

# Japanese View of Hungary as an Investment Destination

In October 1994 I visited Budapest, because JOI was commissioned last spring by Japan's Ministry of Finance (MOF) to conduct research on the investment climate in Central Europe (i.e. the four countries of Poland, Czech Rep., Slovak Rep., and Hungary). Our research focused on the up-to-date political & economic status, FDI systems, business activities of U.S., European and Japanese companies and others. We conducted the field survey last October and submitted our report to MOF this February.

This article is based upon the information which we obtained through our field survey in Hungary and hearings at companies in Japan concerned with Hungary. I will begin with a brief outline of the trend of Japanese overseas investment, and then turn to the main topic of today, that is, the Japanese view of Hungary as an investment destination. I will specifically and objectively introduce to you the actual & frank answers to our questions obtained at the hearings with Japanese companies, item by item, including the motives for their Hungarian investments, and the business performance in Hungary. In conclusion, I will discuss the recommendations for promotion of Japanese investment in Hungary, which will be titled "A view of the future (one approach)".

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## The Trend of Japanese Overseas Investment

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### *Overview*

According to MOF statistics, Japanese overseas investment historically marked 8.9 billion US dollars in Fiscal 1981, twice of the amount of the previous year, followed by 10.2 billion US dollars in Fiscal 1984, and 12.2 billion US dollars in Fiscal 1985. After the international currency adjustment caused by the Plaza Accord in 1985, Japanese overseas investment increased rapidly, recording 22.3 billion US dollars in Fiscal 1986, 33.4 billion US dollars in Fiscal 1987, 47.0 billion US dollars in Fiscal 1988, and then 67.5 billion US dollars in Fiscal 1989, which was the peak in the history of Japanese overseas investment. The main reasons for such a rapid increase were:

(1) The acceleration of the overseas manufacturing effected by the sharp appreciation of the YEN which forced the adjustment of Japanese domestic production.

(2) To alleviate trade friction, the increase of the full-fledged overseas investment in the advanced countries.

(3) The establishment of the Japanese branches & plants in EC as a countermeasure to the unification of the European countries.

(4) At the same time, Japanese companies were expanding their business territories worldwide, and setting up their branches and plants in order to realize their globalization strategy.

However, the overheated Japanese overseas investment decreased during the three years from Fiscal 1990, recording 56.9 billion US dollars in Fiscal 1990, 41.5 billion US dollars in Fiscal 1991, and 34.1 billion US dollars in Fiscal 1992, then returned to the increase trend, showing 36 billion US dollars in Fiscal 1993. I will skip the detailed reasons for these decreases, and mention only the main points that Japanese companies were reducing overseas investment due to the Japanese recession from 1991 (the collapse of Japan's overheated stock and real estate market), the continuing stock adjustment following the boom of large-scale equipment investment, and the downward plunge of personal consumption.

The regional weight of Japanese overseas investment was gradually shifted from the U.S. and Europe to East Asia, the so-called "growing center of the world economy" where foreign direct investment was active. We can clearly observe this trend in the following table, which shows region-by-region, country-by-country percentages of Japanese overseas investment. For your reference, I additionally note the remarkable increase of Japanese rapid investment in China, which recorded 1.7 billion US dollars in Fiscal 1993 (58% up, over the previous year, representing a 5% share of the total value worldwide), and 1.1 billion US dollars during the months of April through September in Fiscal 1994 (64% up, over the same period in the previous year, representing a 7% share of the total value worldwide).

**Region-by-region shares (%) of Japanese overseas investment**

	1991	1992	1993	Apr.-Sep. 1994	Apr. 1951-Sep.1994
North America	45	43	42	40	44
Central & South America	8	8	9	14	12
Asia	14	19	18	22	16
Middle East	1	2	1	1	1
Europe	23	20	22	17	20
(Hungary)	(0.4)	(0.0)	(0.2)	(0.2)	(0.1)
Africa	2	1	2	1	1
Oceania	7	7	6	5	6
Total	100	100	100	100	100

**Japanese View of Hungary as an Investment Destination**

Now I will pursue the topic of the way to promote investment in Hungary in the future, introducing twenty items derived from our various hearings last year. I hope this presentation will be helpful for the expansion of business between Hungary and Japan.

*The general reasons for such low Japanese investment in Hungary*

As stated in the above table, the share of Hungary in total Japanese overseas investment was 0.4% (value: 181 million US dollars) in Fiscal 1991, 0.0% (value: 4 million US dollars) in Fiscal 1992, 0.2% (value: 72 million US dollars) in Fiscal 1993, 0.2% (value: 36 million US dollars) for the period of April through September in Fiscal 1994, and 0.1% (value: 332 million US dollars) for the period of April 1951 through September 1994.

The general reasons for low Japanese investment in Hungary are:

(1) Hungary is located very far from Japan, and the Japanese are not familiar with Hungary historically. Accordingly, Japanese companies are apt to hesitate to invest in Hungary due to the shortage of information concerning the investment climate or prospects in Hungary.

(2) As you know, the economic growth in Asian countries has been remarkable. The top managers of Japanese companies are skeptical, from the viewpoint of overseas corporate strategy, whether they should invest in Hungary, at the sacrifice of investment in Asian developing countries.

(3) As for the special background in Japan called the collapse of the "bubble economy", Japanese overseas investments are not active in general.

We stated the above points in detail in our JOI report special edition, titled "Highlights of JOI Review No. 20: The investment climate of Central Europe" which is delivered to you now. Please review it if you have an interest.

Now Japanese investments in Hungary are very few and small. On the other hand, U.S. & European investments in Hungary are remarkable. When we started our survey last year, we were initially very concerned with the points of whether U.S. & European companies are enjoying some comparative merits of investment in Hungary, and whether Japanese companies have been unaware of these merits, and what would be the specific comparative merits of investment in Hungary.

The number of companies which we interviewed was about ten, covering financial institutions, trading houses, manufacturers and others. In consideration of the scarcity of cases of Japanese investment in Hungary, I will report the actual opinions or comments which we received through the hearings so far as time permits. However, please understand in advance that, for the sake of the duty to protect privileged information, I will not disclose the names of the companies which accepted our request to interview.

*Motives for Japanese investment in Hungary*

Motives of investment in Hungary were diversified according to the background of each Japanese company. The common answers were: the step to Eastern Europe and the former Soviet Union, Hungary's position as the center of Pan-Europe, and Hungary's gradual approach to the market economy during the period of the former communist bloc.

The following were specific motives for Japanese investment in Hungary.

- (1) One of the marketing strategies for Eastern Europe and the former Soviet Union.
- (2) Following the customer's investment in Hungary (or expecting that the customer or client will follow and invest in Hungary).
- (3) Marketing strategy for expanding EU.
- (4) Countermeasure to trade friction.
- (5) The vigor of the agricultural country which has the potential to be self-supporting.
- (6) Advantage in a particular field of technology.
- (7) Geographical location (the center of Pan-Europe).
- (8) Good cooperation and attitude of investment authorities in Hungary.
- (9) The friendliness and familiarity of Hungarian society to Japan.
- (10) Investment incentive. Offers of free land, subsidies of half value for company employee's salaries, tax incentives for Japanese dispatched staff.
- (11) Promising domestic market in Hungary.
- (12) Unique products in the field of chemical & medicine.
- (13) Advantage as the base of research & development for new medicine.

(14) Hungary has been taking the most advanced approach to gradual market economy in Central & Eastern Europe, and can prospectively be expected to become the center of these regions.

(15) From the long-range viewpoint, the pace of economic growth in Asia will slow down, and the next region of economic growth will be Central & Eastern Europe.

(16) Hungary is a reliable country, considering the fact that it persistently paid interest on its debts through the Swiss Bank during World War II.

(17) There was gradual movement to liberalization during the Kadar administration of the 1970s.

(18) Hungary has been closely related historically with the West since the period of Hapsburg.

(19) Hungary prudently avoid the wasteful stimulation & political conflict with the former Soviet Union, and on the other hand tried financing from Western countries before the memorial year of 1989.

#### *Assessment of the investment experience in Hungary by Japanese companies*

The answers were "too early to assess", "forced to review the business planning", "impossible to comment", "good results", etc., which are diversified in accordance with the background of each company. At present, it would be very difficult to assess objectively.

#### *The matters contrary to the forecast at the initial stage of the investment experience in Hungary*

The following frank comments and thoughts are points which would be a heavy burden for Japanese companies seeking to expand & promote business activities in Hungary.

(1) Related industries, such as parts supply, were insufficient.

(2) The promising domestic market in Hungary proved to be insufficient.

(3) Japanese companies did not invest in Hungary so much as expected in the first stage.

(4) Insufficient legal system.

(5) Much job hopping in the labor market.

(6) Contrary to expectations for incentives (changes of procedures & systems).

#### *Business achievements*

The answers of "favorable" and "loss" were equal.

#### *The forecast for business achievements in the coming three years*

The answers were mostly "gradual growth". However, most Japanese companies forecast the increase of foreign direct investment in Hungary and estimate hard competition in a severe business environment.

#### *Business plans for the future*

It will be very difficult to forecast the course of the deadlocked Russian economy, the expanding EU, and the membership in NATO. Japanese companies take a wait and see approach so as to respond quickly to business chances. The answers were as follows.

(1) Now reviewing the scale of production.

(2) Planning business expansion, but the details have not yet been decided.

(3) No plan for business expansion (due to the surplus capacity scale of equipment, and shrinkage of demand).

#### *Problems at the initial stage of preparation to operate businesses in Hungary*

These items are the practical issues to be faced at the time of starting business operations after the decision to invest in Hungary. For smooth and successful business, these practical jobs are basic hurdles to overcome some of which authorities in Hungary would be expected to assist with.

(1) Hiring of employees in Hungary. Necessity to educate them (especially in accounting, etc.) because they did not have such business experience during the communist era.

(2) Preparations to receive Japanese dispatched staff (housing, children's education, others).

(3) Selection of raw materials and parts suppliers.

(4) Rates of local content.

(5) Maintenance of friendly relationships with business partners in Hungary.

(6) Qualification for investment incentives.

(7) Relationships with local administrations.

(8) Employment agreements. Legal problems caused by the difference of the concept for agreement.

(9) Complicated procedures at the administrative authorities. Frequent changes of agreement procedures. We could not trace the timing of such changes so far.

(10) Relationships with local customers. It is very difficult to conduct credit checks satisfactorily. The disclosure of B/S, P/L and other financial statements is very rare.

(11) Change of the business environment in Central & Eastern Europe. The incidence of debt problems in Rumania, Poland, etc.

#### *Problems which occur after starting business operation in Hungary*

(1) Labor management. There are almost no strikes. Although the labor unions seek access to upper organization (sector group), such claims have not been realized at present. Since job hopping is very prevalent, the labor market trends are very changeable.

(2) Financing (difficulty financing operating capital due to high inflation).

(3) Ratios of local content (immature parts industry).

(4) Conditions with local subcontractors. The quality, dates of delivery, countermeasures against specifications change, selling prices, and standards of technology do not occasionally conform to the market economy.

(5) Exchange rate risk. Exchange rate risk was a major problem due to the frequent cuts of the Forint in the course of importation of parts and exportation of finished products.

(6) Living & housing environment for the Japanese dispatched staff. Housing problems, children's education, others.

### *Problem solutions*

The main solutions for the above item 8. problems are as follows.

- (1) Communication with local staff.
- (2) Hiring of management staff.
- (3) Increases of Japanese staff.
- (4) Support of Japanese parent companies.
- (5) Review and adjustment of the domestic sales network in Hungary.
- (6) Hiring of local consultants.
- (7) Close contact with administrative authorities in Hungary.

### *The cooperation and attitude of investment authorities in Hungary toward Japanese companies*

Japanese companies mainly consulted with the authorities concerned, banks, and business partners.

(1) Generally speaking, the investment authorities in Hungary were cooperative. However, the field of cooperation was occasionally very limited.

(2) The authorities concerned tried to carry out promised matter fully. However, procedures to promise sometimes required the parliament decision and also declaration by foreign economic minister.

(3) The Hungarian authorities concerned were cooperative, but Japanese companies sometimes faced insufficient official support system at the final stage of business discussions.

### *The localization of the management*

Japanese companies were trying to carry out, as most important theme, the education & the promotion of local management.

(1) Entrustment of sales activities to local staff.

(2) As for the personnel management, Hungarian and Japanese staff concerned discuss it with each other. At present, local staff is generally trusted in the main field. Wage standards and incentive methods are apt to be understandable by the local management staff only.

(3) In case of manufacturing, the ratio of local content varies, such as 50%, 60%, 90%, due to the diverse backgrounds of the companies, so most of them overcome the hurdle of 50% local content.

(4) Some sophisticated business activities require Hungarian personnel.

### *Some items which should be reviewed for management localization*

The following were listed, as the main points required for aggressive business mobility.

- (1) The credibility of the local partner companies.
- (2) The hiring of local staff.
- (3) Small scale of management, and limited range of independent financing.
- (4) The differences in business custom & practice between Hungary and Japan.

### *Technical assistance for the local subcontractor*

Most Japanese companies thought that technical assistance for the local subcontractor would be necessary. Their specific comments mainly indicated the

transfer of technology, financial assistance, and help with cross licenses.

### *The level of local staff*

The answers regarding the level of local staff were mostly "satisfactory". Especially the intellectual workers received a good assessment, showing positive interest in introducing new technology. Furthermore, Hungarian technical experts and researchers had good reputations for personality and intellectual strength achieved through an education system which stressed logic & basic studies.

### *Trial for the improvement of productivity*

Japanese companies in Hungary were actively employing the standard measures for improvement of productivity, in both offices and production lines.

- (1) Quality control circles.
- (2) Training in basic or advanced techniques and skills.
- (3) Incentives.
- (4) Proposal systems.
- (5) Dispatch to Japan for training.
- (6) Increased automation and computerization of the production line.

### *Living environment for the Japanese dispatched staff*

Japanese staff members were very concerned with the living environment & children's education, as well as being somewhat anxious about the medical environment.

### *The countermeasures for environmental problems*

Increases in environmental regulation were forecasted, and being dealt with through employment of the EU or Japanese standard. Some companies were adapting voluntary control standards for this issue.

### *Intellectual property rights and product liability*

The answers were "no experience of trouble concerning intellectual property rights and product liability". A few companies have taken countermeasures for such troubles. Since the growth of these issue in the future is forecasted, the advance notice and preparation for these issues is advisable.

### *Assessment of Hungary as an investment destination*

The answers varied, as follows.

(1) Based upon the low labor cost and growth of the parts industry in neighboring countries, the growth of Hungarian industries as the production base in the region is forecasted. However, some protections creating advantages for the domestic manufacturers would be necessary. The market scale has not yet grown enough for companies to take break-even business.

(2) EU manufacturers have been enjoying the geographical merits and low labor cost in Hungary, which stimulates further investment in Hungary to set up branches and factories. On the other hand, since it would be very difficult for Japanese companies to access Hungary from the geographical standpoint and to overcome the hurdle of local content, they tend to be very reluctant to invest in Hungary.

(3) Production base in the region of expanding EU. In the course of the expansion of trading blocs in the

international economy (such as North America, Asia, Europe), manufacturing industries can be expected to develop production bases in each economic bloc. In consideration of this trend, we agree that Hungary offers advantages in Central Europe as a candidate for the production base in Europe. Therefore the rapid improvement of economy management in neighboring countries such as Russia, Ukraine, Bulgaria, Rumania, the former Yugoslavia, etc. is persistently expected.

(4) The EU unification will standardize the trade regulations which are currently diversified according to each country and will remove tariff & non-tariff barriers in the EU region, thereby expanding the balance of productivity in the region. For example, the automobile industry in Hungary, which will focus on the EU market bloc, will enjoy the merit of supply bases in Europe. However, industries which are not aiming at the EU market bloc exclusively would not enjoy the advantage of investment in Hungary with its low labor costs.

(5) The access to EU countries would be better for Japanese companies than the access to Hungary. And the hurdle of local content would be easier to overcome in the EU countries than in Hungary.

(6) Trade with the local small & medium size enterprises should be given comparatively high weight in the national economy.

(7) Bad debt problem. Government support improves financial status temporarily, however, it is not always a fundamental solution or settlement. When Hungary's entire economy is activated and completely improved, the bad debt problem will be substantially solved soon. The problem will survive any compulsory, temporary solutions.

(8) Chronic inflation will become an impediment to stable business management.

(9) Language barrier (out of English region. However, we can highly evaluate the Hungarian enthusiasm to master Japanese).

(10) The manufacturing industry may not grow sufficiently, because Hungary played the role of "food storage" in the period of former communism.

(11) Since the national companies have excess employees and equipments, the M & A of such companies should be carefully handled. Accordingly, green field investment would be an easy business step from the viewpoint of risk management.

(12) It will take some time for Hungarian society to become accustomed to competition, because the society was closed during the period of the communism. At present, simple capital investment in Hungary would not be sufficient. Investment developing the participation of the local staff in the management, including the training of workers, would be more effective.

(13) Since Hungary's market is very small, Japanese companies will be better to invest there in the field of export-oriented projects.

(14) Physical distribution base (however, physical

distribution network in Hungary has not been sufficiently developed).

(15) High level of technology from the global viewpoint (in the specialized fields).

(16) The improvement of infrastructure is necessary for Hungary right now. The world will pay attention to Hungary according to its economic growth.

#### *Advice for business in Hungary*

The following advice for business in Hungary was offered by the Japanese companies which have business experience there.

(1) Long-term business strategies which estimate the trends in the next century are required. Good results in the short range are unlikely. Management decisions from the viewpoint of long-term corporate strategies will be necessary. However, doing nothing right now would risk loss of future business chance.

(2) Technical cooperation would be better as a way of access into Hungary.

(3) Corporate planning of business strategy should keep in mind the insufficiency of physical distribution in Hungary.

(4) Adequate consideration of foreign currency regulations.

(5) Businesses with enterprises undergoing privatization should be carefully handled in the course of the procedure. In particular, written agreement will be vital for the confirmation of contract conditions.

(6) Good legal counsel is necessary for business in general, since many customs developed in the years of communism which do not have legal force now.

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#### A View of the Future (One Approach)

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I have reported some of the results of our hearing at Japanese companies which have the experience of investment in Hungary. Finally, based on the results of our survey, I will discuss one approach to promotion of future Japanese investment in Hungary. I will now returned to the fundamental question why Japanese companies will invest in Hungary which is located very far from Japan and historically unfamiliar to the Japanese, in spite of the competition of "East Asia as a growing center of the world economy" as a destination for Japanese investment. I wonder whether low labor cost and geographical location of Hungary will become a decisive point promoting investment in Hungary by Japanese companies. China, Vietnam, other Asian countries geographically close to Japan also offer low labor costs, so what will be the comparative advantages, promoting of Japanese investment in Hungary? I will describe two cases, and suggest one approach.

At first, I will pick up the GE Tungsram case, which is currently the biggest foreign investment in Hungary. Mr. Jack Welch, GE Chairman, simply said the two points for the assessment of Hungary as the

investment destination in Central & Eastern Europe, which are low labor cost and "strong" technology. The chairman highly assessed potential technology power in Hungary through the word "strong". The technology of Tungstram has been producing "Budapest in the night view" which is called "the pearl in the Donau River". The high assessment of Tungstram's strong technology was occurred through these performances. Based upon the comparative advantage of the combination of low labor cost and strong technology, GE put together in Hungary the functions of production and R&D for a lighting business. This is the first case of a world enterprise selecting, as part of its worldwide business strategy, a former communist country as its investment destination, and locating a business division (i.e. lighting) in such a country.

The second case is not so large investment as GE. A Japanese company, Furukawa Electric Co., LTD., purchased an insulator laboratory in Hungary, which was an exceptional Japanese investment in Hungary, with very high-level technology. This investment is highly assessed as a unique pioneer business based upon the potential high technology in Hungary.

Next, the above chapter review also shows that the vital point in a high assessment of an investment country will be potential technology combined with low labor cost. The technology would potentially co-

ver the field of food processing, which oriented from Hungary's agriculture, and then electric, chemical & medicine, etc. This unique advantage is completely different from the status of Asian developing countries. As stated in the above, the key word for the comparative advantage of Hungary as an investment destination, compared with Asian developing countries, would be "strong potential technology based upon low labor cost" which we would naturally arrive at in the course of the final approach, even if I had not quoted Mr. Jack Welch, GE Chairman. I will forecast that, the identification of potential business opportunities which are not known to Japan and are based upon the unique technologies unfamiliar to Western countries and which do not require such a large investment as GE Tungstram, would be surely the key to accelerated promotion of Japanese investment in Hungary.

To cite a familiar example, the fact that seven Hungarian scientists have received Noble prizes in the field of natural science is marvelous, considering Hungary's population of 10 million. There is no such scientifically accomplished nation among Asian developing countries.

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## ÖSSZEFOGLALÓ

# Magyarország mint befektetési célország – japán szemmel

1994-ben a JOI – Japán Tengerentúli Beruházások Intézete – vizsgálatot végzett négy közép-európai országban a beruházási klímára vonatkozóan. E cikk a magyarországi kutatás bizonyos eredményeit foglalja össze.

### A japán külföldi beruházások általános trendje

A hivatalos statisztikák szerint a a japán külföldi beruházások a nyolcvanas évtizedben dinamikus emelkedtek: az 1981-es 8,9 milliárd dollárról 1989-re elérték a 67,5 milliárd dollárt. Bár a kilencvenes évek elején a japán külföldi beruházások volumene csök-

kenni kezdett, 1993-tól a növekedés trendje visszaállt. Regionálisan a külföldi beruházások aránya az USA és Európa rovására Ázsiában indult növekedésnek.

A japán beruházási volumen Magyarországon főként az alábbi okok miatt ilyen alacsony:

(1) Magyarország nagyon messze van Japántól, a japánok kevésbé ismerik Magyarországot. A japán vállalatok – már csak a beruházási információk hiányos vagy korlátozott volta miatt is – hajlamosak óvatossá lenni a magyarországi befektetést illetően.

(2) Figyelemre méltó az ázsiai országok gazdasági növekedési üteme. A japán vállalati felső vezetők szkeptikusak abban, hogy feláldozzanak-e egy lehetséges ázsiai befektetési lehetőséget, Magyarországon kell-e befektetniük.