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Direct Investment from Finland to Eastern Europe;¹ Results of the 1995 Bank of Finland Survey

Abstract

The authors present the results of the 1995 Bank of Finland survey (previous surveys were 1991 and 1993) on Finnish direct investments to the CIS, the Baltics and other CEE countries. The survey describes the situation during or at the end of 1994 and focuses mainly on Estonia and Russia, the main targets of Finnish direct investment in Eastern Europe.

The results indicate that most Finnish direct investment went to service industries – only about a third went to other sectors. Direct investment was generally in the form of equity capital, while about a third was in the form of loans. The level of local banking services and the availability of credit appeared to be fairly low in Russia and Estonia. Investor experiences were described most often ‘tolerable’ in Russia and ‘satisfactory’ in Estonia. The future expectations of investors, in comparison with the results of the previous survey two years ago, remained positive and unchanged in Estonia, but somewhat less favourable than 1993 for Russia. Excessive, arbitrary bureaucracy was considered a major drawback by nearly all respondents.

The authors draw attention to current problems with data collection and data quality. Presently, there is apparently nobody who can accurately specify the number of enterprises under Finnish ownership actually operating in Russia or Estonia.

Keywords: direct investment, Russia, Estonia, Eastern Europe

¹ Eastern Europe in this survey comprises the Commonwealth of Independent States, the Baltic countries and Central Eastern European countries.

Summary

This survey of Finnish direct investment to Eastern Europe (henceforth the BOF-95 survey) is the third in a series of surveys² aimed at following development of direct investment from Finland to Eastern Europe. The data collected by the survey³ describes the situation in 1994 and covers only operative firms with Finnish ownership (FFOs). There are no exact statistics available on the number of operative FFOs in Eastern Europe and estimates vary greatly. For the purposes of this survey, the number of operative FFOs in Eastern Europe is assumed to be 1550 (see Table 5 in the appendix). Based on this "ball park" assumption, the response rate of the BOF-95 survey would be about 40 %. However, judged against the magnitude of actual capital flows, the representativeness of the survey could be considerably higher.

Compared to the total foreign direct investment flows from Finland, the investments made to Eastern Europe have been modest: 1–2 % of the total. The largest recipients of Finnish direct investments in Eastern Europe have been Estonia and Russia, followed by Hungary, Latvia, Poland and Lithuania. While international investors were most likely to invest in Hungary, Finnish direct investment has concentrated on Estonia. Finns have also been aggressively establishing new FFOs in Russia, particularly in the St. Petersburg region.

The majority of FFOs operated in the service sector, which is broadly defined to include trade, transportation, distribution, consulting and financial services. Another third operated in process industries, mainly metallurgy and engineering, pulp and paper, and food and beverage. The ownership structure of FFOs had changed since 1992, particularly in St. Petersburg where the number of 100 %-owned subsidiaries had increased greatly.

About two-thirds of the investments made from Finland were made in the form of equity capital, the rest was in the form of loans. About a

quarter of equity capital was paid in kind. Most credit financing had been taken from Finland and only 6 % of the FFOs had borrowed from banks in their host countries. In comparison to Finnish foreign direct investment in general, investments in Eastern Europe showed lower profitability. This is quite understandable given the fact that most FFOs were still very young and operating in high-risk environments.

The experiences of FFO operating in Eastern Europe generally improved from the previous survey of 1993, as did their evaluations of banking services in their host countries. (The availability of credit was still considered generally poor, though.) Overall, future expectations were positive among the FFOs. Only in Russia were expectations lower than in 1993. In Estonia, expectations were still positive and had not changed much from the 1993 outlook.

Section 1 describes the volume and geographic distribution of Finnish direct investment to Eastern Europe. Section 2 looks at Eastern Europe as receiver of foreign direct investment in general. Section 3 analyzes direct investments by economic sectors. Section 4 looks at ownership structures. Section 5 describes financing and performance of FFOs. Section 6 concludes by describing the experiences and expectations of FFOs in Eastern Europe.

1 Volume and geographic distribution

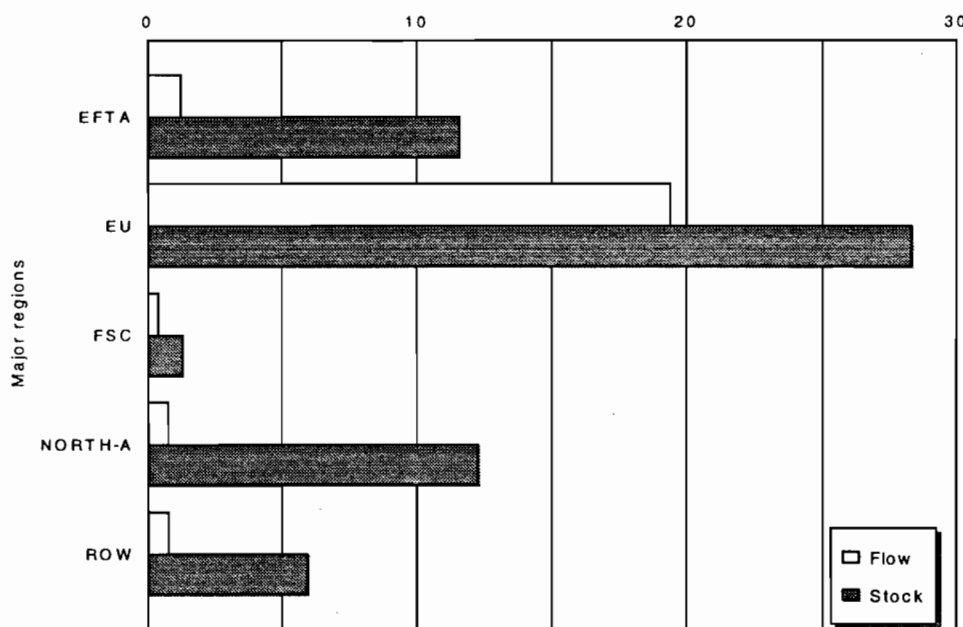
Measured both in terms of net capital flow from Finland in 1994 and as the accumulated stock of investments, the largest recipients of Finnish direct investment in Eastern Europe were Estonia and Russia, followed by Hungary, Latvia, Poland and Lithuania.

Compared both to the stock and flow of total foreign direct investment from Finland, the level of investments to Eastern Europe was still very modest. In 1994 their share of the total investment flow of FIM 22.4 billion was 1.6 % and their share of the foreign direct investment stock of nearly FIM 60 billion amounted to slightly over 1 %. Figure 1 depicts the share of Eastern Europe in the

² Results of the first survey are published in the Bulletin of the Bank of Finland, March 1992, Vol. 66 No. 3, pp. 6–9 (Laurila 1991) and the second survey in the Review of Economies in Transition, 3/1994, Bank of Finland, Unit for Eastern European Economies (Laurila 1994).

³ Research assistant Petra Sinisalo was responsible for mailing the questionnaires and checking the information received.

Figure 1 FDI flows in 1994 and stocks at end-1994 from Finland to major regions, FIM billion



FSC = former socialist countries, North-A. = North America and ROW = rest of the World, Sweden and Austria included to the EU. Source: BOF

total direct investment stock and flow from Finland in 1994.

According to the balance of payments statistics of the Bank of Finland, net capital flows from Finland to Eastern Europe have grown rapidly since political and economic transformation the late 1980s. In 1994 the flow of direct investment⁴ to Eastern Europe registered by the Bank of Finland amounted to FIM 360 million and the cumulative investment stock since 1988 reached FIM 0.8–1.0 billion depending on the method of calculation⁵. Figures 2, 4 and Table 1 illustrate the development of direct investment flows from Finland to Eastern Europe.

Measured by the number of companies with Finnish ownership (FFO) Estonia and Russia were also the largest recipients of Finnish direct invest-

ments in Eastern Europe. In 1994, 42 % of FFOs in Eastern Europe operated in Estonia and 33 % in Russia. FFOs in all other Eastern European countries accounted for the remaining 25 %.

In Estonia, most FFOs were located in Tallinn. In Russia, about 60 % of FFOs operated in St. Petersburg or regions close to the Finnish border. About a quarter operated in Moscow, the rest were elsewhere in Russia. The geographical distribution of FFOs in Russia appears in Figure 3.

2 Eastern Europe as receiver of foreign direct investment

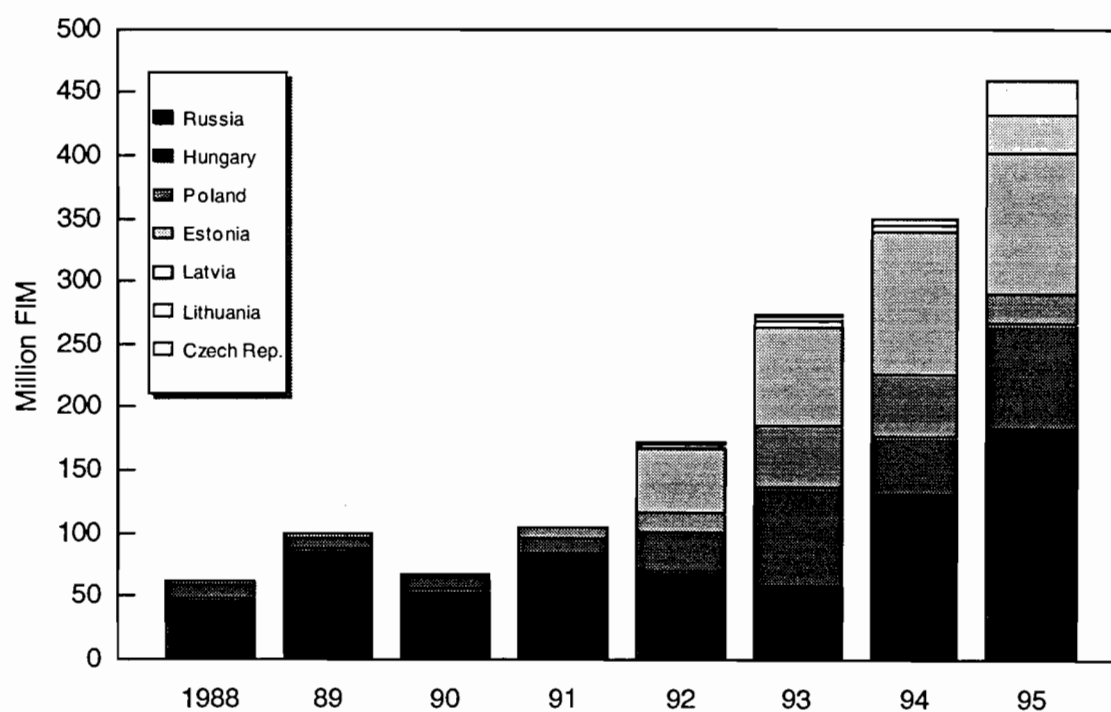
Finnish direct investment in Eastern Europe (like direct investment from other parts of the world) has been modest. The cumulative inflow of foreign direct investment in the Eastern European transition economies during 1990–94 amounted to USD 18.9 billion, only slightly more than the entire stock of Finnish foreign direct investments (UN/ECE Economic Bulletin 1995, p. 100 and Bank of Finland statistics).

⁴ In accordance with IMF guidelines, direct investment is defined as capital investment where the investor's holding or proportion of the voting rights is 10 % or more.

⁵ The higher figure excludes reinvested earnings or incurred losses, the lower figure includes them.

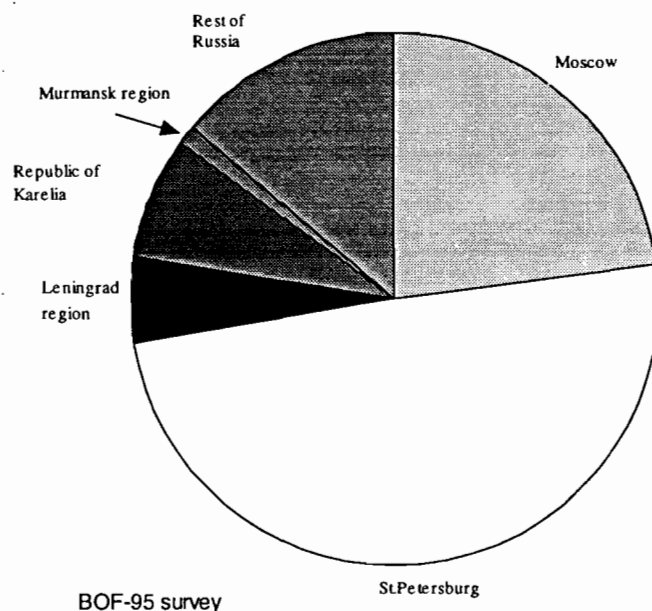
Figure 2 and Table 1

Volume and geographic distribution of Finnish direct investment to Eastern Europe (including reinvested capital)



in FIM million	1988	89	90	91	92	93	94	95	Total
Russia	49	88	56	84	71	59	132	184	723
Hungary	13	9	10	13	31	78	46	82	282
Poland		3	2	8	15	49	49	24	150
Estonia					50	77	113	112	352
Latvia					2	6	5	30	43
Lithuania					2	2	4	27	35
Czech Rep.	0	0	0	0	2	3	1	0	6
Total	62	100	68	105	173	274	350	459	1591

Figure 3 The geographical distribution of FFOs by selected regions in Russia



Finnish investments to Eastern Europe tend to concentrate on nearby Estonia (Figure 4), while generally, international investors focus on Hungary, which is then followed by Russia, the Czech Republic and Poland (Figure 5).

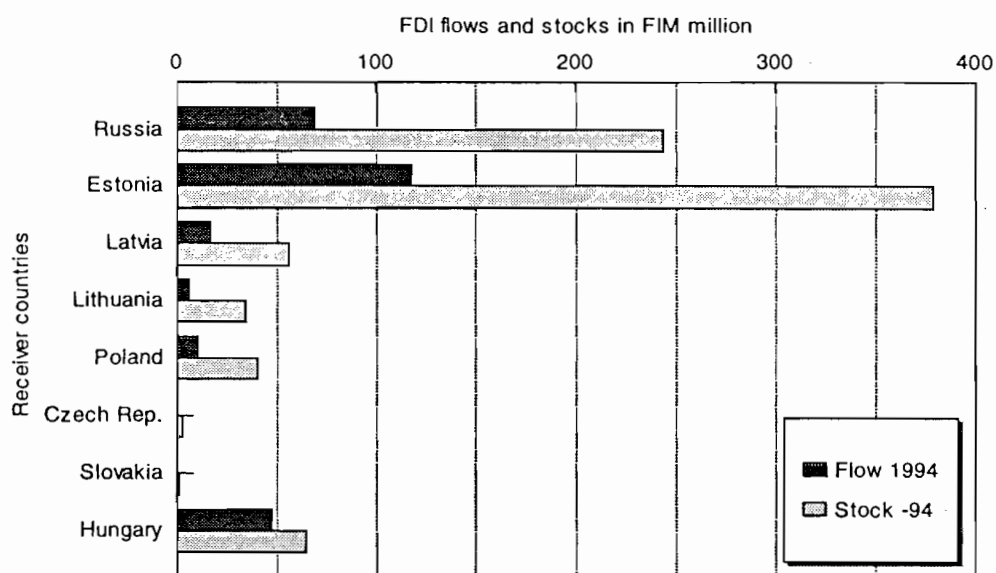
If the amount of foreign direct investments is compared to the population of the host countries, Finnish direct investments to Estonia seem even more prominent as they amounted to USD 34 per capita in Estonia in 1994 compared to less than a dollar (USD 1) per capita in Russia. However, even by this measure Hungary remains the principal destination of FDI among the Eastern European transition economies (about USD 700 per capita), followed by the Czech Republic and Estonia (about USD 300 per capita). The cumulative inflow of foreign direct investment to Estonia reached USD 433 million by the end of 1994 or 2.3 % of the total inflow to Eastern Europe (UN/ECE Economic Bulletin 1995, pp. 99–100). The cumulative flow of Finnish direct investment to Estonia amounted to about USD 104 million or close to 25 % of the total.

The cumulative investment flow received by

the Russian Federation during 1990–94 amounted to USD 3.6 billion (19 % of the total received by Eastern Europe) at the end of 1994 (UN/ECE Economic Bulletin 1995, p.100). Finland's share of the total was about 2 %. The biggest foreign investor was the USA, whose investments during 1990–94 accounted for 29 % (USD 810 million) of the total, followed by Switzerland (15 %, USD 420 million) and Germany (10 %, USD 290 million). Finland, ranked 10–12 in terms of cumulative investment flows and 8–10 in terms of numbers of the foreign owned companies. However, in the bordering Republic of Karelia, Finland was the largest investor. Finns also constituted the third largest foreign investor group in the St. Petersburg region.

The macro-economic significance of foreign direct investments has been marginal, particularly for Russia. In 1994, the FDI flow amounted only to USD 0.7 billion and represented only 0.6 % of gross fixed investment in that year. In fact, there was a net outflow of direct investment from

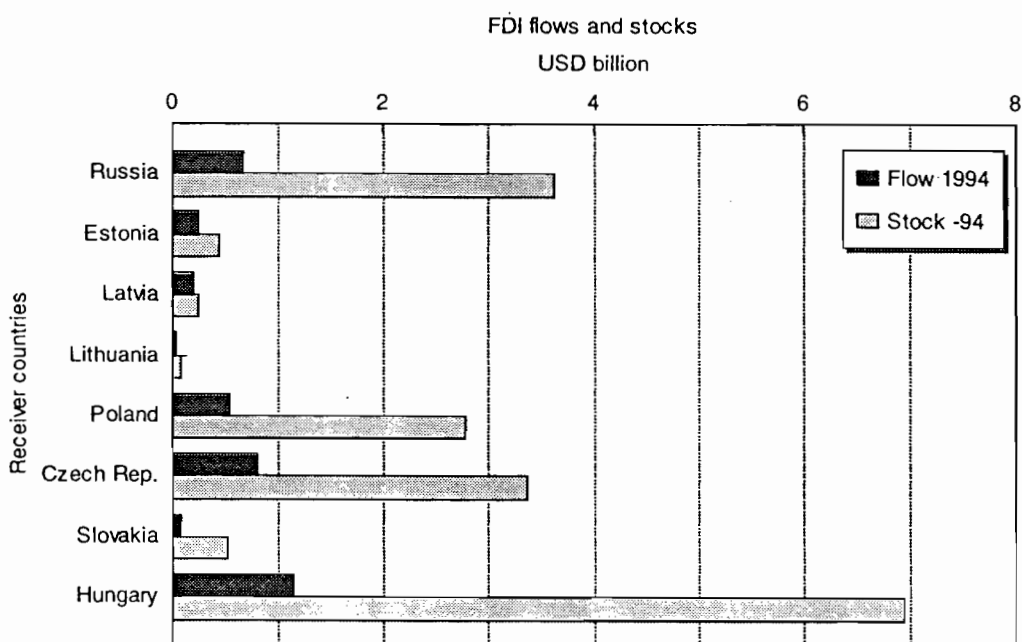
Figure 4 **FDI flows in 1994 and stocks 1985–1994 from Finland to receiver countries in FIM million (excluding reinvested capital)**



Capital transfers through bank accounts only.

Source: BOF

Figure 5 **FDI flows in 1994 and stocks 1985–1994 from abroad to receiver countries in USD billion**



Source: UN/ECE Economic Survey and Bulletin 1995

Table 2 Direction of the Finnish and international direct investment to selected countries measure by number of FDI projects, capital stock per FDI project or capital stock per capita of receiver country at the end of 1994

	FDI from Finland			All FDI		
	Number of FFOs	Capital stock /FFO	Capital stock /cap.	Number of FDI projects	Capital stock per FDI project	Capital stock per capita of receiver-c.
Estonia	1.	1.	1.	5.	5.	3.
Russia	2.	2.	4.	4.	2.	6.
Latvia	3.	4.	3.	6.	7.	4.
Poland	4.	5.	5.	3.	3.	5.
Hungary	5.	3.	2.	1.	1.	1.
Lithuania	6.	6.	6.	7.	8.	7.
Czech Rep.	7.	7.	7.	2.	4.	2.
Slovenia	8.	8.	8.	8.	6.	8.

Russia.⁶ However, the economic significance of foreign direct investments cannot be judged by these figures alone as the investments are known to have many indirect positive effects through foreign trade and the flow of know-how from investors to the host country.

⁶ According to Goskomstat, the FDI inflow to Russia amounted to USD 1,050 million in 1994. The amount of portfolio investment was negligible, amounting only to USD 0.5 million. However, 48 % of the total (USD 504 million) comprised of loans from abroad and from other sources than the parent companies and hence do not qualify as direct investment flows (GiroCredit 1995, p. 25). Only USD 548.8 million meet the definition of direct investment to Russia in 1994. According to the ECE foreign investment database, the gross FDI inflow to Russia was USD 671 million and the cumulative inflow (1990–1994) USD 3,629 million. Taking into account the FDI gross outflow of USD 844 million from Russia to outside the CIS countries, there was a net outflow of FDI of USD 173 million, which continued in the first quarter of 1995 (UN/ECE Economic Bulletin 1995, pp. 99–100).

Table 2 lists the eight principal receivers of Finnish foreign direct investments in Eastern Europe in the order of, first, the number of FFOs operating in the country, secondly, the assets of the FFOs, and thirdly, the assets per capita of the receiver country. The table also provides corresponding information concerning all foreign direct investment to the listed receiver countries.

By all measures (see Table 2) Estonia takes first place as receiver of Finnish foreign direct investment to Eastern Europe. Overall, Estonia ranks third to fifth among the Eastern European countries as a receiver country of foreign direct investment. (Hungary leads by all measures and also ranks high, among the first five, as receiver of Finnish foreign direct investment.) Russia ranks second as receiver of Finnish investment and occupies the same place when ranked by the assets of all foreign investors in the country.

Figure 6 FFOs in Russia by economic sector

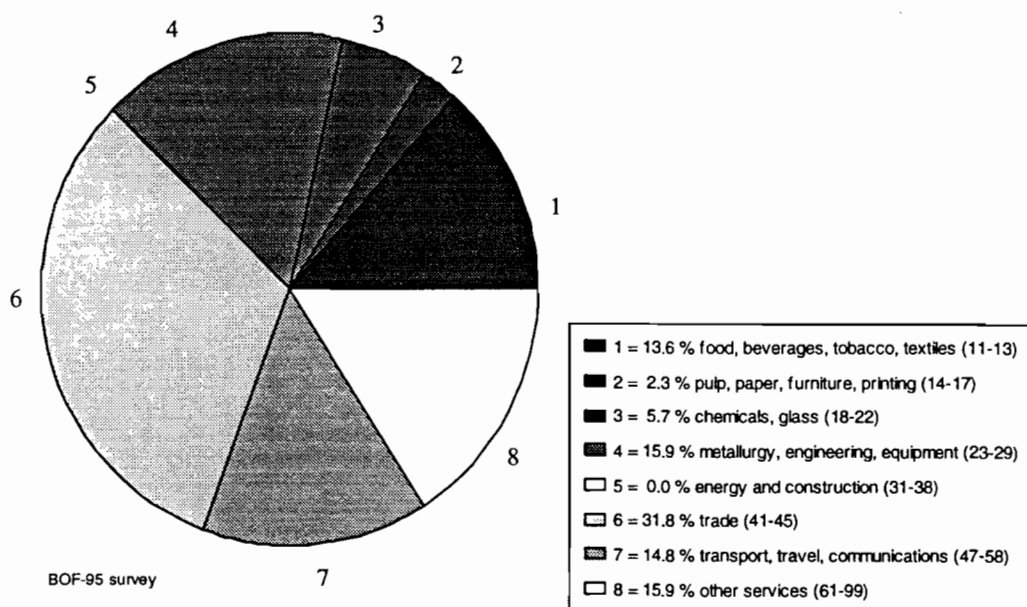


Figure 7 Flows of FDI capital from Finland to Russia by economic sector, 1994

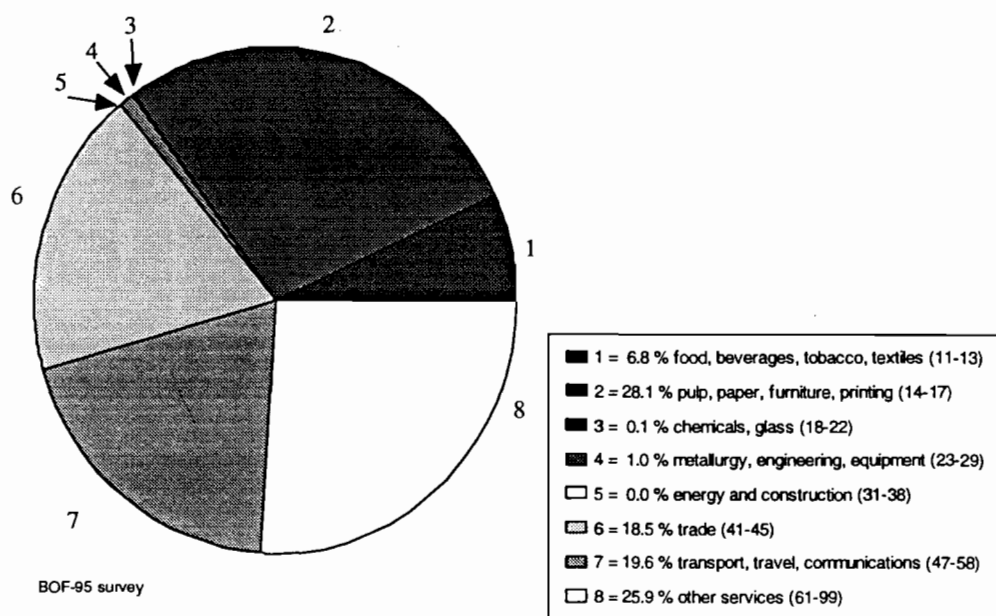


Figure 8 FFOs in Estonia by economic sector

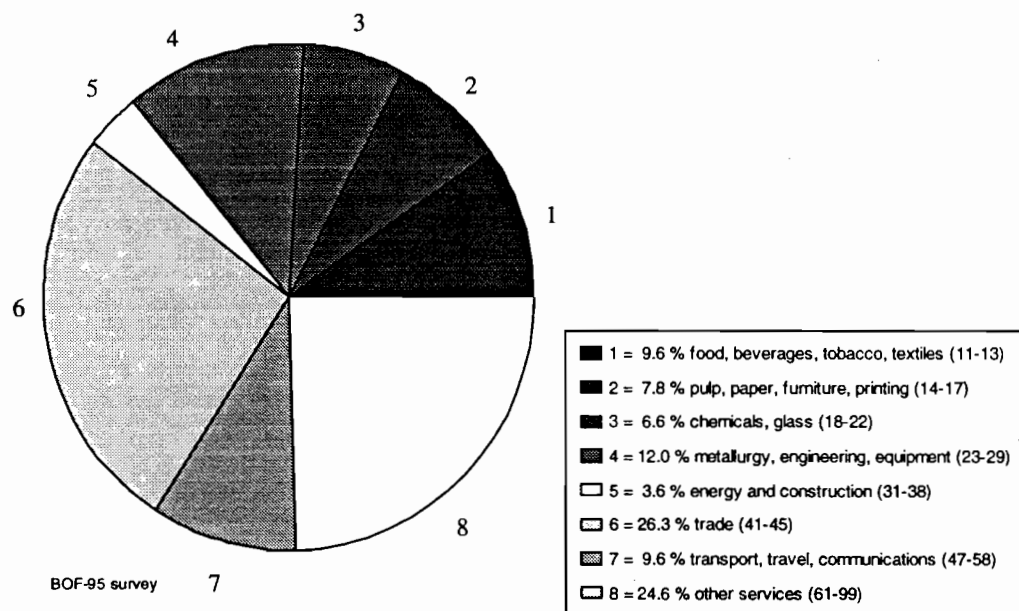
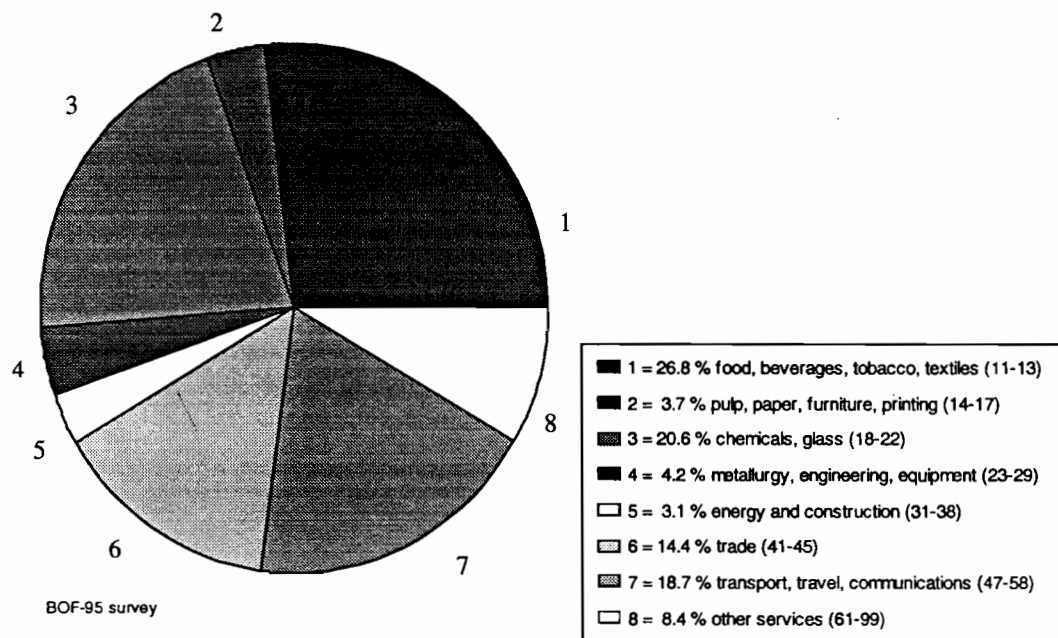


Figure 9 The flow of FDI capital from Finland to Estonia by economic sector, 1994



3 Direct investments by economic sectors and type of production

About two-thirds of FFOs operated in the service sector (trade, transportation, distribution, consulting, financial services etc.) and the remainder in process industries, mainly metallurgy and engineering, pulp and paper, and food and beverage. Figures 6–9 illustrate the distribution of FFOs among various economic sectors in Russia and Estonia on the basis of the number of FFOs in each sector and on the basis of investment.

The emphasis of Finnish direct investment by sector is quite distinct from the general trend of international investors in Russia. Overall, about half of the direct investments to Russia (USD 522 million) in 1994 went to the energy sector; construction was second. Trade and public catering attracted USD 59 million, pulp and paper industry USD 50 million and engineering USD 43 million. In contrast, there were no Finnish investments in Russian energy or construction sectors in 1994.

Table 3 illustrates the distribution of FFOs, total investment, number of employees, annual turnover and assets of FFOs in Estonia, Russia and the St. Petersburg region. It specifies whether the company is solely involved in production of goods, solely involved in services, mainly involved in production of goods, or mainly involved in services. The table shows that the FFOs operating in the service sector generally have a smaller turnover and smaller assets as well as fewer employees than the FFOs operating mainly or only in the production of goods. This is particularly true in Estonia, where 40 % of FFOs were involved in production of goods, whereas the share of their assets was as high as 58 % of the total assets of FFOs in Estonia. Within the industrial sector the metal and engineering companies were somewhat more concentrated in Russia and Moscow, whereas other industrial companies were concentrated in Estonia. However, metal and engineering subsidiaries were also more often operative in a different sector (usually the service sector) than the parent company.

The results of Table 3 also illustrate how the distribution between goods and services – or distribution by economic sectors – varies depending of the choice of measurement. When measured by number of entities (FFOs), the majority were

operative in services, when measured by size of investment, number of employees, annual turnover or assets, the production of goods becomes more prominent as in the case of St Petersburg.

Measured by assets or turnover in 1994 the largest FFOs were located in Poland, Estonia and Russia, in that order. The largest FFOs in terms of the number of employees were operating in Estonia. However, the great majority of the companies in each country employed less than 10 persons. The average number of employees per FFO, 38 in Estonia, 32 in Poland and 21 in Russia were greatly influenced by a few large employers in each case. Within Russia the largest employers by all measures were located in Moscow, whereas the FFOs operating in the St. Petersburg region were generally much smaller. In other words, the absolute totals (or arithmetic means per FFO) hide the fact that the distribution of size of the FFOs is fairly skewed usually there are only few large FFOs in addition of large number of small ones.

4 Ownership structure

According to the joint venture legislation introduced in the USSR in 1987, it was only possible to establish joint ventures where the share of the foreign partner was less than 50 %. The 1992 legislation allowed 100 % foreign ownership as well as all existing juridical ownership forms for foreign investors⁷. As a result of this development, the ownership structure of the FFOs has changed in Russia. Figures 10 and 11 do not illustrate the changes in the ownership structure of FFOs in Russia and Estonia directly, but show the number

⁷ The decision of the Soviet Council of Ministries on 19 Sept. 1987 allowed foreign ownership up to 49 % in Soviet organizations. The first joint venture registered by the USSR Ministry of Finance was the Hungarian-Soviet venture "Littar-Volanpak" in Vilnius, number two was Finnish-Soviet joint venture "Est-Finn" in Tallinn (PlanEcon Report 1989, p. 28; Laurila 1992, p. 7). The restriction on the maximum share of ownership was abolished by the decision of the Council of Ministers of 2 Dec 1988. At the end of 1991 (28 Nov 1991) a decree of the government obliged the existing joint ventures to reregister and both old and new foreign owned companies to assume juridical forms similar to those already available for Russian firms.

Table 3 **Distribution of operative FFOs by type of production in principal receiver areas (Estonia, Russia and St. Petersburg).** Table covers only those FFOs on which all necessary information has been available.

Estonia	Percentage distribution (S = services only, SG = mainly services, GS = mainly goods, G = goods only)				Absolute quantities
	S	SG	GS	G	
FFOs	54	19	10	17	144
Total investment	39	2	17	42	FIM 389 million
Employees	61	2	16	21	8,908
Annual turnover	62	2	17	19	FIM 1.2 billion
Assets	66	1	9	23	FIM 1.5 billion
Russia					
No. of FFOs	64	13	14	9	78
Total investment	46	6	44	4	FIM 247 million
Employees	37	6	39	18	3,860
Annual turnover	39	12	25	25	FIM 0.4 billion
Assets	35	20	18	27	FIM 0.8 billion
(St Petersburg region only)					
FFOs	77	13	2	9	47
Total investment	29	3	11	56	FIM 186 million
Employees	36	3	27	35	1,948
Annual turnover	49	2	1	48	FIM 0.2 billion
Assets	28	8	7	57	FIM 0.4 billion

Figure 10 New FFOs established in Russia, by percentage of foreign ownership

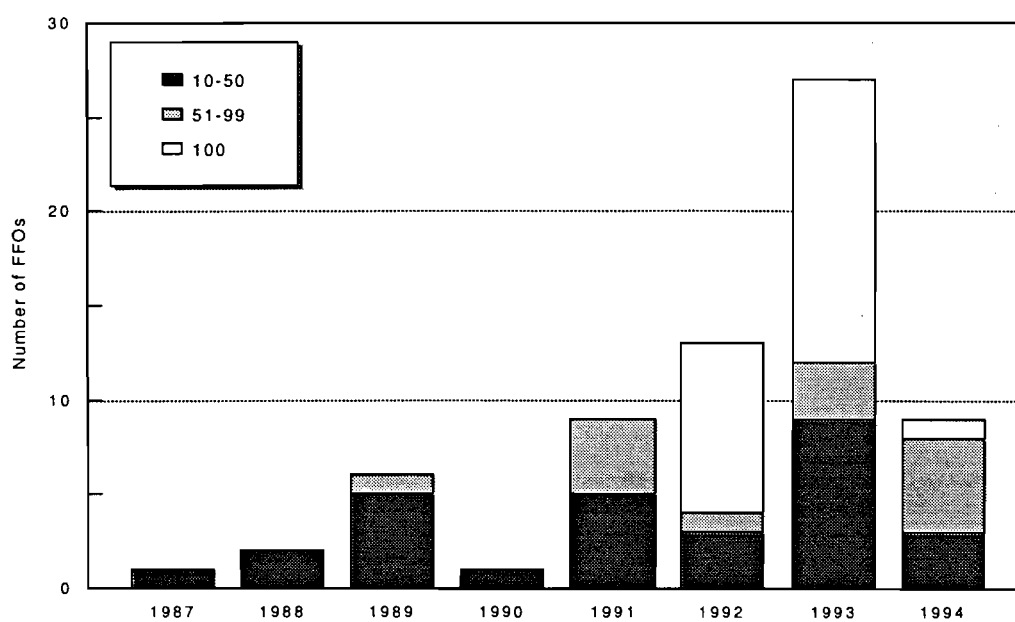
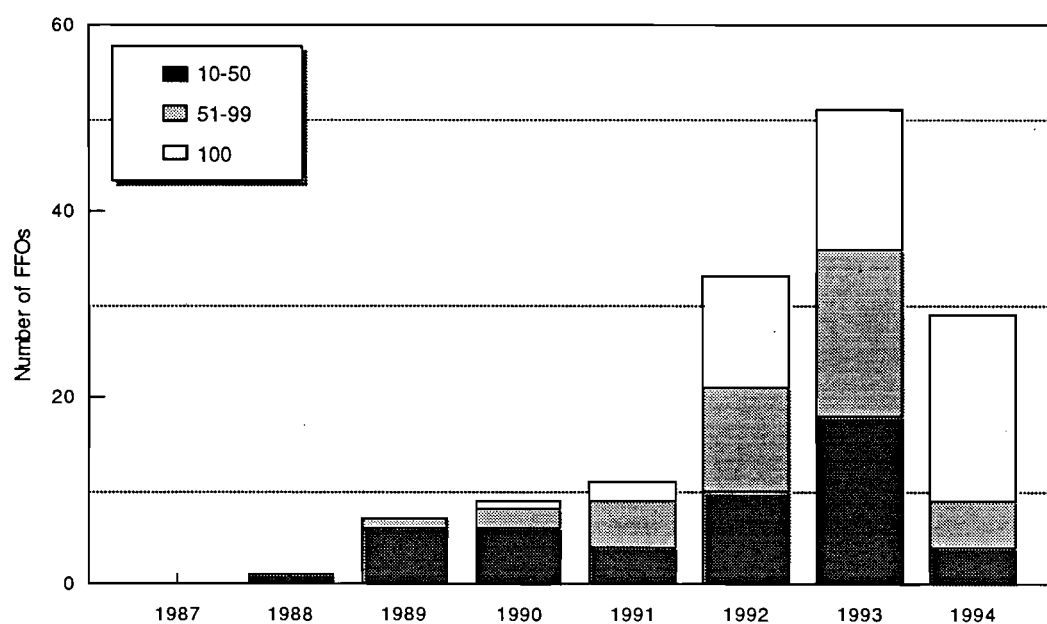


Figure 11 New FFOs established in Estonia, share of foreign ownership



of annually established FFOs grouped by the percentage share of Finnish ownership.

Within Russia the share of wholly owned subsidiaries was higher in St. Petersburg (52 %) than in Moscow (32 %). This probably due to the fact that after 1992 a relatively large number of wholly owned subsidiaries have been founded in St. Petersburg. The share of firms with less than 50 % ownership is relatively high (40 %) in Moscow. In Estonia, FFOs included more firms with less than 50 % ownership.

There were more 100 % Finnish-owned companies operative in the service sector than in process industries. However, among the industrial companies, Finnish ownership had increased and most Finnish investors owned more than 50 % of the shares of their industrial ventures in Russia and Estonia. Probably the proportion of the Finnish (or other foreign) capital of the total founding capital has also increased due to the high rate of inflation (particularly in Russia where it has deflated the rouble-denominated part of the initial capital, while the foreign share has been retained in convertible currency or paid in kind to preserve its value.

5 Financing and FFO performance

According to the BOF-95 survey results, the stock of Finnish direct investments measured by the equity capital of the FFOs and loans given to them amounted to approximately FIM 1.5 billion in 1994. The total assets of the FFOs in Central and Eastern Europe amounted to about FIM 3 billion in 1994.⁸ About 2/3 of the investment made from Finland had been made in the form of equity capital and the rest in the form of loans. About 25 % of equity capital had been paid in kind, the rest was paid in currency. Equity payments in kind were more significant for small industrial companies and companies situated in Russia close to the Finnish border than they were in service companies or large industrial companies. The survey results do not allow evaluation of the current market value of the equity paid in kind. One can only speculate that the current value of a function-

ing piece of equipment can in many cases be higher in Russia than a market based price for it in Finland. According to the survey results the relative significance of payments in kind has diminished after 1992 in comparison to the preceding years.

In 1995 only 5 % of the FFOs reported that part of the equity was planned to be paid later. In most cases the equity was agreed to be paid and was also in practice paid in full immediately. This situation has changed from 1991, when the BOF-93 survey showed that only about 50 % of the equity was expected to be paid in the immediate future (Laurila, 1992, p. 9). Most likely the change reflects both the high share of equity financing and the increasing share of Finnish ownership as well as the small size of more recent investments.

The vast majority of the currency transfers have been made through the banking system according to the survey results. However, about 2 % of capital transfers, especially in small service companies near St. Petersburg, were made in cash carried in the form of bank notes. Cash transfers have diminished in recent years⁹. Thus, the survey results do not confirm that any significant sums had been transferred to Eastern Europe in cash. However, one could hypothesize that companies not participating in the survey might have made more significant cash payments than those which participated.

About a quarter of the FFOs in Eastern Europe had financed their operations partly through loans received from Finland. These loans amounted to approximately FIM 500 million in 1994, an increase of only 23 % from 1992 (Laurila, 1994, p. 14). However, from all sources of financing borrowing from Finland represented approximately 57 % and borrowing from host countries 43 %, a slight increase in favour of the host countries from 1992, when the relationship was 60/40. The companies reporting borrowing from Finland were mostly large industrial enterprises in the pulp and paper and food and beverage industries. More loans were taken from Finland

⁸ Direct investments into banking have been excluded from these estimates.

⁹ Cash payments were generally used by Finnish companies in Russia to overcome the inefficiencies in the banking system during 1992–93 (Hirvensalo, Inkeri (1993) Pankkitoimintaa Pietarissa, Idäntalouksien katsauksia 10/1993 pp. 25–26). However, in Russia cash payments in roubles were strictly limited by legislation and cash payments in foreign currencies became illegal in 1994.

after 1992 by companies operating in Estonia than by companies in Russia. Only 6 % of the FFOs had borrowed from banks in their host countries and this share had not changed from 1992. These companies were usually also large industrial companies who had used the guarantee of the parent company as security for the lending bank in the host country. In a few cases, mortgages or pledges on movable property had been used.

The volume of loans taken from local banks in Eastern Europe was very modest, amounting to approximately the volume of deposits of the FFOs in the local banks. Also the volume of accumulated accounts receivable from the local clients of the FFOs equalled approximately the volume of the accounts payable to the customers and amounted to about 10 % of the sales. Accounts receivable were more significant in Estonia and other Eastern European countries than they were in Russia, which suggests a greater confidence among the FFOs in the credit worthiness of the companies in other countries of Eastern Europe other than Russia.

Generally, investments made to Eastern Europe were less profitable than investments elsewhere in 1994. While the operating income in general amounted to an average of 11 % of sales, the operating income in Eastern Europe was barely positive. While the net income (including net interest charges and excluding direct taxes) in general reached 2 % of sales, the net income of the Eastern European subsidiaries was slightly negative. This is no doubt due to the young age of most of the subsidiaries in Eastern Europe as the older subsidiaries were clearly more profitable than the younger ones. It also reflects the relatively high-risk operation environment.¹⁰ There were no conspicuous differences in the profitability among FFOs in different countries. However, among the industrial companies, those operating in the metal and engineering industries were somewhat less profitable than other industrial companies. This was characteristic of metal and engineering companies in general, not only in Eastern Europe. Within the service industries, trading companies were also

somewhat less profitable than other service companies.

6 Experiences and expectations of FFOs

As in the two preceding BOF-surveys, respondents were asked to assess the quality of banking services in their host countries and give an evaluation of their experiences and future expectations in Eastern Europe. The banking services to be evaluated included opening a bank account in a local commercial bank, transfer of payments in the host country or between the host country and foreign countries as well as the availability of credit. All responses reflect marked improvements both in Estonia and in Russia in comparison to the preceding survey results. However, there still was a clear difference between the evaluations in favour of the Estonian banks. The least improvement was recorded in the availability of credit, but even in this case the responses reflect clear improvement from the situation two years earlier. In 1992, the availability of credit was generally considered to be poor, but by 1994 it was considered increasingly tolerable or neutral. Figure 16 in Appendix 2 describes the evaluation of banking services in Estonia and Russia by FFOs in 1994.

In addition to differences between Russia and Estonia, the evaluations differed according to the size of FFOs and the economic sector. Large companies generally had more positive evaluations than small companies, and the evaluations given by trading companies were generally more favourable and the evaluations of metal and engineering companies less favourable than average. However, in the question of availability of credit, particularly large industrial companies considered the services of the Russian and Estonian banks very poor.

In the assessments of the experiences, there was also a clear distinction between Estonia and Russia (Figures 12–15 below). The experiences the FFOs had gathered about conducting business in Russia was characterized most often “tolerable”. In the comments, which many respondents added to the questionnaire the following reasons were given for the low grade for the Russian economic environment. Problems in conducting day-to-day business were still great. The FFOs encountered recurrent difficulties with the unpredictability of customs regulations and taxation, which changed constantly, generally with no advance information

¹⁰ It is not possible to assess the significance of taxes in the financial performance of the FFOs. However, as was pointed out by some respondents, particularly in Russia the taxation of Finnish subsidiaries has been very high.

available. Moreover, the arbitrary and inconsistent interpretations of the regulations by local authorities were considered an additional difficulty. Domestic payment transfers were slow, which aggravated the problem of credit risk evaluation and cashing in receivables from Russian customers. There were also problems with the sourcing of needed raw materials as well as finding skilled employees (which meant higher training costs than companies had expected). However, the inflation rate had come down and so was no longer mentioned as the major obstacle it had been in 1992 and 1993. Moreover, FFOs had to learn to live with a high inflation environment.

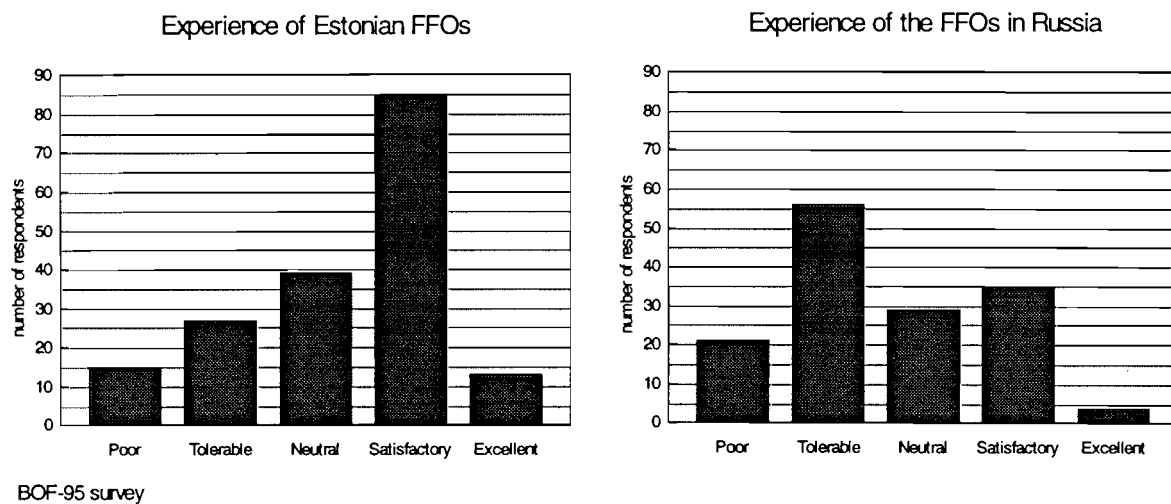
Notably, no respondent mentioned security risks as a special problem, which suggests that the problem was not so big in practice as often described by the Western media. Evidently, the focus of companies which have already made the investment has changed from general issues of risk assessment to more practical everyday problems. Words of one respondent belonging to the latter category may be cited here: "Those firms, who observed laws and regulations suffered most from the bureaucratic and cumbersome practices in the spheres of customs administration, taxation and banking. On the other hand, those foreign companies, who chose to ignore the rules, benefitted clearly from this practice and had the best financial results."

The experiences of FFOs in Estonia were

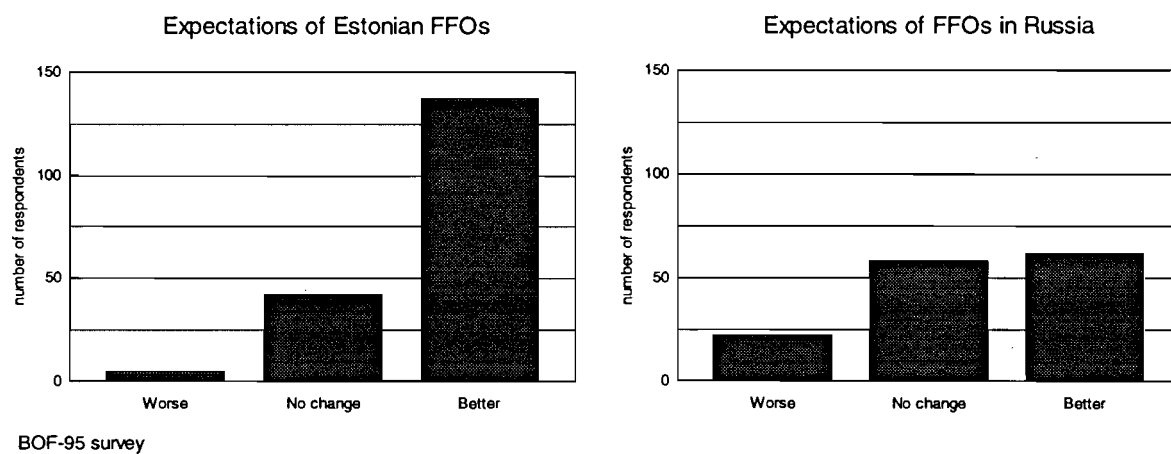
most often described as "satisfactory". Excessive bureaucracy and unpredictable interpretations of the legislation by the local authorities were also considered a problem to many FFOs in Estonia. However, the Estonian legislation was also considered liberal and improving rapidly. For some FFOs, the small size of the Estonian market and limited access to energy and raw material sources constituted a problem. Competition had also increased rapidly. On the other hand, many FFOs were satisfied with the availability and quality of local employees.

Future expectations were fairly positive both among FFOs operative in Russia and Estonia. However, compared to the BOF-93 survey the expectations among FFOs in Russia were somewhat less favourable in 1995 than they were in 1993. The expectations among FFOs in Estonia had not changed. In Russia the opportunities of the future were seen by some respondents in the growing consumption market. In Estonia some FFOs expected that the increase of the FDI into Estonia will further improve the business climate and conditions for conducting business there. The difference between the expectations of the FFOs in Estonia and Russia seemed to be merely in the time horizon; in Estonia improvements were expected to take place in the near future, whereas in Russia they were expected to materialize farther down the road.

Figures 12–13 Business experiences of FFOs operative in Estonia and in Russia



Figures 14–15 Expectations of FFOs operative in Estonia and in Russia



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Appendix 1 Data description and evaluation

The first inquiry concerning direct investments to Eastern Europe by the unit for Eastern European Economies of the Bank of Finland in 1991 was mailed to 400 respondents and covered 320 joint ventures operative in the former Soviet Union at the end of March 1991. The survey was repeated two years later and provided information about 382 operative firms with Finnish ownership. The BOF-95 survey was conducted jointly with the annual direct investment inquiry Information Service Department of the Bank of Finland. In April 1995 questionnaires were sent to 700 Finnish enterprises. Responses were received from 345 enterprises with 601 FFOs in the CIS, Baltic and CEE countries at the end of March 1995. Out of these 562 were operative subsidiaries while the rest had either been dissolved, were resting or were starting operations. Table 1 summarises the data information concerning the three consecutive surveys.

The question of how well the collected data represents the population of operative FFOs in Eastern Europe deserves special attention. Original information about investors who have made direct investments into Eastern Europe was based on the reports given to the Bank of Finland about capital transfers through Finnish banks. Finnish investors are required to provide this information to the central bank for the purposes of compiling balance of payments statistics. After the abolition of the bilateral clearing payment systems and general deregulation of the foreign currency transfers no limitations are imposed on the foreign direct investments, which is why it is no longer possible to check whether all capital transfers are recorded or not. However, it is assumed that most investments of significant size are transferred through the banking system and recorded. One significant limitation of the FFOs to whom the questionnaire was sent concerns the ownership of the FFO. Only FFOs which had been founded by Finnish enterprises were included in the survey. This limitation led to the exclusion of all FFOs founded by private individuals and explains why most of the approximately 4,300 FFOs registered in Estonia were not included in the survey. The great majority of the FFOs founded by private individuals are very small and not operative.

In order to assess the representativeness of the data several sources of information were used. In case of St. Petersburg the mailing list of the Bank of Finland was compared to two other lists of FFOs, first, the list prepared by Finland Trade Center in St. Petersburg of "serious" FFOs and, secondly, a list published by a local St. Petersburg publisher about the most active foreign direct investors (Vorotyntsev 1995). In case of Estonia, the mailing list was first compared to a list prepared by Finland Trade Center in Tallinn and then to a list provided by the Pro Baltica Forum about major foreign direct investment in the Baltic countries. In an ideal case all three lists for each city should overlap significantly. In reality, they did not overlap as much as one would have expected. The results illustrated in Figures 14 and 15 show that only 6 % of the FFOs were included in all three sources of information for both St. Petersburg and Tallinn, respectively. In case of St. Petersburg the BOF-95 survey covered 86 FFOs (37 %) out of the total of 231 FFOs appearing in any of the three lists. The corresponding figures for Estonia are 235 (40 %) out of a total of 582 FFOs.

Another point of comparison is provided by a recent study carried out within the FIBO-research program (Finland's International Business Operations) at Helsinki School of Economics.¹¹ The FIBO data bank included 1,192 Finnish foreign subsidiaries in Central and Eastern Europe in 1993. Responses to the survey carried out in 1994 were received from 721 companies and the number of subsidiaries among them amounted to 601 while the rest were merely representative offices or branches. Due to confidentiality of the data in both cases, it has not been possible to assess the degree of overlapping of the data with the BOF survey. However, as the FIBO survey also excluded companies of private individuals, the population of foreign investors is most likely similar to that of the BOF survey. Also the number of valid answers is of the same magnitude in both cases.

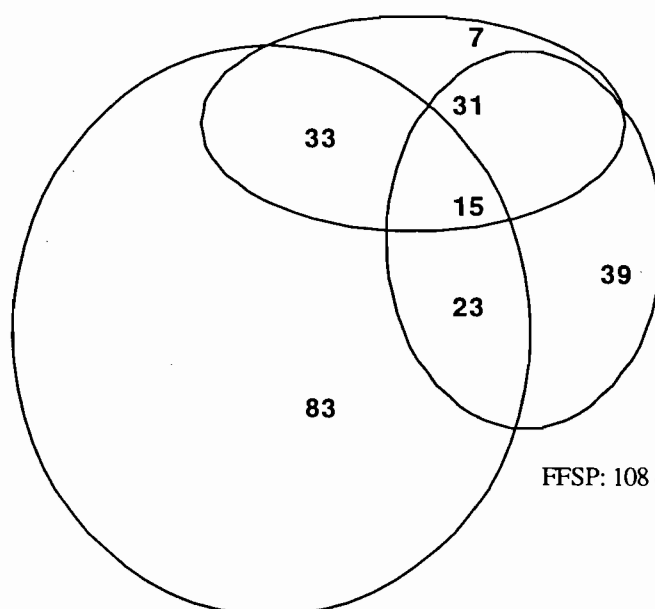
¹¹ Hussi, Sami and Puolakka, Mikko (1995) Internationalization of Finnish companies through foreign subsidiary operations in Central and Eastern Europe, Helsingin kauppakorkeakoulu, International Business, Pro gradu thesis

Table 4 Summary information of BOF surveys

Survey year	1995	1993	1991
Number of questionnaires sent out	700	800	400
Received responses	345	480	280
Number of operative FFOs in			
- Russia	184	117	112
-- Moscow	44	33	45
-- St Petersburg	95	48	33
- Estonia	235	215	91
-- Tallinn	206	167	75
Baltic countries	292	228	95

Figure 16 Overlapping of three lists about operative FFOs in St. Petersburg at the beginning of 1995

BOF-95 survey: 86 of 231 = 37 %



FFSP: 108 of 231 = 47 %

Finland Trade Centre: 154 of 231 = 67 %

Figure 17 Overlapping of three lists about operative FFOs in Estonia in the beginning of 1995

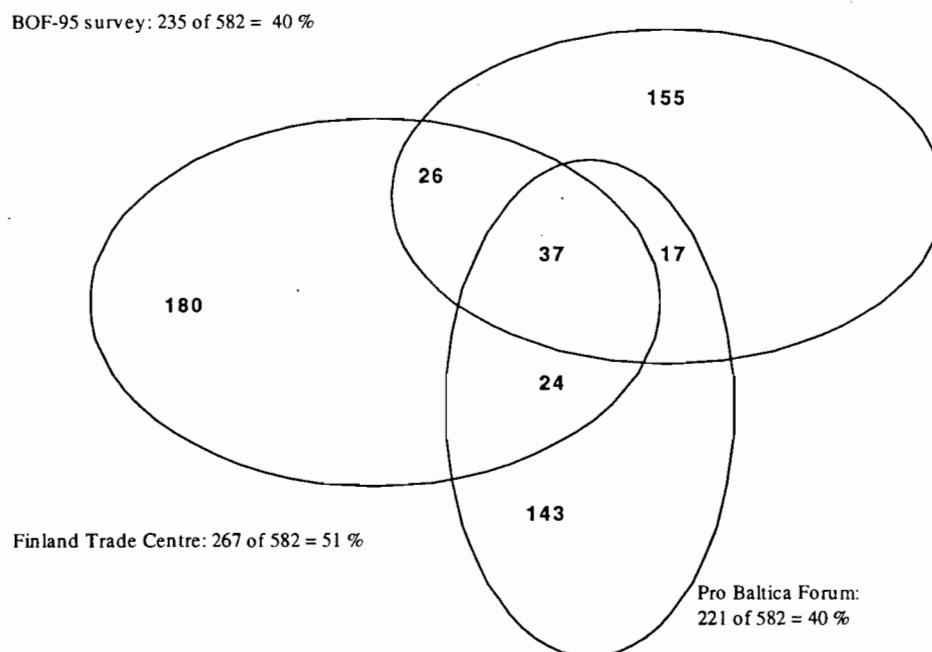


Table 5 Estimate of the number of operative firms with Finnish ownership at the beginning of 1995

Destination area	Number of operative FFOs	Distribution, %
CIS	550	35
Estonia	600	39
Other Baltic and the Central Eastern European countries	400	26
Total	1550	100

Even though it is not possible to know the exact number of operative FFOs in Eastern Europe, a rough estimate is given in Table 5 based on the different sources of information referred to above. There is a colossal difference between the number of operational FFOs and the number of registered FFOs in each country because many registered FFOs are not operative. According to our estimate,

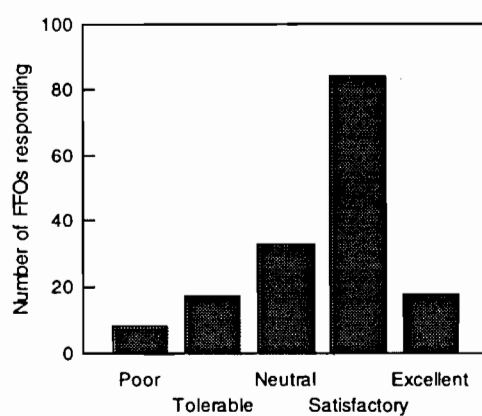
nearly 75 % of FFOs are located in Estonia and Russia of the total number of FFOs in the former socialist countries. Based on the estimate for the number of operative subsidiaries, the response rate of the BOF-95 survey is around 40 %. However, based on the capital flows the representativeness of the survey is most likely much higher.

Appendix 2

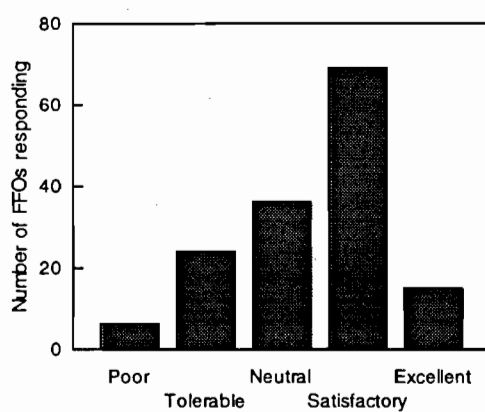
Figure 18 Banking services in Estonia (figures left) and Russia (figures right) assessed by firms with Finnish ownership (FFOs)

Estonia

Account opening

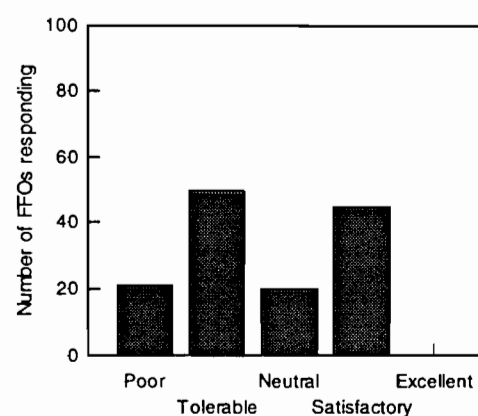


Domestic transfers

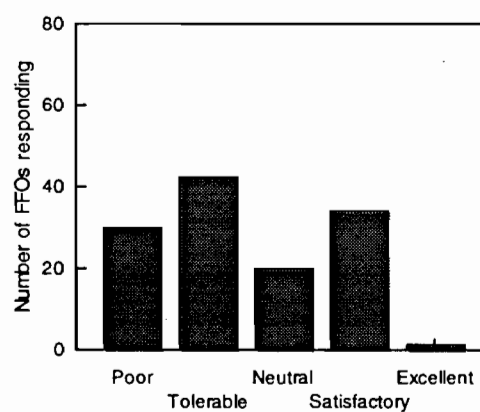


Russia

Account opening



Domestic transfers



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