

## Location choice

# Why German firms invest in the Czech Republic

In the internationally designed project „ReLOC“, IAB asked German and Czech enterprises in the years 2010/11 for the first time about their economic activities since the EU expansion eastwards. The focus was not only on the development of entrepreneurial demand and factors that influenced decisions about location but also on an assessment of entrepreneurial strategies and economic interlinkages at international level.

The relocation of production and service activities abroad plays a prominent role in the economic integration of European markets. In particular, in view of the partly steep wage differentials between the member states of the European Union, two questions arise: To what extent does the increasingly international breakdown of value chains cause jobs in the home country to be lost? And, what results does this development have for the labour market of the country of destination?

In the public sphere, discussions are dominated by the fear that jobs at home will be axed because of the relocation of entrepreneurial activities abroad. However research findings on the effects of the cross-border integration of economic areas in general and foreign direct investments in particular do not yield a clear result. While there is empirical evidence that a loss of employment in the country of origin can be linked to the involvement of companies abroad, other studies show by way of contrast that the effects on numbers of staff are not significant or that employment is even increased in the country of origin because direct investment causes productivity to rise.

In view of this ambivalence in research results up to now, the question of what effect the multinational involvement of firms has on the level of employment in the coun-

tries concerned is of central interest. In addition to this, the foreign activities of firms raise other important issues of which three will be described here briefly:

■ What factors are decisive for the choice of location in cross-border entrepreneurial interlinkages and what role does distance play in this? What is interesting here is whether agglomeration mechanisms bring about a spatial concentration of economic activity and to what extent foreign direct investment leads to differentiated regional patterns – similarly to the effects of the liberalisation of trade.

■ What motives lie behind foreign direct investments? Scientifically based studies produce an ambivalent picture: In theory a general distinction is made between horizontal direct investment, which serves the development of a new market, and vertical direct investment, which is aimed at lowering costs. However empirical evidence shows that these two main motives cannot always be kept apart. Hence the reasons why firms have become involved abroad require to be studied in detail.

■ What specific effect do the activities of firms abroad have on various qualification groups and their wage levels? These may differ considerably both in the country of origin and in the country of destination. Moreover, recent studies show that the levels of qualification are not af-

ected equally by the results of progressive integration. The same applies to tasks which alter in the wake of technological progress. The “task-based approach”, which measures the changes in the labour market by way of the complexity of various different activities such as routine and non-routine tasks, is thus relevant for the analysis of the impacts of the internal organisation of production within multinational firms.

### A cross-border survey of firms

For these aspects there is a research gap both in the theoretical and the empirical field and it is this gap that the IAB is attempting to close by means of its project “Research on Locational and Organisational Change” (ReLOC) (see Box “The ReLOC Project” on page 77). The study builds upon the research design of the IAB Establishment Panel and extends it with questions from the international perspective.



Cooperation partners in this project are, among others, the Czech Center for Economic Research & Graduate Education – Economics Institute (CERGE-EI); the University of Aarhus in Denmark; the Universities of Passau and Erlangen-Nuremberg, as well as the German-Czech Chamber of Industry and Commerce.

Target groups of those surveyed within the framework of the ReLOC Projects in Germany are, on the one hand,

firms that have invested capital in the Czech Republic in the form of shares in a company and, on the other hand, firms that do not exhibit any involvement abroad. On the Czech side, companies that are exclusively in Czech ownership are compared to companies with German participation.

During the first ReLOC survey on economic activities since the EU began to expand eastwards, information was collected between September 2010 and May 2011 from

over 3,000 firms in Germany and the Czech Republic. This already suggests some fundamental results for the group of German parent companies.

**Locations in agglomerations and border regions**

The regional distribution of locations of the German parent companies shows the strong position of metropolitan areas in the south and west of Germany (see Figure 1 on page 76). The enterprise locations are concentrated in particular on the Greater Munich area, the Rhein-Neckar and Rhein-Main regions, as well as the large towns of North Rhine-Westphalia. In the Czech Republic as well, the larger towns are especially attractive for the location of Czech subsidiaries, while the capital Prague occupies a central position. This pattern of locations corresponds very strongly both in Germany and also in the Czech Republic with the regional distribution of the total number of firms.

On the other hand, the border region between the two countries stands out as the site of many German-Czech firms. The spatial proximity to the neighbouring country accordingly plays a decisive role for a number of investment projects: in border regions, lower transport costs, transnational networks and a comparatively higher share of residents who are familiar with both languages, can facilitate the market entry of subsidiaries.

**Differentiated motives for investment abroad**

The German firms surveyed above all named the development of new sales markets (55.8%) as an important reason for their decision to invest in the Czech Republic, along with the low labour costs (52.7%). The extension of the business field also seems to play an important role (see Figure 2 on page 79).

On the other hand, what was not important for the

**The „ReLOC Project“**

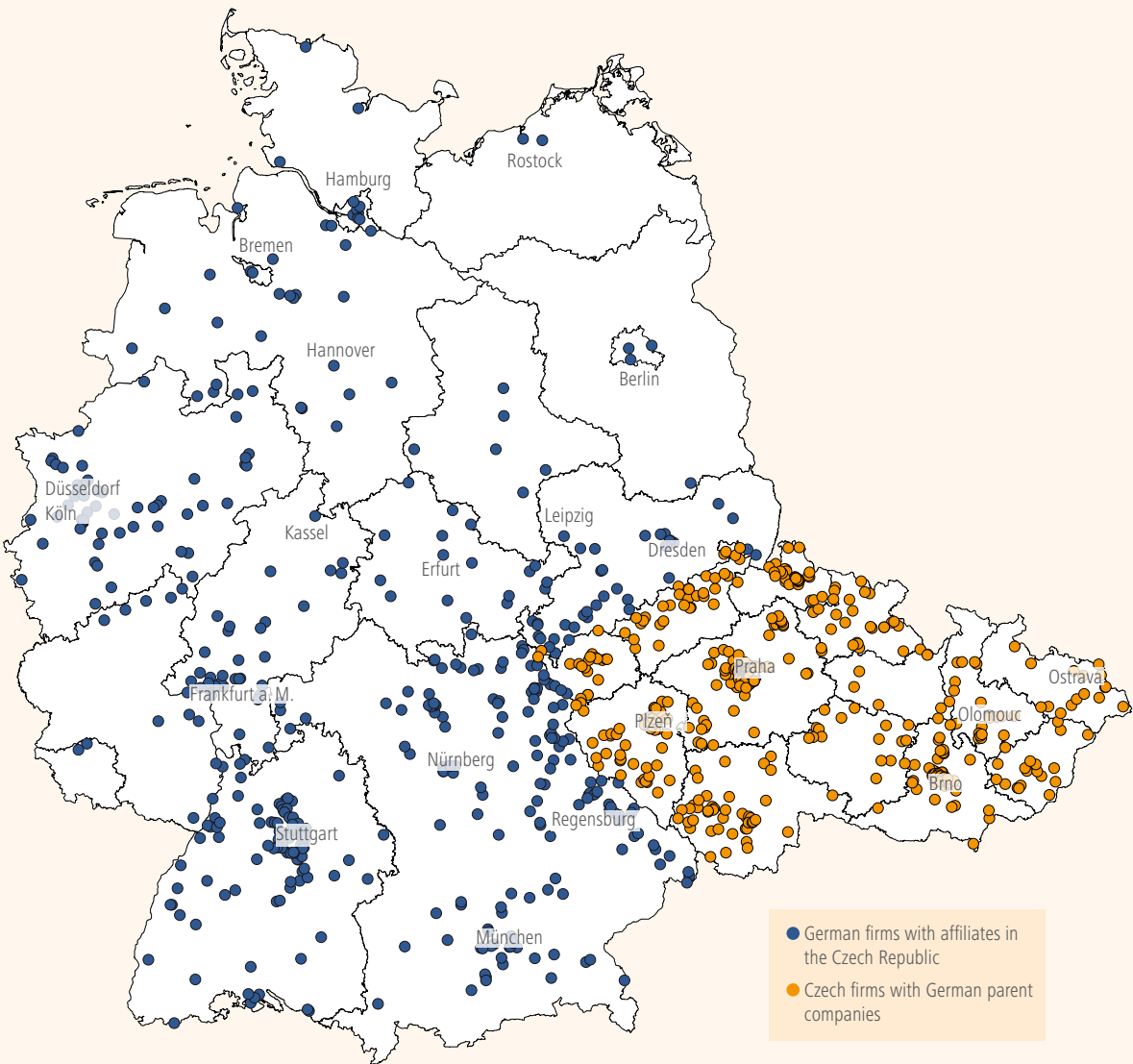
The research project „ReLOC“ is based on a reference group comparison, in which – both in Germany and the Czech Republic – the group of multinational firms is compared in each case with a group of firms that are not financially linked to a foreign country. These four groups of firms formed the basis of the first ReLOC Survey which took place in the period between September 2010 and May 2011. On behalf of the German Federal Employment Agency, data was collected from more than 3,000 firms, as a rule in the form of personal, face-to-face interviews.

The research work pertaining to the German-Czech firms took place on the basis of two commercial Czech databases and a register of the German-Czech Chamber of Industry and Commerce which lists active Czech firms with German owners. In addition, the Czech commercial register provided information about the participation of foreign investors.

The basis for the compilation of the questionnaires, both on the German and on the Czech side, was the questionnaire of the IAB Establishment Panel. As this survey has been carried out annually since 1993, the instruments used have been correspondingly tested and documented, have proven themselves in practice and have been adapted to suit current developments.

Just as fundamental for the project is a methodology which is the same as or comparable to that of the IAB Establishment Panel Survey, along with equal standards in using interviewers and in monitoring data. In the ReLOC Project, information is requested at the enterprise level, some of which consist of several different establishments. In this connection, some questions of the ReLOC Project were fed into the IAB Establishment Panel Survey of 2010 and information on their involvement abroad in the past, at the present time and in future was gathered both for the single-site companies that were participating and for the headquarters of multi-site companies. For further information, see: <http://reloc.iab.de>.

Figure 1  
**Regional distribution of the multinational firms surveyed**  
(Germany N=459; Czech Republic N=474)



Source: IAB ReLoc Survey

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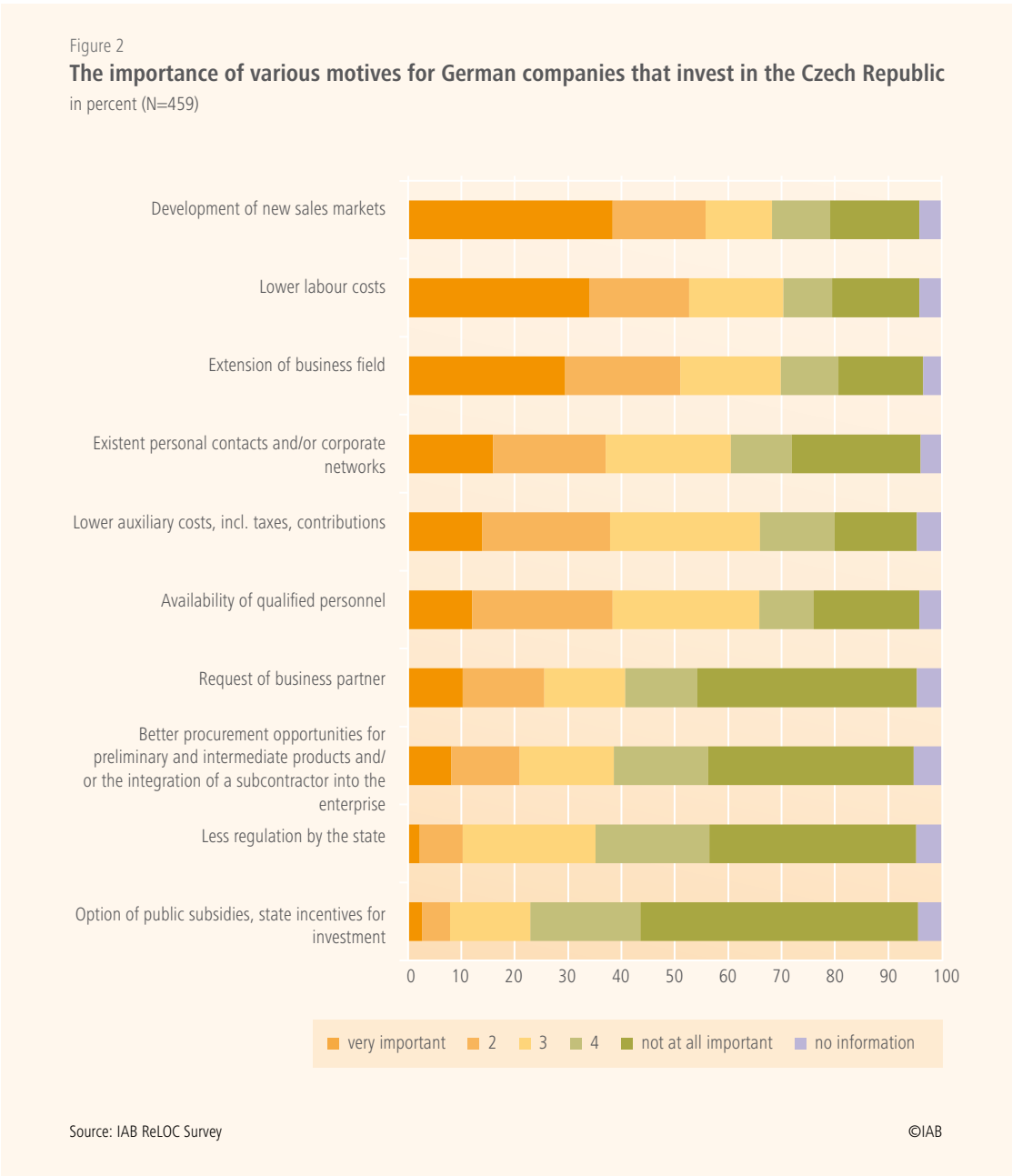




majority of firms in making this decision (72.8%) was the possibility of taking advantage of public subsidies. The motives “less regulations by the state”, “better procurement possibilities for preliminary und intermediate products and/or the integration of a subcontractor” and “request of business partner ” were also for the most part classified as unimportant by the firms surveyed.

**Task structures are stable**  
In order to be able to examine how the foreign involvement of German firms affects the execution of different tasks in the home country, precise information is required about which tasks are to be carried out in order to produce the main product. In this connection, the contact persons interviewed estimated how high in their enterprise the re-

spective share of the following five groups of tasks was: manual routine tasks; manual non-routine tasks; non-manual routine tasks; interactive tasks; and, analytical tasks. The results show that these five classes of tasks are represented very evenly on average in the German multinational firms surveyed (see the Table on page 80). The share of manual routine tasks was the highest at 25.3 per cent while the non-manual routine tasks showed the lowest average figure at 15.5 per cent. The shares of the individual task groups have remained constant overall since the beginning of the involvement in the Czech Republic. What have changed the least are the shares of the non-manual and manual routine tasks, whereby the latter have been reduced the most strongly in any case. The clearest increases since the



beginning of involvement abroad are exhibited by the interactive and analytical tasks: their share has risen by more than 20 per cent in the firms surveyed.

**Conclusions and outlook**  
Up to now, the results of the enterprise survey in the ReLOC Project give an ambivalent picture in respect to the determining factors and results of foreign direct investments. A more in-depth examination is therefore necessa-

ry. For instance, in order to analyse the employment effects of foreign involvement, firms must also be included that are not linked to a foreign country in a corresponding way. From a regional economic perspective, what is interesting is the role played by spatial proximity and the motive for investments for firms from various different economic branches. First the question arises what characteristics the regions in the home country and country of destination exhibit that are particularly affected by cross-border

investments. Is the spatial distance between the German parent company and the Czech subsidiary clearly on average smaller in the case of investment projects that are carried out because of lower labour costs abroad than in cases where market development stands in the forefront? This would indicate that firms prefer to link lower wage costs with the advantage of lower transport costs. What must also be clarified is in which sectors of the economy

investments are favoured on account of cost-cutting reasons and which jobs at home are endangered by a relocation abroad because of this.

Where the trends for the tasks carried out are concerned, an obvious question is whether the increasing share of interactive and analytic tasks in the German parent companies is due to the fact that production and service activities have been relocated to the neighbouring country.

The findings of the ReLOC Project are of major significance for the labour market and regional policy. They can shed light on whether the cross-border activities of German multinational firms in one of Germany's neighbours with more favourable labour costs are a danger for Germany as a location or whether, on the other hand, they actually strengthen its competitiveness. The relocation of jobs to the Czech Republic might be offset, or even over-compensated for, on account of the increased productivity achieved through this.

In view of the regionally different requirements for skilled workers in Germany, the question arises as to what extent firms react to potential shortages with involvement abroad. Of interest is not least which qualification groups profit or come under pressure in the home and destination country due to foreign direct investment. Here the ReLOC Project can offer itself as a basis for further research projects, as investigations relating to labour market advisory services that are in line with reality and timely recommendations for action aimed at political circles are only possible on the basis of valid and reliable data.

In addition, the survey provides information on international factors that determine the employment structure of firms which has not previously been available. These insights can facilitate the decision-making of representatives of management, trade unions and associations – for instance when one has to assess during wage negotiations which qualifications and tasks in Germany are most in demand and which activities will tend to be shifted abroad on account of the foreign involvement of firms. What will also be made easier is the evaluation of which retraining courses and further training measures promise

Table  
**Average share of the task classes in German multinational firms at the time of the survey and changes in this share since the beginning of the investment in the Czech Republic**  
in percent (N=459)

Class of tasks	Average share at the time of the survey	Change in the share since the beginning of the investment in the Czech Republic	
manual routine tasks (e.g., packing, sorting, copying)	25.3	strongly dropped tended to drop unchanged tended to rise strongly risen no information	3.5 8.9 73.2 3.3 1.1 10.0
manual non-routine tasks (e.g., repairs, driving vehicles, serving in a restaurant)	19.8	strongly dropped tended to drop unchanged tended to rise strongly risen no information	2.2 8.1 70.4 8.7 1.3 9.4
non-manual routine tasks (e.g., correcting spelling mistakes, measuring temperatures, bookkeeping)	15.5	strongly dropped tended to drop unchanged tended to rise strongly risen no information	0.7 3.9 76.0 7.0 2.0 10.5
interactive tasks (e.g., negotiations, advisory activities, giving talks)	22.0	strongly dropped tended to drop unchanged tended to rise strongly risen no information	0.4 2.2 68.2 17.2 3.1 8.9
analytical tasks (e.g., research, examinations, planning)	17.3	strongly dropped tended to drop unchanged tended to rise strongly risen no information	0.4 2.0 63.8 19.2 4.1 10.5

the most success and sustainability because they lead to tasks which are less at risk from relocation abroad.

Finally, firms can themselves use the results in the sense of benchmarking as these provide information about how one's own enterprise compares to other firms of the same branch or size.



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