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Direct Investment from Finland to Russia,
Baltic and Central Eastern European
Countries: Results of a Survey by the
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1 Developments since the last survey

The usefulness and significance of direct investments to Russia, Estonia and other eastern economies has been discussed and criticized from time to time from various angles. Finnish entrepreneurs have been blamed for being too slow to begin doing business in Russia in particular. Once they have done so, they have been blamed for investing too much in services instead of goods production, which is considered the more "serious" form of business. If nothing else, they are thought to bring in too little money to their respective host countries¹.

To consider the validity of these allegations and to update the information content to the experiences of Finnish investors in Russia and the Baltic states, the Bank of Finland conducted a survey in April 1993². It was hoped that the data would enable us to check whether and how the intervening political events had changed the developments observed in the previous survey of April 1991³. In the following, we analyze the results, focusing particularly on the data from Russia and Estonia. Data on firms with Finnish ownership henceforth (FFOs; the term covers both subsidiaries and associate companies) in the other Baltic and CEE (Central East European) countries was also obtained but it is used here only for reference purposes.

Another reason for collecting data particularly on Finnish direct investment in Russia and Estonia is that Finland continues to be a major investor in these countries. In the period 1987–1991, Finland annually ranked from first to third (along with West Germany and Austria) in investment in the Soviet Union as measured by the number of registrations, excluding joint ventures with the CMEA countries. If measured by registered initial investments, Finland took fifth place. After the official separation of Estonia from the Soviet Union in August 1991, Finland became the number one investor country in Estonia as measured in numbers of firms, and second to Sweden as measured by the amount of initial investments.

¹ About critical Russian views, see for instance Adrianov, Jakovleva, Lirov, Sadoshenko. See also the study on direct investment and public opinion in the FSU by Astapovich – Grigoriev, pp. 39–47.

² Inkeri Hirvensalo was consulted in planning the inquiry form and Arja Puukko processed the data.

³ Results of the previous survey are published in the Bulletin, Bank of Finland. March 1992, Vol. 66, No 3 (Laurila).

Table 1.

Number of registrations of foreign owned firms in the Soviet Union (end-1989), Russia (mid-1993) and Estonia (end-1993), by country

Soviet Union end-1989, a		Russia mid-1993, b		Estonia end 1993, c	
Finland	28	USA	1433	Finland	3365
Austria	26	Germany	1141	Russia	850
West Germany	26	UK	557	Sweden	730
Italy	14	Italy	511	Germany	231
USA	13	Austria	475	USA	203
Switzerland	10	Poland	438	Ukraine	75
UK	9	Finland	429	Denmark	62
Total		Total		Total	
- registered	191	- registered	9125	- registered	6316
- operating	na	- operating	6488	- operating	2502

a PlanEconReport 24.3.1989, Volume V, p. 14.

b Jakovleva, Kuzmin

c statistics received through Finland's Trade Center, Tallinn

Even though international data was not available for comparisons, the increase of Finnish investment activity, as well as statistical data from other sources indicate that Finland is still one of the main investing countries in Russia and Estonia.

According to the results of the 1991 survey, the most important receiver areas of the eastward direct investments were the Soviet Union and Estonia. The Soviet Union was dissolved in December 1991 and the process of fragmentation and decline of the economy of the area has continued ever since. Estonia declared her independence in August 1991. Since then, political and economic developments have been diverging both within the area of the former Soviet Union (FSU) and the CEE countries.

The Soviet Union welcomed joint ventures from abroad beginning in 1987. The new enterprise legislation of 1991 had a favourable effect, making organizational forms other than the joint venture – joint stock company, limited partnership cooperative, etc. – available for foreign investors and opening the possibility for 100 per cent foreign ownership. Despite criticism and the rise of protectionism in Russia, a special governmental agency, RAMSIR⁴, was established to promote and monitor foreign direct investment in Russia.

To some extent yet in Estonia, and particularly in Russia, heavy bureaucratic procedures, as well as frequently changing and often controversial legislation with unpredictable enforcement continue to prevail. This, along with the political instability as manifested in the unsuccessful coup d'états of August 1992 and October 1993, serve as a major disincentive to foreign investment in Russia.

Meanwhile, changes have also taken place in Finland that have had an impact on direct investment. Foreign exchange controls related to clearing were removed

⁴ RAMSIR stands for "Rossiiskoje Agenstvo Mezhdunarodnogo Sotrudnishestva i Rasvitija" or "The Russian Agency for International Cooperation and Development". It was set up in late 1992 and headed by Aleksandr Shokhin.

with the abolition of the clearing arrangement between Finland and the Soviet Union at the end of 1990. This accomplished the full liberalization of foreign payments and capital movements between Finland and all other countries.

The economic recession in Finland and the collapse of Finnish-Soviet trade⁵ certainly had an adverse effect on direct investment with Russia and Estonia. The impact of this collapse on direct investment is, however, not entirely unambiguous. There is some evidence that bankruptcies and an unforeseeably high rate of unemployment, particularly in the eastern parts of Finland, also brought pressure to look for business opportunities behind the eastern border. Successful implementation of economic reforms in Estonia has led to an increase of direct investment flows there.

⁵ Contrary to general belief, the collapse of the Soviet economy was only partially responsible for the present recession in Finland. The share of Soviet trade had fallen already to 15 per cent of Finland's foreign trade in 1989 from its peak of over 25 per cent in 1982–83. According to estimates, only two percentage points of the 6 per cent fall of Finland's GDP in 1991 can be attributed to the collapse of Finland's eastern trade.

2 Results of the survey

Direct investment from Finland to Russia and other economies in transition has been increasing rapidly since the dissolution of the Soviet Union in 1991. The political uncertainties and risks have not reduced the willingness to invest. Indeed, direct investment can be considered a fairly important vehicle for coping with the problems that arise in operating in economies in transition. The reduction in the risk of loosing markets evidently exceeds the risk associated with local presence. Positive expectations with respect to the progress being made in economic reform in Russia, and particularly in Estonia, have contributed to this development.

The Bank of Finland (BOF) mailed inquiry forms to 823 Finnish participants in FFOs in the FSU, Baltic countries and CEECs. Their names and addresses were obtained from the Bank of Finland's data bank and from a number of other sources.

Information was received from 421 FFOs located in the FSU or OFSCs. Out of these, 280 were fully active, 105 were about to begin operations and 36 had closed down or withdrawn their operations. A few respondents informed us that they had not even planned to invest abroad and had been erroneously included in the mailing list. Once these were eliminated, the final number of FFO participants that responded or should have responded amounted to about 700 and the response rate was about 60 per cent.

Table 2. **Comparison of results of the 1991 and 1993 surveys***

Survey year	1993	1991
Number of questionnaires sent out	800	400
Response rate	60	71
Number of operative FFOs in		
– Russia	117	112
– Moscow	33	45
– St. Petersburg	48	33
– Estonia	215	92
– Tallinn	167	75
– Baltic countries	228	78

* The 1991 survey covered the Soviet Union including the Baltic countries. The 1993 survey was extended to cover the central east European economies (CEECs).

It should be emphasised in this context that the survey data is not comprehensive but covers only a part of the total population. The survey statistics are not exhaustive, as are statistics based on registrations that claim to cover all enterprises (like Table 1). Table 2 offers data from the two consecutive surveys for the purpose of comparison. The results of the present survey are summarized in Table 3.

Table 3.

Statistical data on operative enterprises with Finnish ownership in the FSU and CEE Countries from the BOF's survey of april 1993

Figures on sales and borrowing relate to the preceding accounting period

	Russia	Baltic countries	Estonia	Rest of the FSU	CEE countries
Number of firms	117	229	215	5	36
Number of employees	7500	3740	3246	106	771
Employees/firm	64	16	15	21	21
Sales, mill. FIM	1155	499	397	0.4	164
Sales/firm	10	2	2	0.1	5
Sales/employee, thous. FIM	154	133	122	4	213
Sales in mill. FIM:					
to Finland	250	238	195	0.35	52
to third countries	207	71	57	0	65
to the host country	698	190	145	0.05	47
Distr. of sales, %:					
to Finland	22	48	49	88	32
to third countries	18	14	14	0	40
to the host country	60	38	37	12	28
Total investment(1)	1072	564	332	134	28
Founding capital(2)	311	192	173	38	26
out of which paid, %	86	84	88	76	92
Total investm./firm	9	2	2	27	1
Borrowing mill. FIM	384	77	66	51	302
from Finland, %	60	83	79	0	14
from third countries, %	27	10	12	0	0
from the host country, %	13	6	8	100	86

1) Share capital (accumulated) plus debt outstanding from subsidiary loans, mill. FIM.

2) Share capital (accumulated), Finnish share only, mill. FIM.

The concentration of the Finnish direct investment on Estonia is explained by the geographical and cultural affinity and by each side's ease and willingness in making contacts. The small economy of Estonia can offer only relatively limited markets. Therefore, the size of enterprises is small and only a minor part of their production, 14 per cent, is sold to Estonia. About half the sales of the Estonian FFOs are directed at Finland, and one-third at Russia.

Some of the FFOs in Estonia do subcontracting work for their Finnish parent companies thus taking advantage of lower labour costs in Estonia. This also partly explains their high level of exports to Finland.

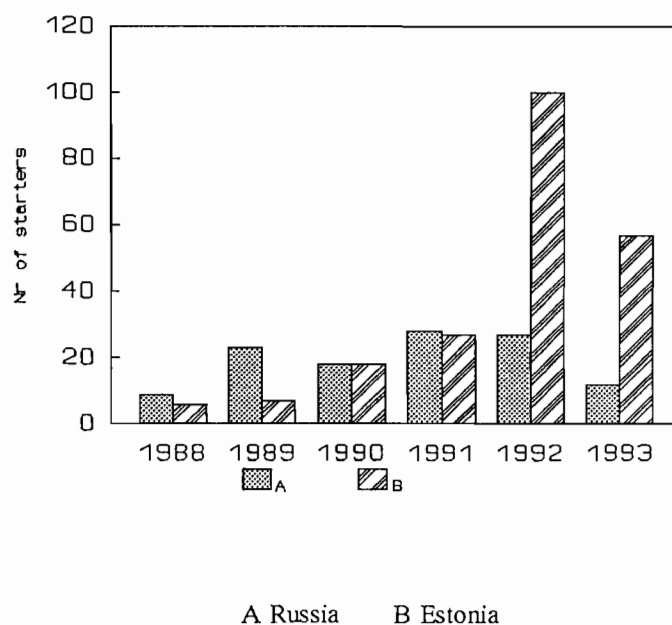
The FFOs in Russia differ greatly from those in Estonia with respect to their size and distribution of sales. Of the total sales revenue of FFOs in Russia, 60 per cent comes from sales to Russia, more than one-fifth from sales to Finland and less than one-fifth from sales to third countries. This bears evidence that the FFOs in Russia are there to maintain or increase their former market shares and/or to gain new markets in Russia.

Sales per employee are larger in Russia than in Estonia. Russian firms also employ more personnel than Estonian firms (Table 2). In Estonia FFO production of services generated 211 FIM/employee and production of goods only 88 FIM/employee. In Russia the opposite was the case: FFO sales of goods generated 178

FIM/employee whereas sales of services generated only 134 FIM/employee. The difference presumably lies in the fact that FFO sales are more locally oriented and output – particularly services – is sold at lower prices in Russia than in Estonia.

In Estonia political⁶ and economic developments were positive. They were reinforced by successful reforms such as the introduction and stabilization of its own currency. These developments induced FFOs to launch operations in Estonia. At the end of 1991, of the 215 FFOs that responded to the survey, 58 were already operating (see Chart 1). In 1992 there were 100 new FFO start-ups, some of which were firms that had been registered only to wait for the appropriate time to start operations. The figure for 1993 is lower but still fairly high. The number of FFO start-ups in Russia bears evidence of more moderate developments.

Chart 1. Start of operations of FFOs in Russia and Estonia



Less than 10 per cent of respondents had decided to end their participation. In Estonia, out of 23 disbanded partnerships, 14 represented the service sector (mostly trade). The 10 disbanded partnerships in Russia were divided evenly between goods production and services.

The distributions of FFOs in Estonia and Russia by economic sector differ slightly from each other depending on whether they are measured by number of firms, personnel or sales revenue (Charts 2–7⁷). **Firms that produce goods account for a major share of employment and sales, particularly in Russia. This contradicts the widely expressed opinion concerning concentration in the service sectors.**

⁶ Estonia declared its independence on 20 August 1991.

⁷ The classification by economic sector conforms with ISIC codes as follows: agriculture 01–09, manufacturing 11–29, construction 35–38, trade 41–45, transport (+ travel + communications) 47–58, technical & business 71–77, other services 61–67, 85–99, "production of goods" 01–38, "production of services" 41–99.

The number of firms and employees as well as sales revenue for 1992 is given in Charts 2–7 for FFOs in Estonia and Russia, by main economic sector.

Chart 2. Number of FFOs in Estonia by economic sectors

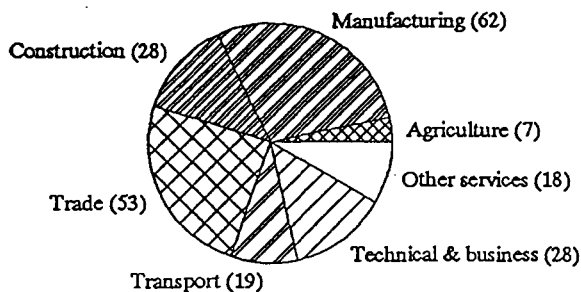


Chart 3. Number of FFOs in Russia by economic sectors

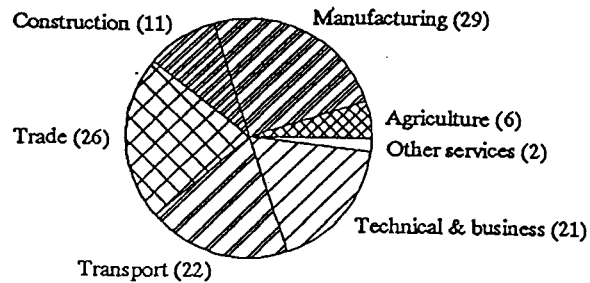


Chart 4. FFOs in Estonia persons employed, % by economic sectors

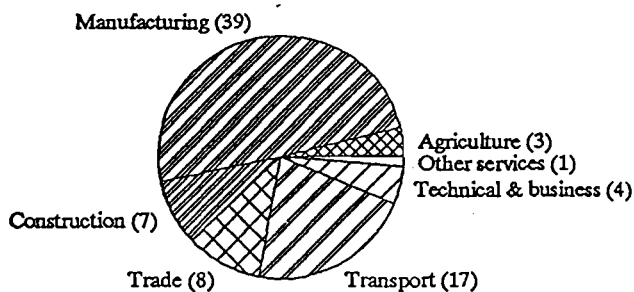


Chart 5. FFOs in Russia persons employed, % by economic sectors

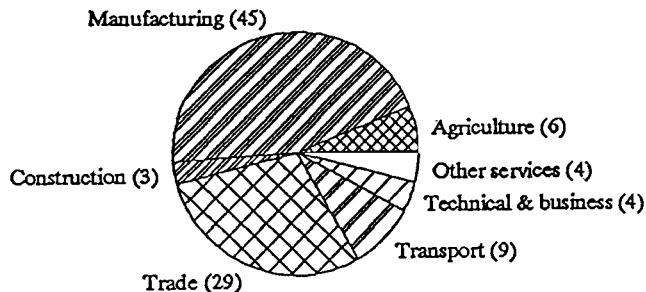


Chart 6. FFOs in Estonia sales in 1992, % by economic sectors

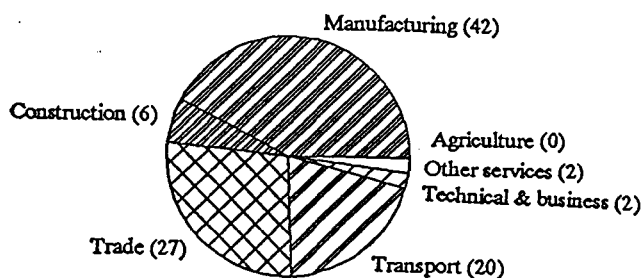
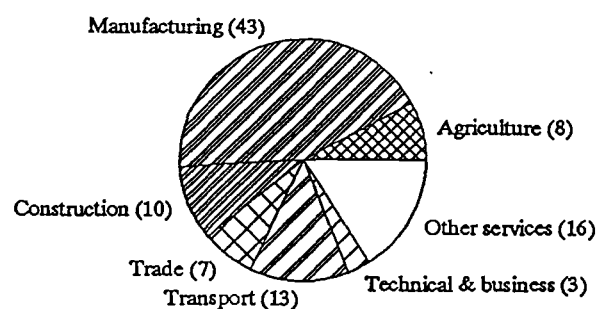


Chart 7. FFOs in Russia sales in 1992, % by economic sectors



The conclusion that there is a preference for services can be reached by looking at the number of firms with foreign participation. In Estonia 55 per cent and Russia 61 per cent of enterprises operate in the services sector. Still, the shares of the goods' production – 45 and 39 per cent respectively – are relatively high. If measured in terms of persons employed or annual sales, the picture changes: goods production turns out to employ more people and generate more sales revenue than the service sector. According to a recent study (Astapovich, p. 28) manufacturing is the main sector, involving more than 40 per cent of all firms with foreign ownership in Russia in 1992 (in 1989 it was less than 30 per cent).

2.3 Assessment of banking services

The Finnish participants were asked to pass judgement on behalf their subsidiary or associate company abroad concerning the quality of banking services available. The numbers of the participants responding on behalf their respective FFOs in Estonia and Russia were classified according to their responses to each of the questions (Charts 8–15).

The results differ between Estonia and Russia. In Estonia the number of enterprises with positive (excellent or satisfactory) responses is larger than in Russia. In the case of Russia all response distributions are clearly skewed to the "bad end". This means that most FFOs in Russia have assessed the banking services to be poor both overall and for each particular class of service.

The possibilities of opening an account with a bank were met with the least criticism even by the FFOs in Russia. Banks' ability to transfer payments domestically as well as to and from abroad are rated as poor by almost half the FFOs in Russia (Charts 11 and 13). About 2/3 of the FFOs in Russia rated as poor the ability of Russian banks to provide them financing. In Estonia the distribution is less negative than in the case of Russia (Charts 10 and 12). As regards the availability of credits, even the Estonian FFOs rated the banks' performance as poor (Chart 14).

Banking services in Estonia and Russia assessed by firms with Finnish ownership (FFOs).

Chart 8. FFOs in Estonia
by experience of opening a bank account

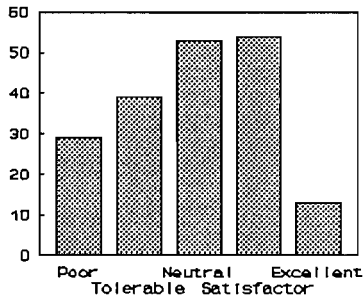


Chart 9. FFOs in Russia
by experience of opening a bank account

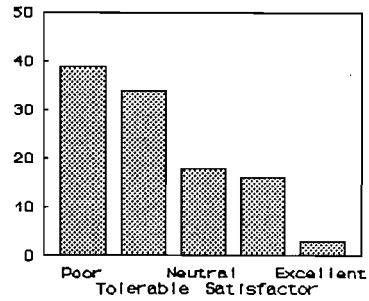


Chart 10. FFOs in Estonia
by experience of transf. domestic payments

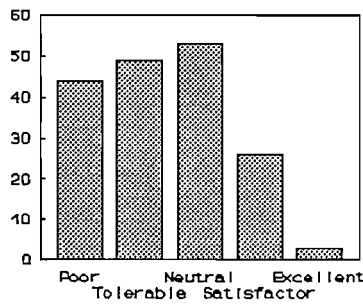


Chart 11. FFOs in Russia
by experience of transf. domestic payments

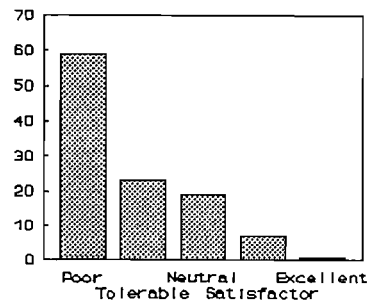


Chart 12. FFOs in Estonia
by experience of transf. foreign payments

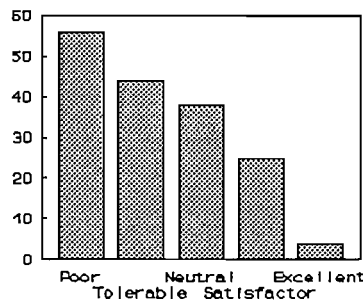


Chart 13. FFOs in Russia
by experience of transf. foreign payments

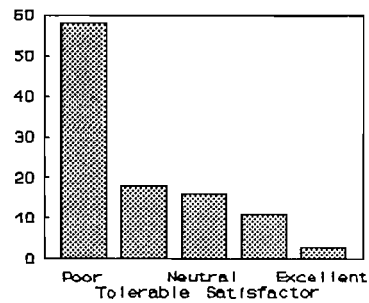


Chart 14. FFOs in Estonia
by experience of availability of credits

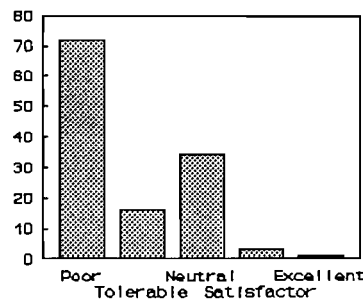
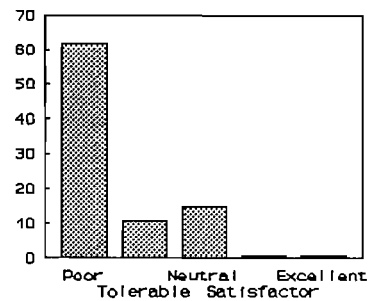


Chart 15. FFOs in Russia
by experience of availability of credits



One would expect that the FFOs in the two largest Russian cities – Moscow and St. Petersburg – would be more satisfied with banking services than the FFOs elsewhere in Russia. The urban centres are usually in a better position than rural areas to provide banking services to enterprises. Somewhat unexpectedly, however, the results of the survey did not support this assumption. The FFOs outside the two largest cities seemed to be somewhat less dissatisfied with banking services than did the FFOs in Moscow and St. Petersburg.

The survey data does not make it possible to state any reasons for this or even to determine whether the FFOs outside the cities are actually served better and/or have had lower expectation from the outset. The distributions of these groups by economic sector are nearly the same, as are the average firm sizes. The Moscow and St. Petersburg – based FFOs have borrowed somewhat more (FIM 4.1 mill./FFO), than the FFOs outside these cities (FIM 1.4 mill./FFO). One might assume that the FFOs in Moscow and St. Petersburg would have based their business strategies more on external financing than the FFOs outside these cities, only to be disappointed in their expectations.

Table 4. Sources of FFO borrowing in 1992

Source of credit				
Total amount borrowed in 1992, FIM mill.		from Finland country per cent	from host country distribution	from third country
Host country of FFO				
Russia	387	60	13	27
Baltic countries	77	83	6	10
Estonia	66	79	8	12
CEEC	302	14	86	0
Other (=other FSU)	51	0	100	0

As shown in Table 4, a major part (60 per cent) of the credit financing in 1992 for the Russian FFOs originated from Finland or from the third countries. A minor part (6 per cent) was borrowed from Russian banks. The situation is even more biased in Estonia where more than 80 per cent of credit financing came from Finland and only 6 per cent from the local banking community. This supports the conclusion that the Estonian and particularly the Russian banking systems are unprepared to finance foreign investors in the respective countries. The situation is better in the CEE countries. There the local banks provided 86 per cent of the credit to FFOs. The profiles of the responses of FFOs in the CEE countries closely resembled those of FFOs in Estonia. Even here, the respondents expressed particular dissatisfaction with the availability of credit.

In Estonia, the high share of borrowing from Finland (79 per cent, Table 3) associated with the high share of sales to Finland (49 per cent) leads to us to conclude that much of the credit financed from Finland was directly trade related suppliers' or buyers' credit. This is not case with Russia. There, 60 per cent of FFO sales were materialized with the host country. Still, the FFOs obtained only

13 per cent of credits from the local markets in 1992. The FFOs in the CEEC countries received 86 per cent of their financing from the local financial markets. Their sales were roughly evenly divided between Finland, the host country and third countries (Table 3).

The FFOs were also asked to assess their experiences in doing business in their respective host countries as well as their expectations. The approach used was similar that used in assessing banking services. The results are presented in Charts 16–18 (experiences) and Charts 19–21 (expectations).

The Estonian experiences are rather balanced: there are more FFOs with poor experiences than with excellent experiences. On the other hand, the number of the FFOs with satisfactory experiences clearly exceeds the number that characterized their experiences as "tolerable". Also the number of FFOs with "neutral" assessment is quite large (Chart 16).

The FFOs located in Russia give a more negative picture: the relative share of those FFOs having "tolerable" or "poor" experiences is larger than in Estonia (Chart 17). In comparison with the profile produced by the 1991 survey, the picture has not really improved, because the share of firms having had "poor" experiences has increased. This is true also regarding the assessments of the FFOs in urban and rural Russia, if compared with the results of the last survey in 1991. These results may have been affected by the fact that Estonia was included to the FSU results in 1991 but not in the present survey. Unlike the Russian FFOs, a clear majority of the Estonian FFOs have neutral or better business experiences (Charts 16 and 17).

The improvement in expectations is evident by comparing the distributions of Charts 20 and 21 with that of Chart 19. The largest group in the 1991 survey consisted of those FFOs in the FSU which expected that the situation will continue unchanged. During April–August 1993 most of the respondents participating in the FFOs in Russia and Estonia assessed the business outlook as improving in their respective countries. In Estonia there were four times as many FFOs reporting an improving outlook as compared to those expecting no change. Only a few FFOs in Estonia expected the situation to worsen (Chart 20).

Experiences in doing business (Charts 16 and 17) and business expectations (Charts 20 and 21) in Estonia and Russia in comparison with those in the FSU in 1991 (Charts 18 and 19).

Chart 16. FFOs in Estonia
experiences from conducting business

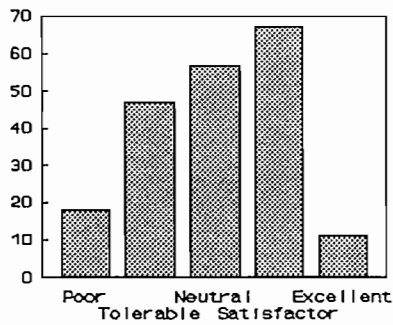


Chart 17. FFOs in Russia
experiences from conducting business

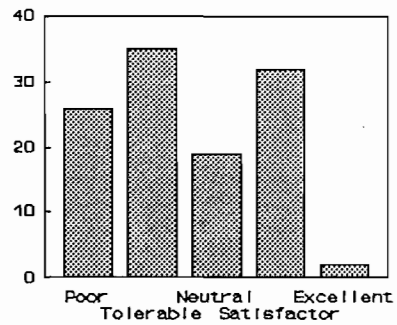


Chart 18. FFOs in the FSU in 1991
experiences from conducting business

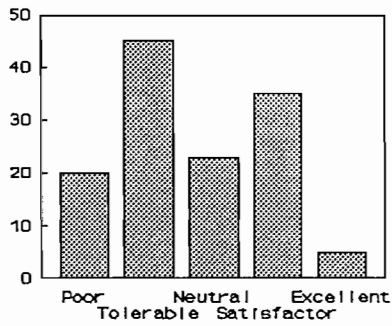


Chart 19. FFOs in the FSU in 1991
business expectations

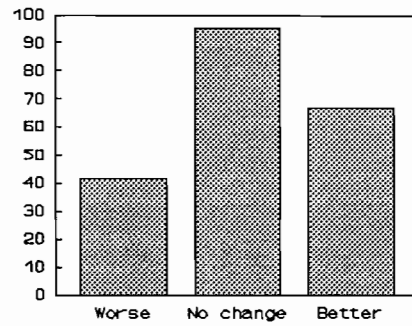


Chart 20. FFOs in Estonia
business expectations

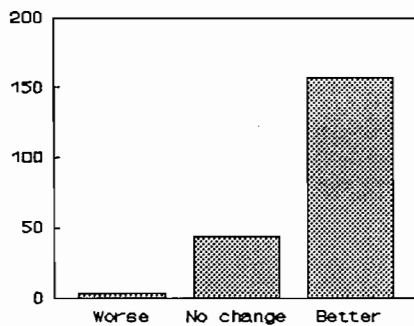
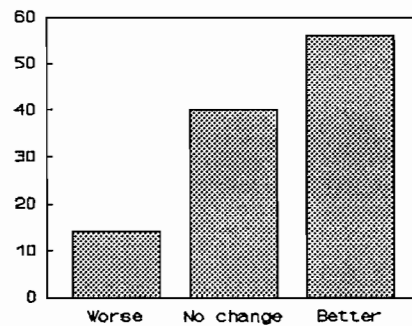


Chart 21. FFOs in Russia
business expectations



3 Summary of findings and comments

Finland continues to be one of the main investing countries in Russia and Estonia. Direct investments from Finland have increased most rapidly to Estonia, if measured in number of participants or establishment of subsidiaries. The results of the survey also support the observation that Finnish direct investments are not lagging behind the investments to Eastern European countries originating from other countries.

The firms with Finnish ownership (FFOs) contribute more the production of goods than to the production of services. The number of people they employ in goods production is larger than in the production of services. These findings run counter to the general allegations that foreign investors prefer to invest in the services sector; the results of survey bear evidence to the contrary. If measured in number of people employed or volume of sales, the direct investments are oriented to the production of goods more than to production of services.

The FFOs in Estonia, and particularly in Russia, consider that the local banks are not yet able to provide them with satisfactory banking services. Poor availability of bank credit was assessed to be the most difficult problem not only in Russia, but also in Estonia and even in the central east European countries. The FFOs in Russia did only 13 per cent of their total borrowing locally, 60 per cent came from Finland. The corresponding percentages for FFOs in Estonia are 12 and 79, and for the central east European countries 86 and 14 (Table 3).

Respondents were encouraged to comment freely on their experiences. The comments received dealt with the circumstances in Estonia and Russia. They confirmed the commonly shared knowledge that Russian and Estonian legislators only insufficiently understand western ideas of entrepreneurship and free markets. Authorities are guilty of unpredictability and arbitrariness. Some respondents drew attention to the small size of the Estonian markets (inadequate purchasing power). In Russia, inflation and changing exchange rates were considered problematic. Also, deficiencies in legislation and continued increases in tax rates and customs tariffs and other payments and "commissions" were cited. Business activities had been hampered by controversial or inadequate legislation with regard to acquisitions and construction works. Sometimes crises of confidence had destroyed a partnership – the firm had been simply "milked dry" of funds by Russian partners.

For the sake of balance one should point out that several respondents were satisfied, stating that "the business goals had been achieved". There are reasons to believe that respondents with bad experiences were perhaps more easily persuaded to disclose their experiences than were the successful ones.

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