

## Transborder corporate integration in the Baltic Sea Region

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**TRANSBORDER  
CORPORATE  
INTEGRATION  
IN THE BALTIC SEA  
REGION**

**A.V. Kuznetsov \***



*The paper examines flows of foreign direct investment within the Baltic region. The author demonstrates close investment ties among the EU members, which are of special importance for Estonia, Latvia and Lithuania. Trans-border corporate integration in the region is characterized by significant imbalances. In many aspects, it can be viewed as Sweden's economic expansion or development of domestic markets for northern European companies. Although many German, Polish and Russian companies are involved in corporate integration in the Baltic region, other vectors of their foreign economic relations are still more important for them. As a result, the integration of Russian business in the Baltic part of the European integration area is still rather weak despite Russia's considerable foreign direct investment in the Baltic States.*

**Key words:** foreign direct investment, the Baltic region, European integration, Trans-National Corporations

Nowadays, almost the entire Baltic region is involved in the European integration process. Only Russia's territories remain an exception. However, this region did not form the original core of European integration: Denmark joined the European Communities only in 1973; the Federal Republic of Germany, which had a restricted access to the Baltic Sea, expanded its territory in the result of the 1990 German reunification; Sweden and Finland became members of the European Union in 1995; Poland, Lithuania, Latvia and Estonia joined the EU in 2004. In this respect, it is of special interest to observe how the top-down formal integration in the EU is backed up by the bottom-up integration in the Baltic region, with corporate integration being a vivid example. Global experience shows that foreign direct investments of Trans-National Corporations (TNC) can create a basis for long-term stability of formal integration projects.

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Within the EU, corporate integration takes rather complicated forms. Along with interlaced capital at the level of an entire integration group (usually in large-scale corporate business), a number of sub-regional areas are also segregated. These areas are characterized by a significant role of direct investments of medium-sized business, often in the framework of cross-border cooperation [6, p. 31—35]. In this connection, we shall focus on investment activities of northern European companies, which are stimulated first and foremost by the traditional cooperation of the Nordic countries and, to a lesser degree, the establishment of the EU common economic space. The next point will be the investment activities of German and Polish TNCs in the Baltic region. We aim to examine the extent to which the accession of the Baltic region countries to the EU contributed to the development of northern European integration into European integration. The third part of the paper will define a position of Russian business in regional corporate integration and estimate the prospects of economic cooperation between Russia and the EU.

### **Reasons for the domination of northern European investors**

According to statistics of the United Nations Conference on Trade and Development, large direct investment exporters in the Baltic region include not only Germany (by the end of 2010 the accumulated volume of German investments had reached 1,421 billion dollars; it ranked fourth in the world) but northern European countries as well. It is Sweden that stands out (336 billion dollars; it ranked 16<sup>th</sup> in the world), although considerable foreign direct investments are also typical of Denmark (195 billion) and Finland (131 billion). Poland (37 billion) is worthwhile noting among the new members of the EU as it occupies a dominant position in central and Eastern Europe. By the end of 2010, Estonia, a small country, had made direct foreign investments of six billion dollars, whereas Lithuania's foreign direct investments had equalled to two billion dollars and Latvia's foreign direct investments had accounted for less than one billion [13, p. 191]. It is obvious that the largest part of these countries' investments, particularly made by large and medium-sized companies, goes out of the Baltic region. At the same time, we should not underestimate the role of direct investment flows within the Baltic region (see the chart).

Many companies — especially at the early stages of internationalization of their business — tend to invest in the neighbouring countries, which they know well and where they do not have to overcome any significant language, cultural, legal or other non-economic barriers. The ideas about an important role of psychological distance in direct investment and gradual acquisition of skills in external economic activities, which are rather complicated in nature, formed a basis for the Uppsala model of internationalization in the 1970s [7; 8]. Based on the experience of Swedish companies, this model demonstrates that novice investors can successfully compete with the leading TNCs in large western European countries and the USA by finding their niches.

**Sources of foreign direct investment accumulated in the Baltic members of the EU at the start of 2010, bln euro**

Investing country	Receivers of foreign direct investment									
	Germany	Sweden	Poland	Denmark	Finland	Estonia	Lithuania	Latvia		
<i>Total</i>	693.9	230.4	128.9	106.4	58.7	11.28	9.76	8		
EU — 27	509	182.1	109.9	74.5	54.5	9.9	7.69	6.12		
Including:	—	12.8	20.9	6.6	2.1	0.14	1	0.51		
Germany	13.6	—	6.4	24.4	30.8	4.47	1.14	1.1		
Sweden	0.7	0	—	0.2	0	0.01	1.03	0.01		
Poland	7.0	17.7	3.1	—	4.8	0.21	0.97	0.55		
Denmark	4.1	22.0	1.2	1.6	—	2.55	0.46	0.33		
Finland	0	0.1	0	0.1	0.1	—	0.72	1.35		
Estonia	0	0	0	0.1	0	0.14	—	0.27		
Lithuania	0	0	0.1	0	0	0.07	0.41	—		
Latvia	51.7	30.9	4.7	10	1.3	0.27	0.15	0.16		
Great Britain	85.1	6.8	14.3	2.9	1.5	0.17	0.22	0.05		
France	60	34.8	22.9	11.3	9.0	1.02	0.67	0.46		
The Netherlands	76.4	15.9	8.4	8.8	0.6	0.14	0.26	0.3		
USA	16.3	1.3	1.2	0.1	0.2	0.01	0	0		
Japan	2.1	0	0.1	0.2	0.5	0.33	0.62	0.37		
Russia	15.2	5	3.6	4	1.4	0.26	0.23	0.22		
Various offshore structures	4	23	25	31	65	73	65	56		
<i>Share of the Baltic countries, including Russia, %</i>										

*Note.* Compiled on the basis of Eurostat on-line charts (EU direct investment positions, breakdown by country and economic activity — <http://epp.eurostat.ec.europa.eu>).

Current processes of globalization and informatization raise some doubts on the traditional assumption that training in skills necessary for conducting business outside the neighbouring countries requires a long period of time. At the same time, the role of neighbourhood is still important for rather small companies that do not have sufficient resources for collecting detailed data on specific features of business environment round the world or attracting top managers experienced in global activities. This idea is illustrated by trans-border investments of Estonian, Latvian and Lithuanian companies, which are locked up in the Baltic region to a certain extent. Also, geographical distance remains important for large-scale companies in some industries with specific technological characteristics. For instance, Vattenfall — a Swedish electricity provider, which is included in the top 50 non-financial TNCs by external assets — concentrates its investment expansion on the neighbouring EU countries. This company is the third largest energy producer in Germany, with power stations in Poland, Finland, Denmark, the Netherlands and Great Britain.

Nevertheless, the role of neighbourhood should not be overemphasized. For example, the Swedish government's indecisive position on further regulation of relations with the EU up to the autumn of 1990 gave Swedish TNCs a cause for concern over their alleged discrimination in the key market. As a result, in the late 1980s — early 1990s, Sweden witnessed an unprecedented expansion of production capacities of supranational companies in the territory of the European Communities members, which were preparing for the creation of full-fledged European Union [2]. At present, northern European companies as well as other TNCs face the key challenges of globalization, including increasing competition with manufacturers from the new industrial countries and China. This stimulates these companies to move some of their enterprises to the countries with cheap labour force — not only outside the Baltic region, but outside Europe as well [1].

Nevertheless, for many companies of the Baltic region these trend lead to gradual transformation of several neighbouring sale markets into one common home market. Apparently, this process mostly affected Swedish and Finnish companies. The pre-accession work in Finland created favourable investment conditions for other countries [12, p. 5—6]. Up to the present days, more than half all direct foreign investment in Finland is of Swedish origin. The special role of Swedish investment is also typical for Denmark, though, to a lesser degree. Some companies, e.g. Nordea Bank or TeliaSonera, a telecommunication giant, being Swedish on a pro forma basis, are partly controlled by other Scandinavian and Finnish capital.

In the late 1990s many Swedish and Finnish investors embarked on active and, quite often, joint market expansion in the Baltic States. They can also place their investment in Poland, Russia (mostly in north-western parts) and other countries. However, they usually see Estonia, Latvia and Lithuania as their expanded home markets. In some cases northern European investors carry out individual expansion campaigns in each of the three countries (like TeliaSonera or Tele 2, which implement either their own projects or joint projects with local mobile service providers). Another way of entering the

regional market is an acquisition of a local TNC. A perfect example is an acquisition of Estonia's Hansabank by Sweden's Swedbank. Sometimes the control is set over the regional TNCs and third investors, as it happened with Tamro, a large company selling pharmaceuticals. This Finnish company with affiliates in Sweden, the Baltic States and Poland was bought by Germany's Phoenix Group.

However, there is a fundamental distinction between the three Baltic States and northern European countries — the role of direct industrial investments is much less important in the first group of countries. The current world economic crisis has demonstrated how dangerous it is to bet on the service industry internationalization alongside actual deindustrialization of economy. A boom in foreign investment in Estonia, Latvia and Lithuania was partly caused by formal improvement of an investment image of the three states after their accession to the EU in 2004, but it did not last for a long time. The situation was worsened later on by a growth of production costs in the Baltic States, which disrupted their competitiveness, although to a large extent it was caused by joining the common market [4].

### **Expansion of German and Polish TNCs in the Baltic region**

Germany's companies began to demonstrate their interest in investing to northern European countries a long time ago. Along with their selling units created in the 1950s-1960s, West German manufacturing ventures had appeared in Denmark before it joined the EU. A counter flow of investment started to grow up. In the beginning, northern European investors concentrated their activity in the north of West Germany — mainly in Hamburg. However, Danish companies invested a lot in the cross-border regions including such well-known companies as Lego, a toy manufacturer, and two machine-building companies, Grundfos and Danfoss. By the 1980s, accompanied by a rise in investment share in the service industry, the expansion of Danish, Swedish and Finnish TNCs had affected many other lands in West Germany. The leading receiver of direct Finnish investment was Frankfurt am Main, for example [11].

The EU enlargement to the north in 1995 gave an incentive for German investors to increase their investment in Sweden and Finland due to intensification of medium-sized German companies' expansion [3, p. 68]. In addition, German TNCs continued to acquire, on a rather regular basis, large companies in the Baltic region, mainly in Scandinavia. Thus, Volkswagen paid 4.4 billion dollars for 17% shares of Swedish Scania in 2008. A year later, Colexon Energy, a second-tier company, bought Renewagy, a Danish alternative energy producer, for 1.3 billion dollars [9, p. 13]. Northern European investors also made large investments in Germany; for example, Sweden's Vattenfall stands out with its "from scratch" projects, which are not very typical of the industrial sector in the advanced EU countries.

Nevertheless, despite the long history and a large volume of counter flows of direct investment between Germany and the Baltic region countries, the role of the latter for German TNCs is rather small, compared to even the new EU members from central and Eastern Europe. Thus, Sweden is behind Austria, Czech Republic, Poland and Hungary (leaving alone the Benelux

countries) according to the scale of accumulated direct German investment [9, p. 10]. Germany, which belongs to the Baltic region only partially, does not depend on northern European direct investment to a large extent (see the chart).

Poland, being Germany's neighbour, cannot be considered the "pillar" of German capital either. Thanks to its rather concise sale market, fast EU integration and close economic links with other eastern European countries (outside the EU as well), Poland has become a base for regional expansion for many TNCs (not only western European ones). There are only 3 large-scale non-financial companies in Poland that belong to Germany among the 20 largest ones; although Metro, a trading company, ranks the first on the list and Volkswagen ranks the fourth (only one northern European TNC entered the list — the above-mentioned Vattenfall) [14, p. 12].

Growing current foreign expansion of Polish investing companies is concentrated in central and eastern European countries, and countries outside the EU rather than in the Baltic region. Poland's neighbour — Lithuania — is an exception due to both numerous small-scale projects and a major acquisition of a Polish TNC abroad — a big oil refinery, Mazeiku Nafta. PKN Orlen bought 84.4% of its shares for 2.5 billion dollars in 2006 [15, p. 2—5].

### **Limited participation of Russian companies in corporate integration**

Russian companies occupy a specific position in corporate integration in the Baltic region. On the one hand, the volume of Russian direct investment in the Baltic region countries is rather large, particularly in the Baltic States. On the other hand, Russian investment is mainly limited to energy and transit projects. The main investor in the region is Gazprom. In the Baltic States and in Finland the assets of Russian business (starting from key businesses, such as Global-Trans and Global-Ports emerged on the basis of N-Trans, up to giant industrial companies such as Severstal, LUKOIL and Acron) serve foreign trade.

There are successful projects in other sectors, too. For example, Finland's nickel refinery, Harjavalta, acquired by Norilsk Nickel; Kubikenborg, an aluminium plant in Sweden, acquired by RUSAL, a joint company; a lube refinery in Finland and a network of filling stations in the Baltic region countries owned by LUKOIL; a steel rolling works, DanSteel, owned by Novolipetsk iron and steel works; a lumbering machine-building plant in Denmark, Silvatec, owned by Tractor Plants group corporation [10]. At the same time the attempts of Russian business to get into the car industry are still ineffective. There is almost no direct investment in service industries, including telecommunication where Russian companies in other regions are rather successful.

The expansion of Russia's investment in the Baltic region faces a number of challenges: weak competitiveness of some Russian companies, which becomes obvious when compared to northern European TNCs that have built their business in the market successfully (in banking and insurance business in particular); some non-economic obstacles, e.g., political issues in the Baltic states (lack of agreement on mutual support and stimulation of investment between Russia, Estonia and Latvia); adverse stereotypes of Russian businessmen in the region [5, p. 77—78].

Russian investment contacts with the Baltic region countries are gradually developing. The volume of investment made by Swedish, Finnish and other TNCs in Russia is growing (including investors from the Baltic States, which are not very active). Most of them are particularly interested in cooperation with north-west Russia. However, the actual integration of Russian business into the Baltic part of the European integration space is still rather weak, especially when considering trans-border production and marketing chains, in which Russian companies take part. Compared to the extent of corporate integration of northern European countries, Russia's participation is mainly limited to counter but non-crossing flows of direct investment.

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