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## Outward FDI in financial services: the case of Hungary

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*This work-in-progress document contains results of a research analysing outward FDI in financial services from Hungary between 2001 and 2014. We identified the main foreign investor companies, of which one is a Hungarian-controlled, majority foreign-owned bank and a local subsidiary of a German bank. The paper examines in detail the foreign investment activities of the leading investors and changes in it during the crisis. The methodology applied is detailed case studies of the main investor banks, based on semi-structured interviews with leading managers as well as other information collected from specialised newspapers and journals and the bank balance sheets. On the basis of these, Hungarian OFDI in financial services is analysed, regarding the main ownership advantages of investors, their motivations to invest, the entry mode chosen, the geographic locations of the investments, the strategy settings of the companies and the home country impact of outward FDI.*

### 1. Introduction

Outward foreign direct investments (OFDI) increased substantially from former transition economies after the start of the transition process. Hungary was among the frontrunners in OFDI in this country group, starting to invest abroad considerable amounts from the mid-nineties. (Kalotay, 2002; Antalóczy and Éltető, 2002) At the end of 2012, the stock of Hungarian OFDI amounted to more than 26.5 billion euros, which is the second largest behind Poland among the new member states of the European Union. In per capita terms, only Estonia and Slovenia have higher OFDI than Hungary in the same country group.

Hungarian OFDI is concentrated in a few sectors, partly in connection with the largest transactions connected to a few companies. (Sass, Kalotay, 2010) Thus it is highly concentrated in terms of the investing companies. According to the data of the Hungarian national bank, the outstanding sectors are mining, in manufacturing: oil, pharmaceuticals and electronics and in services: financial services, professional and other services (mainly business services). Thus the high concentration in terms of the investors is connected with the sectoral composition of OFDI. The leading sectors are: financial services (20% of total OFDI, with OTP Bank as the most important outward investor), mining and quarrying and manufacturing of refined petroleum products (18%, connected to the activities of MOL) and pharmaceutical industry (6%, mainly Richter). OFDI in financial services has represented a significant part of modern Hungarian OFDI (Gál, 2006; Antalóczy and Sass, 2008; Sass, Kalotay, 2010; Sass et al., 2011), though its absolute values had been relatively small: it surpassed

the half a billion euro stock only in 2000, but afterwards it grew dynamically to exceed a stock of 3 billion euros by the end of 2009. At the end of 2009, it represented 23.5 % of total Hungarian OFDI, being the leading services sector in terms of OFDI. By the end of 2012, the OFDI stock in financial services increased to more than 5 billion euros, a significant increase from previous year. (Direct comparison with developments before 2008 is not possible because of the change in methodology in sectoral data collection.)

Similarly to total OFDI, financial OFDI is highly concentrated in terms of the number of significant investors (Gál, 2010): according to our estimation, OTP represents the overwhelming majority of investments abroad in the sector, while a small share (an estimated 100-200 million euros) was taken up by MKB until 2014, thus 2012 data contained the foreign investment of this bank.<sup>1</sup> The third investor is also small, the formerly OTP-related OTP Garancia, operating in investment services may be responsible for the majority of OFDI in that sector, amounting to a stock of 26 million euros in 2009. OTP Garancia was acquired in 2008 from OTP by the French Groupama and thus this company inherited an office in Slovakia.

Table 1 Outward FDI (stock) in Financial activities, 1998-2009 (million euros)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Monetary activities	57.7	67.6	48.3	86.7	127.9	182.1	295.2	1600.9	2075.7	1702.7	1991.3	2158.0
Other financial activities	249.0	326.8	529.8	583.3	565.0	835.6	775.1	442.7	518.4	163.5	616.7	886.3
Insurance	0.4	0.3	0.3	-	6.1	13.3	17.4	12.0	20.3	86.6	25.6	26.9
Total	307.0	396.6	605.4	670.7	731.0	1056.6	1087.8	2080.7	2614.8	1996.9	2650.1	3086.7

Note: equity, reinvested earnings and other capital; stock; NACE'03

Source: Hungarian National Bank

Table 2 Outward FDI (stock) in Financial and insurance activities, 2008-2012 (million euros)

	2008	2009	2010	2011	2012
Financial intermediation	2 547,5	2 655,9	2 947,8	2 607,9	2 215,8
Insurance	12,6	12,3	18,5	14,1	25,2
Total	2 577,5	2 689,7	2 990,2	2 644,5	5 312,5

<sup>1</sup> As we will see later, MKB sold its Bulgarian subsidiary bank in August 2013, see e.g. [http://www.standartnews.com/english/read/bulgarias\\_first\\_investment\\_bank\\_acquires\\_local\\_subsidary\\_of\\_hungarian\\_mkb-290.html](http://www.standartnews.com/english/read/bulgarias_first_investment_bank_acquires_local_subsidary_of_hungarian_mkb-290.html) and its Romanian subsidiary bank in January 2014, see e.g. <http://www.romania-insider.com/mkb-bank-sells-romanians-nextebank/112265/>

Note: NACE'08

Source: Hungarian National Bank

The relative importance of OFDI in financial services in Hungary has changed considerably over time compared to other new EU members, in which OFDI is significant. Financial services was the dominant sector compared to the Visegrad economies before the crisis (Sass and Radlo, 2011). However, this has changed considerably over the crisis years – as in all other countries in the region. (Table 3) In 2012, Hungary had the third highest share of financial services in overall outward FDI stock among the analysed countries

Table 3 Share of Financial intermediation in total OFDI stock, %, selected economies, 2008 and 2012

	2008	2012
Czech Republic	7.3	62.3
Estonia	37.1	9.3
Hungary	16.6	20.0
Poland	25.1	30.1
Slovakia	17.5	6.5*
Slovenia	18.2	10.2
<i>Memo item: Austria</i>	<i>31.0</i>	<i>24.9</i>

Source: OECD International Direct Investment Statistics 2014, [http://www.oecd-ilibrary.org/finance-and-investment/oecd-international-direct-investment-statistics\\_2307437x](http://www.oecd-ilibrary.org/finance-and-investment/oecd-international-direct-investment-statistics_2307437x)

Note: data for 2011

In spite of the decline in relative significance of Hungary as an outward investor in financial services, the main investor, OTP Bank is still the only significant regionally-controlled player in that area together with the Polish PKO Bank. (Raiffeisen Research, 2015) Other banking players in the region are coming from Western European countries (and smaller projects appear from Russia). Thus increasing outward FDI from other countries of the CEE region in Table 3 may be mainly of indirect nature.

The paper is organised as follows. After presenting the theoretical framework, the main aim of the research and the methodology used are shown. The next section provides information about the two main foreign investor banks in Hungary. This is followed by the analysis of their outward investments in various areas (indirect versus direct investors, ownership advantages, strategy, motivation, entry modes, choice of location, impact of/on the home economy; and the impact of the crisis). The last section concludes.

## 2. Financial OFDI and multinational banks – theoretical framework

The emergence of multinational banks can be explained using the theory of multinational enterprises. Thus banks may have different motivations when expanding abroad. Due to the nature of bank activities and the relative fragmentation of markets (due to national regulations), the most important motivation can be to access new markets (especially in relation to developments in the domestic market), thus the market-seeking motive dominates. Furthermore, banks can improve their efficiency through lowering costs or increasing revenues, or through economies of scale and/or scope, thus the efficiency-seeking motive may also be relevant. Furthermore, banks can gain important strategic assets and can diversify risks through their foreign expansion, thus the strategic asset seeking motive may also be relevant.

This paper uses Dunning's extended OLI framework for analysing the process of the internationalisation in the financial services sector. According to the OLI-framework, the investors must own an ownership advantage, which is based on intangible assets in order to be able to move abroad. Ownership advantages enable the foreign bank to compete with local banks in spite of its "liability of foreignness". On the other hand, this intangible asset may be used by the bank by keeping it inside the organisation and not "putting it to market forces", i.e. not to sell it on the market (internalisation advantage). This type of advantage in banking is usually connected to information: for example, a cognitive imperfection (Dunning (1981) and stems from the importance of the flow of information between the bank and the client, which is made mainly through personal contacts. Thus banks may follow their (important) clients to foreign countries – or vice versa. In their most updated form (Dunning- & Lundan, 2008), ownership advantages can be divided into asset-based advantages (Oa) such as cutting-edge technologies, marketing prowess or powerful brand names, and transaction-based advantages (Ot) such as common governance of assets and interaction with other corporate networks. From this it can be deduced that transaction-based ownership advantages are indirectly shaped and influenced by the home-country business and regulatory environment and culture. Furthermore, the locations of the investment must possess some specific advantages in order to be able to attract these investments (locational advantages). Empirical research shows that location-specific advantages such as size, human capital and cultural distance, do provide an explication of the internationalization of financial firms. (Outreville, 2007)

Another theory of "stages internationalisation" is used to some extent, when describing the geographical spread of the investments. According to the stages approach, which is described in detail in the Uppsala model, companies go through different stages of internationalisation. The first stage is the ad hoc export, the second is systematic exporting through an independent foreign sales firm, in the third stage a foreign representative company (for sales) is established, and in the fourth stage, a foreign production unit (affiliate) is established. (Johansson, Wiedersheim-Paul, 1975; Johansson, Vahlne, 1977) In the stages approach, a determining role is played by the decision taking capacity of the management, which is determined by available information, knowledge and experience. The Uppsala model underlines the importance of continuous learning based on foreign experiences, and thus how the stages are built on each other. Moreover, the importance of psychic distance is emphasized, thus in international transactions cultural, language and other differences act as barriers to the flow of information and thus the decision taking capacity of the company. Parallel with the increase in foreign experiences of the company, this psychic distance decreases.

### **3. Research question and methodology**

The main aim of the present paper is to describe developments in Hungarian OFDI in financial services. On the basis of the analysis, we can relate the characteristics of Hungarian OFDI in the financial sector on one hand to the theories and empirical findings of multinational companies and banks and emerging multinational companies and banks. The main areas where the foreign expansion of Hungarian banks are analysed will be the following: direct versus indirect investors, ownership advantages, strategy, motivation, entry mode, choice of location, impact of/on the home economy and impact of the crisis.

The research is based on semi-structured, questionnaire-based interviews with leading managers of the two leading foreign investor banks in Hungary. Two interviews were conducted with the representatives of the two banks back in 2011 and another one with the representative of OTP Bank in 2015. The interviews were based on the same semi-structured questionnaire. Besides information from these interviews, data from the balance sheets of the companies and specialised journal and newspaper articles and texts of interviews with the CEO of OTP Bank were also used. This methodological approach can be justified by the extremely low number of important investors in financial services in Hungary, and thus the high concentration of investment in terms of investors. Furthermore, “qualitative research” could also be carried out using this method, which may supplement well and even correct results gained from quantitative analysis.

### **4. A short presentation of the two leading investors: OTP and MKB**

#### **4.1. OTP**

OTP Bank, is Hungary's leading commercial bank. The legal predecessor of OTP was established in 1949, which was a nation-wide state-owned bank specialised in retail banking. In 1990 it became a public company and non-banking activities were separated. At present, OTP is the determining financial institution in Hungary as far as retail banking is concerned; in retail deposits it commands a market share of around 32%. Its share in the mortgage loan market is also above 30%. It is a market leader also in consumption loans (over 10% share) and the other loans category (over 20%). (Molnár, Holló, 2011) It owns the highest number of ATMs and branches in Hungary. Its market share is estimated to reach 19.3% in Hungary, according to Raiffeisen Research (2015).

The privatisation process of OTP Bank was launched in 1995. It was privatised through the stock exchange, in three “tranches” (1995, 1997 and 1999). As a result of three public offerings along with the introduction of the bank's shares into the Budapest Stock Exchange the state's ownership in the bank decreased to a single voting preference (golden) share. Individual foreign shareholders were limited to 5 %, and domestic shareholders to 10 %. By the end of the decade, the bank's privatization had been completed and nearly all of OTP's shares had been placed on the Budapest exchange. In 2008, OTP sold one of its subsidiaries: the French Groupama S.A. acquired its insurance business line, OTP Garancia. At the same time, Groupama S.A. has acquired 8% of shares of OTP Group. Currently the bank is characterized by dispersed ownership of mostly private and institutional (financial) investors. In

March 2015, 60.06 % was in the hand of foreign investors. Above 5 % was held by Megdet, Timur and Ruslan Rahimkulov (8.88 %), the French Groupama (8.29 %) and the Hungarian petrol company, MOL (8,57 %) as well as the Lazard Group (5.1%). The state owned 5.03 % (until 2007: a golden share); through the Hungarian National Asset Management Inc. Employees of OTP held 1.24 %.<sup>2</sup> Thus while the majority of OTP's shares are held by foreigners, they are widely dispersed, with no controlling shareholder, and Hungarian shareholders are also numerous and none of the foreign or domestic shareholders own more than 10 per cent of the shares. Due to the regulations of the banks, none of the above 5% owners have more than 10% of the voting rights.

OTP started its "shopping spree" in the region after its privatisation was finished in 2001, when it acquired IRB in Slovakia. At present has foreign operations in Romania, Slovakia, Croatia, and Bulgaria (where its subsidiary, DSK Bank, has become market leader), in Russia, Serbia, Montenegro and Ukraine. In 2008, OTP sold its insurance company to the French Groupama, and together with that, foreign affiliates in insurance in Slovakia, Romania and Bulgaria were also sold. In terms of market shares, the Montenegrin bank is a market leader, and the Bulgarian bank also has a relatively high market share: almost 14 per cent and is a market leader in the country. In other countries, the local subsidiary of OTP is of minor importance with 0.4 to 3% market shares, with significant operations only in certain niche segments. (Raiffeisen Research, 2015) Altogether, it has 11.9 million customers in the region and thus it can be regarded as one of the leading banks of the region.<sup>3</sup> The bank's total employment in 2014 was almost 36000 persons.

## 4.2 MKB

MKB (Magyar Külkereskedelmi Bank, Hungarian Foreign Trade Bank) was established in 1950 for managing currency transactions connected to foreign trade. In 1987, with the introduction of the two-tier banking system in Hungary, it became a universal bank with extending its operations. Its privatisation process took place between 1994 and 1996. In 1994, Bayern LB (25%) and EBRD (16.7 %) gained minority share. In addition, in 1994, the Deutsche Investitions- und Entwicklungsgesellschaft (German Investment and Development Society) acquired 8.3 % of the shares. In 1996, BayernLB bought an additional 25.8 %. Through further acquisitions and increases in the base capital, Bayern LB became the main owner. At present, it is owned by Bayerische Landesbank, München, Germany (89,89%) and P.S.K. Beteiligungsverwaltung GmbH, Vienna, Austria (9.77%).

In 2011 it was among the leading banks in Hungary, especially in corporate lending and corporate deposits. It was market leader in factoring (25.3% market share) (Molnár, Holló, 2011). However, the bank made considerable losses during the last years of its Hungarian operations.

<sup>2</sup> See <https://www.otpbank.hu/portal/en/IR/Shares/OwnershipStructure>

<sup>3</sup> <https://www.otpbank.hu/portal/en/AboutUs/History>

In terms of acquisitions, at first it acquired a domestic bank: Konzumbank in 2003. In 2005, the first foreign acquisition of the affiliate was realised in Bulgaria, where it acquired the majority of the shares of Unionbank, and in 2006, Romexterra Bank in Romania was bought. The acquisition price was not disclosed in neither cases.

The parent bank, Bayerische Landesbank incurred large losses during the financial crisis because investments into sub-prime mortgage securities in the US. One of the conditions of the following government bailout set by the relevant authorities of the European Union in 2012 was to sell the Hungarian subsidiary, MKB Bank before 2016.<sup>4</sup> Before that, as it was already mentioned the two foreign banks owned by the Hungarian affiliate were sold.

MKB was sold to the Hungarian government for 55 million euros, and the parent wrote off 270 euros loans given to the subsidiary. Before selling it, the parent had to cut-up the Hungarian subsidiary bank and separate bad loans.

## 5. Various characteristics of financial OFDI from Hungary

As it was already pointed out, the two most important investors in financial services are OTP and MKB, they are responsible for the overwhelming majority of outward FDI in the sector. OTP Garancia, the insurance company was part of the OTP Group, when it realised its foreign direct investments, thus the characteristics of its OFDI are the same as those of OTP. The French Groupama took over OTP Garancia in 2008 together with its foreign affiliates in Slovakia, Romania and Bulgaria and kept the Slovakian subsidiary, while sold the others.

As far as the timing of OFDI in financial services is considered, OTP was the first to start its acquisition in Slovakia. The abrupt impact of the financial crisis is apparent from Table 4.

Table 4 Timing and geographical locations of investments by OTP and MKB

	2002	2003	2004	2005	2006	2007	2008	2013	2014
<b>OTP</b>	Slovakia	Bulgaria	Romania	Croatia, Serbia (1)	Serbia (2), Ukraine, Russia, Montenegro	Russia	Slovakia, Romania, Bulgaria		Romania
entry mode	Privat.	Privat.	Acqu. (from Turkish owner)	Privat.	all acqu.	Acqu. (local)	selling Garancia (insurance) to Groupa-		Acqu. (Portuguese owner)

<sup>4</sup> <http://www.bloomberg.com/news/articles/2014-07-24/bayernlb-to-sell-mkb-bank-to-hungary-for-74-million>

							ma with the subsidiaries		
<b>MKB</b>				Bulgaria	Romania	(HAA)-	-	Bulgaria	Romania
entry mode				Acqu.	Acqu.	(failed acqu.)	-	selling local subsidiary	selling local subsidiary

Source: own compilation based on [www.mkb.hu](http://www.mkb.hu) and [www.otp.hu](http://www.otp.hu)

The following areas and characteristics of the foreign expansion of the two banks will be analysed in this section: direct versus indirect nature of the foreign investment and foreign investor; ownership advantages and strategy; motivation; entry mode; choice of location; impact of/on the home economy and the impact of the crisis.

#### 4.1. Indigenous versus indirect investors

It is important to distinguish between direct and indirect investors. Direct investors are domestically owned firms, while indirect investors are local affiliates of foreign parents. On the basis of the short descriptions of the banks it is obvious, that basically all OFDI from Hungary in the financial services sector can be evaluated as indirect, because both investors are in majority foreign ownership. However, it is important to note the difference between the two cases. In the case of MKB, it is obvious, that the bank is controlled by its major investor. If we simply take the level of foreign ownership at face value and equal it with the level of foreign control, then also OTP should be considered a foreign controlled bank. (This is the approach taken for example by Altzinger et al. (2003) or Rugraff (2010), where an above 50 % foreign ownership is taken as foreign control.) But while OTP is majority foreign owned, it is obviously not foreign controlled: it is not the foreign owner but the mainly Hungarian management which is taking all strategic decisions, including foreign acquisitions. In the senior management (CEO and 6 deputy CEOs) and the members of the Board of Directors (3 executive and non-executive members) there are no foreign citizens; nor are there any foreign managers reporting directly to the executive director. The official language of the company is Hungarian. Thus OTP while on paper it is majority foreign-owned, all decisions of strategic importance are taken by the Hungarian management residing in Hungary, including strategic decisions concerning among others foreign investments. Therefore, while the company can be classified as an “indirect” investor, due to the foreign majority ownership, we would rather call it qualifyingly a “virtual indirect” investor, because there is no single (or an identifiable group of) foreign investors holding a clear majority. (Sass et al., 2011)

“Virtual indirect” investments understandably are much closer in many characteristics to direct than to indirect investments. The most important distinguishing factor between “virtual indirect” and direct investments can be the higher exposure to risk in the case of “virtual indirect” investors, because they are more dependent on foreign/international capital and they are therefore more directly dependent on changes in the business environment in more than two countries. In the case of direct investors, it is understandably mainly the home and the host countries’ business environment which has a direct influence on the decisions and operation of the parent company. For “virtual indirect” investments, there can be further influencing factors in terms of the third country which acts as a mediator in the investments and/or further countries from which significant holders of shares are present in the ownership structure of OTP. In that case a minor influence can be attributed mainly to the French



Groupama, which operates in a similar sector as OTP. However, its voting rights are limited. Otherwise we could say that direct and “virtual indirect” investors are very similar to each other.

Why is it important to distinguish “virtual indirect” from indirect investments? (For more details see Sass et al, 2011). First, the motivations of investing abroad may be different in the case of indirect and “virtual indirect” (or direct) investments. Motivations usually partly reflect the relative competitive advantages of the home and the host countries. Thus in the case of the “virtual indirect” investments, the competitive advantages of the “real” home country must be taken into account. Second, their impact on the home country can differ from each other to a great extent, for example this has clear consequences for profit repatriation, transfer of capital, which again is realised between the host and the “real” home country. Third, the sustainability of foreign investments, the footlooseness of the investor company can also differ in the case of indirect and “virtual indirect” investors. As Rugraff (2010) points out, the outward FDI path of a given country may prove to be unsustainable or highly sensitive to strategic business decisions taken in another than the immediate home country of the investment in the case of indirect investments. This may result also in a high volatility of both inward and outward investments. OFDI realized by foreign affiliates residing in Hungary may prove to be more footloose than those realized by local investors, as the strategy of the multinational is determined by the parent company residing in a different country. However, in the case of “virtual indirect” investments, the home country where these decisions are taken, where the parent company is residing and the business environment of which influences to a great extent these decisions equals to the immediate home country of the investing company. Thus the high presence of “virtual indirect” investments in itself does not necessarily increase the volatility of OFDI.

Fourth, policy implications may also differ in the two cases. Governments of countries which are home to big multinationals support their “fellow country companies” especially of large size or if they are deemed to have strategic importance in their foreign operations through lobbying and exercising political influence. In that case, clearly, the ultimate investor matters. In the case of “virtual indirect” investors, the ultimate investor country equals to the immediate investor country. Fifth, statistical and data collection considerations can also be important. The presence of “virtual indirect” investors may result in false estimations of direct investments abroad; see e.g. UNCTAD (2006), p. 108.

## **4.2. OA/intangible asset and strategy**

Foreign expansion through FDI is always connected to greater risk than domestic activities, including possible factors which cannot be managed on the basis of experience gained in the country of origin. Thus the bank needs special resources in order to be able to internationalise successfully. It is important to see what are those intangible assets or competitive advantages which enable these banks to successfully enter a new market and efficiently compete with incumbent banks. Such ability can stem from specific human and financial resources at hand, banking techniques, specific banking experiences, organisational skills, skilled personnel, etc. (Mutinelli, Piscitello, 2001)

The Hungarian economy provided a special business environment for OTP to be able to internationalise. The presence and operation of international competitors occurred the first here as Hungary was the first among transition economies to privatise banks to foreigners. With the appearance of ‘Western-style’ banking, existing, non-privatised banks had to face an increasing level of competition. Hungary was the first among former transition countries to open up its economy to FDI, including FDI in the banking sector. This has resulted in improved service and products for local affiliates of multinationals and also for Hungarian firms, together with the introduction of innovative financial products to the Hungarian consumer, such as consumer credits. (Akbar, McBride, 2004) Both the method and the timing of privatization matter to performance; specifically, voucher privatization does not lead to increased efficiency and early-privatized banks are more efficient than later-privatized banks. (Bonin et al., 2005) These factors all played a role in shaping the ownership advantages of OTP. In 1992, Sándor Csányi, was appointed chairman and CEO of OTP Bank, who with his management team started to reorganise and modernise the operation of the financial institute in this increasingly “market-like” business environment. By the end of 1994, OTP had reduced the number of managers from more than 200 to 65, and many of these were replaced by young, talented managers. The bank slashed more than 8,000 jobs by the end of the decade. It centralised its back-office operations and developed and introduced its own IT. It was the first to appear on the Hungarian market with novelties such as debit cards, mobile telephone banking services, and Internet banking services. Its dominant position in Hungary and the successful reorganisation of activities resulted in strong capitalisation, which made OTP an attractive target for acquisitions. This push factor together with the accumulated knowledge about restructuring and operation in an evolving market economy environment induced the bank to carry out its first foreign acquisition in a neighbouring country with a significant Hungarian minority population, in Slovakia. It also played a role in further acquisitions. This type of ownership advantage could result in successful foreign acquisitions only around until 2005, because after that there were no privatisation-related “target-banks” in the region. Dynamically, by that time, OTP could change its ownership advantage and rely more on its knowledge about operation in an evolving market environment and it could move in and specialise in certain market niches in its foreign operations, especially in countries, where it had only a very low local market share.

In the case of MKB, the “story” is completely different. The German parent bank realised the opportunities the region had to offer already at the beginning of the years 2000. It had an unsuccessful attempt at acquiring a bank in Croatia, where there were management errors as well. After that, in 2005 a decision was taken, that with close parent control, the Hungarian bank, the management of which is much more familiar with both the region and the modus operandi in it, will be responsible for the acquisitions in the region. The parent bank made the final decision and looked for possible target banks as well. The parent selected the target countries, which were Bulgaria, Croatia, Romania, Serbia and Slovakia on the basis of having there close Hungarian ties. Another reason why the Hungarian subsidiary was selected was that foreign acquisitions would target retail and SME banking, in which the Hungarian subsidiary had considerable experience (the parent dealt mainly with large-sized clients). (Connected to that the Hungarian subsidiary launched a new retail model in Hungary in 2005.) At the end, MKB acquired two foreign banks, the original target was more, but in Serbia, they were outpriced by Greek banks, then the crisis made further acquisitions impossible and the parent even had to sell its Hungarian subsidi-

ary, as we shall see later. Thus the ownership advantages of the Hungarian subsidiary again are connected to a special (local/regional) knowledge, which the parent bank does not own.

According to the theory, certain ownership advantages of firms or banks follow rather than lead internationalisation, because they may pursue asset seeking strategies before converting to market seeking ones. It may also happen that assets and markets are sought for simultaneously. In the case of OTP and MKB, we could not see this type of changes.

### **4.3 Impact of/on the home economy**

Impact of the home economy is especially important in the case of OTP in shaping the (initial) ownership advantages of the bank, thus providing it with transaction-based advantages. First, the mode of privatisation gave an opportunity and resulted in the experience for the management to be able to privatise and restructure formerly state-owned banks. Foreign expansion based on that experience than was the basis for gaining further experiences in the various stages of the post-transition business environment. The mode of privatisation acted as a kind of push factor because being on the stock exchange and having strong capitalisation made OTP an easy target of acquisition, and thus induced the management to strengthen its position by foreign expansion.

Impact on the home economy: according to all the interviewed experts, this is minimal, a minimally positive impact is provided by slightly higher employment. Synergies and thus decrease in costs are minimal. Centralisation of certain back office activities was of very small size in the case of OTP, thus resulting in a small increase in employment. The indirect impact of making the bank more stable due to foreign operations and the possibility of financing home country losses from the gains abroad may be more important, especially that in Hungary the banking sector is put on high burdens from 2010 on.

### **4.4 Motivations**

The motivation in both cases is clearly market-seeking, the efficiency-seeking motive is not present. First of all, representatives of both banks said that their main targets are local customers, as the representative of MKB put it: "90% of customers is completely local". During the interviews, none of the interviewed bank representatives deemed it important that there would be significant benefits from synergies or economies of scale and scope. OTP Bank made an attempt to centralise a few back office activities, but it was not possible for all the subsidiaries due to local regulations prohibiting the transfer of customer data abroad. In a few cases, there were common purchases of inputs (e.g. machinery, software), but this is also more an exception than the rule as the experience is that affiliates could attain better bargains locally. There are a few examples of sharing best practice in key activities, such as risk management, and new product development and allocating funds effectively, which is important for catching-up and remain competitive in international markets, but overall, the local subsidiaries are basically independent.

An interesting case is the motivation to follow important clients abroad – either by the bank or by its customers. According to the interviews, in the case of OTP, in countries, where its market share is small and operates mainly in niche-markets, that is true only for certain activities, but the bank could not become a primary bank for these important Hungarian foreign investor companies (e.g. MOL, Richter). However, it is not their primary bank neither in Hungary. In the case of MKB, the “follow” client” motivation was present for some smaller Hungarian companies, and for certain German ones, but in the latter case, this was not automatic, the local subsidiaries had to contact those German companies, which were present locally. In terms of the motivations of the banks to go where important investor companies from their own home countries are present, was not the case.

#### **4.5. Entry modes and choice of location**

As far as the entry modes are concerned, emerging multinational banks are more inclined to set up small ventures in “unknown” territories, even in the form of greenfield investments. (Petrou, 2007) On the other hand, in the banking sector, acquisition is the main entry mode, as it provides ready assets, knowledge, reputation, access know-how in technical areas, and gives an “easy way” to increase size (Dunning, Lundan, 2008). In the case of the two Hungarian investors, acquisitions either from foreign or local owners, or from the state (privatisation) are the dominant entry modes in countries, which are geographically and culturally very close to Hungary. As we saw, in the case of OTP, its competitive edge laid in the capacity and ability to transform formerly state-owned, uncompetitive and overstaffed banks into competitive ones. Thus until 2005, privatisation-related acquisition was the main entry mode. Even for greenfield purposes, acquisitions are used, as was the case when OTP acquired a Romanian bank “for the licence”, as its previous and later attempts proved to unsuccessful in acquiring a larger Romanian bank in the framework of privatisation. Later on, as the ownership advantages of OTP changed and as privatisation targets disappeared, OTP’s entry mode changed to acquisitions. On the other hand, for OTP Garancia the entry modes were mainly through greenfield investments, connected to the local affiliates of the OTP Bank, low investment requirement makes possible a greenfield entry. For MKB Bank, both foreign banks were acquired independently of privatisation (and the failed attempt was also an acquisition).

As far as the geographic locations of foreign investments are concerned, both banks concentrate on their immediate regions. One common reason for that is the relatively low physic distance. For OTP, according to the interviews conducted with the representatives of the bank, when it acquired the Slovakian bank, one of its aims was to serve local Hungarians. A similar goal was to be achieved in Romania, and to a lesser extent, in Serbia, where the affiliate is headquartered in Novi Sad (in Hungarian Újvidék) – with a Hungarian minority population. (In all these three countries, there is a Hungarian minority population of considerable size.) However, according to the interview, at present Hungarians are clients of the local OTP affiliate in greater proportion only in Romania. The second common reason for the two banks is the low psychic distance due to common socialist heritage and the common elements of the consequent transition process. These banks have a competitive advantage due to their knowledge about how a “socialist bank” operated and how to transform it into a

competitive Western type bank. This obviously played an important role in the case of the Bulgarian bank bought by OTP, according to one interview, this bank was the equivalent of the Hungarian OTP in Bulgaria and due to the later start of Bulgaria in the transition process, OTP could use all its accumulated knowledge there. In the case of MKB, according to the interview, after some failed attempts of acquisitions in the region, the German parent bank decided to rely on the knowledge and experience of the Hungarian subsidiary, and thus it was assigned the responsibility for the takeover of the Romanian and Bulgarian banks. Thus especially in the case of OTP, internationalisation is obviously taking place in “stages” (Johansson and Vahlne, 1977), in terms of going from one location with a lower psychic distance to another one to a higher one and so on. In the case of OTP, confidence and experience gained in geographically closer countries provided the basis for changes in intangible assets and thus in ownership advantages and enabled the bank to access further markets with higher psychic distance, as for example Russia.

#### **4. 6 The impact of the crisis**

As we could see in Table 4, the crisis brought considerable changes for both banks: it first stopped their acquisitions in the region. (On the other hand, acquisition targets were missing, and the existing ones were too expensive reflecting the local problems of banking in the countries of the region.) The crisis induced OTP to sell the insurance arm and around 8% of its shares to the French Groupama for around 600 million euro – this helped OTP to weather the crisis and the consequent negative changes in the Hungarian banking environment. OTP could not really restart its regional expansion since the crisis, it was first in 2014, when further acquisition of shares in a partly-owned by OTP bank in Romania was announced. However, even that transaction was of minor importance in terms of its value.

In the case of MKB, the parent bank had to sell its Hungarian subsidiary already during the crisis, due to fulfilling a condition of its bailout by the German government carried out in 2008. Because the bank could not have been sold in one part, the German parent bank, Bayerische Landesbank first induced the Hungarian subsidiary to sell the two affiliates: the Bulgarian one in 2013 and the Romanian one in 2014. Later on, the Hungarian subsidiary itself was sold to the Hungarian state for 55 million euros in July 2014.<sup>5</sup> The transactions resulted in relatively large losses for the German bank, however, that was the condition of the bail-out posed by EU antitrust rulings. Thus MKB Bank ceased to exist as a multinational bank during the crisis – and due to crisis-related developments in the parent bank.

<sup>5</sup> <http://www.bloomberg.com/news/articles/2014-07-24/bayernlb-to-sell-mkb-bank-to-hungary-for-74-million>

## 6. Conclusion and further research

The paper examines in detail the foreign investment activities of the leading investors and changes in it during the crisis. The methodology applied is detailed case studies of the main investor banks, based on semi-structured interviews with leading managers as well as other information collected from specialised newspapers and journals and the bank balance sheets. As far as the preliminary results are concerned, we distinguished indirect and virtual indirect investors: while OTP Bank is foreign majority owned, the strategy of the bank is determined by its controlling owner(s), which are the members of the Hungarian management due to the dispersed ownership structure (no foreign investor has more than 10 %). On the other hand, MKB Bank was a 100% foreign-owned bank with a German owner in the pre-crisis period, the important role of the Hungarian management is also shown when determining the foreign investment strategies of the Hungarian subsidiary. Thus, while the two cases would be clearcut cases of indirect investments, their closer analysis reveals important “deviations” from the textbook case.

In terms of the ownership advantages (OA) of the banks, we show the direct (MKB) and the indirect (OTP) connection between inward and outward FDI in terms of enabling the banks to develop their own OAs with experience in privatisation and restructuring of formerly state-owned banks and with learning how to operate successfully in a developing market economy environment with numerous competitors. We show that their motivation to invest is mainly market-seeking. Entry modes are acquisition in certain cases related to privatisation. In location choice, the importance of psychic distance is underlined in a wide sense (including a slightly belated progress compared to the home country towards the establishment of a market economy). We show the impact on the home economy being minor mainly in terms of benefitting from synergies, small employment creation in the parent bank and profit repatriation helping the parent bank (OTP) during the crisis. The direct impact of the crisis is shown for the performance of the banks and their internationalisation strategies and its indirect impact on changes in the ownership structure of MKB.

Further research is needed in terms of relating the characteristics of foreign expansion of the two banks to those of developed country banks and emerging multinational banks and to show the unique features of the former. Furthermore, the level of success of foreign subsidiaries needs to be analysed in order to assess the success of foreign expansion.

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