a useful tool in the first stage of a research. They can be a useful tool for identifying problems and determining data needs for a statistical analysis, especially in the circumstances of the unreliability of macrodata and when the analysis is focusing on qualitative issues. They help gain qualified knowledge for a deeper understanding of the analysed theory on the basis of practical cases (Eisenhardt, 1989). Case studies are rich in detail and provide information on the dynamics of the analysed process. They can give insight into phenomena, which are seemingly unrelated to the analysed problems, but can prove useful in the analysis. The advantage of using multiple cases over one company case study is obvious. In multiple case studies there is room for the heterogeneity of firms and strategy, as well as for concentrating on those aspects of the problem, which we deem to be the most important in the given case. The case study

approach is more flexible and thus it can grasp a wider spectrum of factors affecting the analysed phenomenon. We are nevertheless aware of the limits of this method. While they provide very valuable information on the behaviour of firms, generalisation may be difficult due to the small number of firms involved in the sample, compared to the usually large number of company data analysed in econometric studies. The collected material may also be biased due to the selection of companies. Overall, the heterogeneity of Hungarian firms investing abroad makes it useful on one hand to rely on this methodology, and on the other hand, to base our research on multiple case studies at this early stage of research.

RESULTS AND DISCUSSION

FDI in Hungary – Overview

Hungarian companies started to invest abroad substantially in the mid-1990s. Since then, outward flows increased steadily, reaching their highest values in 2006-2007. Flows in the crisis years declined sharply, and then slowly reached the pre-crisis level again by 2012 (Figure 1).

Pre-crisis fluctuations can be attributed to the fact that both Hungarian-based, formerly state-owned, but now privatised, companies and foreign-owned Hungarian affiliates of large MNCs started to get involved in privatisation deals in neighbouring countries. One or more privatisation projects push annual outflows to a higher level in certain years. Thus, Hungarian OFDI was closely related to privatisation deals in geographically close countries. During crisis years and afterwards, privatisation-related deals are much less significant.

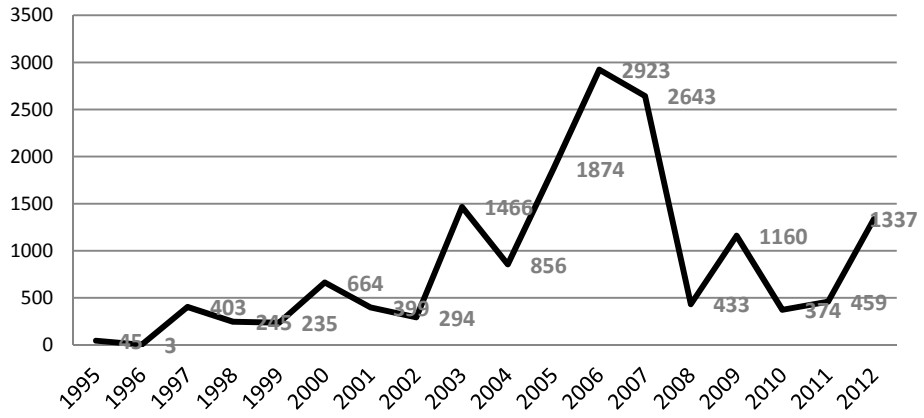

Figure 1. Outward FDI Flows from Hungary, 1995-2012 (million EUR)
Notes: Excluding Capital in Transit, Restructuring of asset portfolios and Special Purpose Entities
Source: Hungarian National Bank.

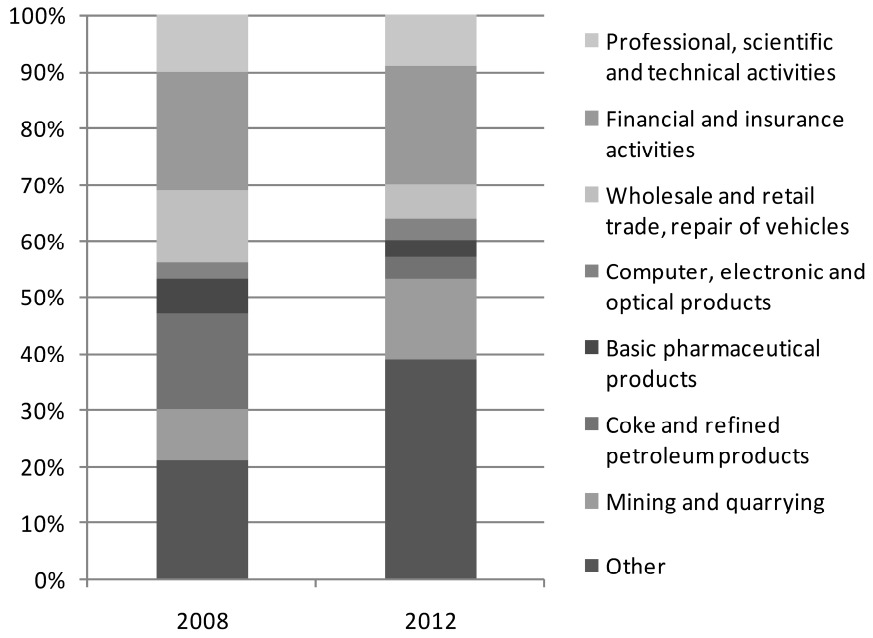

Figure 2. The Sector Composition of Outward FDI Flows from Hungary, 2008 and 2012 (%)
Source: Hungarian National Bank.

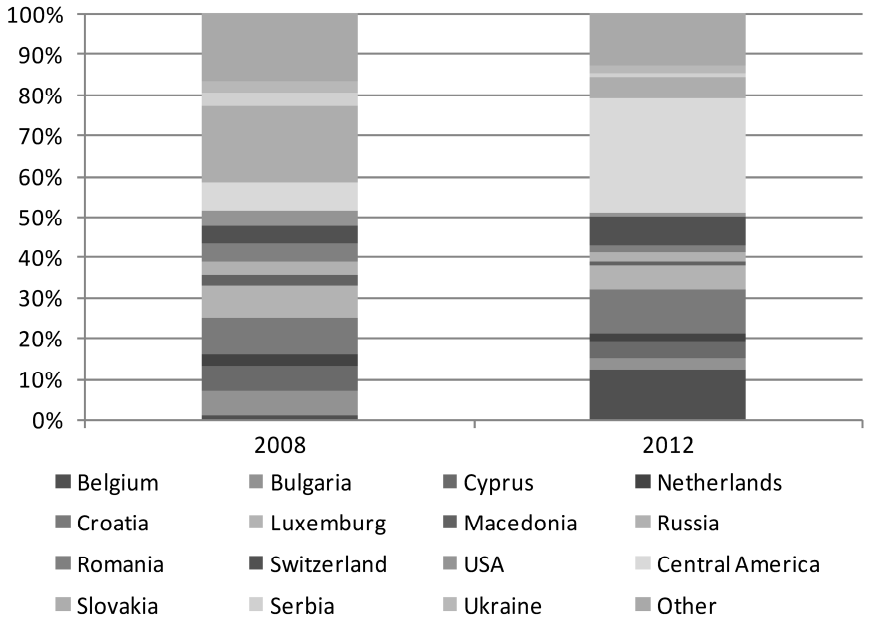

Figure 3. Host Country Composition of Hungarian OFDI, 2008 and 2012 (%)
Source: Hungarian National Bank.

The sector composition of OFDI shows the dominance of a few sectors (Figure 2). While services OFDI initially dominated, the share of manufacturing increased gradually to more than one-third by 2008, declining again by 2012. Certain leading sectors can be connected to the activities of a few companies, as for example mining and petroleum to MOL, financial services to OTP and pharmaceutical products to Richter. This underlines the relatively high concentration of Hungarian OFDI in terms of investing companies.

As for host countries, neighbouring and geographically close countries with which Hungary has had traditional economic ties (Croatia, Slovakia, Romania, Bulgaria, Russia, Ukraine, other former Yugoslav countries) always had a large share in Hungarian OFDI (Figure 3). On the other hand, countries known for their "tax optimisation facilities" (Cyprus, the Netherlands, Luxemburg, Central America and to some extent Switzerland) have an increasing part lately.

Short Case Studies of Hungarian Outside Investor Companies[1]

MOL is one of the leading companies in CEE and in Europe in petrol and gas production and distribution, the largest Hungarian company in terms of turnover, operating profit, exports and foreign assets, and it is the leading one in its sector. As is often the case with these types of companies in the gas and oil sector, it has a monopoly in certain areas. Its predecessor was founded in 1938 and was nationalised in 1949. In 1957, the Hungarian oil industry was integrated into a single entity: Hungarian Oil & Gas Trust (OKGT), the largest Hungarian firm at that time. The OKGT's privatisation process was launched in 1991, when its legal successor, the Hungarian Oil & Gas Company Plc (MOL)'s shares were introduced to the Budapest Stock Exchange (in three tranches: 1994, 1995, 1997). In September 2013, 27.3% of the shares were held by various foreign institutional investors, while 24.6% were held by the Hungarian government. Other shareholders of above 5% are the Czech group CEZ (7.3%), OmanOil (7%), Magnolia Finance (5.7%) and ING Bank (5%). Thus, MOL is majority foreign-owned, but not foreign-controlled, as none of the foreign owners has more than 7.3% of the shares. All strategic decisions are made by the company's management residing in Hungary.

In 2013, MOL was the majority owner of 39 foreign affiliates, as a result of a gradual foreign expansion strategy. Its first two affiliates were established in neighbouring Romania and the Ukraine in 1994 through greenfield investments, followed by other greenfield investments in other neighbouring countries. A strategic change came in 2000, when MOL decided to become a leading regional MNC. Since then, privatisation-related acquisitions have dominated with an increasing project size. In 2000, the company acquired dominant ownership of Slovnaft, the leading Slovakian oil firm. MOL also owns 49% of the shares of the Croatian INA, the national oil company. Other affiliates of MOL include resource-seeking investments in Asia, the Middle East, and Africa, which are smaller in size and focus on exploration and production. Other

[1] The case studies on MOL and OTP are the updated versions of those presented in Sass *et al.* (2012). The sources of information are company websites (www.mol.hu; www.otp.hu; www.richter.hu, www.videoton.hu, www.aboholding.com, www.3dhistech.com) and publicly available balance sheets of the companies, unless otherwise stated.

European affiliates can be found mainly in distribution and wholesale and retail trade, motivated by access to the local market. (These are located, among others, in Austria, Germany, Romania, Russia, Serbia, and Slovenia). As part of the new strategy, MOL also acquired a majority stake of 30% in the leading Hungarian petrochemical company TVK in 2000, increasing it gradually to 87%. Thus, MOL's foreign assets also increased as TVK itself is a foreign investor with affiliates in Italy, Great Britain, Germany, France, Poland and Ukraine. After becoming a regional multinational, MOL was target to unsuccessful hostile takeovers first by the Austrian ÖMV and later by the Russian Surgutneftegas. The Hungarian Government owns a voting preference share, which entitles it to veto certain strategic decisions, including those affecting ownership changes in the company. None of the shareholders or groups of shareholders may exercise voting rights of more than 10%, as is stated in MOL's Articles of Association. Thus, both hostile takeover attempts proved to be unsuccessful, but as a result, the management is trying to strengthen its position further, partly through additional foreign acquisitions and greenfield investments.

The OA of MOL can be found its the knowledge of regional markets and contacts established in the pre-transition period. The firm has a deep knowledge of the privatization process and post-privatisation restructuring of formerly state-owned firms in CEE. However, as we could see, its foreign expansions are characterised by a defensive motive as well.

The Hungarian OTP is the largest regional player in the banking sector in CEE. The legal predecessor of OTP, established in 1949, was a nation-wide state-owned bank specialised in retail banking. In 1990 it became a public company and non-banking activities were sectioned off. At present, OTP is Hungary's leading bank, with an overall market share of more than 25%, and dominance in the retail segment.

OTP was privatised through the stock exchange in three "tranches" (1995, 1997 and 1999). As a result, the state's ownership in the bank decreased to a single voting preference (golden) share. Currently, the bank is characterized by dispersed ownership of mostly private and institutional (financial) investors. As of 31st of December 2013, the ownership structure is as follows: 35.6% of the shares are in domestic ownership; the Hungarian state owns 5.1%, MOL 8.6%, and no other domestic owner has above 5%. 64.4% of the shares are owned by foreigners in a similarly dispersed manner, with no controlling shareholder. None of the foreign owners has more than 9%. Thus, strategic decisions are made by the Hungarian management, residing in Hungary. There are no foreign citizens in the senior management or among the members of the Board of Directors. The official language of the company is Hungarian. Thus, OTP is majority foreign-owned, but not foreign-controlled.

OTP is a strictly regional player; 100% of the bank's assets are located in the CEE region. By the nature of its activities, all its investments can be regarded as market seeking. In 2002, it acquired a Slovakian bank. In 2003, a Bulgarian bank, in 2004, a Romanian bank, in 2005, a Croatian and a Serbian bank, in 2006, another Serbian bank and entered the Ukrainian, Romanian, Russian and Montenegrin banking markets. More recently, in January 2014, it acquired another Croatian bank. Its entry modes are connected to privatisation, with the exception of the Romanian, Russian, Montenegrin, Ukrainian and recently acquired Croatian banks. Altogether, OTP has

13 million customers and 1500 bank offices in the region, and is becoming one of the leading regional banks.

What is the source of OTP's OA? In the first period of its foreign acquisitions, OTP gained expertise in transforming a formerly state-owned bank into a bank able to operate successfully in a market economy. In that sense, the earlier privatisation of banks by foreigners, resulting in a competitive environment, and the earlier transformation of the banking system in Hungary compared to other CEE countries played an important role. In 2002, those countries where the bank is present were clearly behind Hungary in terms of the process of establishing a market economy. Later, when CEE countries made significant steps towards the market economy in terms of the regulatory system and privatisation, OTP bank had to find a new OA. This, nowadays, can be found in operating successfully in a post-transition environment, especially in the retail sector.

Gedeon Richter Plc (GR) is one of the largest pharmaceutical companies in CEE[2]. The company was established by pharmacist Gedeon Richter in 1901. It became an internationally recognized major firm in the period between the First and Second World War. The company conducted R&D activities from the beginning, obtaining 86 patents by 1948. It internationalised early, beginning in 1920 through operating agents and agencies, ten subsidiaries and 40 representation offices abroad. GR was Hungary's second largest exporter before World War II, but after 1945 it lost its Western European export markets and subsidiaries, and was nationalized in 1948. In 1949, the COMECON[3] was formed and GR focused its export activities on the CEE markets, becoming the largest supplier of pharmaceuticals to COMECON. Since the mid-seventies, GR has increased exports to Western countries, and in the 1980s the company concluded R&D development cooperation agreements with American and Japanese firms. After the collapse of COMECON, Richter lost its CEE markets and had to struggle for survival even at home, in the post-transition business environment. The new management introduced a new strategy in 1992 that includes investing abroad and building an international network. The firm was privatised through the stock exchange in three tranches (1994, 1995 and 1997). Currently, RG is characterized by dispersed ownership of mostly private and institutional investors without any investor holding a controlling share. (At present, 25% of the shares are held by the Hungarian state, 69% by foreign (institutional and retail) investors, and 6% by domestic investors.) Strategic decisions are made in Hungary by the Hungarian management.

GR started investing abroad after its privatisation was complete. Nowadays, it is a regional MNC, with production affiliates and representative offices in neighbouring and geographically close countries, including Western European locations (Germany and Switzerland). It also has affiliates in faraway countries (e.g. in India, China, Jamaica, Mexico). GR is present in 38 countries with 5 production sites, 29 representative offices

[2] The case study of GR relies mainly on Antalóczy (2008).

[3] The Council for Mutual Economic Assistance (COMECON) 1949–1991, was an economic organization under the leadership of the Soviet Union that comprised the countries of the Eastern Bloc and other socialist states elsewhere in the world.

and 27 commercial subsidiaries, and is thus the most geographically „spread" firm among Hungarian investor companies. GR is a branded generic company with markets characterized by a very intensive (price) competition both on the domestic market and abroad. Its OA include the knowledge of and contacts to the region's market (especially CIS, Poland and Romania), its strength in generic R&D, its good market position with geographic and therapeutic niches (female healthcare) and its experience, expertise and brand name accumulated over more than 100 years and strengthened in the region during the COMECON era and afterwards.

Videoton was established in 1938. It became a major state-owned company in the eighties employing 18 000 people. After the collapse of its regional markets, it was bought by three Hungarian individuals within the framework of privatisation in 1992. Based on its own traditional technologies and competencies, the firm manufactures parts, sub-assemblies and modules in electronics, plastics and machinery. Videoton provides a wide variety of products for the automotive, consumer electronics, household appliances, IT, office equipment and telecommunication industries. As the largest industrial company in Hungarian private ownership, it has become a major CEE player and could maintain its market position. In 2013, the company employed 7052 workers; its consolidated revenue was 327 million EUR, two-thirds of it coming from exports, mainly to EU markets. Before 1998, Videoton carried out mainly assembly-type activities, and extended its capacity by acquisitions in other Hungarian cities. It benefitted from the early arrival of electronics and automotive MNCs to Hungary compared to other countries in the East-Central European region by becoming their supplier, and based on that experience, through assembling for exports. Due to the relative increase in labour costs in Hungary, Videoton changed its strategy afterwards. The company became a full contract manufacturer, offering complete end-to-end solutions, increasing to a great extent the engineering content of its products. Investments were made in the domestic company and certain labour-intensive production phases were relocated to lower-labour-cost Bulgaria: Videoton bought DZU AD in Stara Zagora in 1999. In 2009, Videoton established a manufacturing plant in the Ukraine (Mukachevo). The main motive of both of its foreign acquisitions was clearly efficiency-seeking, motivated by the lower labour costs available at the foreign locations.

The OA of Videoton consists of accumulated expertise in the field of electronics and the ability and capability of vertical integration among its affiliates. Moreover, it can rely on its established contacts with electronics and automotive MNC affiliates in Hungary and abroad. Videoton could successfully change strategies and adapt itself to the changing features and demand of electronic industry and related services, partly helped by its efficiency-seeking foreign acquisitions.

The predecessor of ABO Holding was Szabolcs Gabona Ltd., founded in 1993 by conglomerating former cooperatives and firms that traditionally had purchased and processed corn and grain. Apart from mills, flour, and cereals, ABO Holding has poultry and pork farms. Thus, it operates in a sector where Hungary traditionally had comparative advantages, and where competition in Hungary is intense. It is owned by Hungarian private persons, and it was thoroughly reformed in 2005 when the present name was introduced. Domestic and foreign market presence was increased by acquisitions and developments: the firm invested in neighbouring Slovakia, the Ukraine

and Romania. The main motivation of investment was market access, but to a certain extent increasing efficiency through lower labour costs was also an aim. In 2007 and 2008, ABO invested about 1 billion HUF in development and innovation on bio food base materials and an increase of poultry and pork capacities in Romania.

The crisis hit ABO Holding severely, resulting in huge losses and, consequently, liquidation proceedings. Apart from the crisis, the abolition of EU and state subsidies on chickens beginning in 2010 and the decrease of meat prices caused severe difficulties. From 2010, ABO rationalised its activity, merged production capacities and liquidated loss-making parts. Abofarm (chicken) in Romanian locations had to decrease employment to one third. The company sold and let out firms' premises and machines that were not used. The main OA of ABO Holding is that it had skill, experience and knowledge regarding corn and grain processing and gained considerable experience early on with the market economy transformation of the sector. Up until the crisis, it also enjoyed favourable credit facilities and conditions at home.

3D Histech is at present a medium-sized company with 72 employees. It was established in 1997, though the year of formal establishment dates back to 1991, when it started its activities with three employers, i.e. as a micro company. However, at that time the company's main activity was wholesale and retail trade, while after a change in ownership in 1997 it has dealt with the development and production of digital slide scanners (virtual microscopy), including both hardware and software production. This change in activity was the result of a spin-off type development: the owner, himself a physician working at a university, elaborated the technology for producing the product. The strong traditions of Hungary in the medical precision instruments sector and the strong international cooperation in R&D activity at universities both helped that development. The company grew relatively quickly after changing its product portfolio, though at the end of the nineties it had problems with financing its activities. As the owner put it: "…at that time we were knocking on the door of venture capital providers in vain – now we are the ones who do not want any money from them." The company internationalised very soon after its establishment in 1997: the share of exports in total sales by 2000 reached 90%, while at present it is 97%. The company exports both inside and outside the European Union. At present, it sells more than 60 digital slide scanners annually all over the world. In 2013, it won the prize of the innovation exporter of the year award from the Hungarian Investment and Trade Agency (MKIK, 2014). Already in 2000, the firm established a representative office in the United States. The main reason for this was, first, the company wanted to be present close to the "knowledge" centre in its field, second, to be close to one of its important markets.

The OA of the company is its innovativeness. It came up with a real novelty even on a worldwide scale, and it is now leader in the digital pathology market. The owner is a trained physician, who once said that the idea of the innovation occurred to him during the dull and cumbersome pathology training in the university. The quality of the products is secured partly through the innovative techniques and technology, partly through the use of high quality inputs imported from Japan and the US[4]. The product is

[4] Source of the information is an interview with the owner of the company, which was prepared in 2009 (Sass, 2012).

thus made up of high tech components and supplemented with specifically developed software. The company can be considered a "born global", as it internationalised both through exporting and through investing abroad very soon after its establishment.

Hungarian Outward Investors – Comparison with "Traditional" and "Emerging" MNCS

Our results can only be considered preliminary due to the research method applied. Because of the limited number of company case studies, we cannot generalise our findings; however, regarding the relatively scarce research efforts in the field, our results can be a basis for further research.

First, we should state that according to estimations our company sample, containing six cases, represents the dominant part of Hungarian investment value abroad. (e.g. Sass & Kalotay, 2011). MOL and OTP are the two leading foreign investors, Richter is estimated to be third, and Videoton fourth (Sass & Kovács, 2013). Our company case studies provide insight into the nature and developments of OA of the analysed Hungarian MNCs. On the basis of their OA, we can distinguish two groups of companies in our sample. In the first group, there are firms which "inherited" their OA from the pre-transition period. Their OA is specific: it is highly related to their knowledge about privatisation and about the restructuring of formerly state-owned companies acquired in the countries of the wider region: CEE and SEE. Moreover, personal and business contacts established in the pre-transition era also play a role.

However, the importance of this OA fades significantly over time partly due to the "running out" of privatisation deals, partly due to the advancement of the countries in the region in establishing a market economy, partly due to the gradual loss of personal contacts inherited from the pre-transition era. When this inherited OA partly disappears, usually the firms in question change strategies, and together with that there is a change in their OA as well. This is most obvious in the case of OTP and RG, where the new OA can be found in concentrating on a specific market segment where the firm develops efficient management skills and knowledge. This new OA enables these companies to be competitive in new markets as well, and thus venture further away from their neighbouring region with market access investments, as was the case with RG. The case of MOL is similar, where the change of strategy consisted in changing the targets of foreign acquisition from downstream to upstream segments. In the case of Videoton, foreign acquisitions are part of the new strategy, which involves acquiring production units in neighbouring countries with lower labour costs, i.e. with an efficiency-seeking motive. Thus, on the basis of our sample, a dynamic analysis of OA in the case of Hungarian MNCs shows that when the initial, inherited OA of formerly state-owned firms expires, they are capable of changing it into a new type of OA, enabling them to continue their expansion abroad successfully. This dynamism can be related to the analysis of Lessard & Lucea (2009), who underline that EMNs are able increase and change their OA – as may be the case for all MNCs, actually.

It is important to delineate the specific type of OA these companies have in the first stage of their expansion. In the traditional meaning (Dunning, 1993), OA usually consists of highly developed technology or globally (or at least regionally) recognised brands. In the case of EMNs, we cannot find this type of OA, while obviously, other OAs are present

(Ramamurti, 2012), such as the ability to function in a difficult business environment, the ability to understand customer needs in specific markets, etc. In our investigation, we kept in mind the following statement from Ramamurti (2012, p. 42): "We need to understand better which advantages can help with successful internationalisation, which ones cannot and why." In the case of the top two Hungarian MNCs, we identified a very specific OA, which enabled and helped their foreign expansion: their experience with privatisation in a post-transition environment in the former socialist countries of CEE and South-East Europe (SEE), and the subsequent restructuring of the acquired company (or bank in the case of OTP). This finding is supported by the fact that in the first stage of their internationalisation, these companies' entry mode was predominantly based on acquisition in the framework of privatisation. Moreover, for almost all companies in the sample (the exception is 3DHistech), we assume that management abilities and the knowledge for successful operations in a post-transition business environment, where market forces are not fully influential, also form part of OA.

The second type of OA in smaller sized MNCs (ABO and 3DHistech) established in the post-transition era are more similar to those of developed country MNCs (Dunning 1993). ABO operates in a sector in which Hungary has traditionally had a comparative advantage over other countries in the region. 3DHistech relies on its innovations. Both of them internationalised relatively early after their establishment.

In our small sample we could not find evidence of foreign companies being acquired in developed countries in order to acquire OA, as it is shown in the case of certain EMNs (e.g. Mathews, 2002). In the case of the two highly innovative companies in our sample: RG and 3DHistech, they have their own resources to be innovative. Moreover, they operate in highly innovative sectors; thus, being innovative, carrying out R&D, and registering patents is their normal *modus operandi*. Their acquisitions in developed countries have aims, which may be related to market-seeking and strategic asset-seeking motives (in the case of RG), as well as being closer to the "knowledge centre" of their sectors (in the case of 3DHistech).

Our second finding relates these OAs with the notion of "virtual indirect" investor companies, which we first introduced in the literature and described in Sass *et al.* (2011). Three companies in our sample, MOL, OTP and RG are all majority foreign-owned, but not foreign-controlled. They all were privatised in the Budapest stock exchange in tranches, which resulted in a dispersed majority foreign ownership, where there is no foreign owner with above 10% shares (or votes). According to the literature, they are considered to be indirect investors as they are majority foreign-owned (e.g. Rugraff 2010), however, we would rather call them "virtual indirect", as many of their characteristics are much closer to direct than to indirect investors. The main reason is that in our understanding, majority foreign ownership is not necessarily equal to foreign control. In the case of our three companies, their majority foreign ownership coexists with a domestic control, where the Hungarian management or the domestic Hungarian controlling owners residing in Hungary make all decisions of strategic importance. In that respect, the OAs of the companies in question and the changes in their OA are connected to this special situation in their ownership and management. We could see that these companies were already important and successful market players in the pre-transition era with a strong management. Through the method of privatisation the management of

these companies obtained a strong position in the company, where there were and are no controlling owners. On the other hand, their early privatisation (compared to their counterparts in other former socialist countries) provided an invaluable asset for them in terms of gaining knowledge about privatisation and the post-privatisation restructuring of state-owned enterprises and banks, on which they could later build their foreign expansion. Moreover, the foreign expansion of these companies also served strategic purposes for the management: it could strengthen their position and the market position of their respective companies as well. The strength of the management is manifested in their ability to change their OA, when the previous one could no longer serve as a basis for their foreign expansion.

CONCLUSIONS

Hungary is one of the leading outward investors in the CEE region, breeding a relatively large number of indigenous MNCs. In our paper, we analysed the ownership advantages of Hungarian MNCs, which enabled them to expand abroad successfully. We relied on six company case studies, including the leading Hungarian investor firms as well as smaller sized foreign investors. We showed the process through which these companies have developed and changed their OA, through reliance on which they could become successful outward investors. In the case of privatised firms, this has specific links to their pre-transition period heritage, while in the case of "virtual indirect investors" it is linked to the strategy of the management, and thus represents a special type of OA, which may be characteristic of formerly state-owned, large companies in post-transition countries. In that sense, their specific OA, at least in the first phase of their outward expansion, is more similar to that of emerging multinationals. For companies established after 1990, OA is more similar to that of "traditional multinationals." We emphasized the dynamism of OA, with constant changes when the actual OA is no longer able to provide a basis for successful foreign expansion and thus the company needs to modify it or change it completely. We showed that for "virtual indirect" investors, this change resulted in an OA which is now more similar to that of "traditional multinationals." This was especially true for the pharmaceutical company, Richter Gedeon, and to a lesser extent for the other two "virtual indirect investors," MOL, and especially OTP.

As for future research, our paper forms a basis for carrying out an analysis first, of a larger sample of Hungarian outward investor firms, and second, of companies from other former transition economies. The notion of "virtual indirect investors" especially should be studied checked in other post-transition economies, as it may be a specifically Hungarian phenomenon due to the special timing and method used for privatisation in our country. Moreover, the initial nature, present state, and dynamic change in-between these two in the OA of foreign investor companies from other post-transition countries should be added in order to show whether the heritage from the pre-transition period influenced and/or still influences the nature of their OA.

On the basis of our research, the policy dimension concerns, first of all, the role of increasing local competition due to increased investments by foreign multinationals. This enables a few local companies to enhance their level of competitiveness to such level where they themselves will be able to become successful foreign investors. Second, highly innovative companies in small market niches are able to internationalise

successfully even in the post-transition environment. Fostering R&D is thus an important tool for trade and investment policy as well.

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Global Shared Service Trends in the Central and Eastern European Markets

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A B S T R A C T

Objective: To disclose what kind of trends are present in the global business service markets and which appear in the Central and Eastern European (CEE) business market.

Research Design & Methods: The research is based on both a literature review and empirical studies. The first part of the empirical research consisted of a series of interviews with qualitative data, the second part was a questionnaire study with mostly quantitative data. The interview research results are based on 12 interviews. The interviewees were business consultants, HR agency leaders, representatives of governmental agencies, professional non-profit organizations, and an academic researcher. questionnaire study is based on the respondents of 51 shared service centers in Hungary.

Findings: The development of the shared service sector plays an increasingly important role in the growth of the national economies in CEE region. In the CEE region the salary level, geographical proximity, cultural homogeneity and the development of infrastructure attract investor companies. Shared service centers (SSCs) provide a range of business services – most notably in the areas of finance, accounting, procurement, logistics, information technology and human resources – mostly regionally and sometimes globally.

Implications & Recommendations: The identified trends are limited to the shared service organizations (SSO) operating in the private sector in the CEE business service market.

Contribution & Value Added: The research determines the most important business service trends that emerged in shared service organizations in the CEE region.

Article type:	research paper
Keywords:	Shared Service Centres (SSC); business service market, global business services; Central and Eastern Europe (CEE)
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INTRODUCTION

Over the last decade, there has been rapid growth in the business service industry in Central and Eastern European (CEE) countries. Nowadays, this region plays a very important role in the global business service market (Shared Services Centers, SSC or much wider as Business Process Outsourcing, BPO). Within the business service industry, the shared service sector has outgrown itself and has become one of the key segments in this service industry.

The growth of the shared service market rearranged the whole labor market in these countries and in the last decade it has become one of the most significant employers. The shared service sector is very popular in CEE countries among recent graduates with foreign language knowledge because it provides quite high salaries, an international work environment, and a modern and young work culture.

However, the shared service market is continuously developing. There are newer and newer global trends influencing it. Understanding the trends and exploiting their advantages could be the source of survival and progress for the market. The research is to disclose what kind of trends are present in the global business service markets and which appear in the CEE business market.

LITERATURE REVIEW

Popularity of the CEE Region on the Global Service Market

The shared services (SS) model was launched in the USA in the 1980s, however, much time passed before its international expansion and it appeared in Europe only in the early 1990s, first in the Nordic region and Great Britan, the Iberian Peninsula and the Netherlands. The first shared service centers in Central and Eastern Europe (CEE) were developed later, in the late 1990s. However, after they discovered the region, the number of new service centers began to grow dynamically.

In the early 2000s, 91 service centers were established in the CEE region on the basis of the UNCTAD data, with nearly one-third of them, 26, established in Hungary (Chikán & Petényi, 2009).

The reasons for the popularity of the region in the early 2000s are complex. One reason is, of course, the attractive economic environment, including the favorable tax regime and available labor advantages due to lower salaries. The labor advantages differ depending on the service areas, but nowadays it is about 30-40% lower compared with the level of Western Europe. Another advantage is the language proficiency (such services required a wide range of European and global languages). As long as North American companies and their partners are mostly use English language and most of the service centers were taken to India, many large European companies and several global companies have multilingual customer and partner base, so it was important to them to establish shared service centers in advanced European countries from where they can serve the multilingual clientele. For this purpose the CEE region is perfect.

Monika Pinter, who was previously the CEE SSC Head of PwC's consulting firm in Hungary and now works as a partner at DLM Consulting Group, argued that one of the

main reasons that American and Western European companies began to establish shared service organizations in the early 2000s was that this was exactly the time when these business markets began to globalize, which brought a variety of nearshoring and offshoring solutions (Pintér, 2012).

Figure 1. European Expansion of the Shared Service Model
Source: (Bangemann, 2012, p. 16)

The expansion is still ongoing, and it is proven that up until 2006, 183 shared service centers had been established in Central and Eastern Europe countries, which are one of the most important nearshore locations for Western Europe.

In addition to the advantages of these countries, NATO and European Union membership could also play significant role. Until the CEE countries' accession to the EU in 2004, multinational companies managed Western Europe and Central and Eastern Europe as different markets. They had to relocate their standardizable functions from Western European centers to the new member countries. Since the latter has become more realizable cost benefits, and it was simpler to find and use Eastern European workers, who speak Western European languages than the other way, many Western companies set up a service center in the CEE region.

Another factor that could have played a role in the huge interest surrounding the CEE region countries was that global companies perceived that they could not deliver business services globally from one geographical location, e.g. from India, which has the highest cost-advantage. Global companies recognized at that time that if they wanted to work globally, they would needs service centers operating 24/7. To do this, it was not enough to establish a service center in the U.S. and/or in India, one or more were also needed in the countries of Central and Eastern Europe (Bencsik, 2012). These companies began building service delivery networks to cover their clientele in all time zones

throughout the world. The significant location of the CEE region in terms of time zones is very beneficial because these centers can serve America in the afternoon and evening hours, Asia in the early morning, but also in the case of the entire Europe, Middle East and Africa – but with a minimum difference. The region is not only very well located geographically, but it also has a developed office and IT infrastructure and a trained labor force with proficiency in many foreign languages, which is relatively cheap compared with that of Western European countries. This advantage is true mainly in Poland, the Czech Republic and Hungary, which is the reason why these countries have become the most important SSC markets in Central and Eastern Europe.

MATERIAL AND METHODS

The interview method was used to get an overall picture with the help of CEE business service market experts. The questionnaire method helped analyze these global trends in practice. In this analysis, the pilot country was Hungary.

Both research analyses were based not on a longitudinal, but a cross-sectional study. The interviewees composed their statements based on their knowledge about the last decades (2004-2013).

In the first part of the primary research consisted of a series of interviews meant to reveal market characteristics and identify market problems. Particular attention was paid to determining the research sample. The experts chosen have an unbiased approach to the trends on the global and CEE service market. These interviewees were chosen not from service centers but from research institutes, academics, consulting firms, and professional and governmental agencies. There was evidence in the literature that these interviewees have adequate knowledge about the market. Initially, eight professionals were chosen as interviewees, but snowball sampling helped recruit new interviewees. Thanks to this research technique, 12 semi-structured interviews were conducted (Appendix). Eight of these interviews were conducted face-to-face, four were conducted by phone. The interviews lasted about 45 minutes and were recorded by digital voice recorder. All interviews were conducted in 2013.

In the second part of the study, global trends on Hungarian shared service organizations were tested. First, 77 separate companies were identified that had at least one shared service center in Hungary at time of the study. The database was combined based on different databases of professional organizations and own collecting. All Hungarian shared service centers were contacted. The response was voluntary, and all centers had the chance to respond. The centers were contacted electronically or by phone, and the data was collected in an online, self-fill-in survey in every case. 51 of the 84 shared service centers filled out the questionnaire, making the response rate 61%.

RESULTS AND DISCUSSION

Position of the CEE Region in the Global Service Market

Currently, the list of global service locations is relatively short. Although this list is constantly changing, some countries have reached very good positions for themselves and have a matured service market, which is popular for service companies planning to

invest abroad. Ten years ago, most of the service FDI was focused on the most developed countries, but now the focus has shifted to developing countries and semi-developed countries like those in the CEE region.

In the global list, India, China and Malaysia have been ranked on the top three places since the first measurement in 2004 (the countries of the CEE region are not in the first positions). However, if we examine the level of the region, but not the particular countries, Central and Eastern Europe is the third most attractive investment location (Lhermitte *et al*., 2010). With regard to location, it seems that no one is in a position to threaten India's position for the time being, since India built a good service infrastructure early (which was supported), and the labor cost is still only a quarter of what it is in Western European countries and about half of what it is in Eastern European countries. Against India, besides the geographical proximity to both Western Europe and the Middle East, another advantage of the CEE countries is its labor force's proficiency in the major world languages and its time zone overlapping with U.S. business time.

Countries in the CEE region have begun competing with one another to attract service center investments to the CEE region. These countries, or even specific regions, have made very attractive offers, incentives and created strategies for the industry and framework designed to help attract and retain investments.

The Central and Eastern European countries are in the global rankings. Although in the past five years Hungary, the Czech Republic, Poland, and Slovakia did not place in the top twenty, the size of the business service sector in these countries continues to increase. However, the position of the Baltic countries (Estonia, Latvia, Lithuania) strengthened significantly, and greatly improved the way Romania and Bulgaria are perceived as well.

In the global services market, there are many countries ahead of the CEE countries, but there is no point in treating India as a competitor because the companies move primarily those mass production-type services that do not require specific skills. Central and Eastern European countries lost their ground in the global services market mainly due to the rising costs and the Middle East and countries in North Africa have appeared among the best locations. However, the position of North Africa was temporarily shaken by the 2011 anti-government demonstrations called "Arab Spring," which caused social and economic turmoil in a number of MENA (Middle-East and North Africa) countries and its impact (e.g. Syria) is still felt.

Compared with Far Eastern service centers, the benefits of the CEE region are that European companies demand that such shared service centers, which operate at the same European linguistic and cultural background, have good local contacts and are easily accessible. The Central and Eastern European region have advanced IT and telecommunications infrastructure and its labor market offers highly qualified, German and English speaking professionals. Nearshore activities allow companies to respond quickly due to the lack of time zone difference and lack of language barriers (Mózsik, 2008). Companies prefer nearshoring to the great cost benefits of offshoring due to the cultural, geographic and linguistic similarities nearshoring provides.

Based on the new SSC jobs created in recent years, Asian cities have a very strong position, but there are thirteen European cities with the best twenty, like Bucharest, Budapest and Prague.

For the time being, Europe holds a stable and balanced position in the global service sector. Stable, because the number of new jobs has not decreased since 2011, and balanced, because the SSC jobs are divided almost evenly between Western Europe and Central and Eastern Europe. Romania occupies a very good position, with Cluj-Napoca and Bucharest in the top twenty cities in a global ranking of SSC sites. Serbia and Turkey were the two most promising countries in Europe in 2011 (van Hove, 2011). Because of the length of the crisis in the region, the competition between Hungary, the Czech Republic, Poland, Romania and Bulgaria is likely to increase.

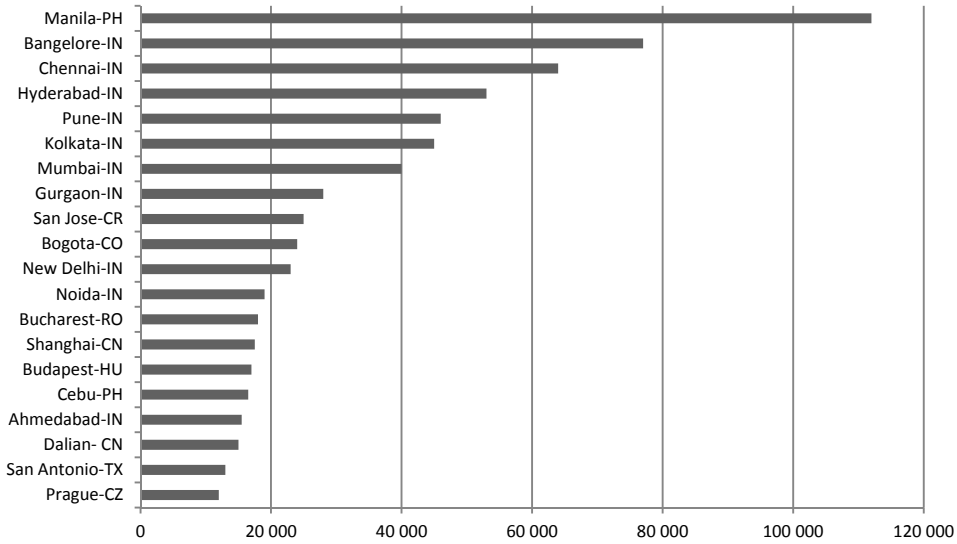

Figure 2. Global ranking of SSC cities
Source: (van Hove, 2011, p. 3).

Global Trends for Shared Service Centers

There are more global trends in the business service market. These trends show the strategic, structural solutions of those organizations that are using these sourcing models in the near and the far future well. These trends affect the CEE market as well. It was analyzed how these trends affect the players in the regional shared service market.

Service delivery trends

One of these trends is the centralization of technology and service delivery that was in the focus in recent years. Centralization does not mean that one function should be delivered from one location. Moreover, technological progress makes this less and less necessary. But it is expected that all functions will be controlled and changed by the same principles. The integration of offshoring, outsourcing and shared service models is another strong trend (A.T. Kearney, 2004).

Examination of these shared service centers has shown that the majority of them are multi-functional centers. Only 14% of the respondent centers were single-function. The average number of services encompass 4.5 areas, but their activities very often vary.

The presence of value-added services was also analyzed. 60.5% of respondents argued that in their service portfolio there is a fifty-fifty ratio between higher transactions and value-added services.

Another trend is the widening of shared service centers' service portfolios. Today, more than half of the active centers perform more than one service activity. There is steady growth in the use of transactional pricing. The centers in charge of shared service functions use transactional pricing instead of FTE-based allocation. This means that the service price is determined by the number of transactions (Sangani, 2011).

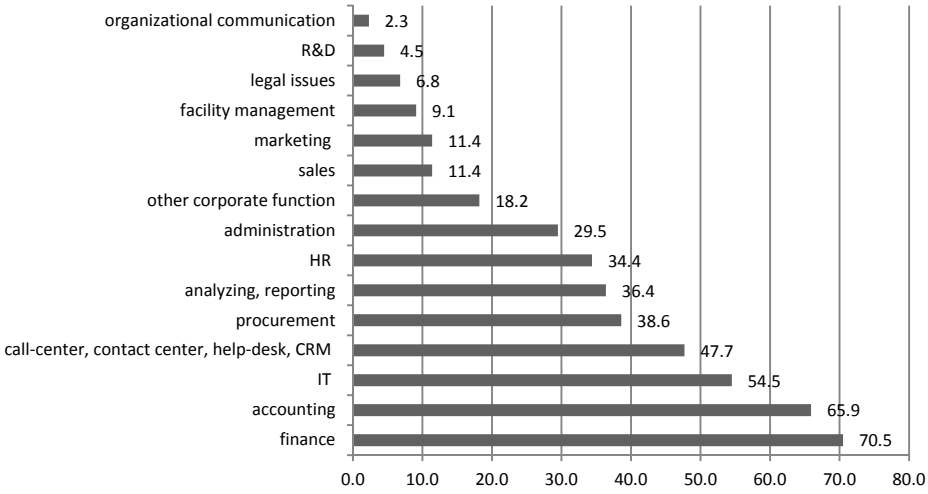

Figure 3. Service portfolio of SSC respondents (in %)
Source: own study based the questionnaire survey among Hungarian SSCs.

The respondent service centers had a mostly international client base. 44% of them provide services to16 to 18 or more countries and 59.5% of them to 18 or more countries per service. 70.5% of the investigated shared service centers provide services only to departments of the parent company, and so, lacking external customers, use the captive center model. Those centers which also had external clients have a large number of clients to serve. 81.8% of the respondents had at least 10 external customers. The parent companies of 58.3% of these centers had other partnerships with the external clients as well.

81% of respondents have changed their service portfolio since its inception. 97.1% of these centers have gained new features, but claimed that only 2.9% of them were quality changes replacing a lower value-added service with a higher one. The future growth of the market was anticipated by service center leaders. Half of them were planning to expand their service portfolios with new services. Based on the research, this expansion will be significant mostly in the areas of HR, analysis and reporting, procurement, finance and service.

Organizational trends

From a geographical perspective, successful shared service centers are changing their focus from the regional service center model to the hub-and-spoke model. As global working and service delivery became possible, , parent companies began establishing their service centers in the most organizationally and financially optimal locations. This is the reason behind the growing number of greenfield investments in the area of shared services. According to Accenture consulting firm, 20-30% of new shared service investment are greenfield. In terms of operating models, multi-functional shared service centers are very fashionable. In such centers, two or more functions are under the control of the same manager, delivered by the same service model and structurally organized in the same way. According to the research done by Accenture, the multi-functional model prevails today. The question could be posed whether the multi-functional model is preferable to the one-functional centre. According to Accenture's research, company executives confirmed that the benefits available through the implementation of multi-functional centers could be even greater than expected (London, 2008).

59% of respondents that have more shared service centers within the parent organization use the hub-and-spoke model. Certain divisions in service delivery exist and in this cooperation Hungary is the hub in most cases.

Appearance of the hybrid model

Over the last decade, both outsourcing and the shared service approach have evolved considerably, but in case any of the exclusive choice, companies must constantly balance evaluating advantages and disadvantages of these models, and usually always have to make a compromise. There are many examples of such a dilemma: cost reduction versus a loss of control over the resources, outsourcing versus retention of non-core activities, rule-based processes versus customized processes.

To solve these dilemmas, the leading companies frequently use hybrid models when combining back-office outsourcing with captive centers under tight cooperation.

The hybrid model may implement rightshoring when companies move some services (e.g., front-office) to onshore or nearshore locations that are close in space and time and culturally-similar (such as in Central and Eastern Europe), and back-office services to cheaper, geographically and culturally distant countries (e.g. India, China, South Africa). The first case is implemented by the shared service center itself, while the latter is achieved through an outsourcing partner (Williams, 2005).

The research confirmed that 54% of respondents use a hybrid model that combines the shared service model with outsourcing. Among these hybrid solutions, the most common (44%) is the virtual captive model, followed by BOT or BOOT (22%), while 25% of respondents use other hybrid solutions.

In the study, only 14% of respondent companies said that there is no virtualization of their organizational operations.

Models for operational excellence

According to Hackett Group's 2012 study, 80% of the best performing companies are preparing for the introduction of knowledge-intensive services to their global provider organization. 70% of companies are planning to expand the service portfolios of their service centers. 72% of companies are already using multi-functional service centers and the rate is expected to increase in the future. The best-performing companies provide 63% of all financial activities from a service center. Similarly, 54% of companies carry out all purchasing activities from a service center (Hackett Group, 2012).

The future belongs to integrated business service providers. These are independent organizations that provide a wide range of services at a high level of accountability, as well asend-to-end services. These service providers will break in those pioneering new service areas, which today are still outside the scope of the centers, such as promotions management, research and planning, or customer analysis. Integrated business services performed usually by back-offices or SSCs are getting closer to front-office activities and so a much more diverse shared services model is created (Boulanger, 2011).

According to Accenture's 2004 survey, the shared service model is becoming less concentrated on transaction-based processing back-office functions and developing in the direction of the Centers of Excellence (CoE) model (Sutcliff, 2004).

Over the past three to five years, significant changes have occurred in shared service organizations. Using new tools and an enhanced corporate image, they have transformed into global business service providers. Their name is telling because they operate in a global environment that exploits both the geographical and labor benefits available. They provide more services that are better integrated with the business of the company. The service orientation is towards the cross-culture and performance optimization, which was missing in the earlier shared service model.

Today, the focus has shifted from classical outsourcing to business process outsourcing in this region. Shared service organizations are being transformed into global business service providers (Global Business Services, GBS) with new tools and a new design. More and more companies are moving from the operations of traditional SSCs towards becoming global business service companies. This indicates that the companies see shared service centers as a strategic factor. This way of thinking made the full strategic control of all processes, the move from functional processes to end-to-end processes and the uniform representation of the business unit's management possible. Global business services were created as an independent legal entity in order to strengthen the corporate trend that SSC will have real service and process-oriented culture and a unique company character. The price of human resources increases as the firms begin to use primarily nearshore locations like Central and Eastern Europe (CEE), and this solution brings higher value-added services rather than transactional advantages.

The study confirmed that market-based service centers are constantly expanding and developing. Most of the respondent centers asserted that they are continuously progressing, visible most notably in the number of people hired by the firm and in the widening of its scope and liability. In addition, the respondents have identified two directions in service center development: the Centers of Excellence (CoE) and the Global Business Services (GBS) organization solutions.

In the study, one third of the shared service centers were in the organization structure as a division, while 35.7% of them were within a division and 31% functioned as independent centers assigned to the central headquarters. Some service centers operate as independent subsidiaries, others have more centers at different sites and others at one company site operated more service centers.

At 51.2% of the shared service centers, the company headquarters makes decisions about the services provided, in 17.2% of these centers decisions are made in the regional center (hub), and in 29.3% of them decisions are made by the division. Only 2.4% of these service centers have decision-making authority. The service centers do not have decisional authority in choosing clients (internal-external), this matter is always decided on a higher level.

The networking of service centers showed that 45.2% of the centers purchase services from other service centers within the parent company or from external service providers. This issue is also centralized, on the top management level in headquarters. For 44% of them the global center makes decisions about the services purchased, for 12% of them it is the regional headquarters that decides, and for another 44%, the division has the decision-making authority regarding services purchased. The centralization of decision-making highlighted the research result that at 72.1% of the companies, the departments of the parent company could not buy services from another provider, but only from the internal shared service center, 16.3% of them are competitors among the internal service centers for service delivering, and 11.6% had the chance to buy from an external service provider as well.

Human labor in the service centers

'Body shopping' is the nickname for the migration of services into shared service centers from cheaper countries. This is so usually in the Far East, but not in the CEE countries, where 'head shopping' is typical instead. While it is common for services with less responsibility to migrate e.g. in India, in Hungary the headquarters and research centers are more important (Figyelő, 2009).

Although most of the shared service centers advertise themselves as the starting points of international careers, according to Hoffmann (2002) there are relatively few employees who can go from a domestic subsidiary to the headquarters within the company. More prevalent in the sector is the 'job-hopping' phenomenon when an employee changes jobs not vertically, but horizontally, i.e. he/she changes companies and not positions for a higher salary (sometimes the difference is 20,000-30,000 HUF per month).

In service centers, the most important requirements for young graduates are the ability to learn quickly and to make decisions quickly. In making a decision the employee's main task is to determine whether they are being faced with a standard process or not. If they are, then it must be handled on the basis of the standard knowledge base, but if not, then the employee has to pass the process on to another colleague who has the authority to handle it.

The majority of workers recruited in service centers are between 25-35 years old and have at least a bachelor's degree. A relatively large number of foreigners work in these centers, so a multi-cultural environment is typical in these centers, which is why

they are recommended only for employees who are open to diversity and use foreign languages on a daily basis.

In the service centers, there is higher employee turnover than in other sectors. This is mostly because the requirements for employees can be met only by those with a higher education. The work in these centers may be very interesting at first, but after a while it may become monotonous and the workers with foreign language proficiency change jobs. Actually, the more successful the centers are (the more standardized the centre are), the more monotonous the work is for the employees. This is contrary to the expectations of newly graduated, well-trained young people, and they will therefore change jobs. It is common for them to move to other service centers to receive higher positions (SSC Recruitment, 2010).

The monotonous work is outweighed by good working conditions and a higher than average salary. In addition, the favorable non-financial benefits may be attractive for young people because the work culture of service centers is oriented in many places to the Y-generation. Examples of such Y-generation-oriented benefits are: work in youthful teams (in most centers the average age is under 30 years), the work environment orientated towards young people (relaxation rooms, dining rooms, fitness rooms, telecommuting options) and opportunities for personal development (foreign language, foreign training).

CONCLUSIONS

The research shows that there is roughly a ten to fifteen-year history of shared service model regional practices, which emerged as a quasi-mature business services market, but apart from some university/college thesis work, case studies and market reports by international consulting firms, very few scientific studies have been conducted on shared services. The reason for this is mainly that the business services sector is relatively difficult to define in terms of a statistically-distinct area.

However, the subject is very interesting as it is one of the few sectors that could grow steadily during the years of economic crisis and significantly has changed the labor market or even office rental market in Central and Eastern Europe over the past fifteen years. But it is no coincidence that the large international consulting firms are interested in the subject, since there are more than one hundred service firms and tens of thousands of employees in this area. These centers are continuously developing and expanding organizationally, and make use of the international knowledge or even local market knowledge of international consulting firms. The employees working in the sector speak several languages and earn a better than average salary. Thus, the sector is of major economic importance, both in terms of taxes and the labor market.

In addition to tax revenues and jobs, of course, the world-class service technologies and processes have clear positive effects on the economies of the region. Therefore, the sector has significant policy emphasis, strong professional advocacy and representation.

In the service centers of the CEE region, a widening of service portfolios and an increase in the volume of services delivered can be observed. However, there is not only widening, but quality change as well. About half of the services delivered by regional shared service centers are higher value-added and according to experts, this tendency will continue in the following years.

There are new organizational models for service center operations like CoE and GBS that could signify some kind of development stage for those centers who want to be state-of-the-art on this market. Virtualizatian is not a typical solution in CEE shared service centers. More shared service center is part of different hub-and-spoke solutions where in more cases the regional centers are in the hub role. I think this kind of work division will strengthen in the near future.

Looking towards the future, Central and Eastern Europe's share of the global market is expected to continue to grow at the expense of the Asia-Pacific markets due to diversification strategies.

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APPENDIX: List of semi-structured interview questions

1. Why were the CEE countries so popular as shared service locations in the last decade? What were the reasons for market progress?
2. Is there any recession in the business service market nowadays? If so, what are the reasons for it? How does the global crisis influence the business service market?
3. How important are shared service centers as actors in the national economies of the CEE countries?
4. What about the competition among the countries in the CEE market? What are the strengths and weaknesses of certain countries?
5. What are the most important factors in location-choosing?
6. What about subsidy systems? Could they positively affect location-choosing?
7. How viable is the shared service model in the long run? What are the model's limitations?

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Economic Integration and Foreign Direct Investment: Review of Main Theoretical Concepts

Adam Marszk

A B S T R A C T

Objective: The objective of the article is to present key theoretical relationships between economic integration and FDI flows.

Research Design & Methods: The research method used is a comprehensive literature review. Most influential publications, including books, articles, working papers, etc. contributing to the subject were identified. The review consists of two essential parts: theory of FDI, and theoretical relationships between economic integration and FDI flows. Finally, the outlined publications were discussed and critiqued, including the empirical context, i.e. empirical verification of the presented links.

Findings: In some areas the theoretical impact of integration on FDI is unclear, thus being an obstacle to making informed policy decisions. According to various theoretical concepts, economic integration should influence FDI flows mostly positively, due to e.g. reduced trade barriers and extended market sizes.

Implications & Recommendations: A number of theoretical concepts support the positive impact of economic integration on FDI flows. Possible directions of future research include comparisons of blocs with members at different development level, and further development of FDI theories in order to account for integration effects.

Contribution & Value Added: For the time being, this paper seems to be the most comprehensive and up-to-date survey of this topic.

Article type:	literature review
Keywords:	economic integration; regional trade agreements; foreign direct investments (FDI); multinational corporations (MNC); trade
JEL codes:	F15, F21; F23

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INTRODUCTION

Over the last few decades, the number of regional trade agreements (RTAs; understood as all forms of integration blocs, including: partial scope agreements, free trade agreements, customs unions and economic integration agreements) has increased rapidly, reaching 377 at the beginning of February 2014 (World Trade Organization, 2014). Despite their important role in the global economy, interdependencies between the economic integration process and foreign direct investment (FDI) flows still remain a relatively neglected research topic, while interactions between economic integration and trade have been studied by numerous authors. An in-depth study of theoretical concepts of linkages between economic integration and FDI seems particularly important, as they form the basis for conducting empirical studies and formulating national and regional policies. However, the current state of knowledge in the field of the integration and investment nexus is assessed by some as unsatisfactory – during the 2013 United Nations Conference on Trade and Development (UNCTAD) multi-year expert meeting on regional integration and FDI, several delegates called for the intensification of such studies and the development of a solid analytical framework (United Nations Conference on Trade and Development, 2013b). Yet another factor increasing the importance of presented topic is the pending negotiations between the United States and the European Union, aimed at creating a Transatlantic Trade and Investment Partnership (TTIP), the world's largest economic bloc. This agreement may have a large impact on FDI flows in the four Visegrad countries, which should be studied carefully and included in the assessment of the agreement's economic consequences.

The main objective of this paper is to present key the theoretical concepts (i.e. conceptual framework) of relationships between economic regional integration and FDI flows. The paper consists of 4 essential parts. The research method which will be used in this article is a theoretical literature review. The summary of theories presented will be based on books, articles, working papers and other papers published in recent years available from various sources, including works accessible through main databases such as ScienceDirect, Springer and Wiley Online Library, as well as the ones published by UNCTAD.

Firstly, the most influential modern theories concerning factors influencing FDI flows will be outlined in order to put the main topic into wider economic and management theory context. The main part of the paper will include a survey of concepts related to linkages between economic integration processes and FDI flows, such as the impact of changes in trade flows caused by intra-regional liberalization on FDI, the impact of more advanced forms of integration (e.g. currency union), and the differences between the effects of integration on intraregional FDI and FDI inflows to the region from external countries.

LITERATURE REVIEW

Theory of Foreign Direct Fnvestment

The causes, directions and consequences of FDI flows were studied by many established economists, such as Balassa (the relationships between FDI and market size), Kojima

(dynamic comparative advantages), Ozawa (FDI and phases of economic development) (Ietto-Gillies, 2005), but probably the most influential works in the field of FDI theory were published by Dunning, who introduced the concept of the "OLI framework" (also known as the "OLI model" or "eclectic paradigm") (Dunning, 1979, 1980). Some authors divide FDI theories into two wide groups: microeconomic (e.g. the industrial-organization, internalization and product-cycle theories) (Kilic *et al.*, 2014) and macroeconomic (e.g. concepts derived by Kojima and Ozawa); OLI framework is included either in the micro category or in a separate one (Kojima & Ozawa, 1993). OLI framework will be described as the first concept, then the new theory of FDI, investment development path (IDP) and the gravity model.

According to Dunning's OLI model (Dunning, 1979, 1980), companies (multinational companies, MNCs) undertake FDI when expansion costs are lower than the simultaneously present advantages of three kinds: ownership (O), location (L) and internalization (I) (Bevan & Estrin, 2004; Di Mauro, 2000). Ownership advantages are both tangible and intangible firm-specific assets, i.e. assets accessible only for a given MNC. Location advantages are linked with features of the market chosen as the location of the MNC's facilities, e.g. factor prices, large customer base, government regulations, trade and investment barriers. Finally, internalization advantages can be used to explain the MNC's decision to undertake FDI and produce goods or provide services internally instead of other forms of foreign expansion such as licensing or franchising – reasons for internalization include the reduction of transaction costs and informational asymmetries, as well as avoiding misuse of valuable knowledge assets.

Due to observed deficiencies of the OLI framework (failure to explain FDI trends in the late 1980s and early 1990s), new approaches were introduced by (among others) Helpman, Krugman and Brainard, formulating "the new theory of FDI" that merged OLI framework with general equilibrium models (Bevan & Estrin, 2004).

In order to gain insight into the modified FDI theories, it is necessary to define the distinction between vertical and horizontal FDI (Athukorala, 2013). Vertical FDI are efficiency-seeking investments in the form of a geographical fragmentation of the production process aimed at using location-specific ("L" in the OLI framework) advantages. Horizontal FDI are market-seeking and involve producing the same goods (providing the same services) in many countries, thus avoiding foreign trade, e.g. export, costs. Costs in the first of the strategies mentioned above (vertical) are mostly coordination costs and in the second (horizontal) include foregoing benefits of economies of scale.

Early new theory of FDI models focused on vertical FDI. According to the Helpman-Krugman model, companies' foreign activities and the creation of multinational companies are spurred by the tendency of factor rewards to differ between countries (Helpman & Krugman, 1985). Later models accounted for horizontal FDI – in Brainard's model companies choose between exporting and related advantages, such as scale economies at the plant and firm level (e.g. R&D expenses), and proximity to the foreign market (Brainard, 1993). When proximity and market-access advantages outweigh the concentration ones, horizontal FDI takes place (Di Mauro, 2000).

In contrast with earlier concepts, the last two of the general FDI theories may be included in the macroeconomic category, despite some elements of the eclectic

paradigm. In IDP theory, based on the OLI framework, the FDI flows respond to the structural changes resulting from economic development (economic development and economic growth are treated here as synonyms) (Dunning & Narula, 1996; Narula & Guimón, 2010). The core of IDP framework is made up of dynamic interactions between FDI and the changes in ownership advantages of domestic companies, the ownership advantages of MNCs and the location advantages of countries ("O", "O" and "L"). The development path of countries is divided into five stages, with varying location advantages – the higher the development level, the lower the importance of factor prices advantages and the higher the importance of intangible resources. Due to differing ownership and location advantages at various stages of economic development, the magnitude of FDI inflows and outflows changes, resulting in varying net outward investment (NOI) positions. The usual NOI pattern suggested by authors is negative at early stages and positive at later stages; however, authors stress that each country's path is unique and dependent upon its size, population, natural resources, political situation and many others (Narula & Guimón, 2010).

The gravity FDI model is based on similar models used in studies on international trade and may be regarded as a synthesis of various types of new theory of FDI models (Di Mauro, 2000), and, consequently, as the most extensive FDI analytical framework. Despite differences between various specifications of gravity FDI models resulting from varying assumptions, there are some common features, described e.g. in Bevan & Estrin (2004). According to the gravity approach, the decision of MNC to undertake FDI depends on two contrasting factors: the costs of investing abroad (e.g. building a new plant) and costs linked with exporting from the domestic country, both measured in terms of relative market sizes and either the absolute or relative distance between them. The market sizes of domestic and host economies are measures of potential demand, growth and supply capacity. Within this framework, distance is the main factor influencing the transaction costs of foreign expansion, such as transportation or informational costs of legal and institutional factors (e.g. local tax systems). Other variables included in these models are used to account for differences in relative labor and capital endowments (and their costs), economic and political risk, or institutional development. Gravity FDI models are also modified in order to more accurately capture changes resulting from economic integration. Such alterations will be described in the next section.

Theoretical Links between Economic Integration and Foreign Direct Investments

Before exploring the various theories concerning links between economic integration and FDI flows, it is necessary to state that a high level of heterogeneity of both integration blocs and FDI is a significant barrier to formulating general statements. However, the presented interdependencies may be grouped into a few categories. In this section of the paper, theories concerning the abovementioned links will be described using two approaches: firstly, in terms of the economic integration effects, and, secondly, with regard to the various analytical frameworks, including the ones outlined in the previous section. In the final paragraph of this section, in contrast to earlier parts, the reverse causality links will be briefly described, i.e. the contribution of FDI to regional integration.

Economic integration is a process with far-reaching implications for many areas of the bloc's economies and, consequently, for the flows of outward and inward FDI. For the purposes of this paper, we divided these mechanisms into the following groups (Table 1; due to insufficient data FDI outflows from the bloc to non-member countries were omitted).

Table 1. Expected impact of the mechanisms of economic integration on foreign direct investment flows

Mechanism	Type of FDI flows	
	intraregional	inflows to region from non-member countries
the reduction of intraregional trade barriers (tariffs and non-tariffs); trade and investment treated as complements	positive (mostly for vertical)	positive (mostly for horizontal)
the reduction of intraregional trade barriers (tariffs and non-tariffs); trade and investment treated as substitutes	negative	negative
creation of a customs union	as above (positive/negative)	depends on differences in trade barriers applicable to member and non-member countries
enlarged markets	positive	positive
investment liberalization and protection provisions	positive	positive
increased efficiency and accelerated economic growth	mostly positive	mostly positive
monetary integration	mostly positive	mostly positive

Source: own elaboration based on (Medvedev, 2012; UNCTAD, 2013a).

The theoretical effects of trade liberalization on FDI flows remain unclear and depend on whether trade and investment are considered to be complements or substitutes. In the first case, establishment of RTAs is expected to increase vertical intraregional FDI flows due to the rising complexity of MNCs' production networks (and their creation costs), as well as to the minimum level of trade links necessary for FDI to emerge (Medvedev, 2012; Witkowska, 2001); another important factor is cost differentials (Kubny *et al.*, 2011). Horizontal FDI inflows from countries outside the RTA may also increase because of the establishment of so-called export platforms served earlier by trade – such flows are analyzed using export-platform FDI models (Velde & Bezemer, 2006). On the other hand, in this process, existing pre-integration extensive sales and/or production networks may be consolidated, thus reducing total external FDI stock in the bloc. According to early concepts (based on the assumption of trade-investment substitutability), creating an economic bloc was expected to decrease the magnitude of FDI flows (or increase FDI flows in the form of divestments) – horizontal FDI flows should decrease due to the lower costs of serving foreign markets through trade than affiliates (reduction of "tariff-jumping" FDI) (Witkowska, 2001).

Conducting an analysis of the consequences of the creation of customs unions for FDI flows requires an extension of the framework presented above, particularly when FDI

flows between members and non-members are considered. In the case of introduced or potentially higher levels of outside protection, horizontal FDI inflows from external countries should increase as a result of greater incentives for MNC to undertake "tariff-jumping" FDI and concentrate their production in member countries with the lowest costs (Chen, 2009). The scale of such capital flows depends on the differences between tariffs and other trade barriers applicable to member and non-member countries (Athukorala, 2013). However, a growing number of customs unions combine intraregional and external trade liberalization which may have the opposite effect, increasing vertical FDI and decreasing horizontal FDI attractiveness for external MNCs.

The creation of an economic bloc leads to increased market size, which in turn influences the magnitude of FDI flows. This effect is strongest in larger economic blocs and in countries belonging to multiple agreements (Chen, 2009). The positive impact of increased market size on FDI flows is regarded in the literature as well established (Medvedev, 2012). The main underlying mechanism is the possibility to exploit the economies of scale in three significant ways (Athukorala, 2013): large plants manufacturing one product, horizontal specialization (decreased number of product varieties manufactured in plants) and vertical specialization (manufacturing parts and accessories of a single product in various locations). Yet another mechanism is the increased international merger and acquisition activity caused by competitive pressure from a larger number of companies (Medvedev, 2012).

Investment liberalization and protection provisions within economic blocs are directly linked to decisions to undertake FDI made by MNC due to the reduced transaction costs (Kubny *et al.*, 2011). Such rules include lifting investment restrictions (i.e. opening various sectors to foreign investors), dispute settlements (e.g. FDI provisions in the North American Free Trade Agreement (Marszk, 2010)), and the harmonization of FDI policies that lower political risk and improve investment climate, making it also more predictable. If changes in regulations are significant, intraregional FDI flows should increase and the inflows of FDI from outside the region, both from new and established investors, should rise as well. Moreover, members of the bloc may decide to introduce measures aimed at promoting FDI e.g. preferential tax treatments (Velde & Bezemer, 2006).

The next category of the potential regional integration's impact on FDI is linked to the dynamic effects of this process, mainly to the higher degree of competition, higher efficiency of resource allocation and accelerated economic growth. While the relationship between FDI flows and economic growth seems to be positive (the direction of causality is, though, problematic, e.g. FDI through technology transfers may further boost growth) (Medvedev, 2012), other linkages are more complicated, e.g. stronger domestic companies can decrease the attractiveness of a given market among foreign investors, but more efficient firms becoming regional leaders should undertake vertical FDI (Velde & Bezemer, 2006) inside the bloc, and horizontal as well as vertical FDI in external countries.

The impact of monetary integration within an economic bloc on FDI flows is linked by and large to the elimination of the exchange rate variability inside the region (Petroulas, 2007). By reducing related transaction costs, monetary integration should boost FDI flows. However, Di Mauro (2000) argued that the net impact on FDI is unclear

– before the creation of a monetary union MNCs prefer to open affiliates in member countries (through FDI) in order to avoid the exchange rate risk, whereas its establishment makes exporting, not FDI, a more attractive option (if trade and FDI are substitutes). Another mechanism of monetary integration's impact on FDI is the proceeding financial integration of the union's countries. Potential positive influences include the reduction of macroeconomic instability, coordinated response to common shocks, as well as increased transparency and policy credibility (Sousa & Lochard, 2006), whereas the higher speed of economic turbulences transmission may decrease FDI flows (Folfas, 2012).

One of the main analytical concepts concerning economic integration's (in the following paragraphs, the forms of integration analyzed are customs unions and more advanced stages) impact on FDI flows is the distinction between investment creation and diversion (analogically to trade creation and diversion occurring during integration processes) (Kreinin & Plummer, 2008). Investment creation is an increase in the volume of FDI inflows from non-member countries due to trade diversion effects, and investment diversion is FDI flows between member countries in response to trade creation effects which require production reorganization (Kindleberger, cited in Witkowska, 2001). Kreinin & Plummer (2008) defined the abovementioned effects in a different way: investment creation is understood as foreign investments substituting domestic ones undertaken in order to benefit from lower production costs (causing the reconfiguration of resources allocation, making it more efficient), and investment diversion as lowering the FDI inflows from member countries to non-member ones and redirecting them to locations inside the bloc due to tariff discrimination (with a negative impact on global welfare because of reduced investment in more efficient countries).

Within the OLI framework, the establishment of customs union influences mostly location ("L") advantages because of changes in external trade policies (Kreinin & Plummer, 2008). For MNCs from both member and non-member countries, FDI inside the union enables the achievement of higher location advantages, resulting from dynamic integration processes such as the reorganization of production or intensified competition (Witkowska, 2001). In the course of these processes, new location advantages are revealed (e.g. decreased transport costs) and FDI are undertaken to seek optimum location. However, in the case of "tariff-jumping," FDI location advantages may diminish due to the increased attractiveness of exporting instead of opening foreign affiliates.

Economic integration can also have a significant impact on ownership ("O") advantages (Witkowska, 2001) because of its dynamic effects. For MNCs from member economies, integration provides access to extended markets and the possibility of exploiting the economics of scale, therefore enabling the companies to increase R&D spending and gain new or boost current ownership advantages. For MNCs from outside the bloc, it is necessary to have some initial ownership advantages in order to compete with internal (i.e. domiciled in the bloc) competitors, and accumulate such advantages.

The effects of economic integration may also be incorporated into macroeconomic FDI theories. The dynamic effects affect economic development and, consequently, FDI flows within the IDP framework. Gravity FDI models were also modified by extending their specification and including variables such as the level of tariffs and non-tariff

barriers, exchange rate variability (in the case of monetary integration) and measures of political integration (e.g. changes in corruption level, with the assumption of a positive impact of some integration aspects) (Di Mauro, 2000).

An important element of the analysis of links between economic integration and FDI (here: the impact of integration on FDI flows) is the spatial distribution of FDI – integration may increase the total FDI inflow to the bloc from external countries, but the effects in individual countries may be insignificant or even negative (Velde & Bezemer, 2006). Relocation and agglomeration effects may lead to efficiency gains at a regional scale due to economies of scale, thus boosting further relocation processes. They may affect the convergence of economies within the bloc and, therefore, also the FDI flows. Countries outside the bloc may decide to enter it, becoming part of clusters in order to increase their attractiveness among foreign investors.

In the previous paragraphs of this section, the causality of links described ran from economic integration to FDI flows. However, the direction of causality is difficult to establish because, on the one hand, FDI flows depend on a number of factors, and, on the other hand, FDI can enable and change the character of integration processes (Ładyka, 2001; United Nations Conference on Trade and Development, 2013a). Increased FDI flows between member countries can spur development and the intensification of trade flows (if FDI and trade are complementary), and, in long term, economic growth and employment (Witkowska, 2001). Another group of FDI affecting growth prospects positively is reorganization and rationalized FDI (Yannopoulos, cited in Robson, 1998). Reorganization FDI causes the reallocation of foreign activity, usually in fewer affiliates, according to countries' comparative advantage (they also reduce adjustment costs in the block (Ładyka, 2001)). Rationalized FDI are undertaken to take advantage of differences in factor costs and their inflow to the bloc should increase due to the lowering or elimination of trade barriers (Yannopoulos, cited in Robson, 1998). Nevertheless, for countries with MNCs which benefit at large from integration (e.g. by accumulating ownership advantages), it may lead to negative net FDI flows (outflows higher than inflows) and lower employment (Witkowska, 2001). FDI are also crucial for countries with insufficient capital and low technology levels as they may be used (under certain conditions, outside the scope of this paper) to overcome these growth barriers.

DISCUSSION

FDI theory has been developed from the OLI framework, through early new theories of FDI, to gravity FDI models, based on established concepts and models used in studies on trade flows (another important theory is the IDP framework). Some of the presented FDI theories focused on microeconomic aspects (decisions and activities of companies), whereas others focused on macroeconomic aspects (e.g. IDP framework). Despite the growing number of publications on the relationship between economic integration and FDI, the current state of knowledge in this field is assessed by some, as mentioned in the introduction, as insufficient. Particularly significant for policymakers are areas in which the theoretical impact of integration on FDI flows is unclear, thus being an obstacle to making decisions to intensify the integration processes (e.g. effects of monetary integration). On the whole, however, according to the various theoretical concepts outlined, economic integration should influence FDI flows mostly positively, due to e.g.

reduced trade barriers, extended market sizes and dynamic effects. Similarly, FDI flows are expected to spur economic integration.

As far as TTIP (i.e. potential USA-EU economic bloc, with V4 countries' participation) is concerned, based on the analytical frameworks described in the third section, one should expect strong increases in intraregional vertical FDI flows (mechanism outlined in: Athukorala, 2013). Such flows should occur because of complementary economic structures of less-developed and highly-developed members of the suggested agreement (e.g. increased FDI flows between USA and East European EU members), enabling intra-industry specialization. Another related factor which should boost FDI flows is relative differences in labor and capital endowments (and their costs), as well as reforms and reorganization undertaken on both a micro (e.g. in companies) and macro (e.g. economic policy) scale in order to sustain or gain competitive advantage.

There have been many attempts (but much less for FDI than trade) at empirically verifying the theoretical links presented in the third section (a review of such studies may be found in: Baltagi *et al.*, 2008; Medvedev, 2012; Velde & Bezemer, 2006). They generally support the positive influence of the creation of economic blocs on FDI flows. Individual mechanisms have been studied to a varying extent (Medvedev, 2012). While basic channels, i.e. trade liberalization, increased market size and investment provisions, are supported by a few studies, dynamic effects are omitted due to problems with the correct selection of determinants (Medvedev, 2012). However, according to Dunning (Dunning, cited in: Kubny *et al.*, 2011), the impact of economic integration on FDI is very complex and it is almost impossible to isolate the effects of integration (another obstacle is their typically indirect character). Therefore, the results of empirical studies should be analyzed with caution. Moreover, because of problems with the correct specifications of econometric models (linked with the issues described above), case studies of selected blocs seem to be a more plausible solution (Kubny *et al.*, 2011; United Nations Conference on Trade and Development, 2013a).

CONCLUSIONS

This paper includes a survey of significant, selected FDI theories and an overview of the potential links between economic integration and FDI flows, together with possible modifications of the main FDI theories to account for such relationships. A number of theoretical concepts support the positive impact of economic integration on FDI flows. However, distinction between intraregional FDI flows and flows between non-member and member countries must be made as the suggested FDI motives and direction of flows may differ. The effects of FDI flows on economic integration are expected to be positive; analytical framework concerning this issue is, however, relatively underdeveloped and, to the best of our knowledge, has not been empirically verified.

The main limitation of this paper is the limited number of FDI theories presented – an in-depth study of a larger body of literature on FDI theoretical determinants, as well as an extended survey of empirical research may be the subject of future research. Such a study may include a comparison of the analyzed effects in blocs at different stages of integration or blocs with members at different levels of economic development, e.g. with developing countries or developed countries only, contrasted with the ones grouping both categories of countries. Furthermore, despite some modifications of the main FDI

theories, the potential effects of economic integration on FDI were to a very limited degree included in the theoretical deliberations. Further development and modification of FDI theories by introducing the elements accounting for integration effects may also be addressed in future papers.

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