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FOREIGN PRIVATIZATION IN POLAND

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FOREIGN DIRECT INVESTMENT AND PRIVATIZATION IN CENTRAL AND EASTERN

EUROPE: Facts and Issues *Władysław W. Jermakowicz, Carl J. Bellas*

INTRODUCTION

The long-term development of the former socialist countries of Central and Eastern Europe (CEE)¹ largely depends on their success in attracting foreign direct investment (FDI) to revive their economies². FDI is the most common vehicle used by foreign investors when entering new markets with their own products and technologies.

The perception of the FDI phenomenon in CEE countries is frequently based on emotional prejudices and short run political considerations, not rational economic considerations. Two divergent perceptions of the FDI phenomenon exist: at one extreme is the illusion that FDI can solve a country's major economic problems; at the other, the fear that the country will be "sold out". Neither of these two perceptions is realistic, and each is detrimental to both the host countries and foreign investors.

It is true that CEE countries have a large potential need for FDI. Foreign investments can be the driving forces toward achieving the four following goals:

- * ***to combat the lack of foreign capital:*** At the macroeconomic level FDI inflows can provide a source of savings with which to finance the major investment requirements of CEE economies, and FDI inflows can provide a source of convertible foreign exchange over and above export earnings, thereby releasing funds for debt repayment and permitting a higher level of imports.
- * ***to accelerate the privatization process of CEE economies:*** FDI inflows can bring in CEE countries the opportunity to link up with Western companies of much greater financial strength, which increases their credit stature with potential lenders.
- * ***to introduce modern technology and management techniques:*** At the microeconomic level, FDI can be a source of new technology, introduce superior management and marketing techniques, provide management and employee training to meet western
- * ***to supply the local markets with quality products,*** as well as provide direct quality and design expertise to meet the requirements of Western markets.

Early optimism about CEE economic reforms and resulting large FDI inflows was based on the expected opening up of new markets with good growth prospects, the existence of a skilled labor force and low labor costs, and relatively low cultural barriers, particularly for West European companies investing in Central Europe. The emergence of a large number of potentially

¹ In this paper, the Central and East European countries are: Albania, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russia, Slovakia, Slovenia, and Ukraine.

² Foreign direct investment (FDI) occur when a firm invests directly in new facilities to produce a product in a foreign country and when a firm establishes an interest in a business entity based in another country by acquiring more than 10 percent of the entity's ownership. Less than 10 percent of the ownership in a foreign business is foreign portfolio investment (FPI).

highly profitable new investment opportunities was expected to generate a flow of FDI as well as internal funds to finance new investment.

Since then, both sides have reassessed the potential costs and benefits. To date, the volume of FDI into CEE countries has been very small, the technology is in most cases outdated, and the management skills of Western investors are disappointing. From the other side, the costs of doing business for Western companies in the CEE are much higher than they expected and the anticipated benefits have been lower, at least in the short to medium term.

Is there a more accurate assessment of the current situation? In this paper, the authors attempt to: present the real growth in FDI from a global perspective; examine the structure of the CEE investment; put forth some basic political recommendations to promote an active strategy and policy towards FDI which the CEE countries can incorporate into the enhancement of their indigenous competitive advantage and capabilities.

FOREIGN DIRECT INVESTMENT IN CEE: A GLOBAL PERSPECTIVE

By 1988 most Socialist countries, with the exception of Albania and East Germany, allowed joint venture partnerships with Western capital (Dunning (1993)). For the entire Communist Block countries, 378 firms had foreign partnerships (an 570% increase over 1985) with a total FDI of \$808 million. In 1993 the number of firms with foreign participation increased to 99.5 thousand (263 times over 1988) and the capital invested to \$19.5 billion (24 times over 1988). (See Table 1.)³

In spite of the tremendous rate of growth, these investments have not met the expectations of the host CEE governments, causing serious disappointment. FDI in CEE countries is still in its infancy and represents only a small share of worldwide FDI. During 1985-1993, total world FDI in the world economy amounted to \$1,350 billion, and accumulated FDI in less developed countries (LDCs) in 1993 amounted to \$203.2 billion (World 1994). Therefore, over a comparable time the CEE countries attracted approximately 1.5 percent of the world FDI inflows, and less than 10 percent of the capital inflows of less developed countries. In 1993 the inflows of FDI to CEE amounted 3 percent of the world inflows and 6.2 percent of developing countries inflows. In 1993 total FDI inflows amounted an estimated \$5 billion in comparison with \$5 billion inflows to Mexico alone in the same year (World 1994).

Even if the FDI flow into CEE continues to increase at the current rate, it seems unlikely that this will divert any appreciable FDI from other regions of the world. In the year 2000 projected FDI inflow to CEE would still account for only about 10 percent of all worldwide FDI.

The decreasing size of FDI per firm seems to indicate that more new firms can be established without central consent, encouraging more small foreign firms to enter the CEE market.

³ The compilation of data on FDI differs from country to country and sometimes even within countries, where they are compiled by several government agencies (Statistical Offices, Foreign Investment Agencies and National Banks). The differences in criteria used may result in considerable divergence in aggregated FDI statistics. As a result, the data are often not comparable and should be used with caution (See: ECE 1994). Nevertheless, the general trends are informative and indisputable.

TABLE 1. FOREIGN DIRECT INVESTMENTS (FDIs) IN CENTRAL AND EASTERN EUROPE IN COMPARISON TO THE LESS DEVELOPED COUNTRIES (LDCs)
(Cumulative data)

Year	Number of FDIs in CEE	FDI in CEE (\$Million)	FDI in LDCs (\$Million)	CEE as % of LDC
1985	6	250	-	-
1988	378	808	19,752	4.1
1989	2,413	2,507	43,059	5.8
1990	9,121	5,150	67,067	7.7
1991	32,828	10,203	100,984	10.1
1992	71,170	14,690	139,246	10.5
1993 ⁴	99,533	19,493	203,246	9.6
Calculations based on Sader (1993), East-West (1991-1993), Gutman (1993), World (1994).				

THE PATTERNS OF FOREIGN DIRECT INVESTMENT IN CEE COUNTRIES

The CEE countries are at different stages in their development. FDI is rather heavily concentrated in Hungary, Russia, Poland, and Czech Republic, which together had 41.4 percent of all CEE investment occurrences and accounted for 68.3 percent of total FDI. Romania ranks high in the number of investments (29.3%), but low in the amount of invested capital (3.9%). Conversely, Slovenia has 6.2 percent of the FDI but only 3.3 percent of the number of investments (See Tables 2 and 3.)

In 1993, Czech Republic had the highest FDI per firm, followed by Russia and Slovenia. Romanian and Lithuanian firms had the lowest, with average FDI investment below \$50 thousand per enterprise. (See Table 4.) These differences indirectly reflect the degree of centralization in decision-making by governments. Central authority is usually required to establish large firms; therefore the more centralized the decision process, the larger the average investment.

FDI projects have tended to decrease in size over these five years. In 1988, the average FDI per firm was \$1.68 million; in 1993 this average decreased to \$196 thousand. Apparently liberalization of foreign investment has increased the number of small private firms with foreign participation⁵.

This principle seems to be confirmed by the analysis of the trends over the last five years. In 1988 only large FDI firms were operating, and their establishment was the result of their willingness to persevere through lengthy bureaucratic procedures. For example, Suzuki needed seven years to complete its agreement with the Hungarian Foreign Investment Agency in 1991. In subsequent years,

The country comparison seems to indicate that the size of the country is also an important factor in average FDI per enterprise. The smaller the country, the more centralized its decision making and the more control the central body exercises over new investment. In Slovenia, it is

⁴ Based on committed (but not actually implemented) FDI projects. As of December 31, 1993 cumulated FDI stock in CEE amounted to an estimated \$13 billion (World 1994:98).

⁵ Undoubtedly, the average size of foreign affiliates in the region is small. For comparison, affiliates in developed countries average \$18 million in invested foreign equity capital and LDC affiliates average \$4 million (World 1994). In Hungary only 4 percent and in Poland 1.4 percent of the projects involving foreign investors had investment exceeding \$1 million (See Chapter 2).

the Agency for Privatization and in Czech Republic, the Ministry of Privatization. These bodies make all of the case-by-case decisions concerning foreign investment. The reverse is true in "anarchistic" Poland and Romania where firms with foreign participation can start their activity without governmental consent. The relatively high FDI per firm in Russia seems to reflect continued centralized decision making, the result of the traditions prevailing in this country.

TABLE 2. NUMBER OF FOREIGN DIRECT INVESTMENTS IN CENTRAL AND EASTERN EUROPEAN COUNTRIES

	1988	1989	1990	1991	1992	1993	% of total for 1993
Albania	-	-	-	-	70	-	0.0
Belarus	-	-	-	283	714	1,250	1.3
Bulgaria	20	25	70	900	1,200	2,300	2.3
Czech Rep.	11	50	500	3,066	3,120	5,000	5.0
Estonia	-	-	-	1,100	2,662	4,150	4.2
Hungary	149	1,201	5,693	9,117	17,182	21,468	21.6
Latvia	-	-	-	295	2,621	2,850	2.9
Lithuania	-	-	-	220	2,000	3,000	3.0
Poland	33	551	2,044	5,583	5,740	6,800	6.8
Romania	5	5	4,421	8,022	20,684	29,115	29.3
Russia	-	-	-	2,022	3,252	7,989	8.0
Slovakia	-	-	-	934	2,875	4,350	4.4
Slovenia	44	182	680	1,000	2,815	3,300	3.3
Ukraine	-	-	-	400	2,000	2,800	2.8
USSR	141	1,000	2,051	-	-	-	-
Others ⁶	-	-	-	-	4,235	5,161	5.2
TOTAL	403	3,014	15,459	32,828	71,170	99,533	100.0

Calculations based on East-West (1991-1993), Gutman (1993), Rojec (1993), World (1994).

TABLE 3: TOTAL FOREIGN DIRECT INVESTMENT IN CENTRAL AND EASTERN EUROPEAN COUNTRIES (\$Million), 1988-1993

COUNTRY	1988	1989	1990	1991	1992	1993	% of total for 1993
Albania	-	-	-	-	37	-	0.0
Belarus	-	-	-	-	265	340.0	1.7
Bulgaria	-	-	-	130	170	200.0	1.0
Czech Rep.	38	85	180	952	1,573	2,053.0	10.5
Estonia	-	-	-	84	142	220.0	1.1
Hungary	48	326	1,017	3,137	3,680	6,005.7	30.8
Latvia	-	-	-	45	84	150.0	0.8
Lithuania	-	-	-	33	90	140.0	0.7
Poland	7.6	104	308	479	1,545	2,100.0	10.8
Romania	-	-	60	269	540	755.0	3.9
Russia	-	-	-	2,827	2,850	3,153.2	16.2
Slovakia	-	-	-	124	231	380.0	1.9
Slovenia	-	136	386	650	962	1,200.0	6.2
Ukraine	-	-	-	440	480	600.0	3.1
USSR	583	1,846	3,208	-	-	-	-
Others	-	-	-	?	?	?	-
TOTAL	676.6	2,497	5,159	10,203	14,690	19,493.7	100.0

Calculations based on East-West (1991-1993), Gutman (1993), World (1994).

⁶ Others also include the Republics that comprised the former Soviet Union and Yugoslavia (with exception of Slovenia)

TABLE 4: AVERAGE FOREIGN DIRECT INVESTMENT PER ENTERPRISE (\$Thousand), 1988-1993

COUNTRY	1988	1989	1990	1991	1992	1993
Albania	-	-	-	-	528.6	-
Belarus	-	-	-	-	371.1	272.0
Bulgaria	-	-	-	144.4	141.7	87.0
Czech Rep.	3,454.5	1,700.0	360.0	300.7	504.2	410.6
Estonia	-	-	-	76.4	53.3	53.0
Hungary	322.1	271.4	178.6	344.1	214.2	279.8
Latvia	-	-	-	152.5	32.0	52.6
Lithuania	-	-	-	150.0	45.0	46.7
Poland	230.3	188.7	150.7	85.8	269.2	308.8
Romania	-	-	13.6	33.5	26.1	25.9
Russia	-	-	-	1,398.1	876.4	394.7
Slovakia	-	-	-	148.7	80.3	87.4
Slovenia	-	747.3	567.6	650.0	341.7	363.6
Ukraine	-	-	-	1,100.0	240.0	214.3
USSR	4,134.8	1,846.0	1,564.1	-	-	-
Others	-	-	-	-	-	-
TOTAL	1,678.9	828.5	333.7	310.8	206.4	195.9
Calculations based on <u>East-West</u> (1991-1993), <u>Gutman</u> (1993), <u>World</u> (1994).						

The average size of the firms also depends on the type of foreign investor. In Poland, Slovakia, and Romania, foreign investors are predominantly natural persons and small firms who invest small amounts of capital. The large multinational enterprises (MNEs) avoid these countries. Generally, more than half of the foreign investors in CEE are individuals (natural persons), usually nationals living abroad and using their own connections in the CEE country. This is typical for all of the countries where emigration in the last ten years has been especially large, e.g., Poland, Romania, and Slovakia.

The analysis of average amounts invested by foreign investors in different countries shows that two stages in FDI development are clearly visible. First stage occurs when liberalization of investment conditions is taking place. In this stage over years the average FDI size is declining. The second stage appears when the investment conditions are already stabilized, and the average FDI increases as a result of larger investors' interest to enter the country.

From all analyzed the countries, only Hungary, Poland, Slovenia, Slovakia and the Czech Republic (mixed results) are in the second, more advanced stage. The remaining countries are apparently still in the first stage. This measure can indirectly indicate the country's relative maturity in dealing with foreign investors.

The distinction in the first and second stage countries is closely related to the type of commercial legislation prevailing in the country. In the first stage countries, the *enclave law model*⁷ still prevails which gives preferred conditions in taxation, profit repatriation, or firm registration to foreign firms. FDI laws in this model often constitute the first step in a series of market-oriented legislation and can be the core of that legislation around which other basic laws evolve. In the second stage *the national treatment law model* prevail, where commercial legislation dealing with securities, stock exchanges, and bankruptcies is the same for both domestic and foreign investors. The enclave model still prevails in Albania, Belarus, and the Ukraine, where FDI legislation still provides the legal base for business and investment (Foreign 1992). By contrast, Hungary, Poland, Slovenia, Slovakia and the Czech republic adopted separate

⁷ The names for enclave model and national treatment model the authors have borrowed from Kubiela (1994).

commercial legislation which forms the legislative base not only for domestic but also for foreign firms. The remaining countries are in the transitional stage.

The research conducted in Poland also shows that a negative correlation exists between the proximity of the country to the investor's home country and the amount of capital invested by the investor. The closer the countries, the smaller the average investment. The smallest firms were those established by German investors, and the largest were those established by Americans and Canadians (Jermakowicz, Bochniarz 1991).

As a final observation, it seems that resource-rich countries (e.g. Russia) have tended to attract larger investments.

THE IMPACT OF FOREIGN DIRECT INVESTMENT IN CEE COUNTRIES

As one would expect, FDI have had a different impact in different CEE countries. FDI per capita is highest in Slovenia (\$600), followed by Hungary (\$580), Czech Republic (\$199) and Estonia (\$137.5). FDI is the lowest in Albania (\$11), Ukraine (\$11.5), Russia (\$21) and Bulgaria (\$22). (See Table 5.)

TABLE 5: FOREIGN DIRECT INVESTMENTS AS GDP SHARE AND PER CAPITA (in Millions US\$) (December 31, 1993)

	Number of Firms	Investment (\$)	Population (Million)	GNP (\$Bil.)	Population per firms	FDI as % of GDP	FDI per Capita
Albania	70	37	3.4	2.7	48.00	1.37%	\$ 11.0
Belarus	1,250	340	10.3	30.1	8.24	1.13%	\$ 33.0
Bulgaria	2,300	200	9.0	36.4	3.91	.55%	\$ 22.2
Czech Rep.	5,000	2,053	10.3	69.0	2.06	2.98%	\$199.3
Estonia	4,150	220	1.6	6.1	.38	3.61%	\$137.5
Hungary	21,468	6,005	10.3	60.1	.48	9.99%	\$580.8
Latvia	2,850	150	2.6	8.9	.91	1.69%	\$ 57.7
Lithuania	3,000	140	3.8	10.3	1.27	1.36%	\$ 36.8
Poland	6,800	2,100	38.5	162.7	5.66	1.29%	\$ 54.5
Romania	29,115	755	23.2	71.9	.79	1.05%	\$ 32.5
Russia	7,989	3,153	148.7	478.8	18.61	.66%	\$ 21.2
Slovakia	4,350	380	5.3	40.8	1.22	.93%	\$ 71.7
Slovenia	3,300	1,200	2.0	21.4	.60	5.61%	\$600.0
Ukraine	2,800	600	52.1	121.7	18.60	.49%	\$11.5
Average	6,746	1,238	22.9	80.1	7.91	2.34%	\$133.6

Calculations based on Gutman (1993), The 1994 Information (1994), World (1994).

The average contribution of foreign affiliates to the gross national product in CEE is 2.34% in 1993. FDI as a percentage of GDP is highest in Hungary (10%), Slovenia (6.61%), Estonia (3.61%) and Czech Republic (2.98%); lowest in Ukraine (.49%), Bulgaria (.55%) and Russia (.66%). For comparison, in Western economies, FDI as a percentage of GDP varies from 22% in Portugal to 40% in Austria. Generally speaking, the smaller the country by population, the higher the ratio of FDI to GDP and the higher the amount of FDI per capita.

Comparing the population of a country to the number of firms with foreign investment in that country is one indicator of investment density. Countries with high investment density are Estonia (360 persons per firm), Hungary (480), Slovenia (600) and Romania (790). Albania, Russia, and Ukraine are at the low end of this scale.

Considering all three indicators, i.e. FDI per capita, FDI/GDP, and population per firm-investments, one can conclude that FDI has been important in Hungary, Czech Republic, Slovenia and Estonia; of some importance in Poland, Slovakia and Romania; and has had only minimal impact in Albania, Bulgaria, Latvia, Lithuania, and the CIS countries. The importance of FDI is positively correlated with the size of GNP per capita. The GNP per capita is the highest in Slovenia (\$10.7 thousand), followed by the Czech Republic (\$6.thousand) and Hungary (\$5.8 thousand). The lowest GNP appears in Albania (\$803), the Ukraine (\$2.3 thousand), and Belarus (\$2.9 thousand).

In spite of the relatively low role of FDI in CEE, the impact of FDI on the economic transition may have been larger than the actual size and relative importance of these investments suggest. In the Czech Republic and in Poland, economic recovery is fostered by the increase in domestic automobile production fuelled by FDI in the automobile industry (Volkswagen, Fiat and GMC). Likewise, in brewing, the best performing sectors of the Hungarian and Polish economy, the largest part of the breweries are owned by foreign companies.

SOURCES OF FDI INFLOWS TO CENTRAL AND EASTERN EUROPE

Table 6 lists the amounts of investment from eight investor nations into eight CEE countries. Four countries, Germany, Austria, Italy and the United States, account for 75 percent of the total investment from 1989 through June 1993.

The variability of a source country's investment (standard deviation divided by the mean) is a measure of the dispersion of investments among the eight host countries. Germany has been the largest investor nation but also has distributed its investments across the CEE countries. Italy has placed more than half of its CEE investment in Poland and mainly in two large projects (Fiat-FSM and Lucchini-Huta Warszawa).

The entries in Table 7 are the rank of a country's investments in relation to all other investors in the host country. For example, German-based investments of \$218 million in Slovenia make it the largest investor there, while its \$215 million of investments in Poland make it the third largest investor in that country.

Medians of the rankings provide a measure of the relative importance an individual country's investors play across the CEE countries listed. Germany is clearly the leader. Despite its relatively low total dollar investment, France's investments in smaller countries have resulted in the second highest median ranking. The EC and EFTA countries have been the dominant investors⁸. The United Kingdom has not been a major source of investment for Central and Eastern Europe.

Three factors help explain the patterns evident in the two tables:

- . Strong economic ties made it easier for already familiar trading partners from the other European countries to upgrade their cooperation to direct investment.
- . The nationals from CEE countries residing in Western Europe are formally registered as foreign investors from their countries of residence.

⁸ Although not included in the tables, Sweden and Finland are major investors in the Baltic States.

The political crises in CEE at the end of 1989 and the early 1990s were a lesser investment impediment to investors from neighboring countries which were more familiar with developments in the CEE because of traditional trading links.

TABLE 6: COUNTRY SOURCES OF FDI FOR SELECTED CENTRAL AND EASTERN EUROPEAN COUNTRIES 1989 - JUNE 1993 (\$Million)

COUNTRY	G	USA	I	A	F	NL	S	UK	Host Total
Albania	6	0.7	10	4	6	2	0.9	0	29.6
Bulgaria	4	1	0.2	0.8	9	0.3	0.1	0.1	51.5
Czech Rep.	657	609	117	138	275	78	149	47	2,070
Hungary	421	117	88	410	135	130	115	72	1,488
Poland	215	347	546	65	84	143	40	60	1,500
Romania	108	88	38	17	109	23	10	29	422
Slovakia	57	44	12	63	1	13	2	0.5	192.5
Slovenia	218	7	95	150	35	1	5	1	512
TOTAL	1722	1213.7	906.2	847.8	654	390.3	322	209.6	6,267
Variability	.97	1.34	1.41	1.19	1.07	1.15	1.37	1.07	

TABLE 7: RANKING OF SOURCE COUNTRIES' INVESTMENTS IN CEE COUNTRIES 1989 - JUNE 1993

COUNTRY	G	F	A	USA	I	NL	S	UK
Albania	3	2	3	6	1	5	6	0
Bulgaria	2	3	5	4	6	8	10	13
Czech Rep.	1	2	6	1	5	13	5	17
Hungary	1	4	2	6	8	5	7	9
Poland	3	5	7	2	1	4	10	8
Romania	2	1	11	4	5	6	14	3
Slovakia	2	11	1	3	5	4	9	23
Slovenia	1	4	2	6	7	9	7	12
Median Rank	2	3.5	4	4	5	5.5	8	12.5

There are instances where United State's firms have made investments in CEE countries through their Western European subsidiaries⁹. These investments would be included with the numbers from the Western European country. As noted in the introduction, the pacific Rim countries, including Japan, have been relatively minor investors in CEE.

Cultural background appears to be very important. The traditionally close relationships between countries constituting the Austro-Hungarian Empire affect the German and Austrian investment in Hungary, Slovenia, Slovakia and Czech Republic. In Poland, the traditionally close relationships with the United States and Italy help explain the investment levels.

As noted earlier, Germany is investing throughout East Europe because of its traditional interest in this region, while American capital has tended to flow into big markets. This is indicated by the dominating position of American capital in Russia (not shown in the tables) and Poland rather than Hungary, Slovenia, Bulgaria and Albania. Also, from a geographical point of view, as noted by Jermakowicz and Bochniarz (1991), German investment is usually located in the western parts of the country, and American investors locate themselves in

⁹ The best example is GMC's investment in Poland, which is made through OPEL, its German based subsidiary.

eastern parts of Poland, Slovakia or Hungary in the hope that this will be a future springboard to the large emerging markets of Ukraine and Russia.

STRATEGIES OF WESTERN INVESTORS

Generally speaking, foreign investors are following two different generic investment strategies in entering the CEE markets. We designate them *Type I* and *Type II*.

Type I investments are focused on local markets and can be called import-substitution FDI. These investments are made to begin production for local markets of simple products and commodities with uncomplicated technology, or the assembly of more technologically advanced products, generally to avoid import barriers. The examples of such investment are new establishments of foreign automobile operations in the Polish market (Peugeot, Volkswagen, Opel and Volvo). The investments are made to gain access to the local market.

Type II investments are export-oriented FDI, which are made to develop firms specializing in the production of products for the world market on an integrated basis. For example, Skoda, Volkswagen's affiliate in the Czech Republic; ABB's affiliates in Poland, or Japan's Daikon affiliate in Hungary provide components to their parent companies on a globally integrated basis. These types of investment are made to achieve a competitive advantage through low taxes, a favorable geographical location, access to resources, and low labor costs.

Type I investments are typically smaller because they involve simple processes or the final, assembly phase of a process. It is possible that a successful Type I investment will lead to expansion into Type II investment. Nevertheless, first intentions determine the investment classification.

Type II investments are usually larger and involve larger capital inflows (more than \$100 million). They include all stages of the production process and result in greater autonomy for the CEE enterprise.

Currently, import substitution strategies dominate, while export-oriented investments are still modest. However, the differences among CEE countries permit classification into three groups. The Type I investment group, comprises Albania, Bulgaria, Romania, Russia, and Ukraine. These countries succeed in bringing almost exclusively Type I investments. This type of FDI includes: enterprises in mineral resource development (Conoco, Deminex, Elf in Russia), in tobacco products (RJ Reynolds in Ukraine, RJR Nabisco in Russia), in automobiles (Balcanscar in Bulgaria), and breweries and food processing (Unilever in Bulgaria, Romania and Estonia).

Type II investment countries (Table 8) include Hungary and Czech Republic where this type of investment comprises more than 50 percent of all investments (percentages at the bottom of the table display the share of the type II investments in all investments in the country)¹⁰.

Poland, Slovenia, and Slovakia form a group of countries with an even mix of Type I and Type II investments. These countries have successfully attracted some large investments such as Fiat, Thompson, International Paper, ABB, Black and Decker, and Volkswagen. Still, the majority of firms create Type I investments with production or service for the local

¹⁰ The five German Bundeslaender established on the basis of the former GDR also belong to this group.

markets. For example the largest foreign investment in Slovakia is K-MART, the U.S.-based retailer, focusing on serving local markets.

The volume of the Type I investment appears to be positively correlated with the country's import barriers, the population of the local market, and their purchasing power, i.e., the larger the population and the higher the barriers, the higher the likelihood that investment will concentrate on the local market. In this respect, the CIS and Polish markets seem to be the most attractive for Type I investors. The volume of Type II investment, in turn, depends on the benefits which a country offers foreign investors, as well as the country's political stability. The benefits can be either institutional (e.g. long tax holidays, reduced taxes, investment in the infrastructure, subsidies, free land) or arise from lower wages, or better access to resources.

The predominant share of Type II investment in Hungary and in the Czech Republic is the result of strong government interventionist policies, relatively inexpensive labor and the perception of their political stability.

TABLE 8: SOME EXAMPLES OF TYPE II INVESTMENTS IN SELECTED CEE COUNTRIES

HUNGARY	CZECH REPUBLIC	SLOVAKIA	SLOVENIA	POLAND
Suzuki	Volkswagen	Volkswagen	Black & Decker	Fiat
Ford	Robert Bosch	Chemlon	Henkel	Thompson
Volkswagen	Asahi Glass	Fermas	Siemens	Lucchini
GE	Rockwell	Hendek	Hoechst	Pilkington
GEA	GE	Samsung	Iveco	ABB
IBM	Hamilton	Siemens	Bayer	International Paper
Caterpillar	T&N		Kloecker-Humboldt	
Phillips	Daimler Benz		Deutz	
Loranger	ABB			
MET				
GM-Audi				
David Brown				
69% in FDI	73% in FDI	28% in FDI	43% in FDI	46% in FDI
Prepared from the following sources: East-West (1991-1993), Sader (1993), Foreign (1992), Bochniarz, Jermakowicz, Meller (1994).				

Given the above, the CEE governments are facing a dilemma: should they pursue liberal policies that are not attractive to foreign investors or should they pursue active, interventionist investment policies that provide investment incentives?

In contrast to Poland's liberal policy, the Hungarian and Czech governments offer long tax holidays and reduced taxes, free land, and government investment in infrastructure, worker training and enterprise subsidies. For example, in Hungary Audi has received a five-year tax holiday and a 60% tax reduction for the following five years. Also, Suzuki, Japan's investment in the Hungarian automobile industry was conditioned on high tariff protection of domestic automobile production. Similarly, in Czech Republic, Volkswagen's engagement in Skoda (originally at \$5.3 billion) was linked to protective tariff measures on imports and tax reductions for 10 years. Also, Philip Morris was aided by increased import tariffs for cigarettes produced abroad. These efforts bring rapid results. The relative unattractiveness of Poland, Slovenia, the Baltic States, and Russia for Type II investors is the result of a lack of clear investment policies in these countries. They are prisoners of their own liberal approach to economic doctrine and practice.

MODES OF FDI

A part of a foreign company's decision to invest in a particular country is the selection of the most appropriate investment mode. This depends to a large degree on the investor's motives and the industry. No one mode is better or worse than another; all depend on individual intentions and circumstances.

There are three basic modes: greenfield (new) investment; indirect acquisition through establishment of a joint venture; and direct acquisition, through which a foreign investor buys a share (partially or entirely) in a local company.

The *greenfield* mode is selected if the production process is labor intensive. High labor intensity lowers the relative cost of a greenfield venture. Furthermore, greenfield mode is chosen when the investor's name and products are already widely known in the local markets; when the costs of restructuring an acquired local company could prove to be higher than the establishment of a new operation, and when an unresolved ownership status due to the restitution process could be a serious impediment to privatization.

Indirect acquisition (Joint-ventures) is an appropriate way to gain access to a new business if it is uneconomical or risky for a foreign investor to make a greenfield investment. This type of acquisition works best when pooling resources and competencies produces a competitive advantage. The foreign investor brings technology and know-how; the local partner contributes a plant site, qualified labor, and knowledge of the local laws and government operation.

Direct acquisition (privatization) is likely to be successful if the acquired enterprise is in a capital intensive industry, making a greenfield investment very costly. Furthermore, direct acquisition is appropriate if the local producer has a strong market share and local brand recognition as well as a well developed local supply and distribution network (Dunning, Rojec 1993).

Table 9 illustrates the dramatic change in CEE foreign direct investment modes between 1988 and 1993. Although the value of all modes of investment have increased, the proportions of greenfield and privatization have increased while that of joint ventures has significantly decreased.

TABLE 9: MODES OF FOREIGN DIRECT INVESTMENT IN CEE (\$Million)

Year	Greenfield		Indirect Acquisition		Direct Acquisition		Total	
	\$	%	\$	%	\$	%	\$	%
1988	17	2.6	632	93.3	28	4.1	677	100.0
1989	266	9.6	1,594	64.6	644	25.8	2,497	100.0
1990	1,139	22.2	2,775	53.8	1,236	24.0	5,159	100.0
1991	2,266	22.2	4,744	46.5	3,193	31.3	10,203	100.0
1992	4,618	31.3	4,407	30.0	5,665	38.7	14,690	100.0
1993	7,038	36.1	5,458	28.0	6,998	35.9	19,494	100.0

Calculations based on Bellas, Bochniarz, Jermakowicz, Meller (1994), Sader (1993), East-West (1990-1993), Robinson (1993).

Up until 1989 a joint venture was the only attractive and available way to bring foreign investment into a state-owned enterprises. By 1993 a wider range of investment options, including privatization and greenfield opportunities, were available. As privatization progresses the most attractive enterprises will have found foreign investors or due to resistance within a country, may not be available to outside investment. Greenfield

investments are likely to become increasingly attractive options, however some countries, notably the Czech Republic have not instituted land ownership reforms that are necessary for greenfield investment.

MODELS OF FDI DEVELOPMENT

John Dunning (1993) has suggested three models of FDI development in CEE countries. The gradualistic model (Dunning calls it "the developing country model") is characterized by the gradual attraction of inflows of foreign capital. It is based on the hypothesis that the CEE countries are comparable to industrializing developing countries which changed from being small to substantial hosts to foreign capital inflows as they moved along a particular development path. This model has been applied in South Korea, Taiwan, Malasia, and some South American countries.

The second model is the reconstruction model. It explains the massive and wide-spread involvement of FDI over a short time period. This model recalls the experiences of the German and Japanese economies in the years after the Second World War. It assumes that the CE countries are highly industrialized and developed, but their industrial structure is outdated and inferior to that of the fastest growing, newly industrialized countries. Massive investment will turn them around and bring rapid profitability.

The third or "mixed" model is a combination of the first two models. The willingness of foreign investors to enter CEE markets depends primarily on the speed and extent to which these CE countries alter their economic and legal systems, and also on the ethos of their people towards entrepreneurship and wealth-creating activities. The nature of the systemic changes and the rate and efficiency with which they are introduced will determine the rate of FDI.

Foreign investors tend to apply the gradualistic model to Central and Eastern European countries. While this may be superficially pertinent, the underlying assumptions in most cases are, however, less appropriate. These countries consume more energy and have a work force that is better educated, better trained and well-off medically than most prosperous developing countries. Expenditures for research and development, as a percentage of GNP, approach that of some Western countries.

The Central and Eastern European countries are inclined to expect that foreign investors will follow the reconstruction model and will bring large amounts of FDI over a short period of time. They seem to disregard such difficulties as the need for a new commercial and legal system, the high political risk, and the investment necessary to improve a backward infrastructure.

Given the above, it is likely that the learning process will make everyone's assumptions more realistic. Foreign investors are using different strategies in different countries. The reconstruction approach, which implies rapid and widespread FDI, is being applied in Eastern Germany, the Czech Republic, Hungary, and Estonia. Investment from west to east within Germany has been approximately \$100 billion per year. German investors treat the Czech Republic and Hungary as countries within its sphere of interest, and they invested more than \$500 million there in 1991 and 1992. The Finnish investors, in turn, regard Estonia as their own future market and investment area.

The gradualistic model is applied toward the East European (EE) countries. This path, from attracting little to attracting substantial inflows of foreign investment, is used toward

investment in Russia, Albania, Romania, Bulgaria, Ukraine, and Belarus. Investors with small amounts of capital apply a "wait and see" strategy before they risk larger commitments.

The mixed approach is applied to such countries as Poland, Latvia, Lithuania, Slovenia, and Slovakia. The western investors expect a much slower initial participation of foreign investors due to the substantial initial and continuing costs they might have to incur to establish production units and market their products. Over time, it is expected that more FDI will accompany emerging reforms.

CONCLUSIONS

Analysis of the 1988-1992 data presented here leads to the conclusion that overall the CEE countries' privatization strategies have not been successful in attracting foreign direct investment. The \$19.5 billion in investments constitutes only one and one-half percent of worldwide investment inflows. Only about two-third of the enterprises that were granted licenses actually commenced operations, a statistic which makes the picture of foreign investment even more dismal (Dunning 1993; Jermakowicz and Bochniarz 1991; Kubiela 1994).

Equally disappointing is the contribution that FDI has made to the privatization of state-owned enterprises. The estimated \$7 billion of these investments is only a small percentage of the initial state-owned equity. In Poland, as shown by Jermakowicz (1994) foreign direct investments in privatization projects through June 1993 were only 1.67 percent of the state equity as valued in 1989 prices. This percentage is higher in the Czech Republic and Slovakia but does not exceed three percent. "Internationalization" of CEE enterprises has been a substantial contributor to economic restructuring and activity.

There has been some noticeable introduction of new technology and management practices provided by the large multinational investors. The smaller investors who account for much of the investment have contributed little. As experts from the Polish Foreign Investment Agency note, most of the foreign partners are trying to use already existing equipment (Spó_ki 1990). They are using different forms of equipment and machinery leases and returning stock payments as shareholders' dividends to their partners. The capital stock of many companies is kept artificially low.

Foreign direct investment has not fulfilled expectation that it would increase supplies of goods and services to local markets. The share of the total sale of goods and services provided by FDI enterprises is approximately ten percent. More than forty percent of enterprises with foreign direct investment are focusing on trade while most of the others are involved in simple food processing, textile production, and commodities.

Several major flaws contributed to these unsatisfactory results.

First, the recession in the European Union, and investment competition from the developing countries could have contributed to the slow growth of FDI in CEE.

Second, the overall domestic environment in most of CEE countries, with declining domestic output, high inflation rates, inconvertible currencies, underdeveloped infrastructure and financial services, and lack of the regulatory framework pertaining to land and property ownership, is also not conducive to attracting foreign investment.

Third, in a number of countries, the actual process of building market economy, privatization and creating the necessary institutional framework has not advanced significantly.

DEVELOPMENT OF FOREIGN DIRECT INVESTMENT IN POLAND *Zbigniew Bochniarz, Władysław Jermakowicz, and Michał Meller*

INTRODUCTION

Despite the fact that since 1976 Poland has been the recipient of foreign direct investment (FDI), the real acceleration of FDI begun after the first free election in June 1989 and after the beginning of the "Big Bang - Balcerowicz Program" in January 1990 (Balcerowicz 1993). These political and economic factors immensely influenced the new FDI legislation and dramatically improved the "business climate."

This paper examines the influx, origin, and strategy of foreign direct investment in Poland which we define as a majority or minority ownership in another country's business entity. The paper particularly examines a strong relationship between the historical relationships and the past experience of western companies investing in Poland.

CHANGES IN LEGISLATION

The first joint venture law allowing full foreign participation was passed by the Polish Sejm on 23 April 1986. From this date forward, foreign investment legislation has become progressively more liberal, opening more sectors of the economy to foreign investors, allowing the full transfer of profits abroad, and finally, giving the investor more control over the venture (Jermakowicz, Bochniarz 1991).

This process of liberalization of FDI legislation culminated with the law of June 14, 1991. This law abolished the former requirement of a \$50,000 minimum investment. The new law now requires a minimum start-up capital of only \$1,000 for a limited liability company and \$26,000 for a joint stock company. Furthermore, the 20% minimum stock ownership requirement was abandoned, and foreign companies became subject to the same taxation as Polish firms. Special permits are no longer required except in areas dealing with operation of sea-ports and airports, real estate agency transactions, defense industry, wholesale trade of imported goods, and consulting and legal services. The new legislation also removed some investment incentives such as tax holidays of between 3 to 6 years. Under the new law a firm may apply for a tax holiday, if stringent conditions requiring an investment of at least 2,000,000 ECU in regions experiencing structural unemployment are met.

POLISH EXPECTATIONS AND REALITY

There are high expectations about the role of FDI in the transition process, particularly in a country with a very limited capacity to generate capital and change its structure due to long history of central planning and mismanagement. Poland expects foreign direct investment to play a major role in three areas.

First, it expects FDI will stimulate the privatization process of Poland's economy. It expects that this process will not only convert the structure of the Polish economy into an efficient one, but will also be a major factor in integrating the economy into the international

system. Furthermore, FDI is expected to be a strong contributor of foreign capital which Poland needs due to its hard currency shortages. And lastly, Poles expect from FDI not only the introduction of modern technology know-how, but also managerial skills. The major argument is that foreign investment through its introduction of modern technology and international connections will change Poland's export structure to high value added products (Jermakowicz, Bochniarz 1991).

Poland has experienced increasing FDI inflows since 1987. The largest increase over the preceding year occurred in 1989. In 1988 there were 30 investments in Poland whereas in 1989, 518 foreign investors entered the country (Table 1). This dramatic, almost eight fold increase in capital and joint ventures numbers in 1988 was beaten the next year when the number of joint ventures increased by a factor of 16.7 and capital increased by 13.7. It is obviously clear that such a dynamic could not be sustained.

Year	Growth of FDI By Number			Growth of FDI by Capital			Average Size of the Firm	
	Number	Accum	Dynamic	Capital	Accumulate	Dynamic	Annual	Accum
1987	3	3		696	696		232.0	232.0
1988	30	33	11.00	6,880	7,576	10.89	229.3	229.6
1989	518	551	16.70	96,413	103,989	13.73	186.1	188.7
1990	1,493	2,044	3.71	204,458	308,447	2.97	136.9	150.9
1991	3,125	5,169	2.53	425,096	733,543	2.38	136.0	141.9
1992	3,456	8,625	1.67	679,984	1,413,527	1.93	196.8	163.9
1993	4,179	12,804	1.48	1,375,929	2,789,456	1.97	329.2	217.9

Source: Computation based on the data provided by Ministry of Privatization and the Main Statistical Board

A similar situation occurs with invested capital. Although the number of projects increased by 48 percent in 1993, the growth of capital is about 97 percent. The observation of the average size of the firm measured by invested capital shows that beginning in 1992, the per firm capital contribution each year was greater than in the previous year. This may mean that larger investors are starting to invest in Poland.

GREENFIELD VS. ACQUISITIONS

A part of a foreign company's decision to invest in a particular country is the selection of the most appropriate investment mode. This depends to a large degree on the investor's motives and the industry. No one mode is better or worse than another; all depend on individual intentions and circumstances.

As stated in the Chapter One, there are three basic investment modes: greenfield (new) investment, indirect acquisition through establishment of a joint venture, and direct acquisition through which a foreign investor buys a share (partially or entirely) in a local company. The last mode is closely related to the privatization process.

Table 2 illustrates the dramatic change in the structure of the investment modes between 1988 and 1992. Although the value of all modes of investment have significantly increased, the proportions of greenfield and privatization have changed over these years.

TABLE 2: GREENFIELD INVESTMENT AND INDIRECT AND DIRECT ACQUISITIONS IN POLAND (1987-1993)

Year	Greenfield		Indirect Acquisition		Direct Acquisition		Total	
	\$	%	\$	%	\$	%	\$	%
1987	82	11.8%	614	88.2%	0	0.0%	696	100
1988	1,686	24.5%	5,194	75.5%	0	0.0%	6,880	100
1989	26,514	27.5%	54,399	56.4%	15,500	16.1%	96,413	100
1990	72,992	35.7%	91,266	44.6%	40,200	19.7%	204,458	100
1991	180,666	42.5%	126,796	31.4%	105,300	26.1%	403,646	100
1992	320,272	47.1%	9,712	1.4%	350,000	51.5%	679,984	100
1993	692,092	50.3%	4,934	0.4%	678,903	49.3%	1,377,929	100
Total	1,294,308	46.4%	293,748	10.6%	1,189,903	43.0%	2,768,006	100

Source: Computation based on data provided by the Ministry of Privatization and the Main Statistical Board

First of all, an impressive process of increase in the role of greenfield investment is observable. If in 1987 only \$82 thousand were investments in new companies, then at the end of 1993, these investments were more than eight thousand times higher and constituted almost half of all FDI inflow (46.4%). This increase is the best indicator of the increase in the trust in the Polish market and its growing willingness to start new ventures.

A second clear observable phenomenon is an increase in the receipts from direct acquisition. If in 1989 only \$15.5 million was received for firms privatized, which constituted 16.1% of all inward investment, then in the year 1993 the receipts for privatization were more than 42 times higher (\$678.9) and constituted 49.3 percent of all inflow.

The third phenomenon is the decline of the share of the FDI in joint venture establishments. If in 1987 joint ventures were the only attractive method to improve the financial situation of State-Owned Enterprises (SOEs), then six years later they play a more than marginal role (.4%). Apparently, greenfield investment and privatization are more attractive paths.

The fourth observable process is the relatively faster growth of greenfield investment than direct acquisition (privatization) investment. Privatization was a hit in 1992 when it constituted 51 percent, but in 1993 it seems to grow more slowly than new establishments. The author believes that greenfield investments will increase at a faster rate than those involving privatization. Poland has either already privatized the most attractive enterprises, or privatization is meeting increased resistance among population. Adding to the relative interest in greenfield investment is the growing investor confidence in political stability and the potential for high returns.

The role of greenfield investment is more impressive if the number of enterprises is compared (see Table 3). In 1993 there was a total of 10,672 greenfield investments which constituted 92.4 percent of all FDI as opposed to 815 indirect acquisitions which comprise 7.1 percent of foreign investors, and 60 direct acquisitions which constitute a mere .5 percent of all cases. The analysis of the capital invested by both groups, however, shows that indirect and direct acquisitions have contributed relatively more capital than greenfield in both aggregate amounts and average investment per enterprise.

Investors acquiring Polish firms directly in the framework of the privatization process in the years 1989-1993 contributed \$1,189.9 million or 43 percent of the total FDI capital contributions. The average foreign share in capitalization per one firm shows enormous differences. Greenfield investment amounts to only \$121.3 thousand per firm, whereas the average share in capitalization per joint venture is \$360.4 thousand (nearly three times more),

and per direct acquisition is \$18,028.8 thousand (149 times more). Apparently, greenfield investments are fairly small shops made by small investors. In privatization through direct acquisition, in turn, mostly large firms are involved.

TABLE 3: DISTRIBUTION OF FOREIGN INVESTMENT BY THE TYPE OF INVESTMENT (December 31, 1993)					
					Average Size of Firm
Modes of Investment in Poland					
Greenfield	10,672	92.4	1,294,308	46.4	121.3
Indirect Acquisition	815	7.1	293,748	10.6	360.4
Direct Acquisition	66	0.5	1,189,903	43.0	18,028.8
Total	11,553	100.0	2,768,006	100.0	239.6
Modes of Investment in CEE					
Greenfield			7,038,000	36.1	
Indirect Acquisition			5,458,000	28.0	
Direct Acquisition			6,997,000	35.9	
Total	99,533	100.0	19,493,000	100.0	195.8
Source: Computation based on the data provided by Ministry of Privatization, the Main Statistical Board and Jermakowicz, Bellas (1994). See also Chapter One.					

The comparison of the Polish FDI distribution to distribution present in other Central and Eastern European countries (CEE) show few differences. First, foreign investors entering the Polish markets choose greenfield investment to a higher degree than in other post-communist countries (46.4% vs. 36.1%). This can be the result of both a more liberal investment climate existing in Poland or quite the opposite, fears of a restitution process due to the lack of the Reprivatization Law. Also the opinion of the strong rebelling trade unions existing in Polish enterprises which could be acquired in acquisition cases, contributes to the relative popularity of greenfield investment. Through greenfield investment, the foreign investors can build the firm and its culture and select a staff according to the owners' visions and desires. Second, the comparison of the distribution of foreign investment by the mode of investments also shows that in Poland to a much lower degree indirect acquisition through joint ventures is applied (10.6% vs. 28.0%). This may also be an indicator that the Polish economy is entering a more mature stage in attracting foreign investors according to the rule that the large share of joint ventures in an economy seems to indicate that the economy is in its infancy stage.

Data on the direct acquisition between different the Central European (CE) and selected Eastern European (EE) countries also shows different features (See Table 4)

The comparison of CE and selected EE countries seems to show that the first are much more advanced in privatization than the latter. The small, two million population Slovenia sold to foreigners more equity than the 148 million Russia (This situation has already changed in 1994.) Romania is much behind the small Estonia, and so forth. Undoubtedly, the Central European countries are more advanced in the road to a United Europe and more attractive for West European investors.

The situation among the CE countries is also very differentiated. Over the years 1989-1992, Hungary has recorded the largest number of sales (102) and the largest amount of FDI in privatization (\$2.3 billion). About 81 percent of FDI in this country is accounted for by direct foreign acquisition. Poland is second with 66 privatization projects, however the capital invested is very modest (\$511 million) and much lower than that in Czechoslovakia (46 projects and total capital inflow from privatization of \$1.8 billion). In Czechoslovakia,

over 1/3 of the foreign investments were made in the companies privatized within Large Scale Privatization. It should be noted that two Central European countries, Lithuania and Latvia, had no FDI flowing into the privatization of state-owned enterprises.

TABLE 4: DIRECT ACQUISITIONS IN CENTRAL EUROPEAN AND SELECTED EASTERN EUROPEAN COUNTRIES (data on December 31, 1992)						
Country	# of acquired firms	Equity of acquired firms	Equity sold	Equity sold to foreigners	Future commitments	Av. size of the sale
Czech-slovakia	46	3,749.1 (100%)	2,023.8 (53.9%)	1,822.3 (90.1%)	7,043.3	44.0
Estonia	5	296.0 (100%)	124.0 (41.8%)	124.0 (100%)	0	24.8
Hungary	102	4,742.3 (100%)	3,134.5 (66.1%)	2,295.0 (73.2%)	828.0	30.7
Poland	66	1,046.4 (100%)	735.5 (70.3%)	511.0 (69.5%)	1,876.0	11.1
Slovenia	3	148.3 (100%)	129.0 (87.0%)	129.0 (100%)	0	43.3
Romania	2	70.6 (100%)	60.0 (70.3%)	31.0 (51.6%)	0	15.0
Russia	8	140.1 (100%)	120.0 (70.3%)	120.0 (100%)	0	30.0
Ukraine	3	15.7 (100%)	8.0 (51%)	8.0 (100%)	0	4.0
Yugoslavia	3	720.0 (100%)	360.0 (50.0%)	360 (100.0%)	0	120.0
Source: Own calculations on the basis: Sader (1993), <i>East-West</i> (1991-1993)						

Poland's situation in comparison to other countries is very mixed. Poland has the second largest number of firms acquired through foreign investors but at the same time the average size of the sale is the smallest one among central European economies -- one-fourth of the size of Czechoslovakia and Slovenia and one-third of that in Hungary. Undoubtedly the Polish privatization projects are the smallest ones. Poland, however, was successful in getting the second largest future commitment (1,876.0) after Czechoslovakia (\$6.1 billion Volkswagen alone) and before Hungary (828.0). In Poland the future commitments are 3.6 times higher than the capital invested by foreign firms. This is a typical game pursued by Polish managers: lower the sale price because receipts from the sale will go to the State Budget, and maximize future commitments because these commitments will stay in the company. Unfortunately, many firms have problems in executing these commitments in the future.

MAJORITY VS. MINORITY STAKES

Foreign investors prefer majority holdings over minority stakes. Table 4 shows the relationship between acquisitions and greenfield investments in terms of equity ownership. The general trend suggests an investor preference towards majority holdings, although there are some discrepancies between greenfield and acquisition type investments. Approximately 1/2 of foreign investment through acquisitions results in minority share holdings between 11 percent and 50 percent. The second half falling between 51 percent and 99 percent. There

are only 5 acquisitions with 100 percent foreign ownership. Nevertheless, the tendency is an ownership structure of at least 50 percent of shares.

Error! Reference source not found. TABLE 5. DISTRIBUTION OF FDI BY FOREIGN SHARE IN CAPITAL						
Foreign share in capital (%)	Total		Foreign Acquisitions		Greenfield Investments	
	Number	%	Number	%	Number	%
up to 10%		0.2	5	.6		0.1
11% to 49%	1,4	12.1	255	31.4	1,1	10.7
50%	1,9	16.6	174	21.3	1,1	16.2
51%		4.3	112	13.7		3.6
52% to 74%		7.8	199	24.4		6.5
75% to 99%	2,7	23.9	64	7.9	2,1	25.1
100%	4,0	35.2	5	0.6	4,1	37.8
Total	11,55	100.0	815	100.0	10,7	100.0

Source: Computation based on the data provided by Ministry of Privatization and the Main Statistical Board

In terms of greenfield investments, we see two different strategies. In the first group 36 percent of the investors hold either a minority or a 50 percent stake with about 16 percent of greenfield investments having exactly 50 percent of the shares. The second group or 62 percent of new start up ventures have a clear majority stake between 74 percent and 100 percent. A little over half of this group has a 100 percent ownership structure. When comparing investments between greenfield and acquisitions, the investors choosing the acquisition path have a tendency toward a lower share holdings than greenfield investors. Since an acquisition in Poland is equivalent to privatization, a large portion of shares becomes distributed among employees, the state, and in some cases, creditors or banks. This partially explains the difference in the percentage of ownership associated with foreign investment through acquisition.

In 1992 the major concentration of FDI was channeled into industry; 35 percent of FDI entered that sector. Some of the better known investments are the Italian concern Fiat, General Motors, Asea Brown Boveri and Unilever. Trade accounts for about 8 percent of FDI and the remaining investments are distributed among construction, services, and tourism. It is interesting that services account for a small percentage of FDI. The service sector has generally been underrepresented in the CEE countries which suggests that this lack of competition would attract investors. One reason for the small inflow of FDI in the service sector may be the quick entry of local companies, therefore increasing competition.

ORIGIN OF INVESTORS

The majority of investors come from countries bordering Poland or those which have historically been Poland's trading partners. The role of immigration also plays an important part in the source of FDI inflow.

In terms of numbers of FDI projects, among 93 countries whose capital is present in Poland, four of them (Italy, the United States, Germany and the Netherlands) account for 47.6 percent of investment projects and 69.2 percent of the capital invested in Poland. Germany has the largest share with 27.3 percent of the total foreign investment projects. In terms of capital, however, Italy occupies the first position, having invested 30.2 percent of the foreign

capital. The average size of Italy's firm amounts to \$887.9 million, the result of the large capital investments made by Fiat, Luccini Groupe, and Frotrade Financing. Germany, in turn, has a large number of firms with very small average capital amounting to \$67.9 thousand per firm. According to average investments, Germany is ranked 20th place among all countries.

From an investment strategy perspective, Italy accounts for 53.8 percent of foreign acquisitions in Poland while its share in greenfield investments has been relatively low at 2.9 percent. On the other hand, the United States, Germany and the Netherlands account for 69.2 percent of the FDI projects, and their combined share of greenfield investments is 60 percent.

While examining this pattern, it is interesting to note the historical relationships which are mirrored in today's investment patterns. Those past relationships have created a tradition or familiarity with the region. Today firms from those countries are less wary of Poland and tend to invest greater amounts. The European Union accounts for 62.2 percent of the capital invested, and 61.2 percent of FDI projects. We see that it holds the majority stake, followed by the United States and Canada. Japan has a very low share of both capital (.2 percent) and projects (.4 percent); Japanese firms tend to be more conservative in their investment patterns.

Country	Total				Acquisition		Greenfield	
	\$Millions	%	Firms	Ave.	\$Millions	%	\$Millions	%
ITALY	546.058	30.2	615	887.9	521.501	53.8	24.557	2.9
USA	347.706	19.2	983	353.7	66.532	6.9	281.174	33.5
GERMANY	214.983	11.9	3,167	67.9	71.800	7.4	143.183	17.0
NETHERLANDS	143.731	7.9	739	194.5	79.915	8.2	63.816	7.6
FRANCE	83.671	4.6	621	134.7	11.989	1.2	71.682	8.5
SWEDEN	70.063	3.9	634	110.5	40.571	4.2	29.491	3.5
AUSTRIA	65.935	3.6	700	94.2	35.606	3.7	30.329	3.6
GREAT BRIT.	59.878	3.3	490	122.2	31.441	3.2	28.437	3.4
NORWAY	40.331	2.2	91	443.2	32.561	3.4	7.769	0.9
SWITZERLAND	40.174	2.2	302	133.0	17.237	1.8	22.937	2.7
DENMARK	36.862	2.0	263	140.5	24.638	2.5	12.223	1.5
LIECHTENSTEIN	24.300	1.3	74	328.4	6.522	0.7	17.778	2.1
BELGIUM	20.461	1.1	281	72.8	5.273	0.5	15.187	1.8
AUSTRALIA	13.066	0.7	123	106.2	7.307	0.8	5.759	0.7
AFGHANISTAN	11.631	0.6	14	830.9	0.000	0.0	11.631	1.4
USSR	9.359	0.5	150	62.5	2.974	0.3	6.384	0.8
CANADA	9.181	0.5	184	49.9	2.138	0.2	7.043	0.8
IRELAND	8.949	0.5	21	426.1	2.484	0.3	6.465	0.8
ISRAEL	7.179	0.4	56	128.2	1.067	0.1	6.112	0.7
GREECE	4.358	0.2	92	47.4	0.135	0.0	4.223	0.5
SPAIN	3.927	0.2	100	39.3	0.428	0.0	3.499	0.4
JAPAN	3.063	0.2	36	85.1	0.000	0.0	3.063	0.4
LUXEMBOURG	1.593	0.1	33	46.6	0.115	0.0	1.478	0.2
PORTUGAL	0.528	0.0	10	52.8	0.287	0.0	0.241	0.0
OTHERS	42.947		9,779					
EEC TOTAL	1,125.000	62.2	7,066	159.1	750,006	77.3%	374,994	44.6%
	100.0%		61.2%		66.3%		33.4%	
TOTAL	1,809.934	0.0	11553	184.9	969.720		840.213	
%	100.0	100.0	100		53.6	100	46.4	100

Then next observation relates to the structure of FDI. In the case of EEC countries, 2/3 of all investment is made by acquisition of existing businesses and only 1/3 by new greenfield allocations. In the case of the rest of the world, the proportion is quite opposite: two thirds of FDI is made in greenfield and only one third in existing businesses. Undoubtedly,

geographical distance is an important factor: the closer the country the more investment is made via acquisitions, the further located country the more greenfield investment seems to be attractive. We see very little investment from the CEE countries; there is some investment from the former USSR and that is mostly related to the construction of a gas pipeline from Siberia to Western Europe.

INVESTMENT PROJECTS

According to the latest information from the State Foreign Investment Agency (November 15, 1993), the total financial involvement of the 173 biggest foreign investors (equity and credit) amounts to \$2.614 billion. The investment commitments of these 173 investors reach the level of \$3.467 billion. Table 6 shows the 20 largest foreign investors in Poland. The joint venture between the Italian Fiat and the Small Car Factory (FSM) in Bielsko-Biala is the absolute leader on this list both in actual financial involvement and their attitude about future investment commitments.

No.	Foreign Investor	Country	Area of activity	Financial involvement (equity+debt) (\$ mill.)	Future investment commitments (\$ mill)
1.	Fiat	Italy	car industry	180.0	830
2.	Coca-Cola	USA	soft drinks	170.0	50
3.	Int. Paper (IPC)	USA	paper products	120.0	175
4.	Warimpex	Austria	hotels, offices	100.0	80
5.	Asea Brown Boveri	Swiss/Swede	power eng. ind.	100.0	20
6.	Curtis Internat.	n	electron./constr.	100.0	0
7.	Unilever	USA	chemicals, food	96.0	0
8.	Pol.-Amer. Enterp. Fund	Netherlands	capital participat.	83.0	29
9.	EBRD	USA	banking, port.inv	72.0	0
10.	Procter & Gamble	-	hygiene products	60.0	130
11.	Thompson C.E.	USA	tv. tubes and sets	60.0	40
12.	Fortrade Financing	France	office & ind. bldg.	55.0	0
13.	Cimenteries CBR	Italy	cement industry	54.0	33
14.	RJ. Reynolds	International	tobacco industry	50.0	0
15.	Ameritech	USA	telecommunication	45.0	100
16.	France Telecom	USA	s	45.0	100
17.	Alcatel	France	telecommunication	42.7	85
18.	IFC	Spain	s	42.0	144
19.	Pepsico	International	telecommunication	40.0	68
20.	Ringnes	USA Norway	s glass, construction sweets, soft drinks packaging, distrib.	40.0	29
	Total			1,564.7	1,913
	% of all firms			(60%)	(55%)

Table 7 shows different modes of foreign investment. Some of them are typical joint ventures between foreign investors and Polish state-owned companies (FSM with Fiat, Dolmel and Zamech with ABB), involvement in equity privatization through direct buying of strategic packages of shares (Kwidzyń Paper Company acquired by IPC, TELFA Telecommunications Equipment Company in Bydgoszcz bought by Ameritech), portfolio investment in new private companies as well as in privatized ones (Polish American

Enterprises Fund, WEDEL with PepsiCo), and typical greenfield investments (Curtis International, Procter and Gamble, Warimpex, RJ Reynolds) (Błaszczuk, Dąbrowski 1993). These twenty largest foreign investments constitute 55,8 percent of all the investments and 55 percent of all investment commitments: a high capital concentration of FDI in Poland. Eight companies are from the United States, two from Italy, two from France. Very remarkable is the absence on the "Top Twenty" list of any companies from Germany, which seems to confirm the observation about small average capital investments from Poland's western neighbors.

TRENDS IN THE FOREIGN DIRECT INVESTMENT IN POLAND

Zbigniew Bochniarz, Michał Meller, David Toft

INTRODUCTION

Poland made a historical turn to a pluralistic society with a market economy during this period of analysis. This historically important fact, does not necessarily mean the same for foreign investors. Although, it would be difficult to find foreign investors glorifying the old communist regime, many of them, indeed, felt lost in the turmoil caused by the political and economic changes in Central and Eastern Europe and in the Newly Independent States (NIS). For them, these radical changes, although regarded as highly positive, presented distortions in the business environment in which they used to operate.

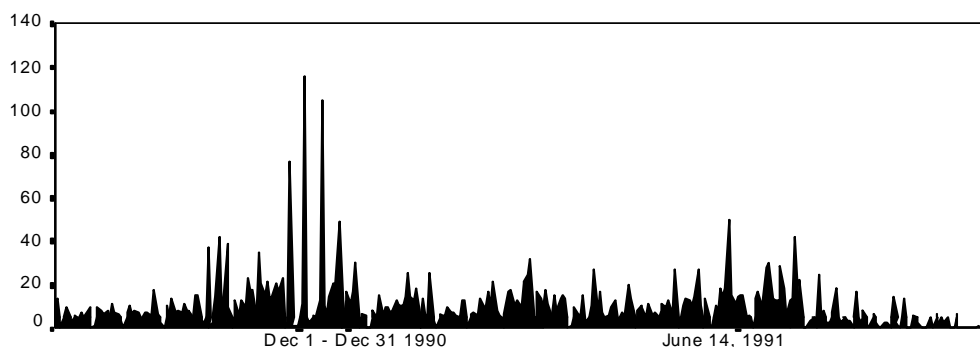
Despite the pioneering role of Poland in political and radical economic reforms among nations in transition, five governments within four years often suggested a lack of political stability.

In the previous chapter we analyzed foreign direct investment data in terms of greenfield and acquisition type investments. This chapter examines the impact of environmental degradation, unemployment, development, and the degree of urbanization on the regional inflows of foreign capital into Poland between the years 1990 and 1992. We obtained data on the date the investment was registered, the number of Polish and foreign partners, the percent of Polish and foreign share in a proposed joint-venture, the home country of the foreign investor and the total capitalization rate of the investment. This work serves as an initial overview of detailed data from the Polish Ministry of Privatization.

Time

Figure 1 presents data of FDI by weeks from the end of 1989 to the beginning of 1993. The registration peak (close to 120 registrations per week) was reached at the end of 1990, when the new budget law was announced canceling three years of tax holidays from January 1, 1991.

Figure 1: Number of Investments by Weeks (weeks since January 1989)



The second highest peak of registration took place after the new J-V Law was passed by the Parliament on June 14, 1991. Despite the lack of tax holidays, the new law abolished the

FDI limits. This particular provision lobbied for a long time by Poles living abroad, resulted in an increase in the registration of joint ventures to over 40-50 per week in June 1991.

Classification of Regions and Assumptions

For the purpose of our first analysis we have divided Poland into six regions; North, East, Silesia, West, Center and Warsaw. Because almost one half of all joint venture projects are located in Warsaw, we have excluded that voivodship from the Central region in order to have a uniform base for analysis. For this reason the Warsaw voivodship is treated as a separate region in our analysis and in many cases, investment data from Warsaw has been excluded in order better to examine FDI trends. We have also established indicators of development, the degree of urbanization and environmental degradation to serve in this analysis. Much of the analysis is based upon comparisons of the top seven investing countries (based on total number of investments). The top seven were chosen so that Italy, the country with the seventh highest number of investments but a large contributor in terms of total capital, would be included.

One significant issue which requires mentioning is the value of foreign capital inflows into Poland that are presented in this work. We use this term to mean not only the contribution of the foreign side of the venture, but also the Polish partners contribution which can be either in kind or monetary. Thus, the actual foreign capital inflows would actually be smaller than what is suggested in this chapter.

ANALYSIS BY SIX REGIONS

We can examine the industrial potential of each of the six regions in terms of industrial output sold per capita (Table 1). We used the final 1992 data from the Main Statistical Office to obtain this crude indicator of development. While we recognize the limitations of this measure, it is still instructive for general trends in investment as it reveals preferences of foreign investors. From this perspective, the Warsaw voivodship has the highest per capita industrial output sold totaling US\$ 2,087 followed by Silesia with US\$ 1,868. The Northern and Western Regions have per capita output of US\$ 1,450 and US\$ 1,420 respectively. Finally, Central Poland has per capita industrial output sold of US\$ 1,365 and Eastern Poland is last with US\$ 738.

TABLE 1. Industrial Output and FDI Per Capita

Region	Industrial Output Sold Per capita (US\$ ths.)	Value of FDI per Capita (US\$ ths.)
North	1,450	43
West	1,420	38
Silesia	1,868	35
East	783	14
Center	1,325	53
Warsaw	2,087	364

The highest per capita FDI is found in the Warsaw voivodship, followed by the Central and Northern regions which have per capita FDI of US\$ 53 and US\$ 43 respectively. Furthermore, taking into account the limited number of observations, there does not seem to be a relationship between our indicator of development and the amount of FDI inflows per

capita. Regions that have a high per capita industrial output do not necessarily attract high levels of FDI.

Number, Value of Capital and Average Capitalization Size of Firm by Region

In terms of the number of joint venture projects started, the Warsaw voivodship has clearly attracted the largest amount of FDI both in terms of capital and the number of projects. Over 3,475 joint ventures have located in the Warsaw voivodship with a combined value of capital of US\$ 878 million. This number accounts for 43% of all joint venture projects started and 49% of foreign capital inflows into Poland from 1990 to 1992. This should not be surprising, however, since most of the investors will choose to establish their headquarters in the capital city.

Table 2. Number of Joint Ventures and Aggregate Capital Invested by Region (1990-1992)

Region	Aggregate Capital Invested	Number of JV
North	136,934,640	867
West	158,752,413	914
Silesia	240,181,471	836
East	81,643,074	300
Warsaw	878,794,105	3478
Center	277,420,926	1538

The largest concentration of FDI (outside of the Warsaw voivodship) is found in Central Poland. This area accounts for 19.2% of all FDI projects and 15% of foreign capital invested. Each of the next three regions, Western and Northern Poland as well as Silesia account for approximately 10% to 11% of the total number of FDI projects. In terms of capital, Western and Northern Poland received between 7 and 9% of the total invested capital while Silesia experienced considerably larger FDI inflows of 14%. The smallest concentration of foreign capital is found in Eastern Poland where 300 joint ventures were established, this number represents 3.7% of joint venture projects in Poland with the value of capital invested totaling US\$ 81 millions or 4.5% of foreign capital. (Table 2)

Capitalization

Table 3 shows the average capitalization of joint ventures in the six regions. Our data show that the highest level of capitalization is found in the central region where the average capitalization of joint ventures is US\$ 516,443. On the other hand, the lowest capitalization is found in western Poland, where the average joint venture has a founding capital of US\$ 174,071. The capitalization rate for the remaining four regions varies from US\$ 192,077 in Northern Poland to US\$ 288,333 in Silesia.

The high capitalization rate in Central Poland is primarily due to two large investments totaling almost US\$ 141 million. Removing those investments from our data reduces the average capitalization in the Central region to US\$ 181,000. After correcting for outliers in the remaining five regions we find that the order of highest capitalization to lowest

capitalization shifts. Although Central Poland still has the highest founding capital per enterprise, the region with the lowest capitalization rate changes from Western Poland to Warsaw. The capitalization corrected for outliers varies from 127,405 in Warsaw to 181,084 in Central Poland. Clearly, many small entrepreneurs are investing in the Warsaw region and for this reason we see a high concentration of foreign capital with a fairly low capitalization rate.

TABLE 3. Average Capitalization Rate and Corrected Average Capitalization by Region (in USD)

Region	Capitalization	Corrected Capitalization
North	192,077	159,226
West	174,070	135,189
Silesia	288,333	178,405
East	273,053	157,855
Warsaw	252,890	127,405
Center	516,442	181,084

Table 4 shows the region and the structure of capital invested. In Warsaw we see that over 80% of foreign capital invested does not exceed US\$ 100,000 per enterprise. Similarly in Central Poland 74% of foreign investors contributed US\$ 100,000 or less. However, in the Warsaw voivodship 16.9% of the joint ventures invested more than US\$ 100,000 thousand while in Central Poland 22.3% of foreign investors invested more than US\$ 100,000. Nevertheless, we see that in each region the largest concentration of capital is between US\$ 6,000 and US\$ 100,000. This is consistent with the general trend found in Poland where the average capitalization rate per enterprise is quite small.

We can examine the inflow of FDI into the different regions of Poland based on the type of entity that has undertaken the investment. Usually joint ventures that involve a private investor are more numerous than joint ventures that involve foreign institutional entities. Only in the case of Central Poland does the percentage of institutional foreign investors exceed the percentage of private investors. In the remaining regions private investors are more numerous. Our data shows that on average in each region, including Warsaw, individuals invest between US\$ 94,000 and US\$ 103,000, while institutional foreign investors invest between US\$ 350,000, and US\$ 600,000. This pattern of investment is consistent with the general tendency of institutional foreign investors to invest significantly larger amounts than individuals (Figures 2 and 3).

TABLE 4. Structure of FDI by Largest Capital Intervals by Region

Region	Value (in ths. USD)	Percent	Value (in ths. USD)	Percent
North	6 to 100	54	Up to 6	25
West	6 to 100	49	100 to 1,000	25
Silesia	6 to 100	50	Up to 6	27
East	6 to 100	46	100 to 1,000	28
Center	6 to 100	52	Up to 6	29
Warsaw	6 to 100	48	Up to 6	26

Figure 2: Foreign Investor Type by Region

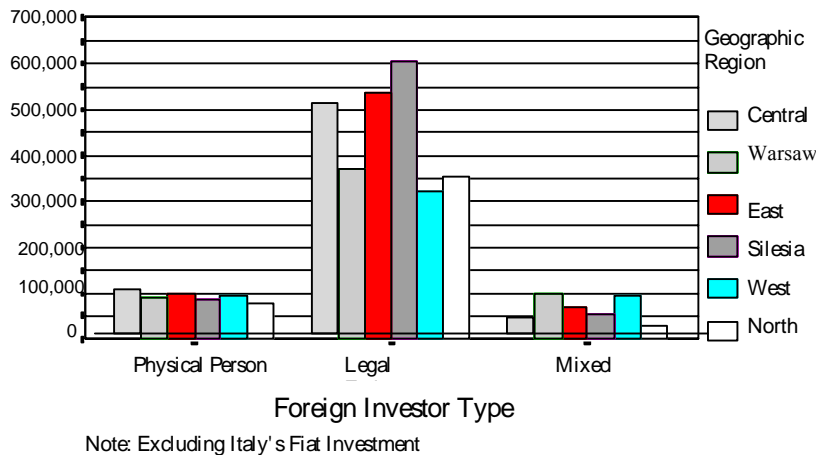
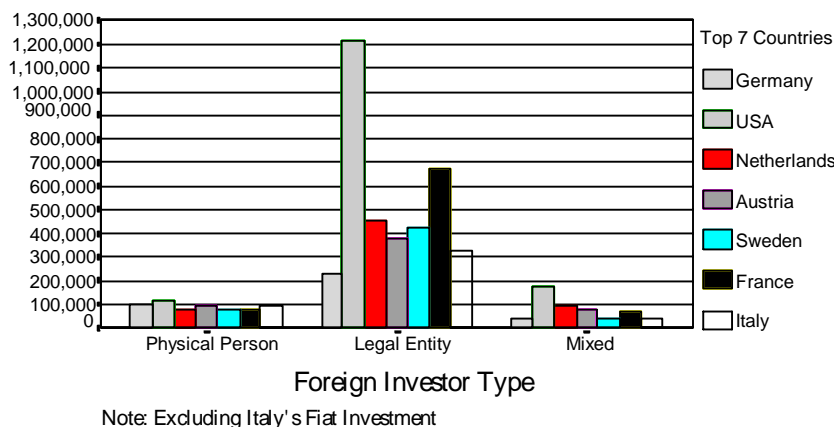


Figure 3: Investor Type by Country



There are clear patterns as to the average level of FDI per legal entity in each of our six regions. (Figure 2) Silesia has the highest investment in terms of institutional investors. The average foreign institutional entity invests around US\$ 600,000, followed by Eastern and Central Poland with US\$ 560,000 and US\$ 550,000 respectively. It is interesting to note that Eastern Poland with the smallest share of FDI has the second largest level of average FDI per legal entity. This is most likely due to large acquisition type investments in that region.

Regional Distribution of FDI by country

The largest foreign capital inflows by region can be attributed to seven countries; the United States, Germany, Netherlands, Austria, France, Italy and Sweden. Those countries are the dominant sources of foreign capital in all six regions.

In the areas encompassed by our analysis we see that German investors are most numerous in all of the regions. In the Eastern region, Germany has 100 joint venture projects which account for 30% of all FDI ventures in that area. In Warsaw the number of German FDI projects exceeds 450. American joint ventures are not as numerous as German

investments. However, in the Warsaw voivodship as well as in Central and Eastern Poland U.S. investors are second only to the Germans in terms of the number of projects.

We also see a large number of Swedish investors in the Northern region of Poland, where there are more than 150 Swedish joint ventures present in the Northern region. Sweden is the only country, from the top seven investing countries, with a greater number of investment projects in a region other than Warsaw.

Figure 4: Total Investment Value by Region

(Excluding Fiat Investment)

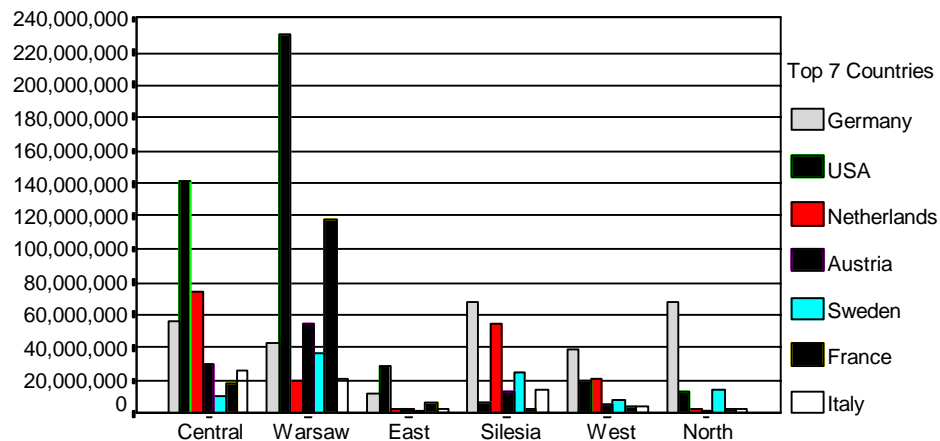
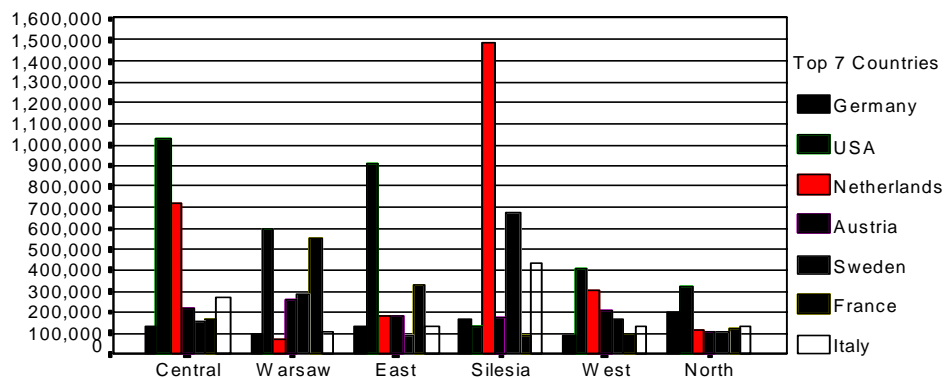


Figure 5. Mean Investment Value by Region

(Excluding Fiat Investment)



When we examine the value of capital invested German firms no longer dominate the scene. In the six regions German joint ventures on average invested less than US\$ 300,000 per firm. This is consistent with the general trend that German firms are committing small amounts of capital in Poland (Figures 4 and 5).

On the other hand, American companies have played the leading role in the average amount of foreign capital contributed in each region. Average American investment varied

from over US\$ 100,000 in Silesia to more than US\$ 1 million in central Poland. The three regions attracting the largest average American investment were the Central region, Warsaw and Eastern Poland. The average per firm capital invested by U.S. companies into this region is twice as high as the average capital invested by all other countries.

Unemployment

One issue we aimed to address was the impact of unemployment rate by voivodship on FDI. We wanted to test whether foreign investment was attracted or repelled by areas of high unemployment. We divided the voivodships into quartiles based on the final 1992 unemployment rates among those economically active citizens. Of particular note, the Central Region, with highest percentage of all unemployed persons in Poland, attracted the second-highest level of FDI both in terms of total capital and number of investments. The Northern region, with only 12 percent of Poland's unemployed, attracted the second-lowest level of investment in terms of capital. This is an artifact of the regions lower population since the area has the highest rate of unemployment at 18 percent.

In general, however, we found that unemployment was not significantly correlated with the value or number of investments. This may be due to the fact that the unemployment rate across the regions (and indeed all of Poland) is uniformly very high. The exception is the Warsaw voivodship with an unemployment rate of 7 percent (among the lowest in the country).

Degree of Urbanization

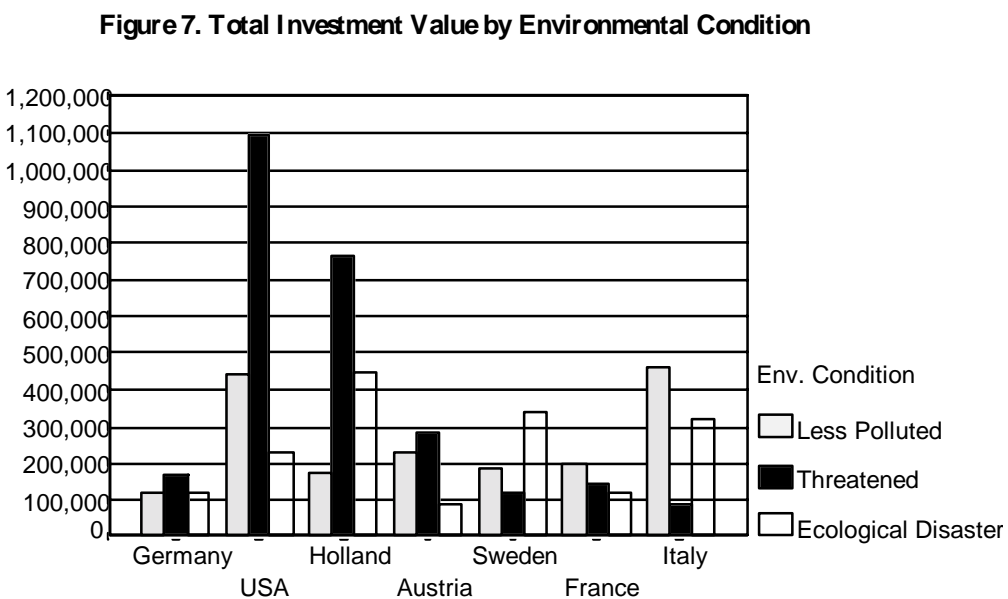
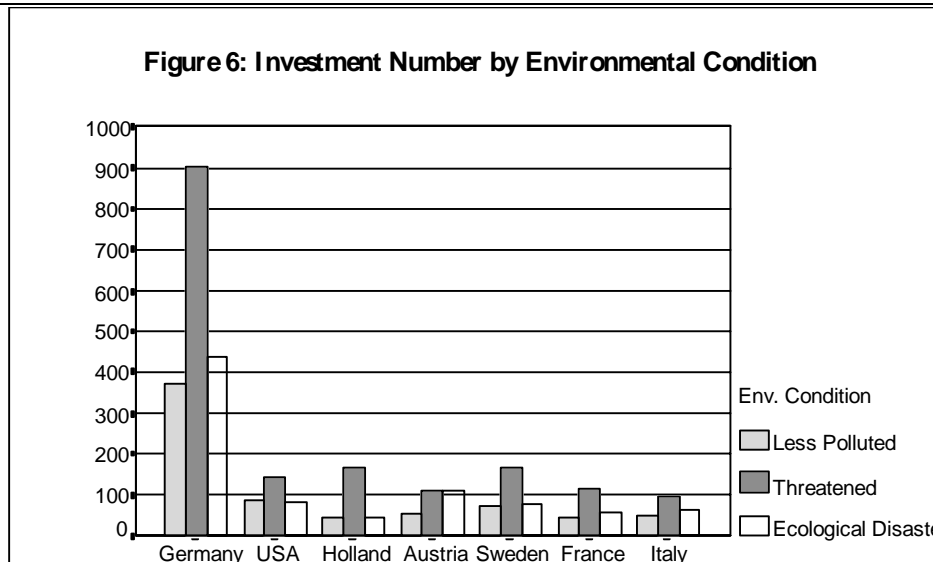
For this measure, we developed a basic indicator of urbanization by simply calculating the ratio of urban to rural citizens. Through this ratio, 21 voivodships were designated "rural" and 27 "urban." Once again, Warsaw comprised its own category. In general, we noted a tendency to avoid voivodships with predominately rural populations. Only 7 percent of all investments went to such voivodships. We found that the degree of urbanization was positively (though weakly, but significantly) correlated with the percent foreign share and negatively (again weakly, though significantly) with percent Polish share. This lends credence to the prediction that foreign share tends to flow toward urbanized areas.

Ecological Regions

An important question is what influence does environmental quality have on investment? Do investors tend to come to environmentally degraded regions? To attempt to answer these questions, we divided the 49 voivodships into 3 categories based on the extent of environmental hazard. These environmental categories are based on the Polish Main Statistical Office's 27 ecologically threatened regions. Four voivodships were classified as ecological disaster, nineteen as ecologically threatened and twenty-three as clean.

As with other indicators, Warsaw (a "clean" voivodship according to the above criteria) was set aside for this analysis; including it would have skewed the results toward less polluted voivodships. Of 4500 cases, just over 51 per cent went to ecologically threatened voivodships, 27 per cent to voivodships with areas of ecological disaster and 22 per cent to less polluted areas. Examining the data by regions, we also observed that the majority of

investments went to ecologically threatened voivodships, with the exception of the eastern region where 70 per cent of investments went to clean voivodships. This is a predictable result since the East region contains only two ecologically threatened areas. The North region and Silesia saw investments chiefly concentrated in polluted areas; again this is a likely result given the amount of environmental degradation in these regions and the urban character of the voivodships. In general, the level of development and environmental degradation are positively correlated.



The total number of investments by country reveals that all of the top 7 countries invested most often in voivodships with areas of environmental threat. The fact that a voivodship was clean did not seem to influence any one country's investment behavior. Viewing the average investment value by country according to environmental condition reveals a slightly different picture, but in most cases, the results may also be explained by other tendencies. For instance, Sweden's heavy involvement in northern Poland helps explain its investment in very polluted voivodships (Gdańsk) and Italy's investment in Bielsko-Biała (Fiat) inflates its average value for clean regions (Figures 6 and 7).

An interesting avenue for further study would be to examine foreign investment by economic classification. Unfortunately, we did not have a complete list of the joint ventures according to proposed economic activity. Such information would permit a deeper analysis into the environmental impacts of investment activity.

FOREIGN ACQUISITION STRATEGIES IN THE POLISH PRIVATIZATION PROCESS (Survey Review)

Władysław W. Jermakowicz

Foreign direct investment plays an increasingly growing role in the Polish privatization process. The official data usually concentrate on the statistics of foreign investment according to different branches of the economy or regions and countries of origin, but as yet they omit the crucial aspects of foreign capital participation in the privatization process. The lack of reliable and systematic official data on privatization through FDI is clearly observable.¹¹

The research presented in this report is based on a survey made among the largest firms with foreign share participation already present in Poland. The survey attempted to

- recognize the role of different institutional players (like the State Foreign Investment Agency, Ministry of Privatization, executive boards of Polish firms) in the foreign acquisition process,
- recognize the motives laid down by foreign partners' decisions to acquire a Polish firm instead of making a greenfield investment,
- recognize what methods and techniques are used during the foreign acquisition process, and
- find out what type of governmental incentives are offered to the foreign partners entering the Polish market.

The responses to the survey are maintained in a confidential database. General aggregated statistics from the database are reported in this document only. Disclosure rules do not allow information to be made public, which could trace the information to a company.

CHARACTERISTICS OF SURVEY RESPONDENTS

The Characteristic of the Sample

Survey questionnaires were sent to 160 largest Polish firms with foreign participation from a list provided by the State Agency for Foreign Investment. The first questionnaires, in the Polish language, were sent on January 7, 1994, with a deadline of March 1, 1994. From this questionnaire 31 responses are received. On March 8, 1994 the second follow up was made and 129 questionnaires, this time in the English language were sent, to those firms who did not respond to the first inquiry. An additional number of 27 responses are received which made the total number of 57 responses - a response rate of 35.6 percent. In both cases the introductory letter to questionnaires was signed by Dr. Leszek Balcerowicz, the former Vice-Prime Minister and Minister of Finance, the person with the high authority and recognition in Poland.

¹¹ The only exception is the research done by J. B³uszkowski and J. Garlicki (1993) on social conditions of foreign investment in Poland. That research, however, although very impressive, aims to investigate factors that determine why foreign investors take up business activities in Poland. The privatization aspect through FDI is regarded very marginally.

The list provided by the State Agency did not distinguish between firms which entered the Polish market by acquiring already existing state owned firms or by greenfield investments. Questionnaires were sent to all firms without distinction. Therefore, it is necessary to divide responses into two groups: responses from firms which made an acquisition, and firms which made a new greenfield investment. In this sample, acquisitions were made by 28 foreign firms; and greenfields investment were made by 29 foreign firms.

Table 1. Structure of responses

Type of FDI	# Answers	%
Acquisition	28	49.1
Greenfield Investment	29	51.9
Total	57	100.0

Because the main goal of this research is to analyze the strategies applied by foreign firms who take part in the privatization of Polish firms, only responses from firms which entered Poland through acquisition of already existing firms were selected. Thus, the survey sample comprises only 28 firms.

The Profile of Acquired Companies in Poland.

Twenty-eight companies which responded to the survey had a total annual sales in 1993 of \$489.2 million; a total equity of \$161.5 million and a total foreign equity of \$118.21 million (See Appendix 1).

Annual sales ranged between of \$2 million and \$75 million, with an average of \$17.47 million. The largest surveyed firms had an equity of \$45 million, the smallest \$100 thousand. An average founding capital was \$5.77 million, very high in comparison to the country average which is \$162 thousand. Foreign participation in this capital ranged from \$10 thousand to \$27.5 million with the average of \$4.22 million per firm. The foreign share in the total capital ranged between 49.1 percent to 100 percent with an average of 73.1 percent.

Employment in all interviewed firms totaled 6,413 with the smallest number of 3 in company #1 and the highest number of 948 employees in company #24.

Table 2. Employment in different ranges.

No. of employees	No of firms	%
1- 10	3	10.7
11- 50	12	41.8
51- 100	2	7.1
101- 500	5	17.8
501-1000	6	24.6
Total		100.0

The largest share in the sample constituted firms engaging between 11-50 employees (40%); the lowest firms employing between 51-100 people (7.1%) (See Table 2). A positive correlation exists between annual sales and number of employees ($r=.6465$ Sig.001).

The whole group is dominated by limited liabilities companies (JSC Ltd.) - 19, followed by joint-stock companies (JSC) - 7, and sole proprietorships (SProp) - 2 (See Table 3 and Appendix 1).

The year 1992 marked a record twelve-month period in the process of company establishment. The breakdown of companies in respect to the year of establishment is shown in table 4.

Table 3. Legal Status of Pooled Companies

Legal status	Number of companies	%
1. Limited liability company	19	67.8
2. Joint stock company	7	25.0
3. Sole proprietorship	3	7.1
Total	28	100.0

Table 4. Company Establishment Year

Year	Number of companies	%
1989	1	3.6
1990	7	25.0
1991	7	25.0
1992	8	28.7
1993	5	17.7
Total	28	100.0

A8 great number of companies are engaged in the pursuit of multi-business operations. A complete list of economic branches, according to ISIC code, involving the largest companies with foreign capital is presented in Table 5.

Table 5. Companies according to type of business

ISIC	CODE DESCRIPTION	FI- RM	FI- RM	FIR M	FIR M	FIR M	FI- RM	TO- TAL	%
1	AGRICULTURE	1	14					2	5.7%
31	FOOD BEV. & TOBACCO	13						1	2.8%
32	TEXTILE & LEATHER	7	10	24				3	8.5%
33	WOOD PRODUCTS	8	16	21				3	8.5%
34	PAPER PRODUCTS	8						1	2.8%
35	CHEMICALS & PLASTICS	5	16	20	22	27	28	6	17.1%
36	NON-MET., MINER. PROD	2	9	19				3	8.5%
37	BASIC METAL IND.	12						1	2.8%
381	FABRIC. METAL PROD.	6	11	17				3	8.5%
382	MACHINERY EXC. ELEC	6						1	2.8%
383	ELECTR. MACHINERY	6	26					2	5.7%
384	TRANSPORT EQUIP.	3	18	25				3	8.5%
385	PROFESSIONAL EQUIP.	11						1	2.8%
5	CONSTRUCTION	14						1	2.8%
6	TRADE & TOURISM	1	4					2	5.7%
7	TRANSPORT	4						1	2.8%
8	FINANCE & INSURANCE	15						1	2.8%
								35	100.0%

According to the list industrial production takes the dominant position with three-fourth of companies engaged. The largest number of companies is located in branch ISIC 35 - Chemicals, Petrochemicals, Rubber and Plastics (6 out of 28) followed by ISIC 32 -- Textile, Wearing Apparel and Leather, ISIC 36 -- Non-metallic Mineral Products, ISIC 381 Fabricated Metal Products except a machinery and equipment, and ISIC 384 -- Transport

Equipment. In each of these ISIC codes, three firms are present. On the average, each firm is present in 1.25 branches.

Profile of Foreign Companies

On the merits of the pool, there are ten countries on the complete list of foreign investors. The largest group of eight firms constitutes companies with German capital followed by firms with U.S. capital (4 firms) and British capital (3 firms). The pool, generally speaking, seems to mirror the structure of foreign investment in Poland.

Data on the annual sales of parent companies are only available in 13 firms (See Appendix 2). These 13 firms are characterized by total annual sales of \$299,000 million, with range of \$25 million to \$150 million. The average sales of foreign companies amounts to \$21.3 million. The sale of the Polish subsidiaries in comparison to foreign parent companies is more than miserable and amounts .1 percent of the total sales of foreign firms.

The data on employment are available for 24 parent foreign firms (See Appendix 2). The total employment in these firms amounts to 125,475 with an average of 5,454 per firm. The lowest number of employees is 41, the highest of 41.3 thousand. The share of employment in Polish subsidiaries in relation to the foreign parent company ranges between .3 percent to 57.1 percent with an average of 4.2 percent. It is noteworthy that 4.1 percent of the Polish employment share contributes to only .1 percent of the total annual sales.

Country	Number of firms	%
Germany	8	28.6
United States	4	14.3
Great Britain	3	10.7
Switzerland	3	10.7
Austria	2	7.1
France	2	7.1
Netherlands	2	7.1
Sweden	2	7.1
Denmark	1	3.6
Japan	1	3.6
Total	28	100.0

Most of the parent foreign companies are engaged in multi-country activities. Only six of 28 (21.4%) stress that their only foreign subsidiaries are established in Poland. In the case of the remaining 22 firms, their foreign involvement ranges from two countries to 150 countries with an average of 21 countries per firm (See Appendix 3). The largest number of parent countries have their subsidiaries in Great Britain (17 of 28), followed by other West European countries like Germany, Denmark, France, and Switzerland (16 each of 28). On the top of the overseas countries are the United States (11), Canada (10), and Japan (7), (See Appendix 3).

Institutional framework for privatization and foreign direct investment in Poland.

In the last five years two government institutions have been responsible for supervision, structure, registration and assistance to foreign investment in Polish privatization.

Until July 14, 1994, it was the Foreign Investment Agency (FIA), that monitored and controlled functions, set guidelines, and led the registration process for all new joint-ventures. After July 14, 1994, and the imposition of the new Companies with Foreign Shareholdings

Act of June 14, 1991,¹² the Foreign Investment Agency is transformed into a politically independent joint stock company, so called the State Foreign Investment Agency, without any political power and authority. Its role is to promote foreign investment in privatization, and to ensure that greenfield projects and private joint ventures are not neglected. The Ministry of Privatization took over role of the political body responsible for setting guidelines, approving privatization through FDI programs, and selling state owned companies to foreign investors.

Therefore, in this report the State Agency is understood to be either the Foreign Investment Agency or the Ministry of Privatization depending on the time the foreign acquisition happened (before or after July 14, 1991).

PRE-ACQUISITION STAGE

Pre-acquisition is the first stage in the complex process of privatization, followed by the acquisition (company sale) and post-acquisition stage, when a new owner carries out the restructuring process and adapts the firm to market conditions. In the pre-acquisition stage decisions are made concerning entering the Polish investment market. Two aspects are analyzed: motivation of both the foreign company and Polish side and the acquisition strategies applied by both sides.

Motivation of foreign Parent Company

All foreign direct investments can be divided into four groups: a. market seeking FDI, b. resource seeking FDI, c. efficiency seeking FDI, and d. strategic assets seeking FDI.

All the investments are "pushed" or "pulled" abroad by different factors; thus they are attracted to different countries. *Market seeking FDI* is attracted to countries with large and prosperous markets; *resource seeking FDI* is almost entirely determined by the availability and quality of natural resources in the target economy; *efficiency seeking FDI* prefers a location consistent with that country's comparative advantage in world markets (thus labor intensive FDI are directed to countries with low wages, while technology intensive countries are directed to advanced industrial countries and those which offer the best supporting infrastructure). *Strategic asset seeking FDI* will be partly firm specific, but will normally take place in countries similar in economic structure and living standards to the investing country. This is true except, perhaps, in the case of natural resource sectors and where FDI is geared towards buying into unfamiliar markets and distribution channels (Dunning 1994).

To determine what strategies are applied a question is asked assessing the relative importance of different factors in a foreign company's decision to acquire the local company (See Table 7). Factor a. from the questionnaire is closely related to market seeking strategy, factor d. to the resource seeking strategy; factors b. c. and e. to efficiency seeking strategies, and factors f., g., and h. to strategic assets seeking strategies.

There is no doubt that the market seeking strategy prevails among foreign firms investing in Poland. Almost a forty million consumers market is a factor which is worth consideration. In the second place are strategic reasons, especially creation of an export base for Central and East European countries. The perspective of free market union between Hungary, Czech, and Slovak Republics, and Poland as well with nearly 65 million customers is also appealing to potential investors. Efficiency seeking and input seeking strategies do not

¹² See Companies with Foreign Shareholdings Act of June 14, 1991 (Dz. U. 1991, No. 60, item 253) in (Doing).

play any important role. Especially low in importance are possibilities to lower labor costs (1.3). It seems that foreign investors are not attracted by the \$1.2 average hourly wage of Polish workers, seven time below that in Germany. Probably low productivity and threat of strikes are the main reasons to disregard the low wages as an investment attracting factor. Also, the possibility of securing input plays more than a marginal role (1.2).

	unimportant (1)	important (2)	v.important (3)	Average
a/ to get access to the local market*	1	6	21	2.7
b/ to reduce costs in general	11	7	10	2.0
c/ to reduce labor costs	19	6	3	1.4
d/ to secure inputs	20	7	1	1.3
e/ to increase profit levels**	17	5	6	1.6
f/ to create export base in general	11	11	7	2.5
g/ to create export base for CEE countries***	3	8	17	2.1
h/ strategic reasons	11	2	15	

CORRELATIONS:
 * with sales ($r=.7839$ Sig. 01)
 ** with sales ($r=.6932$ Sig. 01)
 *** with sales ($r=.6160$ Sig. 01) & with employment ($r=.0000$ Sig. 001)

The major motives of a foreign parent company for acquiring a local company go along with these factors. The main motives mentioned by respondents in the open question are obtaining the position of the only distributor on the Polish market, developing sales, the possibility of obtaining new markets, increasing quality food processing in Poland, accessing the Polish telecommunication market, accessing the Polish/Eastern European market. Undoubtedly, market seeking motives are dominant.

The correlation analysis comparing the size of the firm measured by annual sales and some of the motives attracting the foreign investors to acquire the Polish company shows that a clear distinction between larger firms and smaller firms exists. Firms with high annual sales are to the higher degree attracted by the size of the Polish market ($r=.7839$), the export opportunities to CEE countries ($r=.6160$) and profit level ($r=.6932$). For smaller firms these factors seem to play a less important role. A further analysis will confirm this tendency.

Other alternatives to investment in Poland

Any decision to enter any foreign market is associated with an analysis of other alternatives for investment. The representatives of foreign investors who took part in this study were asked to answer the question: Did you consider alternative countries as investment locations when deciding to invest?. The results are presented in Table 8. Twenty-one of 28 firms (75%) indicated that they considered other countries for possible investment but decided to enter Poland. Only five countries neighboring Poland or located close to Poland were considered as an alternative investment opportunity: Hungary (40.7%), Czech Republic (25.9%), Slovakia and Russia (each 14.8%), and Lithuania (3.7).

Table 8. Did foreign parent company consider alternative countries as investment locations when deciding to invest?		
NO	7(25%)	
YES	21(75%)	
If Yes, which countries	# of answers	%
Hungary	11	40.7
Czech Republic	7	25.9
Slovak republic	4	14.8
Russia	4	14.8
Lithuania	1	3.7

To determine the main reasons for choosing Poland an open question was asked: "what urged the decision to acquire the company in question?" As main reasons are given: "the flexibility of Poles and their abilities in solving difficult problems," "better developed market conditions and less bureaucratic system than in other countries," "high quality of employees and managers," "large market", "promising perspective of development," "high entrepreneurial spirit of Poles, not present by representatives of other CEE countries." No one mentions labor cost-- it seems not to be an attracting motive worthy of note -- and economic growth prospects. Discouraging factors mentioned are, obsolete transport facilities, limited land purchase possibilities, high rate of inflation, and difficult access to credit.

Initiative on acquisition on the Polish side

The representatives of foreign investors were also asked who initiated the target company sale on the Polish side. Four governing bodies are mentioned: company's management, government agency, supervisory board, or worker's council. The assumption is made that privatization through FDI can be either state agency driven, management driven, workers' council driven, or supervisory board driven.

The analysis of the results (see Table 9) shows that in two-thirds cases the idea for the cocompany's sale was brought exclusively by the company's management, in one-third of cases both by the company's management and the state agency. Only in one case the idea of a company's sale was initiated exclusively by the State Agency. The supervisory boards and workers' councils did not play a role in the firm's sale.

Table 9. On the host country side, who was the initiator of the target company's sale?		
	No of answers	%
(a) excl. company's management	18	64.3
(b) excl. government agency	1	3.5
(c) both	9	32.1
(d) supervisory board	0	0
(e) workers' council	0	0

Undoubtedly, Polish privatization through FDI is management driven and State Agency driven. State Agency initiative is prevalent in the case of ten large firms which are included in the sectoral program of privatization. The company's management boards are instrumental in searching for a foreign partner and for the company's sale in the case of smaller firms.

Motivation on the Polish side

It is interesting to analyze why a target company's management is interested in bringing foreign investors. Each such acquisition can bring management termination or -- in the best case -- restructuring. Respondents answering an open question about main objectives give these reasons: to increase capital opportunities, to get know-how, to gain access to new financing, to gain opportunities to increase market share, to finish firm's restructuring, to receive new sources for development in new market conditions, to get access to the new technologies, to locate new export opportunities for the firm's products, to have possibility to get access to the new capital etc. The managerial approach to all these questions is clearly visible.

The same approach is also stressed by the answers to questions about the importance of different factors (See Table 10).

Table 10. Assess the importance of the following factors as objectives of target company's management in attracting strategic foreign investor!				
Factors				
	unimportant (1)	important (2)	v.important (3)	Average
a. to save the company from bankruptcy	12	4	12	2.00
b. to obtain new sources for development financing	5	10	13	2.28
c. to acquire new technology	8	7	13	2.07
d. to preserve employment*	16	12	0	1.42
e. to enter foreign markets	13	7	8	1.82
f. to get management/marketing skills	4	12	12	2.28
g. to obtain access to raw materials, components, inputs	21	4	3	1.46
h. to secure company's long-term development	2	0	26	2.85
CORRELATIONS:				
* with employment (r=.6993 Sig. 001)				

The most important motive in attracting the foreign business on the Polish side is the necessity of securing the company's long-term development (2.85), followed by the willingness to get management/marketing skills (2.28), and to obtain new sources for development financing (2.28). Surprisingly the lowest value is given for employment preservation (1.42), followed with the willingness to obtain access to raw materials, components, and inputs (1.46). The first factor especially seems to indicate that the managerial strategic goals of firms development and financing are much more important than social objectives of securing employment.

Correlation analysis shows that the larger the company, measured by the number of the employees, the more important is employment preservation factor. A very strong correlation between two variables exists (r=.6993). Firms with a larger number of employees tend to stress the necessity to secure employment after privatization; for smaller firms this factor is less important.

The major objectives of acquisition expressed by the State Agency

The respondents were reluctant to answer the open question: What was considered the major objective of the State Agency in acquiring a strategic foreign investor? saying that they do not know motives of the government agency. Only three firms responded to this question. The first stated that the objective is to save the company from bankruptcy; the second company cynically stated that the objective is the need for political success of Minister Lewandowski before the coming elections, the third listed the necessity of modernizing production and obtaining further investment.

The answers for the closed question are presented in Table 11.

Table 11. Assess the importance of the following factors as objectives of government agency in transaction with strategic foreign investor				
Factors	Importance			Average
	unimportant (1)	important (2)	v.important (3)	
a/ to speed up privatization	13	11	4	1.67
b/ to collect high purchase price*	15	9	4	1.61
c/ to save the company from bankruptcy	14	3	11	1.89
d/ to secure company's long-term development	9	0	19	2.36
e/ to speed up local economy's integration into international economy	9	5	14	2.18
f/ to promote economic cooperation with particular country	23	1	4	1.32

CORRELATIONS:
 * with sales (r=.5515 Sig. 01) & with employment (r=.8693 Sig. 001)

According to the representatives of the foreign investors, the State Agencies responsible for privatization and foreign investment place the most importance on such factors as "long-term development" and "speeding up local economy's integration into international economy." Both of these factors express the developmental aspects and long term goals of integration with the world economy. Surprisingly, the operational goals such as revenues to budget through price setting, ownership structure (speeding up privatization) as well as economic cooperation with a particular country (promotion of economic cooperation with a particular country) played a marginal role. The last answer seems to indicate that Poland does not differentiate among foreign investors on a favored status.

Collection of a high purchasing price is positively correlated with the size of the company measured both by the annual sales and employment. There are two possible explanations for this phenomenon. First, larger firms usually cost more, and the State Agency expects to collect a higher price thus increasing revenues to the state budget. Second, the State Agency is to the higher degree responsible for the sale of larger companies than the firm's management. Therefore, this Agency is more persistent in increasing the firm's price than firm's management for which, as shown above, other factors play a more important role.

The comparison of management expectations with government expectations shows on some dissimilarities. With the exception of the most frequently mentioned answer, "to secure the company's long term objectives (2.85 vs. 2,36), the management stresses opportunities to increase management skills, and the possibility of getting access to new resources; the State Agency, in turn, stresses the benefits of local economy integration with the world market or saving the firm from bankruptcy. The State Agency, apparently, takes a more macro-social approach.

Disagreements between management and government agency

The institutional conflict between the state agency responsible for privatization and privatized firms is natural to any process of privatization.

The analysis of the results seems to indicate that these differences are, generally speaking, non-existent or marginal in Polish conditions (see Table 12). There is no conflict concerning inviting and selecting the foreign investor in general. The only disagreements seem to reveal some elements of the acquisition process and basic objectives of the transactions. These differences concern formal-legal aspects, the reluctance of the state agency to sell a company which is in relatively good financial shape in comparison to other companies, the price level, the majority vs. minority controlling interest, and the value of a sold company.

Factors	Yes	No	%(yes)
a/ inviting strategic foreign investor in principle	0	28	0.0
b/ selecting strategic foreign investor in question	2	26	7.1
c/ some elements of the acquisition process and/or contract	11	17	39.3
d/ basic objectives to conclude transaction	9	19	32.1

Privatization or greenfield investment

Once a foreign company has decided for FDI type of involvement, its next step is to select the most appropriate FDI modality. The selection to a large extent depends on the individual investor's motive for entering the country and on the respective industry. In principle, no modality is better or worse than other; all modalities depend on individual intentions and circumstances.

The first entry decision concerns the choice between greenfield (internal start up) investment and the acquisition of the existing local enterprise. In the case of Poland this becomes a "privatization or greenfield" choice. As mentioned in the introduction to this report, 29 of the sample of 57 firms which responded on the survey are firms which have been established in the form of new wholly foreign-owned subsidiary or when privately owned company acts as a local partner/target company. These cases are not discussed here; in this report the only focus is placed on firms privatized through acquisition or partnership.

The respondents were asked in an open question: What was the major reason the foreign company decided for acquisition instead of a greenfield investment. The answers differ. Some firms indicate that acquisition of the Polish firm is the only method to gain access to the Polish market. Others mention a time factor-- acquisition takes less time than a new start up - - the ability to start production after the adaptation of physical resources, lower potential restructuring cost for the acquired company than the cost of establishing a new company, access to local supply and distribution networks, etc.

The relative importance of all these factors are shown in Table 13.

Most important appears to be restructuring costs which are expected to be lower in acquisition than in greenfield investment. In second place are the suitability of acquired company, acquired market share, and the advantages of the acquired company's integration into the local economy. Local producers already have a strong market share, and foreign investors opt to tap into this strength via acquisition. This factor is specially stressed by larger companies ($r=.8693$). Integration with the local economy can be understood as an acquisition of existing distribution network (1.92). The local supply network does not play any role in the acquisition decision (1.11). Also, both the simplicity of the privatization procedure and

acquired company's export market share play a marginal role. The breakdown of trade links after the disintegration of Commecon market contributes to the low importance of the last factor.

Factors	Importance			Average
	unimportant (1)	important (2)	v.important (3)	
a. acquired company's local market share*	10	7	11	2.04
b. acquired company's export markets' share	23	1	4	1.32
c. acquired company's distribution network	10	10	8	1.92
d. acquired company's trade mark/ brand name	17	5	6	1.60
e. acq. company's supply network	25	3	0	1.11
f. advantages of acquired company's integration into the local economy	7	13	8	2.03
g. suitability of acquired company/ established local partner	4	11	13	2.32
h. favorable price of the acquired company	14	5	9	1.82
i. acquisition price plus restructuring costs lower than greenfield investment	3	9	16	2.46
j. capital intensity of the activity	16	6	6	1.64
k. simple privatization procedure	18	10	0	1.32

CORRELATIONS:
 * with employment (r=.8693 Sig. 001)

All these factors appear to be closely related to market factors, which seems to confirm the earlier observation that the main reason for investor entry is access to the Polish domestic market.

Acquisition modes applied

Generally speaking, any acquisition can be divided into "indirect FDI privatization" or "direct FDI privatization."

Indirect FDI privatization exists when the existing local non-private ownership is not transformed but is combined with new private foreign ownership in the form of a joint venture acquisition or through equity increase. In the case of **joint-venture**, the assets and liabilities of a state-owned enterprise (SOE) are contributed as part of the capital in a newly formed company. The State Treasury, via the founding body, owns a part of the shares capital of the new company determined by the valuation of the assets and liabilities transferred. In the case of **equity increase** the foreign investor makes a partnership agreement with privatized company and through investment increases the capital of the existing company.

Direct FDI privatization appears when the existing local non-private ownership is transformed into private foreign ownership through direct sale in a form of share deal or assets deal. **The share deal** assumes that the foreign investor can purchase shares either through public invitation to enter into negotiations or through an auction process. The foreign investor may initiate the privatization process by making known his interest in acquiring the enterprise.¹³ **The assets deal** in Polish conditions, happens when enterprises are privatized through liquidation. In this case the assets and liabilities of the SOE are sold to a newly formed company to which the State Treasury relinquishes its shares. When, in the case of indirect FDI privatization, the state owned part of the company remains to be privatized, then in the case of direct FDI privatization, the direct sale of shares or assets means definite privatization of the acquired company. This can have a significant immediate impact on improving company's efficiency.

As shown in Table 14, among firms which took a part in the study, the most popular method of acquisition is indirect privatization through the establishment of joint-venture. This mode is applied in 67.9 percent of acquisition cases. In second place is direct privatization through the direct sale of shares to a foreign investor. Assets acquisition is used only once, and equity increase is not used in any of the analyzed cases.

Type of acquisition	Through:	
	No. of answers	%
(a) JV acquisition:	19	67.9
(b) share acquisition:	8	28.5
(c) asset acquisition:	1	3.6
(d) equity increasing:	0	0.0

The marginal role of assets acquisition can be explained by the fact that the questionnaire was sent to large firms. Privatization by liquidation -- the most popular privatization method in Poland-- is, however, applied by smaller firms, and thus this mode of acquisition is under-represented in this survey.

Reasons for choosing JV acquisition

The open question was asked, "*What are the major reasons for choosing the JV acquisition?*" JV acquisition is a joint venture (with the status of a new legal person) formed by a part of the existing local company and the new capital invested by a strategic foreign investor. In the case of JV acquisition, the local partner contributes as his share only that part of his total assets necessary for a certain activity. Therefore, the foreign respondents stress that JV acquisition is the least risky solution. They say that foreign investor deals only with the entity or assets of his main interest. Additionally, the foreign parent companies mention the possibility of gaining control over the company with a minimal investment, the possibility of diversifying risk, and the fact that the local company retains proceeds of the sale. In other modes of direct privatization, the proceeds go to the state budget.

Management of the acquired companies as most important stress the possibilities of retaining proceeds in the firm and the capital brought by the foreign investor.

¹³ In Poland the shares deal can also be made through the purchase of shares of already privatized companies on the secondary market, either through the Warsaw Stock Exchange or OTC transactions.

The government agency stresses a few factors like the speed of JV acquisition, the relevance of the Polish legislation (which is, until mid of 1991, the best suited to JV acquisition), and the low risk of JV acquisition.

The same question was asked in the closed form.

Factors	Importance			
	unimportant (1)	important (2)	v.important (3)	Average
a/ the only type possible/allowed	3	0	16	2.68
b/ advantages of having local partner (risk sharing, lower capital exposure, "local" expertise, connections and image)	9	0	10	2.05
c/ acquisition of only interesting parts of the acquired company	15	3	1	1.15
d/ avoiding risk of hidden liabilities and debt	11	8	0	1.42
e/ purchasing money stays in the acquired company	7	5	7	2.00
f/ avoiding legal and administrative problems	1	2	16	2.78
g/ advantages of being a new company				

The 19 firms which chose the JV form as a very important indicate advantages of being a new company and the fact that JV is the only possible and allowed method. As important are mentioned advantages of having a local partner and the possibilities of avoiding the risk of hidden liabilities and debt. Surprisingly, unimportant are such factors as the possibility acquiring only interesting parts of a acquired company and avoiding the risk of hidden liabilities and debt.

Control over company

Foreign investors usually insist on managerial control over the company. This is commonly achieved through acquisition of at least 51 percent of the company shares. Seventy-eight percent of firms which responded to the survey give full control or majority control to the foreign party. Twenty-two percent of the firms use a balanced 50:50 relation. Fifty-fifty solution is the worst one for the company's management because no one gets full control. It is chosen as a compromise solution when both parties struggle for the majority, and the 50-50 compromise appears to be the only solution possible. Only one of the foreign investors agreed to a minority owned solution. Control over the acquired company appears to be a very important factor.

	# answers	%
(a) 100% foreign owned	9	32.1
(b) majority-foreign-owned	12	42.8
(c) 50:50 owned	6	21.4
(d) minority-foreign-owned	1	3.6

Major reasons for choosing majority control through the foreign company are the reduction of risk during the first years after acquisition, and an impact on the firm as a whole. On the Polish management side, the most important factors are the hope that the foreign firm will turn the company around and give an access to foreign markets.

Contacts before acquisition

The experience of any joint venture or acquisition shows that in most cases these acquisitions are preceded by a long lasting trade relation or an other type of international cooperation. To learn how it is in Poland the question was asked, "How was contact made between the foreign parent company and the target company/government agency?"

First of all the majority of interviewed companies mentioned that they had no formal contacts with the acquired company. They either were invited by the state agency to take a part in the tender or in a direct sale, or the firm was discovered by the representatives of Polish management group.

Only 9 of the 28 firms say that they had previous formal contacts; in most cases they are joint export or import activities. In four cases the licenses to the Polish company were sold, in two cases the foreign company subcontracted production to the Polish company, and in two cases they entered into other types of contractual agreements (see Table 17). The correlation analysis shows that larger firms are involved in contractual or sub-contractual cooperation while smaller firms, in turn, are involved in export and import relationships.

Pre-acquisition activities

Both sides, foreign and Polish, participate in a negotiation process and each of them conducts pre-acquisition studies.

NO		YES	
19	71%	9	29%
If YES, what type of business cooperation?			
		# answers	%
(1) exports/imports		7	83.3
(2) licensing		4	50.0
(3) subcontracting		2	33.3
(4) other types of contractual cooperation		2	33.3
(5) joint venture		0	0.0
CORRELATIONS:			
* with sales ($r=.9909$ Sig. 001) & with employment ($r=.8337$ Sig. 001)			

The foreign parent company, in almost all cases, conducts industry feasibility studies, market research, and a legal audit of the targeted company. In two-thirds of the cases financial audit, asset valuation and business valuation are made. For foreign firms the general analysis of the industry as well as the legal status of the company are more important than the financial aspects. The foreign investors probably do not trust the assets valuation methods used in the country and prefer physical over a financial evaluation. In marginal cases an environmental audit and overstaffing analysis are made (see Table 18).

Business valuations are made by companies with higher sales, restructuring costs assessment and overstaffing analysis are made in firms with a higher number of employees. Apparently, overstaffing is a problem from the beginning, and foreign firms make an analysis of the costs of employment reduction.

Activities	YES	NO	%
a/ feasibility study of the industry	27	1	96.4
b/ market research	27	1	96.4
c/ legal audit of the target company	27	1	96.4
d/ financial audit of the target company	21	7	73.9
e/ asset valuation	19	9	73.9
f/ business valuation*	16	12	52.3
g/ environmental audit	9	19	34.8
h/ restructuring costs assessment**	15	13	52.2
i/ analysis of overstaffing***	10	14	38.1

CORRELATIONS:
 * with employment ($r=.6200$ Sig. 01)
 ** with employment ($r=.6200$ Sig. 01)
 *** with sales ($r=.6014$ Sig. 01)

The Polish State Agency and management of local companies, in turn, put more emphasis on the financial aspect of firm's evaluation. Business valuation is used in 93% of the cases, the financial review in 89% of the cases, and asset valuation in more than two-thirds of the cases. Marginal situations instigate operational restructuring (13%), working capital financing analysis (21.7%) or sale of non-business assets (26.1%). The Agency assumes that new owners will take a care of these restructuring activities. Debt restructuring (see Table 19) is conducted in 42.8 percent of the cases.

Activities	YES	NO	%
a/ financial review of the target company*	25	3	89.2
b/ asset valuation	19	9	67.8
c/ business valuation**	26	2	92.8
d/ initiating a competitive bidding process	10	18	34.8
e/ working capital financing	6	22	21.7
f/ debt restructuring***	12	16	43.5
g/ operational restructuring	4	24	13.0
h/ reduction of overstaffing****	12	16	43.5
i/ sale of non-business assets	7	21	26.1

CORRELATIONS:
 * with sales ($r=-.9550$ Sig. 001)
 ** with sales ($r=-.9550$ Sig. 001)
 *** with employment ($r=-.5605$ Sig. 01)
 **** with employment ($r=-.5605$ Sig. 01)

The correlation analysis shows an opposite relationship between the size of the firms and the financial review or business valuation of the targeted company. The same is true in case of debt restructuring and overstaffing reduction. In other words, the higher the annual sales, the lower the State Agency's and management's willingness to conduct financial reviews and business valuations of the companies prepared for sale. High sales is perhaps for sellers the best indicator of the company's viability and worth.

The same is true in the case of debt restructuring and overstaffing reduction. The larger the employment of the firm in question, the less frequently debt restructuring and employment reduction are made. Apparently, the political strength of a company being the result of large employment, discourages government and management from any restructuring activities.

ACQUISITION

Acquisition is the process of a company's sales, it is the privatization process *per se*. Two aspects are worth discussion: the bidding procedure and incentives offered by the Polish state.

Major elements of acquisition

The bidding procedure assumes transparency, participation of consultants on both sides, and discussion on key elements of the acquisition transaction. Bidding is usually a lengthy process where sellers and buyers try to set a price and establish acceptable sales and purchasing conditions for both sides.

The analysis of responses (see Table 20) indicates that in both the negotiation process and the agreement closing, a key role is played by the management boards of the Polish company. The boards choose the foreign investor, set the price and discuss the basic elements of the acquisition transaction. The legal and financial consultants hired by the government agency play secondary role. Paradoxically, the role of the government, although still important, is less that of management and consultants.

According to the foreign negotiators, the procedure of competitive bidding where few bidders participate is used only in one-thirds of all transactions. Also in one-thirds of the transactions this bidding procedure is transparent. It seems that the managements of targeted companies, practically by using subjective methods for foreign partners evaluation, select partners which, for some reason, appear to be for them most appropriate. What type of reasons are there?

Activities	YES	NO	%
a/ transparent bidding procedure	11	17	39.2
b/ competitive bidding	11	17	39.2
c/ management of the target company was important in negotiations	25	3	89.2
d/ hired consultants were important in negotiations	22	6	78.5
e/ government agency was important in deciding on key elements of the acquisition transaction	18	10	64.3
f/ management of the target company was important in deciding on key elements of the acquisition transaction	21	7	75.0

The results provided in Table 21 say that the most frequently applied and most important argument used to accept a foreign partner is investment commitment, in other words the promise made by foreign investor to make additional investment after the company is purchased (2.57). This investment would be made during the next one to five years. In second place is the price offered by the foreign investor followed by an employment promise to the existing management (1.96). Employment commitment to company's crew appears to be the least important factor (1.71).

Again the firm's development *de facto* appears to be more important than the price offered and the promise to keep employment unchanged. This contributes to the unambiguity and subjectivity of the applied bidding procedures. In practice, the management decides who should be a foreign partner. Furthermore, the management believes that investment commitment will bring in future additional capital which will remain in the company, and will

be not paid to the State Budget. It is a trade off process between the purchasing price which increases revenues to the budget and additional investment which increases the equity of the acquired company.

Table 21. Assess the importance of the following factors in making the foreign parent company the winner				
Factors	Importance			
	unimportant (1)	important (2)	v.important (3)	Average
a/ higher purchasing price offered	9	11	8	1.96
b/ employment commitments	13	10	5	1.71
c/ investment commitments	6	0	22	2.57
d/ employment promise to the existing management of the target company*	16	0	12	1.86
CORRELATIONS: * with sales (r=.7334 Sig. .001)				

The experience of other countries and other firms shows that the investment commitments are very often not kept, and the State Agency is not in a position to execute them. In this case the loss is twice as much: the losers are the State Budget and the company itself.

The correlation analysis shows a paradox that the larger the company, the less frequently employment security is offered to the existing management. This is due to the fact that the bidding procedure in large companies is initiated and controlled by the State Agency which is more interested in price level, budget revenues or in employment security than in promising employment for the existing management.

Incentives offered to the foreign parent company by the government agency

To accelerate economic reforms, Eastern Europe is expecting foreign aid and private foreign investment. In the past the governments of these countries tended to believe in a pure market system and to assume that once they allowed foreign investment in their countries, western companies would rush in. As experience shows, it was a misconception. There is tough competition for foreign investment from other areas around the world. Many West European and Asian countries as well as depressed regions in Canada and the United States offer very attractive incentives to future investors. These incentives are tax holidays, free land, subsidies to pay interest on loans, funds to retrain people and to do research, start-up expenses, etc. Polish legislation until July 14, 1991, was generous and provided up to six years of tax holidays. This provision was changed in the new 1991 law. According to the new law, the Minister of Finance may grant a company up to three years tax holiday contingent on a few requirements: the capital invested has to exceed 2 million ECUs and the activity of the company has to be conducted in regions of high unemployment. Additionally, the new investment should ensure the introduction of new technologies and enable sales of goods and services for export equaling at least 20 percent of total sales value (Doing; Guide). There are legal provisions. What is the reality?

The comparison of survey results presented in Table 22 shows that tax incentives are still the most important incentive offered by the Polish government (64.3%). Next comes profit repatriation guaranties (53.5%) followed by guaranties of indemnification for hidden liabilities and the promise in the help in resolution of overstaffing problems. The Polish State

privatization agencies do not offer such incentives as reduction of purchasing price, subsidies from government funds, provision of infrastructure facilities, etc.

Activities	YES	NO	%
a/ tax incentives	18	10	64.3
b/ reduction of purchasing price	0	28	0.0
c/ loans/subsidies from government funds	0	28	0.0
d/ guarantees of introducing tariffs for competitive imports	0	28	0.0
e/ profit repatriation guarantees	15	12	53.5
f/ guarantees of indemnification for hidden liabilities	12	16	34.8
g/ guarantees of indemnification for hidden ecological damages	0	28	0.0
h/ provision of infrastructure facilities	0	28	0.0
i/ preliminary resolution/subsidies for the resolution of overstaffing problem	7	21	21.7

(a) insignificant	12	42.9
(b) important	3	10.7
(c) very important	13	46.4
CORRELATIONS:		
* with employment (r=.6993 Sig. 001)		

The incentives given by the Polish State Agency in 46.4 percent appear to be very important, in 10.7 percent important, and in 42.9 percent as insignificant. These incentives appear to be important in larger companies traded by the State Agency and insignificant in smaller firms sold through the firm's management (r=.6993).

Guarantees	YES	NO	%
a/ employment guarantees	8	20	21.7
b/ best effort employment promise	8	20	21.7
c/ future investment guarantees	22	6	82.6
d/ best effort investment promise	16	12	56.5
e/ employment promise to the existing management of the target company	15	13	47.8

The foreign investors were also asked what promises they gave to the Polish negotiation partners. They admitted that, generally speaking, they accepted the conditions required by the Polish side. Future investment guarantees are given in 78.6 percent of cases and best effort investment promises in 57.1 percent of the cases. These two promises are closely followed by an employment promise to the existing management. Employment guarantees or best effort employment promises are given in a little more than one fifth of the cases (21.7%).

The findings from the foreign side confirmed the findings from the Polish side. Investment commitments are the most important, employment promises to the firm's crew, the least. Foreign investors in half of the cases stress that they promised employment contracts to the firm's management. Maybe this is an additional invisible price they have to pay for the firm's acquisition.

Negotiators

Who is instrumental in conducting negotiations and closing contracts? The analysis of responses shows the dominant role of the management boards of SOEs of JSCs, (78.6 percent of the cases). Next is the government agency which is mentioned in seven cases (25%). There is no doubt that in three-fourth of the cases, the leading role is played by the company's management and in one-fourth of the cases by the State Agency. The role of worker's councils and supervisory boards is more than marginal. Hired consultants, although instrumental in setting a contract, do not have any influence on the process of a company's sale.

The correlation analysis confirms the earlier findings that the targeted company's management plays a decisive role in small firms' acquisition, the State Agency in the case of large firms ($r=.9561$ and $r=.6528$).

Table 25. On the host country side, whose role was more important/decisive in negotiations and deciding on key elements of the contract?		
(a) target company's management	22	78.3
(b) government agency	7	21.7
(c) hired consultants	0	0.0
(d) worker's council	2	7.1
(e) supervisory board	1	3.6
Total	28	100.0
CORRELATIONS:		
* with sales ($r=.9561$ Sig. 001) & employment ($r=.6528$ Sig. 001)		

Disagreements between the target company's management and the State Agency are present only marginally in one-fourth of the cases, and only in cases of large firms where the State Agency plays a leading role in negotiations and decision making on the financial shape of a contract ($r=.6981$). (See Table 26)

Table 26. Were there any disagreements between target company's management and government agency regarding the final decision on key elements of acquisition transaction?		
NO	21	75.0
YES	7	25.0
CORRELATIONS:		
* with employment ($r=.6981$ Sig. 001)		

Summing up, the dominant role in acquisition is played by the company's management. The management, using ambiguous bidding procedures and subjective evaluation methods tend to eliminate these foreign partners which offer higher prices and selects these investors who give promises to make higher investments in the future. This fact has an impact on the priorities included in the contract where developmental factors and investment in the future are more important than the social factors of employment commitments to the employees. An exception, however, exists. The company's management is usually successful in securing its own position in the future management boards. The trade off process is clearly visible: contract and future management employment or nothing. Everywhere, the State Agency is instrumental in negotiations, the promise of future management employment is absent, but at the same time disagreements between the target company's management and the State Agency are present. Everywhere, the management board plays a dominant role in negotiations, the same management remains in fact in the new company. In these cases the social aspect of a promise of employment for employees, although stressed by official declarations, plays a marginal role.

POST-ACQUISITION

The acquisition of the local company not only changes its formal status but also starts a new period of the firm's adaptation to market conditions. Foreign direct investment is closely related to expectations that the foreign parent brings new technology, new management techniques, new accounting standards, and new organizational culture. This part of the report discusses on to what degree all expectations on both sides are fulfilled, what type of post-acquisition changes are introduced, what plans are made to expand the existing company, and what type of R&D cooperation is apparent?

Post-acquisition changes introduced by the foreign parent company

Table 27 presents the changes introduced by the foreign company after acquisition.

Table 27. What changes, restructuring operations have been undertaken by the foreign parent company after the acquisition?			
Activities	YES	NO	%
a/ financial consolidation	15	13	53.6
b/ selling of non-business or non-core-business assets/parts of the company	4	24	14.3
c/ reduction of overstaffing*	6	22	21.4
d/ reorganization of management	13	15	46.4
e/ replacing members of the management	6	22	21.4
f/ training of management	19	9	67.9
g/ introduction of new programs	24	4	85.7
h/ reorganization of marketing activities	27	1	96.4
i/ reorganization of supply activities	10	18	35.7
CORRELATIONS:			
* with sales ($r=.7383$ Sig. 001) & employment ($r=.5171$ Sig. 01)			

There is no doubt that changes introduced by the new management have in most cases a cosmetic character. In all cases the reorganization of marketing activities has taken place, followed by the introduction of new production programs. In two thirds of the cases also, the training of management is conducted. In half of the cases, financial consolidation as well as reorganization of management boards (without exchanging board members) is executed. Only in less than in one-fourth of the companies the inviable parts of the businesses are sold, or part of employment is reduced. The last occurs only in a big firms ($r=.7383$). The new management goes the easy way by postponing unpopular and complicated decisions. Also, only in six of the 28 cases the members of management boards were replaced. The new companies, with small exceptions, are continuing the old practices, old organizational culture, and old production programs.

Operational aspects of the acquired company

The new companies are, in the majority of cases, independent, autonomous units, not integrated with the foreign parent companies. They have independent legal status, and their accounting system is not consolidated with the foreign system. Only in six cases, and only in large companies measured by annual sales ($r=.6199$) the Polish subsidiary is integrated with the international network of its parent company's activities (see table 28).

Table 28. Is the acquired local company		
(a) a stand alone entity, not integrated into foreign parent company's activities	22	78.8
(b) an integral part of foreign parent company's (international) network of activities	6	21.4
CORRELATIONS: * with sales (r=.6199 Sig. 01)		

Also in case of the large companies, the Polish subsidiary produces the same goods as the foreign parent company (See table 29).

Table 29. Does the acquired local company produce the same goods as the foreign parent company?		
NO	10	35.1
YES	18	64.3

The similarity of goods is lower than the share of independent companies. This means that of 22 the independent units, twelve of them (55%) are producing different goods or providing different services than the parent foreign companies. In this case it is hard to speak about technology or know-how transfer between foreign companies and their Polish companies. This is purely a capital investment in most cases in unrelated businesses in an attempt to increase risk diversification.

Table 30. Have the results of the acquired company's operations met the objectives/expectations?		
A. Of the government agency		
(a) yes, fully	4	14.3
(b) only partially	2	7.1
(c) not at all	0	0.0
(d) too early to evaluate	22	78.6
B. Of the acquired company/its management		
(a) yes, fully	13	46.4
(b) only partially	9	32.2
(c) not at all	0	0.0
(d) too early to evaluate	6	21.4
C. Of foreign parent company:		
(a) yes, fully	7	25.0
(b) only partially	14	50.0
(c) not at all	0	0.0
(d) too early to evaluate	7	25.0

Table 30 attempts a first assessment of foreign acquisition. The main players were asked if the creation of the new company fulfills their objective and expectations.

In three main players the management boards seem to be the most satisfied with acquisitions (13 of 28). Next are the foreign parent companies, whose respondents stressed, however, that acquisition met their objectives "only partially." The State Agency in 22 of 28 cases (78.6%) mentioned that it is too early to evaluate the results of acquisition.

In all management driven privatization processes through foreign acquisitions, the managers are the group which is the most satisfied with establishment of new company.

Moreover, no one of the main players mentions that the results do "not at all" meet their objectives.

In 26 of 28 cases (93%), the foreign companies express their further interest in expanding acquired Polish companies (see table 31). This is the best indicator of the optimism which prevails among those investors who acquired Polish companies and responded to the survey.

YES	26	92.9
NO	2	7.1

Balance of payments aspects

When asked about the world market, 22 firms of 28 (78.6%) provided an answer on a question concerning export activities. Half of these 22 firms mention that their production is destined for export, and half said that they focus on the domestic market. The correlation shows a negative relationship between the size of the firms measured by the number of employees and the share of production for foreign market ($r=-.8522$). Smaller firms are more export oriented than larger firms. The larger firms seem to regard the Polish domestic market as their target market.

1. What percentage of the acquired local company's production/total sales is destined for exports?*	50.0%
2. What is the regional structure (in %) of the acquired local company's exports? (a) Developed countries** (b) CEE countries*** (c) Others	63% 30% 7%
Total	100.0%
3. What percentage of the acquired local company's exports is accounted for by foreign parent company itself****	68%
4. What percentage of the acquired local company's input is imported?*****	51%
5. What percentage of the acquired local company's imports is supplied by foreign parent company itself?*****	41%
CORRELATIONS: * with sales ($r=-.8522$ Sig. 01) & employment ($r=-.8271$ Sig. 01) ** with employment ($r=-.8911$ Sig. 01) *** with sales ($r=.7559$ Sig. 01) & employment ($r=.8522$ Sig. 01) **** with sales ($r=.9213$ Sig. 001) and employment ($r=.7599$ Sig. 01) ***** with sales ($r=.8522$ Sig. 01) ***** with employment ($r=.8911$ Sig. 01)	

What are directions of this export? The survey shows that 63 percent of the firms export their goods to highly developed countries, 30% to the CEE countries and only 7 percent (one firms) to other countries. Two opposite tendencies are clearly visible. A negative correlation exists between the firm's size and their export to developed countries (in the case of employment $r=-.8911$, sales $r=-.8522$) and a positive correlation exists between size and the firms' involvement in the CEE market ($r=.7559$ and $r=.8522$ respectively).

This surprising result shows that large companies acquire the Polish firm to enter the Polish or CEE market. Only small companies are interested in re-exporting their products to Western markets. This is confirmed by the responses on the next three questions: what

percentage of acquired local company's exports is accounted by the foreign company itself (with sales $r=.9213$; and with employment $r=.7599$); what percentage of the acquired company input is imported (with sales $r=.8522$) and what percentage of the acquired local company's imports is supplied by the foreign company itself (with employment $r=.8911$). The larger companies tend to regard the export of Polish firms as their own and regard their Polish subsidiaries as assembly places for final products from parts provided by parent company.

Technological and research and development aspects

In most cases (89.3% of all responses) the acquired Polish companies are technologically backward in comparison to those in Western countries. The production in Poland, in comparison to production in the foreign parent company, is more labor intensive (89.3% responses), or capital intensive (21.4%). In only three of 28 firms (10.7%) the respondents state that the production process is more or less identical (See Table 33)

The expectation that foreign parent company will bring new technology or new know-how prevailed. To what degree are these expectations met?

1. Production process in the acquired local company is, comparing to the production process in the foreign parent company plant is			
(a) more or less identical		3	10.7%
(b) more labor intensive		25	89.3%
(c) more capital intensive		6	21.4%
(d) the question is not relevant		0	0.0%
2. Did the foreign parent company transfer its technology/know-how to the acquired local company?		NO	3
		YES	25
If YES, in what form?			
(a) machinery/equipment			20
(b) industrial property rights/know-how and similar			23
3. Has the transferred technology/product been in any way adapted for the needs of the acquired local company?		NO	7
		YES	20
4. Has the acquired local company itself made (or intends to make) any improvements/developments on the transferred technology/product?		NO	8
		YES	20
5. Is there (or is intended to be) any direct cooperation between the foreign parent company and the acquired local company in the R&D area?		NO	7
		YES	21
If YES, what is the type of this cooperation?			
(a) exchange of literature and other information			7
(b) regular exchange of research results			17
(c) regular exchange of experts			17
(d) <i>ad hoc</i> exchange of experts			7
(e) joint research by foreign parent company and the acquired local company			12

The survey shows that in all cases where technological superiority of foreign firms is evident, the foreign firms plan to transfer their technology to the Polish firm. In 23 of 25 firms (82.1%) this transfer is in the form of industrial property rights, and in 20 of 25 cases (71.4%) in the form of machinery and equipment. Additionally other transfers occur: training of management and employees, manufacturing and marketing know how, the computerization of the firm, transfer of organizational and managerial know-how, etc.

In 21 of 28 cases (75%) this new technology or know-how is adopted. In 20 out of 28 cases (71.4%) the acquired company intends or already has made their own improvements in received technologies, or they have developed products to adapt them to firm's conditions or

Polish markets. In most cases (75%) close direct cooperation is intended between the foreign company and its Polish subsidiary.

What type of cooperation is it?

In 17 of 21 cases this cooperation takes the form of a regular exchange of research results and a regular exchange of experts. In 12 of 21 cases (57.1%) it takes a form of joint research. In one-thirds of the cases an exchange of literature and an *ad hoc* exchange of experts takes place.

RECOMMENDATIONS

The respondents were asked the question: How can the restructuring and development impact of foreign acquisitions on the acquired companies and host country to be improved? They were particularly asked to define the three most important host country measures or instruments which could improve the restructuring and development impact of foreign acquisitions on the acquired company/host country.

Respondents gave these measures as most important:

- to stabilize the functioning of the Polish economy especially in the area of tax policy and business law,
- to stop inflation and the devaluation of zloty, because the high cost of credit hinders investment policy,
- because of the negative attitude of state and local authorities to the companies with foreign capital, to secure a clear governmental declaration concerning foreign investment with consistent fulfillment of these declarations,
- to improve financial terms and conditions of business activities in Poland, and to improve the operation of the Polish banking system,
- to stabilize the government's tariff policy,
- to introduce a coherent and reliable insurance system inclusive of credit insurance,
- to remove the constraints on the acquisition of real estate by non-Polish entities, a grave impediments which discourages the inflow of foreign capital to various areas, agriculture included. This legislation, dating back to 1920 must be revised for various reasons including Poland's pursuit of European Union membership.
- to revise current foreign exchange legislation to facilitate borrowing from foreign lenders and to allow foreign businesses to make time deposits with Polish banks.
- to modify the existing system of licenses and permits for establishing production. These instruments can be justifiably applied to protect domestic producers, but have to be used in a best, carefully considered manner.
- to introduce simplified investment procedures allowing acquisition of only interesting parts of the company and to lower purchasing price,
- to allow the gradual reduction of the number of employees
- to lower the tax burden, through elimination of the impact of inflation on the price of assets and the level of income,

- to introduce a legal disclaimer from future ownership claims from possible previous owners,
- to lower the influence of trade unions
- to undertake actions to change public opinion about joint stock companies with foreign capital in Poland,
- to bring additional capital influx,
- to encourage the further transfer of production and technology.

CONCLUSIONS

The survey clearly divides all enterprises into large firms and small firms and displays basic differences in their business behavior.

Large firms

The privatization of large firms is State Agency driven. The Ministry of Privatization or the Foreign Investment Agency (before July 14, 1991) announces the bid, selects the foreign partner, leads all stages of negotiations with a heavy use of consultants, controls bidding procedures and closes the contract. All stages are completed in the framework of the so called sectoral approach to privatization. To be privatized, large companies have to be in one of the 36 sectors of Poland's economy designated for sectoral privatization.

The State Agency offers some incentives to these large firms. The most frequently used incentives are tax holidays; others, like higher import tariff for products produced by the new company or retraining programs for laid off employees are used less frequently and only in the case of very prestigious firms.

The State Agency in the negotiations process takes into account macro-social aspects such as employment security for employees, the revenues to the state budget, integration of the Polish economy into the world economy, etc. The interests of the acquired company's management in securing their position or increasing their management skills is taken into account to a lower degree.

A foreign company before entering the Polish market, has had long contact with the Polish company. These contacts are usually contracting or subcontracting activities. In spite of that, the foreign company conducts a feasibility study, conducts a business valuation, conducts a restructuring cost assessment and analysis of overstaffing, and commits itself to future investments. The first action usually undertaken by the foreign firm is overstaffing reduction.

From the foreign company's perspective, the Polish subsidiary, should be an integral part of the foreign parent company with production focused exclusively on the Polish or the Central and Eastern European market. The Polish subsidiary should be a place where assembly of the final products from the parts provided by the parent company is made.

Table 34. Characteristics of the acquisition process by large and small firms		
Characteristics	Large firms	Small firms
Annual sales	More than \$20 million	Less than \$20 million
Equity	More than \$3 million	Less than \$3 million
Employment	More than 200	Less than 200
Polish negotiators	The State Agency	Firm's management
Dominant strategy	Market seeking FDI	Efficiency seeking FDI
Dominant motives on the foreign side	- to get access to the market	- to create expansion base to the CEE firms
Dominant motives on the Polish side	- to collect high purchasing price - integration with world market - to preserve employment	- to increase management skills - to get access to new resources
Types of contacts before acquisition	- subcontracting - contractual cooperation	- exports/imports - licensing
Pre-acquisition activities of foreign firm	- business valuation - restructuring cost assessment - legal audit - analysis of over-staffing	- feasibility study - market research
Pre-acquisition activities of the State Agency	- asset evaluation - initiating competitive bidding process	- financial review - business valuation - debt restructuring - staff reduction
Promises given by foreign company	- investment commitments	- employment promise to existing management
Incentives given by the State Agency	- tax incentives	
Post-acquisition changes	- reduction of over-staffing	- financial consolidation - training of management
Polish company is	- an integral part of foreign parent firm	- a stand alone entity
International activity of new company	- focus on Polish market - export to the CEE countries of goods assembled from parts provided by foreign parent company	- export - export to the Western countries

Small firms.

Small firm privatization is usually management driven. The firm's management conducts all stages of the acquisition process. The management also tends to regard their own interest as more important than the macro-social aspects of privatization. They seek foreign investment to gain access to new resources, to increase their management skills, to secure long term development of the firms. They also, as a rule, expect they will secure their management positions in the new firms, which usually happens.

The State Agency, however, keeps an eye on the acquisition process. To increase their own control, it orders financial review, business valuation, debt restructuring, and reduction of overstaffing, which usually is not required in the cases of large firms.

After acquisition, the new company is usually financially consolidated, training of management is performed, and the marketing area is restructured.

From the foreign parent company's perspective the acquisition is made to increase the firm's efficiency. It regards the Polish subsidiary as a stand alone entity with much autonomy

and independence. In most cases, this unit produces different goods or provides different services from the parent company.

To close a deal, the foreign company is forced to find consensus with the Polish firm's management. To secure employment for this management is an additional price that a foreign company has to pay to acquire the Polish firm.

There is no doubt than in the case of small firms, the real winner is management. The management is usually the player in this privatization game, who is the most satisfied with foreign acquisition.

CONCLUSIONS, PROBLEMS AND RECOMMENDATIONS

Władysław W. Jermakowicz

CONCLUSIONS

The impact of FDI on the Poland's economy is not impressive. The goal of attracting substantial foreign capital has not been achieved. The \$2.8 billion investment in Poland constitutes approximately 14 percent of all the investment made in Eastern and Central Europe and only .2 percent of worldwide investment inflows (Jermakowicz, Bellas 1994).

The second goal of accelerating the privatization process in Poland has not been achieved. Approximately \$1,189.9 million of FDI in privatized Polish companies represents through June 1993 only 41.1 percent of all the invested capital and only 1.67 percent of the state-owned equity as valued in 1989 (Jermakowicz 1994). There is no doubt that the internationalization of Polish enterprises has been a very weak contributor to Poland's economic structure and activity.

The third goal, the introduction of modern technologies and management practices has been only partially achieved and only in case of large firms. Large firms' investment in key industries seems to have contributed to Poland's economic recovery. This recovery was fostered by the increase in domestic automobile production fuelled by foreign investment in the automobile industry (by Fiat and GMC). Likewise in brewing - the best performing subsector of the Polish economy -- most of the main breweries are owned by foreign companies (World 1994). Another important contribution of large transnational firms is the transfer of modern technology and management practices to Polish affiliates and Polish supplier firms. In case of International Paper, a series of technology transfer contracts were signed between its headquarter and its Polish subsidiary in Kwidzyń. Furthermore, human resource developments and local labor-force training to help in the acceptance of Western quality standards in both manufacturing and services industries are in fact, a common impact of FDI in Poland. For example, Fiat undertakes training of all employees in specially designed schools ("Automotive 1994). Also, Citibank spends \$400 thousand on training each year (Bobiński 1994). Moreover, the transfer of many soft technologies has been complemented by the provision of "unique" services that used to be unavailable (or unknown) in Poland (Lipsej, Zimny 1994). As Kubiela (1994) points, foreign investors chose as investment targets rather industries qualified as technology (or capital) -intensive and human-capital intensive and avoid traditional labor-intensive sectors. This may, be interpreted that Polish unqualified labor is rather expensive in relation to other possible host countries labor as measured by its relative productivity.

In the case of small firms the picture is poorer. As experts from the Polish Foreign Investment Agency note, most of the small foreign partners are trying to use already existing equipment (Spółki 1990). They are using different forms of equipment and machinery leases and returning stock payments as shareholders' dividends to their partners. The capital stock of these companies is kept artificially low.

The fourth goal of integrating the local markets with European markets was also achieved only partially. In case of large firms the picture is rather positive. The large multinational firms from Western Europe especially have helped establish new trade linkages between Central and Eastern Europe on the one hand, and the European Union on the other, sometimes in the framework of regional core network strategies. For example, Asea Brown

Boveri's affiliate in Poland now provides electrical engines on a globally integrated basis (Robinson 1994). As a result, the share of foreign affiliates in foreign trade appears to be quite high. Foreign affiliates accounted for 10 percent of total exports and 12 percent of imports. To the extent that trade plays an important role in promoting growth and facilitating the adjustment process, it appears that the role of large corporations has been somewhat larger than what other indicators suggests regarding the importance of FDI in Poland.

In the case of FDI from small firms the picture is again rather negative. The small firms have not fulfilled the expectations of strengthening ties with EU markets. The share of the total sale of goods and services accounted by small FDI enterprises is approximately 10 percent. More than 40% of the small firms with foreign participation are focusing on trade while most of the others are involved in simple food processing, textile production, and commodities.

Overall, the FDI in Poland has been fairly small and uneven. But part of this unevenness has been that FDI has been relatively important in a number of industries, and areas that are central to the resumption of growth and the transition process.

PROBLEMS

Despite the significant acceleration of foreign investment during 1992, Poland is still behind other Central European countries in terms of the relative size of foreign investments and the role of foreign capital. In the SOEs, the privatization process, as stated before, is still marginal.

Several major flaws contributed to these results.¹⁴

In the last five years three government institutions have been responsible for supervision, structure, registration, and assistance to foreign investment in Polish privatization. Until June 14, 1994, it was the Foreign Investment Agency (FIA), that monitored and controlled functions, set guidelines, and led the registration process for all new joint ventures and acquisitions. After June 14, 1994, and the imposition of the new Law on Companies with Foreign Shareholdings (Law 1991), the Foreign Investment Agency was transformed into a politically independent joint stock company, the so-called State Foreign Investment Agency, with no political power or authority. Its role to promote foreign investment in privatization, and to ensure that greenfield projects and private joint ventures are not neglected. The Ministry of Privatization took over role of the political body responsible for setting guidelines, approving privatization through FDI programs, and selling state-owned companies to foreign investors. As a result of these changes there is no state agency in Poland clearly responsible for foreign direct investment. The Ministry of Privatization, as a part of the state administration, is burdened with various privatization tasks, and this Ministry does not have the resources, know-how, or motivation to focus on promoting and attracting foreign investors. The State Agency for Foreign Investment functions as a strategic advisor to the foreign investors during negotiations with the Polish partners. The Agency, according to its President Marek Górski, is not responsible for foreign investment policy and is not involved in the sale of Polish enterprises. The Agency plays only an advisory function (Bochniarz, Jermakowicz, Meller 1994). As an effect there is no state

¹⁴ According to the Foreign Investment Agency, the main reasons for the reluctance of foreign business entities to invest in Poland are the unstable law and taxes (91% response), social unrest (71% response), high investment risk (76%), strong labor unions (76%), slow pace of Polish reforms (51%), excessive employees' wage claims (38%), technological backwardness of the country (32%) (Zyba³a 1993).

agency in Poland which is responsible for promotional activities, or for technical and financial support for foreign companies. Formally, two institutions are responsible, but no one institution really fulfills its objectives.

Second, a high level of legal instability and uncertainty created frequent, somewhat chaotic changes and delays in legislation. The first example was an eight month delay in passing the basic privatization law which cannot be justified by the initial macroeconomic imbalance or the need to focus on the stabilization program (Bossak et al. 1992). The second example was a delay in the passing of a legislative framework for a mass privatization program. Originally, it had been expected that this law would be passed at the end of 1991. It was rejected by the Sejm on March 18, 1993, and again passed by the Polish Diet three months later. Other examples are the restrictive land legislation, the very late liberalization of the foreign investment law (only in the second half of 1991), the nationalization of casinos in spring 1992, or the delaying of liberalization of the insurance market for foreign firms until 1999. All these decisions were based on anti-foreign sentiments, especially among the peasants' and nationalistic parties.

Third, Poland is still a country with high Country Risk Rating. According to Euromoney (September 1989) Poland's rating was 38.0 (1989), and 43.0 (1990), and Poland occupied the 75th and 74th position respectively among 133 countries. During the last five years five governments ruled the country and seven prime-ministers were nominated. Only "Solidarność," one of the few labor unions registered in Poland called more than 1000 strikes in this period. From October 1991 to May 1992 some 186 of called strikes or protest actions were "wild" or illegal. The bureaucracy is still very strong. The foreign investor starting his enterprise has to conform to 830 norms (598 state and 232 branch) and is expected to submit opinions from 29 administrative units in 47 different areas during the preliminary project analysis (Zybała 1993).

RECOMMENDATIONS

What can be done to increase the amount and economic impact of FDI in the Polish economy? First of all, a strong Foreign Investment Agency should be established. This Agency should be financially and administratively autonomous but backed by the government and operate on the "one-stop shop" principle, enabling the foreign investor to arrange everything related to its investments in one institution.

The new FIA should become more active in searching for potential foreign investors. They should especially be sought in the neighboring developed countries which are Poland's major foreign trading partners familiar with the local situation and able to appropriately assess risk. Companies which already have done business in the host country are good prospects. These investors should be attracted by the geographical location, skilled labor, and easy access to natural resources. There is little likelihood of attracting investors from Japan or South Korea. They tend to skip the "main course" and arrive for "dessert."

The new Foreign Investment Agency should develop different policies toward different types of investors. The incentives should be given only to *large* investors pursuing *Type II investment* strategy. In this case FIA should institute more interventionist policies, offering widely-accepted incentives such as tax holidays, tax reductions, interest subsidies, R&D training grants, and developed plant sites (Schriber 1992).

Promotion should be concentrated on predefined priority areas. The first step should be to identify key technologies and target sectors to be attracted through inward FDI. The crucial

issue in the selection of target sectors is that they should represent the synergy between foreign investor's wishes and what the host country can offer in those sectors/products.¹⁵ In the second step the State Agency should identify target markets, those home countries in which to direct major efforts to attract foreign investors. Target markets are to an important degree already defined by the selection of target sector/products. For instance, selection of microelectronics as a target sector definitely will lead to the USA and Japan, the automobile industry to Germany and Japan, and the chemical industry to Germany as target market.

To achieve this goal the Foreign Investment Agency should establish offices in selected West European countries and establish direct personal contacts with potential foreign investors. The only task of these offices is to promote the Polish FDI program. To realize this goal they should identify target companies/products and decision makers who should be persuaded to invest in Poland. They should strengthen the business image of Poland, make presentations in individual companies, offer help in developing adequate investment proposals, ensure investment proposals, and keep already established and establish new contacts. For each individual target market or promotion campaign, the FIA must prepare a specific strategy and set of methods.

Finally, Poland needs to make major improvements in areas that are outside the scope of this paper. Clear, coherent legal systems are needed to afford full legal safety. The tax and tariff systems need to be reformed. Currencies must be stabilized. Financial markets must be organized and banking systems reorganized to help raise initial capital, improve external credit, and resolve the capacity for payment.

¹⁵ In Ireland key technologies and target products were defined by a range of selection criteria: a) export markets growth opportunities, b) low raw material import requirement, c) high value added, d) low volume (freight) e) skilled labor requirement in production, and e) utilization of Ireland's natural resources (Dunning, Rojec, 1993)

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APPENDIXES

Appendix 1. BASIC CHARACTERISTICS OF SURVEYED FIRMS

Error ! Reference source not found .FIRM	ANNUAL SALES	TOTAL EQUITY	FOR. EQUITY	FOREIGN SHARE	EMPLOYMENT	YEAR	OWNER-SHIP	CO.
1	15.00	0.12	0.12	100.0%	3	1990	SPROP	USA
2	10.00	9.00	4.50	50.0%	600	1993	JSC Ltd	DK
3	25.00	0.66	0.66	100.0%	32	1992	JSC Ltd	JAP
4	4.50	0.57	0.28	50.0%	74	1990	JSC Ltd	SWE
5	3.00	1.70	1.70	100.0%	40	1992	JSC Ltd	USA
6	50.00	5.00	3.80	76.0%	545	1990	JSC Ltd	SWI
7	4.50	1.70	1.70	100.0%	40	1990	JSC Ltd	USA
8	3.50	4.50	4.45	98.9%	38	1992	JSC	GB
9	3.57	1.43	1.15	80.4%	35	1992	JSC Ltd	GER
10	16.00	0.20	0.10	50.0%	6	1990	SPROP	USA
11	13.00	8.00	4.00	50.0%	600	1993	JSC Ltd	FRA
12	25.60	0.56	0.56	100.0%	32	1992	JSC Ltd	NDL
13	2.50	0.67	0.32	50.0%	74	1990	JSC Ltd	AUS
14	2.00	1.30	1.30	100.0%	40	1992	JSC Ltd	AUS
15	75.00	5.64	4.10	72.7%	634	1991	JSC Ltd	FRA
16	6.50	2.70	1.70	63.0%	40	1990	JSC Ltd	SWE
17	6.50	4.89	3.47	71.0%	35	1992	JSC	GB
18	3.70	1.20	1.20	100.0%	30	1991	JSC Ltd	GER
19	3.70	0.27	0.20	74.1%	36	1991	JSC Ltd	SWI
20	45.00	8.00	1.40	17.5%	340	1992	JSC	GER
21	37.00	4.20	3.36	80.0%	254	1991	JSC	GER
22	28.90	3.60	2.88	80.0%	450	1993	JSC	GER
23	21.20	2.80	2.80	100.0%	47	1991	JSC Ltd	GER
24	3.3	2.18	2.00	91.7%	280	1993	JSC Ltd	GER
25	4.4	0.3	0.15	50.0%	10	1989	JSC Ltd	SWI
26	5.4	18	17.5	97.2%	450	1993	JSC	GER
27	70.5	27.5	27.5	100.0%	948	1991	JSC Ltd	NDL
28	.	45	24	50.0%	700	1991	JSC	GB
Sum	489.2	161.5	118.1		6413			
Mean	17.47	5.77	4.22	73.1%	229			

Appendix 2. Profile of Foreign Companies (in Million US \$)

FIRM	ANNUAL SALES OF FOREIGN COMPANY	SHARE OF POLISH SALES	EMPLOYMENT OF FOREIGN COMPANY	% OF POLISH EMPLOYMENT
1	65	23.1%	77	3.90%
2	.		5000	12.00%
3	150000	0.0%	10000	0.32%
5	.		330	12.12%
6	150	33.3%	3150	17.30%
7	.		70	57.14%
8	7260	0.0%	3500	1.09%
9	.		88	39.77%
10	25	64.0%	77	7.79%
11	.		5000	12.00%
12	123000	0.0%	10000	0.32%
14	.		41	97.56%
15	160	46.9%	3200	19.81%
16	.		671	5.96%
17	8000	0.1%	4100	0.85%
18	.		74	40.54%
21			5430	4.68%
22			1546	29.11%
23	76	27.9%	471	9.98%
24	120	2.8%	650	43.08%
25	.		700	1.43%
26	533.8	1.0%	41300	1.09%
27	8434.21	0.8%		
28	47	0.0%	30000	2.33%
Total	297871		125475	
Aver.	21276.50	0.1%	5455	4.20%

Appendix 3. Countries in which Foreign Parent Company has Subsidiaries

FIRM	US	DK	GB	FRA	GER	SWI	NDL	NOR	CAN	JAP	SWE	AUS	OTHER	TOTAL
2		X	X	X	X	X	X	X	X					8
3	X	X	X	X	X	X	X	X	X	X	X	X	128	140
4	X	X	X	X	X	X	X				X	X		37
6		X	X	X	X	X	X	X	X				1	9
8	X	X	X	X	X	X	X	X	X	X	X	X		80
11		X	X	X	X	X	X	X	X					10
12	X	X	X	X	X	X	X	X	X	X	X	X	85	97
13	X	X	X	X	X	X	X	X			X	X	18	30
15		X	X	X	X	X	X	X						7
17	X	X	X	X	X	X	X	X	X	X	X	X	56	68
19	X	X	X	X	X	X								6
20			X	X		X					X		5	9
21					X							X		2
23	X	X	X											3
24													2	2
25	X	X	X	X	X	X	X	X	X	X	X	X		9
26	X	X	X	X	X	X	X	X	X	X	X	X	138	150
27		X	X	X	X	X	X	X					16	24
28	X	X	X	X	X	X	X	X	X	X	X	X		80
TOTAL	11	16	17	16	16	16	14	13	10	7	10	10	-	21

Appendix 4. Export-import activities of new company

FIRM	SALES DESIGNATED FOR EXPORT	EXPORT TO DEVELOPED COUNTRIES	EXPORT TO CEE COUNTRIES	EXPORT TO OTHERS	EXPORT ACCOUNTED BY FOREIGN COMPANY	IMPORTED INPUT	IMPORT SUPPLIED BY FOREIGN COMPANY
1	10%	90%	10%		100%	10%	2%
2	3%	10%	90%			1%	
3					100%	100%	100%
4	98%	95%	5%		40%		
5						80%	
6	30%	100%			60%	20%	30%
7						80%	
8	98%	95%	5%		40%		
9						80%	
10	10%	10%	90%		100%	10%	2%
11	3%	10%	90%			1%	
12					100%	100%	100%
13	98%	95%	5%		40%		
14						80%	
15	30%	100%			60%	20%	30%
16						80%	
17	98%	95%	5%		40%		
18						80%	
19	98%	95%	5%		40%		
20	20%	45%	30%	25%	30%	40%	10%
21	20%	60%	30%	10%	30%	40%	10%
22	40%	90%	10%		100%		2%
23	60%	30%	45%	25%	100%	20%	25%
24	100%	100%	0%		100%	90%	
25	95%	0%	70%	30%	70%	99%	80%
26	35%	35%	0%			10%	
27						55%	
28	5%	20%	80%			30%	100%
Mean	50%	63%	30%	7%	68%	51%	41%

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