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Czech Republic: the results of a
fields analysis

2004/33



UNIVERSITÀ DELL'INSUBRIA
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Printed in Italy in November 2004
Università degli Studi dell'Insubria
Via Ravasi 2, 21100 Varese, Italy

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ITALIAN DIRECT INVESTMENT IN THE CZECH REPUBLIC: THE RESULTS OF A FIELDS ANALYSIS*

Jindřich Soukup ♦ and Antonio Majocchi ♦♦

November 2004

Abstract

The present paper presents the first results of a filed survey on Italian investments in the Central and Eastern European countries. More specifically, this paper is focused on the Italian Investments in the Czech and Slovak Republic. The survey has a qualitative approach put it allows to develop some hypothesis that will be tested in a more comprehensive quantitative analysis. The filed analysis shows that the most important reasons behind Italian investments in the region are: seeking a new market, lowering labour cost and the better law environment in the host country. By the survey, the Italian companies are often export oriented. The respondents have evaluated the degree of autonomy of the subsidiaries which are functioning on the Czech market as medium or low almost unanimously. The Czech and Slovak subsidiaries of Italian firms serve mainly for two markets – the local and Italian one, thus confirming that Italian firms have not used the foreign subsidiaries as a base for entering in the wider regional market. The performance of subsidiaries is evaluated by respondents as good or even very good during last three years. The subsidiaries are conclusively integrated to the Czech economy..

1. Introduction

This working paper presents the results of the research project on Italian investment in Central and Eastern European Countries (CEECs). The primary aim of the whole project was to build up a database of the subsidiaries of Italian firms operating in the CEE countries. The main goal of the research is to confront different behaviours in the different countries by Italian firms in order to catch national peculiarities. In the present paper the presented results are partial as the working paper examines only the position of Italian investors in the Czech Republic and Slovakia..

*The present paper is the result of a large empirical analysis of the Italian firms in the Eastern European countries. The focus of this paper is on the behaviour of Italian investors which was mapped in the Czech and Slovak Republic. Researchers from the Department of Economics of the University of Insubria, Varese (Italy), the University of Pavia Faculty of Economics and Business, University of Maribor (Slovenia), the West University, Timisoara (Romania), Faculty of Business Administration, University of Economics, Prague (Czech Republic), University of Economic Sciences and Public Administration, Budapest (Hungary), University of Economics, Poznan (Poland) participated in the project. The empirical and analytical work concerning the Czech Republic was realised at the Faculty of Business Administration, University of Economics, Prague. The research team was headed by Prof. Jindřich Soukup. The contribution of the University of Insubria, “Progetto di eccellenza su Internazionalizzazione ed innovazione d'impresa: evidenze dal sistema italiano e locale e prospettive d'evoluzione” is gratefully acknowledged.

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2. Foreign Direct Investment Inflow into the Czech Republic: Basic Characteristics

The inflow of the foreign direct investment into the Czechoslovakia was fractional. At the beginning of nineties the FDI influx to the Czechoslovakia increased. It was mainly affected by some big privatisation cases (like the entry of the Volkswagen group to the Auto Skoda, Nestle to Orion – the main Czech producer of chocolate and other sweetness or TelSource to the Czech Telecom).

The graph No. 1 shows how the amount of the foreign direct investment fluctuated during period 1993 – 2003. It depended heavily on the privatisation activity of the Czech cabinet – mainly in the banking, electricity, gas and other network sectors. Since 1998 the government investment incentives have got also the important positive impact on the FDI influx into the Czech economy. The highest amount of the FDI came to the Czech Republic in 2002, mainly thanks the privatisation of the gas company Trngas.

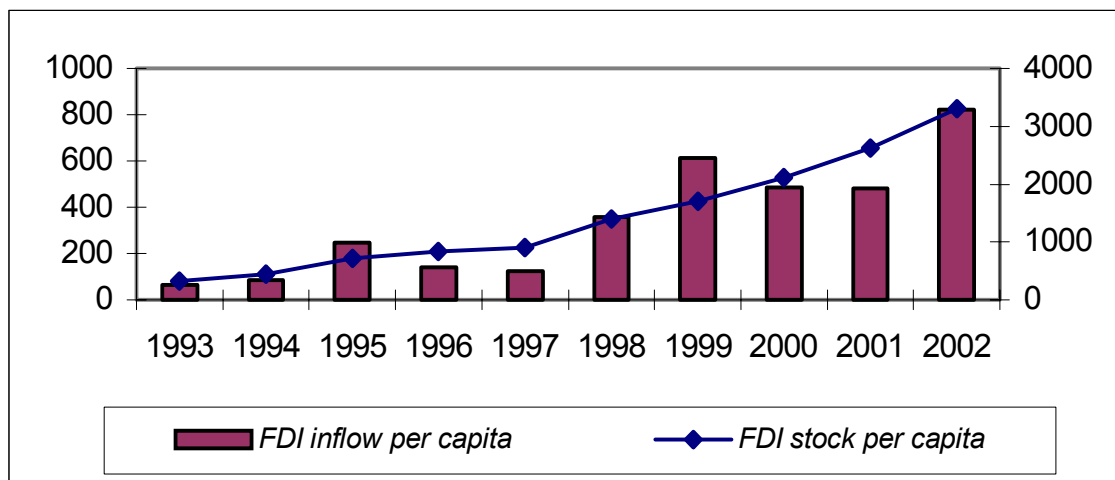
During years 1993 and 1994 there was a significant decrease of the volume of the FDI. The year 1995 was characterised by the relative big increase of the FDI. The increase can be mainly explained by several economic and institutional factors as the acceleration of the economic growth, relatively low prices of shares, relatively high interest rates, full convertibility of the Czech crown, the further development of the privatisation process or that time new membership of the Czech Republic in the OECD.

But the increase of the FDI inflow in 1995 was short and following years (1996 and 1997) were connected with the significant decrease in the amount of the foreign direct investment. The Czech economy had problems with its external balance (mainly on the current account of the balance of payments) and the Czech economy was gradually falling into the recession during this period.

The influx of FDI was recovered in the years 1998 and 1999. The year-to-year index of the FDI increased by 88 per cent in 1999. In 1999 the Czech economy had received the amount of 218,8 bil. CZK (i.e. roughly 6,3 bil. USD) of the FDI. The Czech Republic has occupied the leading position among the transition economies thanks the amount and also the dynamics of the FDI during this years.

The positive role of the FDI was significant also for the following years. The relatively high level of the FDI in 2000 and 2001 was mainly given by the step of the powerful foreign investors in the Czech economy. Foreign investors have started to make use of investment incentives which the Czech Cabinet has offered them. The investment incentives are transparent and provide to investors higher subsidies or reductions than Polish or Hungarian ones. The FDI inflow was also supported by the persist privatisation process, mainly in the banking sector. The Cabinet sold its shares – for example – in the two of the fourth biggest banks (Česká spořitelna and Československá obchodní banka).

Graph 1 - Foreign Direct Investment in the Czech Republic. Inflow and stock (USD per capita) 1993 - 2002



Source: Král, P. Identification and Measurement of the Relationships Concerning Inflow of FDI: The Case of the Czech Republic. Working Paper Series No. 5, Czech National Bank, Prague 2004, p. 24

The highest amount of the FDI in the period 1989 – 2003 was realised in 2002. The FDI inflow reached the volume of 9,9 bil. EUR in 2002. The amount of the FDI would decrease by one third if we do not regard the impact of the privatisation process. The payment of the German company RWE played the key role in this year. RWE bought the governmental share in the Transgas company. The payment corresponded to the 41 per cent of all FDI in this year. Other FDI were mainly connected with the purchases of shares in the private companies and by the re-invested profits.

In 2003 the FDI inflow has decreased almost by 74 % against the previous year. The FDI inflow has reached the amount of 72,9 bil CZK (i.e. 2,6 bil. USD or 2,3 bil. UER). The decrease was influenced mainly by the minimal privatisation activity of the Czech government, the purchase of the Eurotel shares by the government and by the sale of the Telecom shares by the foreign investor. The relatively high comparative base of the previous year 2002 (given by the above mentioned sale of Transgas company to RWE) had got the impact on the decrease of the FDI in 2003.

The net position of the Czech republic in the foreign direct investment is also changing, but slowly. In the year 2003 - by the preliminary data of the Czech National Bank - there was the FDI inflow into the Czech Republic 72 899,5 mil. CZK (i.e. 2 289,3 mil. EUR). On the opposite side, the outflow of the investment from the Czech economy reached 6 546,5 mil. CZK (i.e. 205,6 mil. EUR) in the same year. So the investment abroad was almost 9 % of the total FDI inflow into the Czech Republic.¹

¹ Source: <http://www.cnb.cz> (cited 15-09-2004)

2. *The industrial structure of the FDI*

The industrial structure of the foreign direct investment in years 1993 - 2002 is described in the table No. 1. During this period almost two third of the cumulative foreign direct investment inflow was oriented toward the manufacturing industry, mainly to the manufacture of machinery, electrical and optical equipment and to the manufacture of the transport equipment. The services and the financial intermediation sectors have received about one fifth of the FDI. The trade sector has received roughly 13 % of all FDI.

Table 1 - Foreign Direct Investment in the Czech Republic by Industry. Shares on Cumulative FDI Inflow during 1993 - 2002

| Industry | Share (%) |
|---------------------------------------|------------------|
| Refined petroleum and chemicals | 4 |
| Food and tobacco | 5 |
| Electricity, gas and water supply | 6 |
| Real estate and business activities | 8 |
| Machinery and equipment | 12 |
| Transport, storage and communications | 19 |
| Financial intermediation | 19 |
| Trade, hotels and restaurants | 13 |
| Others | 14 |
| Total | 100 |

Source: http://www.cnb.cz/en/stat_pb_pzi.php (cited 15-09-2004)

According to the prevailing companies' motivation, we can speak about two types of the foreign direct investment - horizontal and vertical ones.

In the case of the horizontal FDI, the investor creates the similar capacity in the host country as in the home economy. Reasons for this type of the FDI is e.g. the seeking of the new market and to cover its supply or to decrease the cost associated with supplying the market from abroad. The decrease of the cost can be reached - for example - by the lower transport cost or by the avoiding to tariffs. Naturally, the savings given by the lower transport and tariffs must be higher than costs connected with the foundation of the new plant and doing the business in the host country. The horizontal FDI often replace exports from the home market.

The vertical type of the foreign direct investment is oriented toward the production cost minimising. The company shifts the part of the production from the home to the host country. The company may seek cheaper inputs (raw materials, labour) or the use of some "advantages" in institutional framework of the host economy (such as less rigorous environmental acts, more liberal labour code). The result of the vertical FDI is a vertical division of the production process. This type of the FDI is also often export-oriented.

In years 1991 - 1994 the FDI were realised almost exclusively in the vertical form. They were based on the specialisation connected with the cheaper labour in the Czech economy and they often avoided to the capital intensive industries. Factors which are regarded as dominant in the contemporary theories such as the increasing returns to scale, concentration or human capital were not very significant for foreign investors.

In 1995 -1997 the FDI have been oriented much more into the capital intensive industries (with the relatively high factor productivity and the better-than-average profits per employee) then during the previous period.

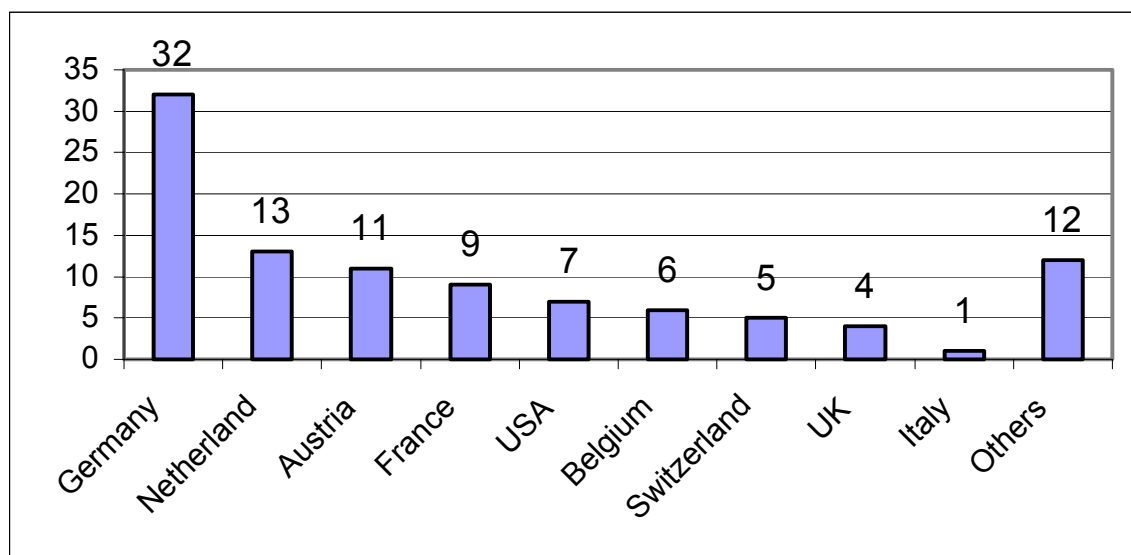
In 1999 about 44 per cent of the total FDI was invested to the manufacturing industry. Almost fifty per cent of the FDI to this sector of the economy was divided among four industries: the manufacture of other non-metallic mineral products, the manufacture of food products and beverages, the manufacture of motor vehicles and the manufacture of tobacco products. About 35 % of the FDI came to trade and services sectors. The aim of the big retail chains was to improve their distributive systems; investors also invested to the purchases of the big Czech banks.

In 2003 almost fifty per cent of the FDI (46,2 %) came to the industry, mainly to the manufacturing. The biggest part of the FDI was invested into the manufacture of basic metals and fabricated metal products, the manufacture of transport equipment, machinery and the manufacture of rubber and plastic products.

2.2 The territorial structure

The graph No. 2 shows the territorial structure of the FDI in years 1993 - 2003. During this period almost one third of the cumulative foreign direct investment inflow has come from Germany. Just the FDI from Netherlands and Austria represents more than 10 % share of the total FDI during this period.

Graph 2 - Foreign Direct Investment in the Czech Republic by Country. Shares on Cumulative FDI Inflow during 1993 – 2002

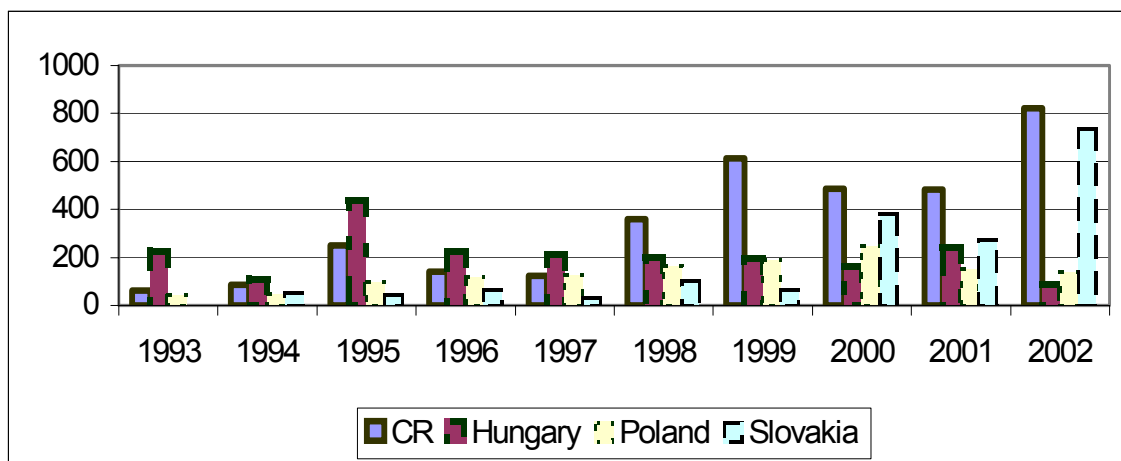


Source: http://www.cnb.cz/en/stat_pb_pzi.php (cited 15-09-2004). 2003 - preliminary data (cited 15-09-2004)

The FDI inflow from other countries is not so important for the Czech economy. The item "others" in the graph No. 2 otherwise represents 12 per cent of the total FDI inflow into the Czech Republic but the share of each country incorporated in this item is 1 % or less.

We can also to express the relative position of the Czech Republic among CEE countries. The graph No. 3 shows the division of the FDI inflow among four Visegrad group countries.

Graph 3 - Foreign direct investment into the Visegrad group member states, Inflow (USD per capita) in years 1990 – 2002



Source: selected data from the table No. 3 from the Statistical Appendix

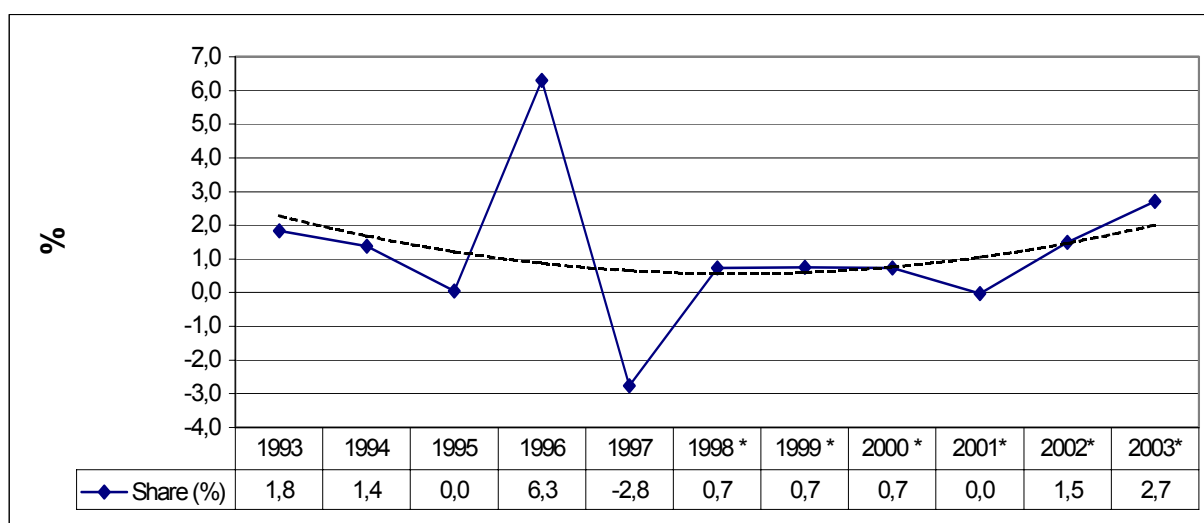
Till 1998 the Czech Republic was the second most important market for the foreign investors. But after the year 1998 the Czech economy has occupied the pole position among the Visegrad group member states. It is not probably a coincidence that the first integral system of the investment incentives was implemented in the Czech Republic this year.

2.3 Italian FDI in the Czech economy

The graph No. 4 shows the position of the Italian direct investment in the total inflow of the FDI into the Czech Republic from the year 1993 to the year 2003. From the general point of view, it seems that the Italian investors are not very significant for the Czech economy.

In 2002 the amount of the Italian FDI reached the volume of 135 millions EUR and the share of the Italian investment was roughly 1,5 %. In 2003 there was the decline of the total FDI inflow into the Czech economy. Also Italian investment declined this year. In 2003 Italian companies invested to the Czech economy about 62 mil. EUR. But the decline of the Italian investment was not so rapid as the total volume of investment was. The result of these two processes was the Italian share in the total volume of the FDI has increased from 1,5 % to 3 %.

Graph 4 - Italian Direct Investment in the Czech Republic, Inflow in years 1993 – 2002



* Until 1997 data included the FDI in the equity capital, starting from 1998 data on the reinvested earnings and other capital have been included in the FDI flows. 1) year 2003- preliminary data

Source: http://www.cnb.cz/en/stat_pb_pzi.php (cited 15-09-2004)

Nevertheless, the trend line (dashed line in the graph No. 4) shows the share of the Italian FDI is relatively stable. It has oscillated between 1 and 2 per cent of the total direct investment inflow. There are only two exceptional years. In 1996 the Italian share jumped to 6 %, but the next year (1997) the Italian FDI fell into negative numbers.

This statement is also confirmed by the share of the Italian FDI on the on cumulative FDI inflow during period 1993 - 2002. This indicator signalises again the Italian share is slightly above 1 per cent during the whole analysed period.

The CzechInvest - a public owned development agency - publishes regularly on its web sites the list of the major investors in the Czech Republic. In August 2004 there was listed also 19 important Italian investments (for details, see Statistical Appendix, table No. 6). About half of the listed investment activities is oriented toward to two branches of manufacturing industry: engineering (5 cases) and electronics (4 cases). This facts may signalise the main interest of the Italian investors is concentrated in the manufacturing industry.

Also the Czech direct investment are present in the Italian economy but their current role is marginal. But it makes sense to warn this activity exists although in an embryonic form. The table No. 2 characterises the Czech investment in Italy in 2003.

Table 2 Czech Direct Investment in Italy - Mil CZK or %, 2003 (preliminary data)

| <i>Eurostat/OECD</i> | <i>Equity capital</i> | <i>Reinvested earnings</i> | <i>Other capital</i> | <i>Total</i> |
|----------------------|-----------------------|----------------------------|----------------------|--------------|
| | mil. CZK | mil. CZK | Mil. CZK | mil. CZK |
| Italy | 2,1 | 6,6 | 0,0 | 8,7 |
| EU-15 | 1 117,0 | -49,0 | 5 825,8 | 6 893,8 |
| Total - world | 2 516,2 | -2 192,1 | 6 222,4 | 6 546,5 |
| Share Italy/EU-15 | 0,19 % | -13,45 % | 0,00 % | 0,13 % |
| Share Italy/world | 0,08 % | -0,30 % | 0,00 % | 0,13 % |

Source: http://www.cnb.cz/en/stat_pb_pzi.php (cited 15-09-2004)

The Czech subjects brought the investment in the volume of 2,1 mil. CZK (i.e. about 0,07 mil. EUR) to Italy in 2003. Most of them has the form of reinvested earnings and only one quarter of them has been invested to the equity capital.

The total Czech direct investment abroad reached 6 546,5 mil. CZK (i.e. 205,6 mil. EUR). The most important territory where the Czech direct investment finds its placement is the European Union. But it is not true for Italy. Its share in the Czech total investment abroad or in the Czech direct investment just in the European Union is very low. So even these relative indicators confirm the Italian market is for Czech investors marginal.

3. Empirical Research

Generally speaking, the research on the field of the foreign direct investment is solving two "pre-eminent" problems:

Firstly, economic studies analyse factors which are playing the crucial role in the inflow and the existence of the FDI in the host country or in the concrete industry.

Secondly, economic research studies effects which the FDI has on the host firm (direct effects) or on the host economy as the whole (indirect effects).

Let us start with the first domain of the FDI studies. The working paper of Král P. (2004) from the Czech National Bank belongs among the latest studies in the Czech Economic literature on this field. He names following factors related to the FDI inflow and stock for the Czech Republic:

- Host country market size
- Clustering or agglomeration effect (this means that FDI may show tendency to cluster in a particular locality because of linkage among projects creating incentives for the subsidiary or branch of an multinational company to be established in the vicinity of other firms or "follow-the-leader" strategy)
- The decrease of the factors costs (especially labour and human capital costs)
- Government investment incentives and promotion
- A stable political and macroeconomic environment
- State interference in the economy
- Transport costs and economic distance
- Privatisation

- Business (investment) climate
- Trade barriers (openness)
- Regional integration
- Legal and order, legal and regulatory framework and efficient public governance
- Proximity to potential FDI source countries

Benáček, V. (2000) provides the overview of eight analytical studies which have examined determinants of the FDI inflow into transition economies (emerging markets). The table No. 5 in the Appendix provides a basic description these surveys.

Practically all these surveys have confirmed that the proximity of the European Union was very important determinant for the investors' decisions, mainly for exporters. The same positive role has got the volume of the host country trade with EU-15 member states and the abatement of trade barriers. The political and economic stability and riskiness have played the same role for the respondents in the surveys as the foregoing determinants of the FDI influx.

Král, P. (2004) has used econometric approach to test determinants of the FDI inflow in the Czech economy. He has confirmed statistically significant long-run cointegrating relationship between the real FDI inflow on the one hand and the evolution of unit labour costs, the vulnerability of the economy, the economic performance in the main EU countries, the share of Czech Invest² projects in the FDI inflow on the other hand.

Secondly, economic research studies direct and also indirect effects of the FDI. Zemplinerová, A. - Benáček, V. (1997) analysed the direct effects of the FDI in the case of the firms which operate in the Czech economy. They found in their empirical analysis that enterprises of the manufacturing sector into which the foreign capital was invested, were generally speaking physical capital intensive and labour saving. At the same time, the FDI significantly has increased the capital and labour efficiency above the domestic average. The enterprises with the FDI are also - by the same authors - very export intensive and they have got much better capital endowments than other firms.

Benáček, V. (2000) and Mišun J. - Tomšík V. (2002): discussed factors which effect the host economy as the whole (indirect effects of the FDI). Benáček, V. (2000) specified positive spillovers. For example, he describes how the technology transfer leads to the increase of the factor productivity and to the economic growth. V. Benáček also alerts the negative spinoffs like the hostile mergers or the crowd out effect of the foreign savings on the domestic ones.

Mišun J. - Tomšík V. (2002) analyse the relationship between foreign direct investment and domestic investment in Central Europe. They have found that for the time period 1990 - 2000 there was an evidence of crowding out effect in Poland. In Hungary they found a crowding in effect for the time period 1990 - 2000 as well as for the Czech Republic for the time period 1993 - 2000.

Our project has dealt with the Italian investment in the Czech Republic. It has investigated the reasons of the FDI influx from Italy into the Czech Republic. More specifically, the project has examined the process of internationalisation, the headquarter-subsidiaries relationship and subsidiaries' characteristics.

² CzechInvest was established by the Ministry of Industry and Trade (MIT) in November 1992. Its task was to promote the Czech Republic internationally to ensure a sustained inflow of foreign direct investment that would support industrial restructuring and development. Over the past eleven years, CzechInvest, originally a marketing agency, has gradually changed into a development agency through the implementation of programmes supported by both the MIT and the EU.

The project also investigated subsidiaries' relationships with local firms and the R&D role in these investments. These parts of the research so concerned the second basic domain of the FDI studies.

The research which examines reasons why investors choose the concrete country or industry usually takes the form of a surveys and/or econometric tests. The project was based on the survey and the face to face discussions. It was very narrow: only nine Czech and Slovak firms participated in it and so the results have got only a qualitative character.

Six respondents were coming from the Czech Republic and three respondents sent their answers from the Slovak Republic. The empirical research was realised in spring of 2004.

The respondents were coming from following industries (by the NACE): manufacturing (D), electricity, gas and water supply (E) wholesale and retail trade (G) and financial intermediation (J).

3.1. Internationalisation and the headquarter-subsidiaries relationship

Headquarter characteristics

By the number of employees, it is possible to separate Italian headquarters in to companies with one thousand employees or more and with 250 employees and less.

By its sales, it is possible to divide the respondents into two groups: subsidiaries with the average sales 0,5 - 5 mil. EUR and with the average sales 5 - 12,5 mil. EUR. The sales volume and number of employees naturally corresponds.

This fact is also reflected by the number of countries which subsidiaries operate in and also by the number of subsidiaries which are active out of Italy. Generally speaking, the larger sales are reported by the subsidiary the higher number of subsidiaries were founded by Italian company abroad. Also is valid the larger average sales are reported by the subsidiary then the Italian company operates in the higher number of countries.

Large companies own more then 150 subsidiaries, small firms have only 1 foreign subsidiary as a standard. From the number of subsidiaries follows small firms can operate only in 1 country (i.e. in the Czech Republic). Big companies reported their subsidiaries operates in 10 or more countries.

All firms has expanded abroad after the collapse of the iron curtain. The first respondent left Italy and founded its first foreign subsidiary in 1989. The first foreign subsidiaries of all respondents were founded during nineties.

It is remarkable that all Italian headquarters are listed in the Northern Italy; more precisely in Lombardy.³ It seems that more active abroad are firms this part of Italy than from others.

The serious question is - at least from the point of view of economic policy - what are main motivation behind the decision of Italian managers to invest in the Czech Republic. The respondents regarded as the most important reasons:

- Seeking new market
- Lowering labour cost
- Better law environment

³ The conclusion is based on the information about respondents of the survey which is available in the Czech and Slovak Companies Registers.

The first two motives are in the line with similar surveys concerning the FDI inflow to the Czech Republic which were described earlier in the text. Surprisingly, the respondents specified as the important factor for their decision to invest in the Czech economy the better Czech law environment - with the comparison with the situation in Italy. The evaluation of this aspect is unfortunately behind our study and it would require further comparison (analysis) of the Czech and Italian law environment.

But the first three motives for the influx of the Italian investment into the Czech Republic are not alone. There is further group of motives which Italian investors have taken in account. These factors are closely related to the level of competition on the Italian market. The competition in Italy has lead respondents or to decrease their costs (by the shifting of the production to the Czech or Slovak Republics) or simply to follow their competitors in the further market. The first motive was expressed by the answers of the "we are looking for raw materials" or "we seek to diminish labour cost" type. The second motive was possible to find in the answers f.e. "Competitors were moving here", "Significance of the Czech market" or "Our main clients were already or were coming here".

It is necessary to underline Italian investors are often also export oriented. The share of export on the total sales of headquarters was between 30 - 60 % during last three year.

The Italian investors almost do not look on the fiscal and/or the financial supporting facilities provided by the Czech authorities. It is suitable to remind here the conclusion of Král P. (2004). On the base of econometrics analysis, Král P. has stated that there is the statistically significant relationship between the share of Czech Invest projects and the total real FDI inflow (in the long-run). In this point our study and the Král's study may be in discussion.

Correspondingly, the previous contacts with local (Czech) firms and their competencies do not play any role for the decision of Italian investors to come to the Czech Republic. The financial supporting facilities from the Italian or European Commission authorities have got the zero impact to the decisions of Italian investors to come to the Czech Republic, too.

Headquarter-subsidiaries relationship

It is almost a cliché to say that the headquarter has to formulate a relationship toward a subsidiary after its foundation. As a standard, the headquarters of Italian firms are responsible for the formulation of strategic goals. The headquarters provide strategic planning, corporate governance and co-ordination of the whole group.

Less companies have placed the administration and planning, research and education and/or the responsibility for finance to the hands of managers in the headquarters. Also production, marketing and sales problems are more often solved by local subsidiaries in the Czech market.

Generally speaking, the respondents have evaluate the degree of autonomy of the subsidiaries which is functioning on the Czech market as medium or low almost unanimously.

The Italian headquarters have exerted as a formal as a personal control on the local branches. The degree of the personal control that Italian managers have to set the strategies and policies is perceived as high or even very high by local managers.

The personal control is accompanied by a formal one. This form of control is realised mainly by financial instruments (monthly or year financial reporting). Managers from the

Italian headquarters also often control the quality of production or services provided by a local subsidiary or branch.

The direct control of raw material selection, production or sales and profitability goals were not so often mentioned by respondents. It is evident the capability to reach these goals influences the financial reports and it is readable from them.

It is evident from the survey that the examined companies are relatively centralised. In companies there is an intense flow of information, personals and resources between the headquarter and the subsidiaries. Also the strategy is essentially defined by the Italian headquarter and subsidiaries often strive to lower costs. Headquarters are often playing a dominant role a priori.

The cross control questions have confirmed this situation. By respondents, there is not an intense flow of knowledge, personals and resources between the subsidiaries within their companies. This flow is controlled by the headquarters. Subsidiaries are not responsible for the local market and they do not produce and adapt production to local preferences. By our knowledge, it is not necessary as Czechs as Italians (mainly from North Italy) are living in the same cultural environment and their preferences are quite similar.

3.2. Subsidiaries' characteristics

Basic features

Almost all subsidiaries or joint ventures have been founded after the year 1998. It is perfectly in line with the date of the creation of the first package of the investment incentives which was offered to investors by the Czech cabinet just in 1998. The incentives system was shortly described in the first part of the paper. The econometric analysis (Král 2004) has also confirmed the impact of the incentives on the foreign investment influx

Subsidiaries were almost exclusively founded with a green field investments. The Italian firms entered in the Czech market only rarely with an acquisition.

All subsidiaries or joint ventures which respondents are coming from have taken the legal form of the company with limited liability.

The owners of these firms are coming exclusively from Italy. Italian investors (i.e. headquarter as the whole or headquarters' shareholders) own more then 95 % proprietary share in the subsidiaries.

The subsidiaries which operate in the Czech Republic are controlled by its Italian founders not only through owners relations but also by the Italian management. The Italians definitely dominate among their managers.

There is inevitably a strong element of arbitrariness in the statistical definition used for the small and medium firms. Nevertheless, all subsidiaries in the survey belong among them as by their sales or by the number of employees.

Production

The small firms have got less then 250 employees by the definition of the Act on support of small and medium business⁴. With respect to this definition, the subsidiaries of Italian firms on the Czech market belong among small firms as they reported 150 or less

⁴ The Act No. 47/2002 on support of small and medium businesses, the paragraph No 2 Source: www.mpo.cz (cited 10.10.2004)

employees. The respondents in the survey have reported that the share of labour cost has reached roughly 20 per cent of the subsidiaries' total cost.

The companies included into the survey have mainly operated in the manufacturing, wholesale trade and services (sectors "D" and "G" by the first digit NACE classification).

It is self-evident the value chain of subsidiaries which operate in manufacturing or in wholesale trade and services is different. The local Czech entities of Italian firms which operate in the manufacturing are performing mainly in the production. Then they are active in services connecting with production as administration and accounting, procurement and treasury management (i.e. in commercial credits and short term, financial management).

On the other hand, there is not surprise the subsidiaries which operate in the wholesale trade and services are performing mainly in sales and distribution. Marketing (i.e. product adaptation to the Czech market, pricing policy for this local market), advertising and promotion are playing an important role in their activities.

By the survey, the share of amortisation and depreciation reaches roughly 5 per cent of the subsidiaries' total cost.

The local branches are not playing often the role of strategic centre (centre of excellence) for the whole group. We have to keep in the mind it is a position of managers from the Czech subsidiaries which are collected in the survey. If local subsidiary plays the role of a strategic centre, it performs this role in production.

Sales

By their sales, it is possible to divide the respondents into two groups: subsidiaries with the average sales 0,5 - 5 mil. EUR and with the sales 5 - 12,5 mil. EUR. We can use the definition of small and medium sized companies in the Act No. 47/2002 on support of small and medium businesses again. By the sales, small and medium sized firms have got their sales 1.450 mil. CZK (i.e. about 45,5 mil. EUR) or less. So we can again to observe the subsidiaries which are analysed in the survey belong among small and medium firms. The sales volume and number of employees naturally correspond.

The Czech subsidiaries of Italian firms serve mainly for two markets. More than 50 % of them have realised 100 % of their sales in the Czech market. The second key market for these firms is in Italian one. Some subsidiaries have realised their sales in other European Union members markets or in other Eastern European countries but the role of these markets is not so important.

The respondents in the survey have reported that the share of procurement of goods and services cost reaches roughly 60 per cent of the subsidiaries' total cost.

The performance of subsidiaries which operate in the Czech market is has been evaluated by the respondents as good or even very good during last three years as a rule. Almost all respondents also have stated that the sales of their company have been increased if they compare this year sales to the previous year sales.

3.3. Subsidiaries' relationships with local firms

The subsidiaries of the Italian companies are conclusively integrated to the Czech economy. Almost all respondents have confirmed their subsidiaries have got regular clients

and suppliers in the Czech market always for several years. In many cases the relationship is more than five years old. Italian firms are planning to stay in the Czech market as they regard the relationship with their local clients as fruitful and they plan to maintain it in the future.

The number of clients depends of the type of the economic activity of the firms and it is very different for each subsidiary. The role of the Czech market for analysed firms was given in the previous part of this text. Now we are going to describe the influence of clients on the managers' decisions of the Czech subsidiaries of Italian companies.

The respondents of the survey have stated products and services are not autonomously defined by managers of subsidiaries but they are mostly defined following clients' indication. Above it, there is a regular exchange of knowledge and technology with clients in order to improve the quality of exchange.

But the subsidiaries behave independently in the Czech market. Just one respondent has confirmed the subsidiary is working as a subcontractor for some local firm. With the regard to the Italian market, the subsidiaries behave by the same way. Only few branches are working as a subcontractor for some Italian firms. Also the number of suppliers depends on the type of the economic activity of the firms and it is very different for each subsidiary. Managers of Italian subsidiaries regard the long-term and stable contacts with local suppliers. These contacts last often more than five years. Managers regard these long-term contacts fruitful and they plan to maintain it in the near future.

Products and services which are delivered by the local regular suppliers are not autonomously defined by the suppliers but they are exactly defined on the base of the indication of the Italian firms. On the opposite of the contacts with regular clients, there is not regular exchange of knowledge and technology with suppliers in order to improve the quality of exchange. In spite of the preference of the long-term contacts with local suppliers, the respondents have stated in the survey their firms are not using the sub-contracting relationships with local suppliers often.

In some cases the position of subsidiaries of the Italian companies is strengthened by an agreements (both formal or informal) with other firms which operate in the Czech market. Almost fifty per cent of respondents have confirmed their subsidiary has got some agreement of this kind. The number of firms which participate in agreements varies but it is less than ten as a standard.

Agreements mostly concern the exchange of marketing information. Agreements cover ordinarily the information exchange on the local market and/or the information exchange on commercial opportunities in the Czech market. Even though the agreements about the technology exchange and the co-operation in product development exist they are not common.

3.4. The R&D role

The respondents have reported the internal sources of the companies play the key role for their technological innovation process.

It was observed in the section 3.1. the degree of autonomy of the subsidiaries which are functioning on the Czech market is medium or low. The result has been confirmed also in the field of the R&D outlays. The main sources of knowledge or information used in the technological innovation activities were headquarters in the analysed Italian companies during the period 2000-2002.

Activities of other enterprises within the enterprise group including subsidiaries operating on the Czech market were the second but much less important source for the technological innovation.

It possible also to regard the analysis of the influence of the behaviour of clients, consumers and competitors as an internal source of the R&D development in firms. External - as private as public - sources for the R&D are not so important for companies. Consultants, universities, professional conferences and meetings play only limited role in the technological innovation.

The managers have felt some stress of the government regulation, mainly in the field of the health and safety and the environmental standards. On the other hand, the managers have not perceived the stress of governmental bodies in the field of the technical standards thanks the level of quality control in the companies.

The respondents have stated the specific sources of information as trade associations, technical and trade press, computer databases or fairs and exhibition have not been utilised in their companies.

The outsourcing is not used in the field of the R&D. Companies do not use services of the suppliers of equipment, materials, components or software, commercial laboratories, R&D enterprises, government research organisations or private research institutions.

4. Conclusion

1. During period 1993 – 2003 the FDI inflow depended on the privatisation activity of the Czech cabinet – mainly in the banking, electricity, gas and other network sectors. Since 1998 the government investment incentives have got also the important positive impact on the FDI influx into the Czech economy. The highest amount of the FDI came to the Czech Republic in 2002.

2. In 1993 - 2002 almost two thirds of the cumulative FDI was oriented toward the manufacturing industry, mainly to the manufacture of machinery, electrical and optical equipment and to the manufacture of the transport equipment. The services and the financial intermediation sectors received about one fifth of the FDI. The trade sector received roughly 13 % of all FDI.

3. In years 1993 - 2003 almost one third of the cumulative FDI inflow came from Germany. Just the FDI from Netherlands and Austria represents more than 10 % share of the total FDI during the same period.

4. The share of the Italian direct investment was relatively stable during period 1993 - 2002. It oscillated between 1 and 2 % of the total FDI inflow. There are only two exceptional years. In 1996 the Italian share jumped to 6 %, but the next year (1997) the Italian FDI fell into negative numbers.

5. Also the Czech direct investment are present in the Italian economy but their current role is marginal. The Czech subjects brought the investment in the volume of 2,1 mil. CZK (i.e. about 0,07 mil. EUR) to Italy in 2003. Most of them has got the form of reinvested earnings and only one quarter of them has been invested into the equity capital.

6. All Italian firms (headquarters) included into the survey have expanded abroad after the collapse of the iron curtain. The first foreign subsidiaries of all respondents were founded in nineties. The respondents regarded as the most important reasons for their expansion: the seeking new market, the lowering labour cost and the better law environment in the host country. By the survey, the Italian companies are often export oriented. The share of exports on the total sales of headquarters was between 30 - 60 % during last three year. The Italian investors almost do not look on the fiscal and/or the financial supporting facilities provided by the Czech authorities or by the European Commission in their investment decisions.

7. The respondents have evaluate the degree of autonomy of the subsidiaries which are functioning on the Czech market as medium or low almost unanimously. The Italian headquarters have exerted as a formal as a personal control on their local branches. The formal control is realised mainly by financial instruments (monthly or year financial reporting).

8. Almost all subsidiaries or joint ventures have been founded after the year 1998. It is perfectly in line with the date of the creation of the first package of the investment incentives which was offered to investors by the Czech cabinet just in 1998. Subsidiaries were almost exclusively founded with a green field investments.

The companies included into the survey have mainly operated in the manufacturing, wholesale trade and services. The main parts of the value chain firms which operate in the manufacturing are production and services connected with production as administration and accounting, procurement and treasury management (i.e. in commercial credits and short term, financial management). On the other hand, the main parts of the value chain of the subsidiaries which operate in the wholesale trade and services are sales and distribution, marketing (i.e. product adaptation to the Czech market, pricing policy for this local market), advertising and promotion.

The Czech subsidiaries of Italian firms serve mainly for two markets - Czech and Italian one. The performance of subsidiaries is evaluated by respondents as good or even very good during last three years. The sales of the subsidiaries have been increased in comparison with the previous year sales.

9. The subsidiaries are conclusively integrated to the Czech economy. Almost all respondents have confirmed their subsidiaries have got regular clients and suppliers in the Czech market always for several years. In many cases the relationship is more then five years old. Italian firms are planning to stay in the Czech market as they regard the relationship with their local clients as fruitful and they plan to maintain it in the future.

In many cases (almost 50 %) the position of subsidiaries is strengthened by agreements (both formal or informal) with other firms which operate in the Czech market. Agreements mostly have concerned the exchange of marketing information.

10. The respondents have reported the internal sources of the companies play the key role for their technological innovation process. During the period 2000-2002 the headquarters were a main source of knowledge or information used in the technological innovation activities in subsidiaries. Consultants, universities, professional conferences and meetings play only limited role in the technological innovation. The managers have felt some stress of the government regulation, mainly in the field of the health and safety and the environmental standards.

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- Czech Statistical Office, <http://www.czso.cz>
- Czech Ministry of Finance, <http://www.mfcr.cz>
- Czech Ministry of Industry and Trade, <http://www.mpo.cz>
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- Italsko česká obchodní a průmyslová komora (Italian - Czech Chamber of Commerce and Industry), <http://www.camic.cz>

Statistical Appendix

Table 1 - Foreign Direct Investment in the Czech Republic, Inflow and stock per capita 1993 - 2002 (USD)

| year | FDI inflow per capita | FDI stock per capita |
|------|-----------------------|----------------------|
| 1992 | NA | 280,1 |
| 1993 | 63,2 | 331,5 |
| 1994 | 85,0 | 440,1 |
| 1995 | 248,7 | 711,9 |
| 1996 | 139,1 | 831,2 |
| 1997 | 124,9 | 896,4 |
| 1998 | 359,4 | 1396,9 |
| 1999 | 614,0 | 1707,2 |
| 2000 | 485,4 | 2107,0 |
| 2001 | 481,7 | 2618,7 |
| 2002 | 822,3 | 3306,2 |

Source: Král, P. Identification and Measurement of the Relationships Concerning Inflow of FDI: The Case of the Czech Republic. Working Paper Series No. 5, Czech National Bank, Prague 2004, p. 24

Table 2 - Foreign Direct Investment in the Czech Republic by Country. Shares on Cumulative FDI Inflow during 1993 - 2002

| Country | mil. EUR | Share (%) |
|----------------|----------|-----------|
| Germany | 733 | 32 |
| Netherlands | -1383 | -60 |
| Austria | 542 | 24 |
| France | 462 | 20 |
| United States | 180 | 8 |
| Belgium | 135 | 6 |
| Switzerland | 233 | 10 |
| Italy | 62 | 3 |
| United Kingdom | 240 | 10 |
| Japan | 224 | 10 |
| Others | 861 | 38 |
| Total | 2289 | 100 |

Source: http://www.cnb.cz/en/stat_pb_pzi.php (cited 15-09-2004)

Table 3 - Foreign Direct Investment in the Czech Republic and other selected CEE countries. Inflow and stock per capita 1990 - 2002 (USD)

| year | FDI inflow per capita | | | | FDI stock per capita | | | |
|------|-----------------------|---------|--------|----------|----------------------|---------|--------|----------|
| | CR | Hungary | Poland | Slovakia | CR | Hungary | Poland | Slovakia |
| 1990 | NA | NA | NA | NA | NA | 53,3 | NA | NA |
| 1991 | NA | 141,2 | 7,6 | NA | NA | 205,7 | NA | NA |
| 1992 | NA | 142,9 | 17,7 | NA | 280,1 | 351,8 | NA | NA |
| 1993 | 63,2 | 227,4 | 44,7 | NA | 331,5 | 591,4 | NA | NA |
| 1994 | 85,0 | 111,0 | 48,8 | 50,5 | 440,1 | 723,6 | 98,6 | 167,8 |
| 1995 | 248,7 | 438,8 | 95,2 | 44,0 | 711,9 | 1284,4 | 204,1 | 241,9 |
| 1996 | 139,1 | 221,3 | 117,1 | 65,3 | 831,2 | 1574,1 | 298,5 | 380,7 |
| 1997 | 124,9 | 211,5 | 127,7 | 32,3 | 896,4 | 1708,8 | 379,7 | 386,9 |
| 1998 | 359,4 | 199,5 | 165,7 | 104,2 | 1396,9 | 1852,4 | 585,3 | 535,9 |
| 1999 | 614,0 | 194,3 | 189,4 | 65,5 | 1707,2 | 2019,1 | 679,5 | 590,3 |
| 2000 | 485,4 | 162,4 | 246,6 | 379,4 | 2107,0 | 1968,6 | 892,4 | 877,6 |
| 2001 | 481,7 | 241,3 | 149,1 | 272,5 | 2618,7 | 2202,0 | 1076,3 | 1027,6 |
| 2002 | 822,3 | 85,3 | 141,0 | 737,5 | 3306,2 | 2636,2 | 1250,4 | 1150,8 |

Source: Král, P. Identification and Measurement of the Relationships Concerning Inflow of FDI: The Case of the Czech Republic. Working Paper Series No. 5, Czech National Bank, Prague 2004, p. 24

Table 4 - Italian Direct Investment in the Czech Republic, Inflow in years 1993 - 2002

| year | Italy | total FDI | Italian Share |
|--------|---------|-----------|---------------|
| | mil EUR | mil. EUR | % |
| 1993 | 10,2 | 558,6 | 1,8 |
| 1994 | 10,1 | 733,8 | 1,4 |
| 1995 | 0,8 | 1981,9 | 0,0 |
| 1996 | 71,9 | 1140,3 | 6,3 |
| 1997 | -31,9 | 1152,2 | -2,8 |
| 1998 * | 24,1 | 3317,3 | 0,7 |
| 1999 * | 44,0 | 5932,7 | 0,7 |
| 2000 * | 39,1 | 5403,6 | 0,7 |
| 2001* | -2,3 | 6296,0 | 0,0 |
| 2002* | 134,8 | 9012,4 | 1,5 |
| 2003* | 62,2 | 2289,3 | 2,7 |

Source: http://www.cnb.cz/en/stat_pb_pzi.php (cited 15-09-2004)

Table 5 - Determinants of the FDI (analytical studies)

| Author | Year | Territory | Number of respondents | Investors |
|--------------------|------|--|-----------------------|---------------------|
| Lankes/Venables | 1997 | 16 countries of the former COCOM | 262 | Not distinguish |
| Pomery | 1998 | Czech Republic | 163 | Not distinguish |
| Pye | 1998 | Czech Republic, Slovakia, Hungary, Poland, Romania | 334 | OECD countries |
| Altzinger | 1999 | All post communist countries | 150 | Austria |
| Lansburry et al. | 1996 | Czech Republic, Hungary, Poland | 126 | OECD - 14 countries |
| Holland - Pain (a) | 1998 | 11 post communist countries | 55 | Not distinguish |
| Holland - Pain (b) | 1998 | 8 CEE countries | 40 | Not distinguish |
| Barrell, Holland | 1999 | Czech Republic, Hungary, Poland | 132 | Not distinguish |

Source: Benáček, V.: Přímé zahraniční investice v české ekonomice (The FDI in the Czech Economy). Journal Politická ekonomie č. 1, Praha 2000

Table 6 - Selected major Italian investors in the Czech Republic - August 2004

| NAME OF CZECH SUBSIDIARY OR PARTNER | CzechInvest Project List | Region or town | INVESTOR | SECTOR OF INVESTMENT |
|--|---------------------------------|-----------------------|--|-----------------------------|
| Akuma a.s. - Mladá Boleslav | | Central Bohemia | Flamm Group | Engineering |
| Beghelli - Elplast, a.s. | | South Moravia | | |
| BSK Přestanov, a.s. | CzechInvest | Usti | ITS Ceramiche - S.p.A | Construction |
| CONTA CLIP, s.r.o. | | Usti | CONTA CLIP VERBINDURGSTEC HNIK GmbH, SRN | Electronics |
| CONTA s.r.o. | CzechInvest | Usti | Candy | Electronics |
| Česká rafinérská, a.s. | | Usti | IOC - Agip, DuPont-Conoco, Royal Dutch Shell | Chemical |
| Elplast, a.s. | | South Moravia | Beghelli s.p.a. | Electronics |
| Gildemeister Italiana s.r.o. | | Zlin | Gildemeister Italiana S.p.A. | Engineering |
| Gio' Style PAP a.s. | | Plzen | Gio' Style Monouso S.P.A. (LAURA G) | Packaging & Paper |
| Hayes Lemmerz Alukola s.r.o. | CzechInvest | Moravia-Silesia | Hayes Lemmerz International | Engineering |
| IVG Colbachiny CZ, s.r.o. | CzechInvest | Moravia-Silesia | IVG Colbachini | Automotive |
| Logit s.r.o. | CzechInvest | Usti | Radici Group | Textiles |
| Manifatture di Brno, s.r.o. | | South Moravia | | |
| Manuli Hydraulics, s.r.o. | | South Moravia | | |
| Nová Mosilana a.s. | CzechInvest | South Moravia | MARZOTTO S.p.A.. i | Textiles |
| RAF Armatury s.r.o. | | Olomouc | RAF Rubinetteria | Engineering |
| SIAD Czech spol. s r.o. | CzechInvest | South Moravia | SIAD Czech | Chemical |
| Tajmac-ZPS, a.s. | | Zlin | Tajmac-MTM | Engineering |
| Trafil Czech s.r.o. | CzechInvest | Usti | Trafilix S.r.L. | Metal works |
| TTC Telekomunikace, s.r.o. | | Praha | MARCONI S.p.A | Electronics |

Source: www.czechinvest.com (cited 16-09-2004)