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ESTABLISHMENT AND OPERATION IN HUNGARY

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FOREWORD

Drives behind the creation of east-west joint ventures in different countries, despite some similarities, demonstrate national peculiarities. Differences as well as similarities can range from governmental policies regulating the economic behavior of enterprises to the strategies employed by different companies.

East-west joint ventures have a relatively short history in all countries, rendering empirical studies of their problems and experiences necessary.

IIASA's comparative study on east-west joint ventures and their operational problems is based on an international network. Many countries represented in this network have already conducted their own analyses of varying scope and depth.

Such an analysis has been done by Hungary, and a summary of the findings are presented in this working paper by Dr. Tamas Benedek. The study tries to resolve several research questions important from the point of view of national goals and policies. The findings and conclusions generalize the current practice of operating joint ventures in Hungary and demonstrate the need for more detailed studies in the future.

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SOME EXPERIENCES OF JOINT VENTURE ESTABLISHMENT AND OPERATION IN HUNGARY

Dr. Tamas Benedek[1]

INTRODUCTION: WHY JOINT VENTURES?

Joint ventures are fundamentally the highest level of international business relations. A typical progression could begin with the simple export-import (trade) activities, followed by hiring personnel, and then by developing international cooperation. The joint venture, as a form of international economic or business relations, can indeed integrate all other forms, but is much more important as an organizational body or system. It is not only a progressive development, but also a change of direction in the quality of business relations.

This fact itself would be enough to underline the importance of joint ventures, but in the last three or four years, we have identified many other rational arguments for joint ventures. Practically the economic and governmental demands and expectations have been growing intensively in Hungary during the last four or five years.

Hungarian authorities estimated that with the help of special regulations, newly introduced laws (in other words, "the green light") would multiply the number of such companies and that this trend should indirectly help the entire economy.

We must recognize that the experiences of this very short period are not enough for a deep analysis or research, but on the other hand, we think that there are some very important elements or questions which can be or must be addressed now.

The main purpose of those studies behind this summary was to answer questions dealing with joint ventures on both macro and micro levels. Our aim was to clarify the ideas, expectations and demands in order to identify the main problems of this topic.

The first governmental expectation intended to use joint ventures or **moving capital** to help resolve a balance of payments problem. The concept can be explained as follows:

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Hungary was having problems with its balance of payments. If moving capital were to enter the country, the shortage of hard currency to finance research and development activities could be partially solved. It was also estimated that this process would allow the government to maintain the standard of living and to pump additional money into the economy.

The second expectation believed that with the help of newly established joint ventures, advanced technology and techniques would enter the country and could be adopted within a shorter period of time with the help of foreign specialists.

Thirdly, it was expected that the new joint ventures would solve or at least demonstrate the main directions necessary to solve the permanent problem of structural change.

The fourth demand was to give direct help to the national budget. The main factor in the balance of payments is the trade balance. If the new joint ventures could increase export activities, the result could be a better trade balance.

Until now, there has been a minimum requirement which is stated in the joint venture regulation. Any joint venture can exist in Hungary if its hard currency expenditure is not higher than its hard currency income.

The fifth expectation was to establish and disseminate advanced methods of management, data processing computer techniques, marketing and "orgware." Within this frame, two variations are possible. First, the new joint ventures would establish or further a good working relationship with the mother company, and secondly the specialized joint venture companies could sell consulting services on the Hungarian market.

The sixth expectation was to improve the market competitiveness of Hungarian companies abroad. With the help of joint ventures, the Hungarian companies would have cheaper access to learning how international markets work, and overall what kind of relations, actions and organizations are needed, etc.

After four years, we have to conclude that to date only a few of these expectations have be realized. At the same time, we think that, with the help of a better economic and legal background, not only the above mentioned benefits of joint ventures will be realized, but perhaps additional ones as well.

STUDY QUESTION 1: THE STATISTICS

In mid-1988, we counted approximately 150 joint venture companies in Hungary. About 10% of them are sleeping companies, and about 30 were established after the completion of our research in

1987. Of the 104 joint venture companies in our count mid-1987, we found 66 in the production sphere and 38 in the service sector. Twelve of them are located in the extraterritorial zone (duty-free).

Table 1 shows the Hungarian companies who have established joint ventures by industrial profile.

TABLE 1.

Profile	Number of Companies
Foreign trade agencies	22
Banking	16
Agricultural firms	15
Machine and instrument manufacturers	14
Services	14
Construction	11
Chemicals	10
Home trade	8
Light industry	8
Travel agencies	6
Food industry	4
Transport	4
Mining	3
Health services	1
TOTAL	136

Comparing the profile of the newly founded joint venture companies in Hungary with the companies shown in Table 1, the picture is rather different. Table 2 shows the profiles of these 104 joint venture companies.

TABLE 2.

Profile	Number of Companies
Machine and instrument manufacturers	28
Consulting services	16
Construction	10
Light industry	10
Chemicals	9
Food industry	8
Travel agencies	7

Agribusiness	6
Banking	3
General services	3
Health services	2
Transport	2
TOTAL	104

At the end of 1987, the total capital of the joint ventures located in Hungary was about US$ 200 million.

Until 1984 and especially since 1985, there has been a strong development in establishing joint ventures. Through March 1987, a total of 90 joint venture companies had been registered:

4% were established between 1972-80,

32% between 1981-84,

64% between 1985-87.

Nearly 60 joint venture companies were established in 1987 alone!

Most of the joint ventures are very small companies with capital amounting to between US$ 1-2 million. Two thirds of them are located in Budapest.

The hard currency budget of the joint venture companies is rather balanced, but only due to one major exporter (US$ 1.2 million). During 1986, the total income was approximately US$ 36 million in hard currency. The total income including soft currency (HUF) is three times higher.

Most of the joint venture companies were profitable over the last four years. The average profit realization was 29% of the average capital involved.

The growth of net profit after taxation was higher (by 2.5%) than the profit before taxation (by 1.8%).

The most active countries among Western partners are the Federal Republic of Germany and Austria. Table 3 shows the countries which had established joint ventures in Hungary as of July 1987.

TABLE 3.

Country	Number of Joint Ventures	
FRG	27	INTERNATIONAL
Austria	25	(more than one)
Switzerland	9	
USA	7	CIB
Great Britain	4	Skala-Arab WT.
Sweden	4	Sphero-Evig
Netherlands	4	Club Tihany
Canada	3	Unicbank Ltd.
Finland	2	FLEXYS
Japan	2	Hungarian-Japan Fermentation Ltd.
Italy	2	

Norway, Denmark, France, Belgium, Greece, Portugal, India, Liechtenstein (1-1).

STUDY QUESTION 2: IS HUNGARY ATTRACTIVE FOR MOVING CAPITAL?

We have interviewed foreign specialists (businessmen) to obtain their views as to what are the advantages of the Hungarian economy for a joint venture. Their responses can be summarized as follows.

Market Expansion

This aim was mentioned most frequently by the foreign entrepreneurs as a reason for establishing a joint venture in Hungary. Naturally, they do not mean only the Hungarian market, but also the future possibilities of exporting to other Socialist countries, primarily the Soviet Union. Most of those interviewed consider Hungary as a possible bridge between East and West.

Attractive Economic Background

Most of the specialists characterized the Hungarian political and economic situation as relatively good or average. Hungary, with the 1968 reform, has a good image abroad.

We must stress here that:

* all serious business people conduct very systematic research before making a decision to establish a joint venture and

* the Hungarian situation has changed in recent years.

Low-priced Manpower

Wages are relatively low in Hungary, and that implies low labor costs, one of the most important issues when considering an investment. The Boston Consulting Group mentioned in a study that the "low-priced manpower in Hungary is only a myth, and we must forget about it." This statement, however, cannot be evaluated without investigating the actual productivity under the related business structure and company organization studied.

Characteristics or Criteria

As a result of this study, we collected nine important characteristics or criteria. These criteria underline the demands important to a foreign entity which is considering investing capital abroad.

1. Product Knowledge: Product knowledge, especially of highly advanced products, is very often not sufficiently high at Hungarian firms. Knowledge of the entire business sphere is also necessary (competition, technology, demand, market situation, raw materials, etc.).

2. Market Knowledge: The Hungarian company must understand its existing market. Otherwise, the company and its managers will not be able to command a minimal level of trust with its Western partners. Without trust, no one is willing to cooperate.

3. Professional Knowledge: The level of technical and professional knowledge in Hungary is not bad. Sometimes, however, the operation or preparation of a project is not worked out on a sufficiently advanced level, which can give a worse impression than the situation really merits.

4. Organization of Meetings and Discussions: "Time is money!" Everyone can lose out on an opportunity if he/she is not able to organize or direct a discussion or meeting. This is one of the main weak areas of Hungarian managers.

5. Organization: Most Hungarian companies are over-organized. External bureaucracy is quite enough to fight against, so cut it internally if possible.

6. Flexible and Fast Decision-making Process: If a company is over-organized, the decision-making process is bureaucratic. The decision-making ability is the most sensitive element of business life. WHO MAKES THE DECISION?

WHEN? HOW TO PRESENT IT? Hungary must answer these questions if we want more joint ventures in our country.

7. Keeping the Terms: One must keep the terms of a contract or agreement if one is to remain competitive. Correct behavior in personal contacts is as important as the terms of delivery.

8. Execution of Contracts: Reliability is the most important factor in business relations. It is very difficult to obtain and very easy to lose. In normal competitive circumstances, no one can ignore or forget written or verbal (!) agreements.

9. Productivity and Performance: Competitors always try to propose something better: better quality, better price, better package, etc. To be better depends on the most important element of competitiveness, namely, productivity and work performance. Without better performance, no one can achieve profitable business results steadily.

STUDY QUESTION 3: SOME WEAKNESSES OF HUNGARIAN ENTERPRISES

In this study, we have tried to compare Hungarian companies (and their economic circumstances) with other countries and firms, first of all with the main competitors in the field of joint ventures, such as Portugal, Turkey, Greece, and some economies in the Far East. The main negative or weak characteristics are as follows:

Question of Property: Foreign ownership must be less than 50% of the joint venture.

Government Guarantees: Hungary is not able to offer the same guarantees as its competitors.

Free Market Situation and Free Competition: The monopolistic situation is strongly established.

Balance of Payments Aspect: Hungarian currency is not convertible.

Old Products, Old-fashioned Methods: There are difficulties in adapting to new ideas.

Difficulties in Western Import and Eastern Export: It is difficult to obtain licenses.

Shortage of Capital: The interest is to remain poor and small.

Difficulties in bookkeeping and accounting: Different standards exist in these areas.

STUDY QUESTION 4: WHY ARE LARGE HUNGARIAN ENTERPRISES SO PASSIVE?

There are in total nine large Hungarian enterprises which have decided to establish joint ventures. They are:

* TUNGSRAM (main product is lamps)
* HUNGARIAN ALUMINUM TRUST
* VIDEOTON (televisions and computer components)
* HUNGARIA PLASTIC WORKS
* COALMINES OF TATABANYA
* SKALA TRADE (largest warehouse chain)
* TAURUS RUBBER FACTORY
* BABOLNA AGROCOMBINAT (poultry)
* PAPER MILLS

We have realized during our research that this passive behavior can be attributed first of all to the interests of these companies. It is not forbidden to establish a joint venture, but no one helps them do so. The government wants to have more joint venture companies in Hungary, but has not yet taken sufficient measures to encourage the large companies in this. The reasons for this passivity, therefore, are:

* Economic regulations and uncertainty,
* Poor sources of R&D,
* Uncertainty as to what to offer, what can be offered,
* Uncertainty how to offer and to whom,
* Uncertainty how to manage the joint venture, etc.

Summarizing this problem, we have found four main groups of gaps:

* Group one: economic regulations which present many difficulties if the enterprise wants to grow.

* Group two: views and interests (and sometimes the level of comprehension) of the Hungarian companies and their management.

* Group three: shortage of knowledge and fear of change, of new ideas and methods.

* Group four: miscellaneous reasons, such as bureaucracy, long-standing prior relationships, etc.

STUDY QUESTION 5: HOW CAN WE ADOPT ADVANCED TECHNOLOGY?

The basis of a truly successful joint venture company is mostly a long-standing and creative relationship between two companies or individuals. The traditional partners of the Hungarian companies are not the large multi-national firms of the West, but small- and middle-scaled entrepreneurs. This type of firm is mainly in the "second line" of the innovation process, which means that they are not leaders in R&D, they do not produce the newest products.

When this type of company decides to establish a joint venture outside its home country, in a less developed country with a less developed market and problems of conversion, then the firm does not want to sell or transfer its newest technology and know-how.

This means that most of the technical and technological projects offered for adoption with the help of a newly registered joint venture company are in the "third line" (see Table 4).

TABLE 4.

Phases of Technology and the Market

1st Line:	PIONEERS	Highest technology, privilege of use, own R&D, leading products, first stage of the Product Life Cycle (PLC).
2nd Line:	FOLLOWERS	Adopted technology, ability to adopt, quick reactions, 2nd stage of PLC.

3rd Line:	CLIMBERS	Medium-developed, technology with old-fashioned elements and methods, difficult competitive position, adopted products with 2- or 3-year lag, 3rd stage of PLC.
Under the Line:	TECHNICAL DESERT	Old technology, minimum ability to adopt, old products, not competitive.

Our research has proved that:

* A new joint venture established between a firm from a developed and a firm from a developing country does not automatically mean that advanced technologies and methods will be transferred;

* If a firm from a developing country wants to import modern technology with the help of a new joint venture, IT MUST BE PRODUCING ITS OWN R&D RESULTS;

* If a firm wants to adopt a new technology, it must prepare not only internally (place, people, money, etc.), but externally as well (infrastructure, raw materials, services, etc.).

STUDY QUESTION 6: THE JOINT VENTURE EFFECT

Most of the existing successful joint venture companies can be described by contrasting them with traditional firms. The differences lie primarily in the following areas:

* customer relations,

* work discipline,

* business organization,

* human-oriented management,

* internal and external relationships.

Wages are definitely higher at joint venture companies. The average difference is about 40%, but we find cases ranging between 10-70%. The salary of a blue collar worker is higher by 50% in a new joint venture company, but

IF THE COMPANY WANTS TO RAISE WAGES BY 10%, THEY HAVE TO RAISE PRODUCTIVITY BY 30%!

The salaries of managers depend closely on the results of the joint venture company, but here the differences can be much greater.

The other important factor which appears when contrasting new joint venture companies with traditional firms is more flexible behavior and quicker reaction time. Letters and telephone calls are answered within three days; offers and pre-contracts are prepared in half the time it would take a traditional firm.

STUDY QUESTION 7: SPECIAL CONSULTING JOINT VENTURE COMPANIES

There are sixteen joint venture companies in Hungary which deal with consulting activity. This shows the shortage of this service in our country. The World Bank requirements have especially increased the demand for this service.

The foreign companies which have established these special joint ventures are by country: Federal Republic of Germany, 4; Switzerland, 4; Austria, 3; USA, 2; France; Finland; India (1 each).

The activities of these consulting joint venture companies are rather mixed. They try to satisfy the entire demand of the Hungarian market. Until now, they have not been able to export, but in their plans have underlined their intention to do so in future.

Because of the "fresh market situation in Hungary," the competition among the consulting firms is strong and specialization is weak (everybody does everything).

We have tried to separate the main services they offer as follows:

* functional and economic analysis of companies,
* system analysis,
* orgware,
* software development,
* strategic planning,
* automating work processes,

* selling hardware and software,
* analyzing investments,
* improving business relations,
* searching for potential partners,
* selling R&D results,
* marketing and market research,
* organizing joint venture companies,
* publishing.

CONCLUSION

Finally, we would like to point out that:

* In our studies, we have dealt with the development of joint ventures. We felt that there are mainly two requirements to move forward. On the one hand, we must encourage the foundation of joint venture companies, and on the other hand, we must help them operate. In our studies, we have collected some proposals which would be able to help both the Hungarian government and the companies to achieve better results in this field (see Chapter 5 and 6 of the original study).

* In a recently published study, we dealt with the problems of operating a joint venture company (how to stay alive).

* In a separately published study, we dealt with the problems and experiences of joint venture companies between CMEA countries.

We deeply hope that the cases of joint venture companies in Hungary and elsewhere in the world will help to build stronger relations between nations, cultures, and peoples. We think that the joint venture is not only a high level of cooperation in business life, but politically a strong basis for our future.