cee d central & eastern europe development institute

Bulletin of Central and Eastern Europe

No

11

www.ceedinstitute.org

EMERGING MULTINATIONALS FROM THE CEE REGION: THE CASE OF POLISH OUTWARD INVESTORS[1]

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Poland has recently emerged as an important outward foreign investor among Central Eastern European countries. Polish firms are increasingly relying on their own foreign operations or acquiring foreign businesses as a means of fostering their international growth and improving their competitiveness. Their dynamic expansion has raised questions as to their motivations, locations, forms, and actual outcomes.

A rising phenomenon

Outward foreign direct investment (FDI) from Central Eastern Europe (CEE)[2] is a relatively recent phenomenon, which took off with the radical political changes in the region at the beginning of the 1990s. Following inflows of foreign capital into the region, which were frequently facilitated by widespread privatisation processes and played a significant role in the modernisation of local economies, domestic firms embarked on foreign expansion in its most advanced form, which is establishing own operations or acquiring foreign firms. However, while all CEE countries experienced surges of outward investment, this process was not equally dynamic in specific countries.[3] Poland, whose firms were initially less active abroad than those from Slovenia or Hungary, gradually emerged to the currently leading position as a source of outward investment from the CEE region (not including the Russian Federation).[4]

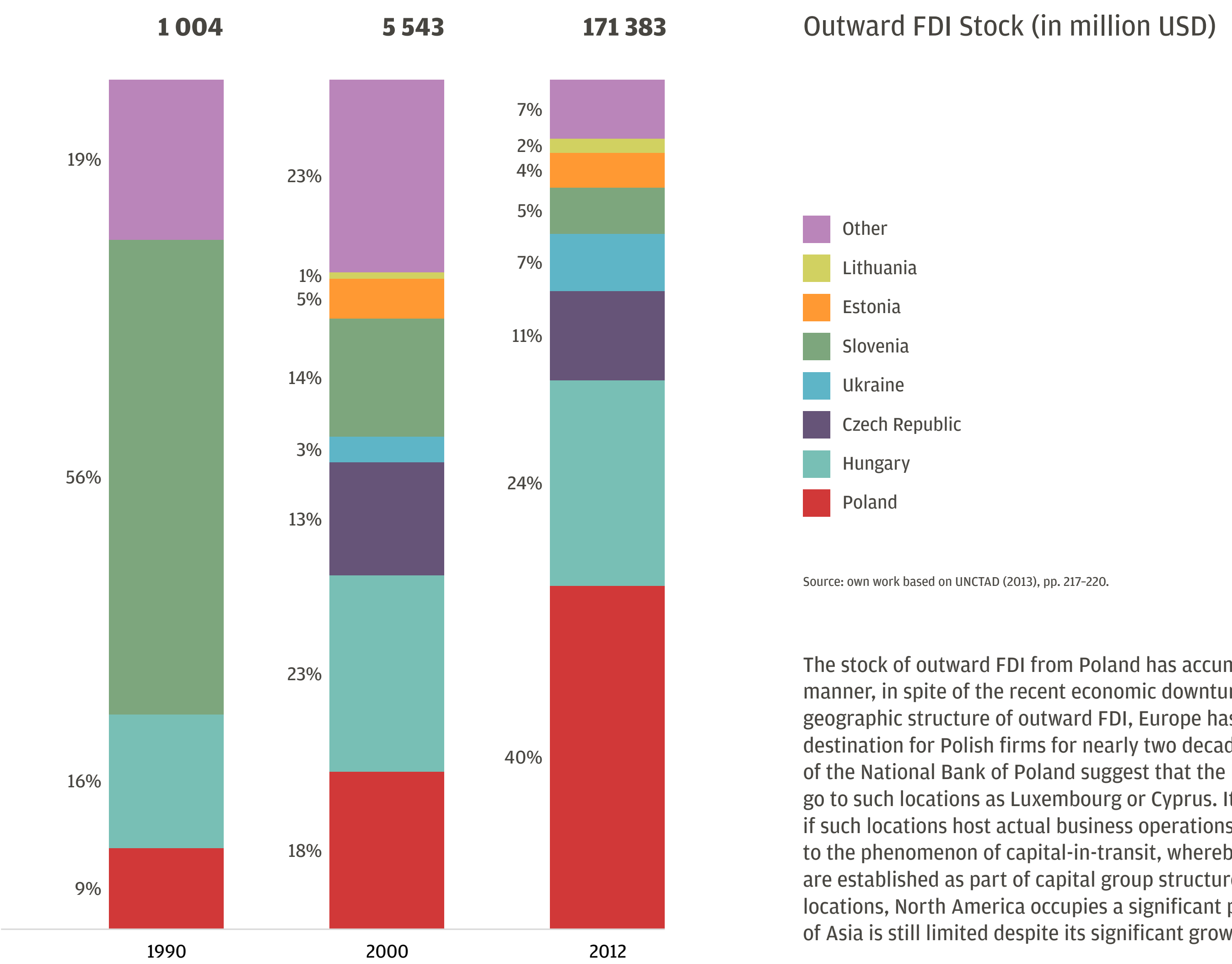
1 The study presented in this report has been financed by the research grant of the National Science Centre, awarded based on the decision no. DEC-2012/07/N/HS4/00283.

2 The category of CEE countries in this study includes new EU-members (EU-13), as well as former Soviet republics in Europe.

3 UNCTAD, 2013, World Investment Report. Global Value Chains: Investment and Trade for Development, United Nations Conference on Trade and Development, New York and Geneva, pp. 217-220.

4 Russia is excluded due to disproportionately higher FDI values and specific reasons thereof.

Evolution of Polish outward FDI compared to CEE countries (1990-2012)



Source: own work based on UNCTAD (2013), pp. 217-220.

The stock of outward FDI from Poland has accumulated in a systematic manner, in spite of the recent economic downturn.[5] In terms of the geographic structure of outward FDI, Europe has remained the major destination for Polish firms for nearly two decades. Interestingly, data of the National Bank of Poland suggest that the bulk of these investments go to such locations as Luxembourg or Cyprus. It is doubtful, however, if such locations host actual business operations. Rather, they are related to the phenomenon of capital-in-transit, whereby special purpose vehicles are established as part of capital group structure. Among non-European locations, North America occupies a significant place, while the role of Asia is still limited despite its significant growth potential.

[5] National Bank of Poland, 2014, Cykliczne materiały analityczne NBP. Inwestycje bezpośrednie - polskie, Narodowy Bank Polski, Warszawa, No. URL: http://www.nbp.pl/home.aspx?f=/publikacje/pib/pib.html [access: 25.02.2014].

Polish outward FDI stocks in million USD (1996-2012)

Location	1996	2006	2012
Europe	453	13 503	53 544
Luxembourg	-	3 553	12 493
Cyprus	-	350	5 870
United Kingdom	76	1 091	5 799
Netherlands	-	1 260	4 253
Switzerland	4	2 864	4 149
Belgium	-	4	3 011
Czech Republic	3	948	2 606
Germany	93	419	2 579
Lithuania	3	757	2 475
Norway	-	48	1 665
Russian Federation	107	281	1 414
France	60	235	1 390
Ukraine	21	495	1 091
Romania	-	171	754
Hungary	1	151	637
Other Europe	85	877	3 359
Africa	17	125	227
North America	52	191	2 067
Central America	1	35	166
South America	1	3	78
Asia	193	359	1 249
Oceania and Polar Regions	-	1	33
World	**735**	**14 318**	**57 364**

Sector or foreign affiliate	1996	2006	2012
Agriculture, Forestry and Fishing	-	2	42
Mining and Quarrying	-	47	1 046
Manufacturing	17	1 463	16 526
Electricity, Gas, Steam and Air Conditioning Suppy	4	2	619
Construction	33	313	2 013
Total Services	661	2 822	37 010
Total	**735**	**14 318**	**57 364**

Source: own work based on the data of the National Bank of Poland 1997-2013.

In regards to the sectoral structure of Polish outward FDI, an increase of the role of services can be observed. They include wholesale and retail trade and repairs, transportation and storage, accommodation and food services, information and communication, as well as financial and insurance activities. Among traditional industry sectors, manufacturing has dominated, followed by construction and mining. Accordingly, the structure of Polish foreign investments increasingly resembles that of advanced economies. Nevertheless, the role of services among foreign affiliates of Polish firms can be partly attributed to the fact that many of them engage in sales and marketing activities and are registered under another sector.

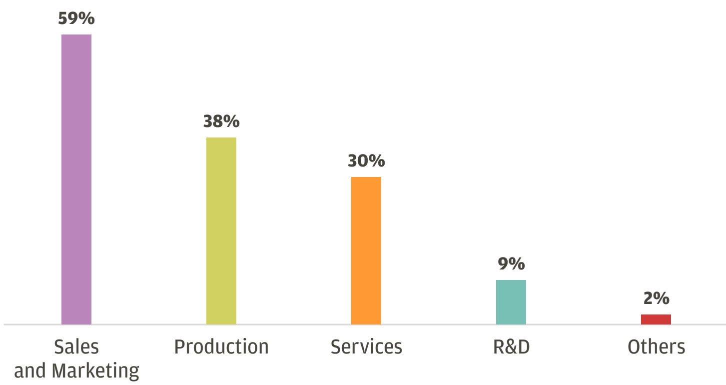
Polish multinationals are still in their "infancy"

The trends evident from macroeconomic data of the National Bank of Poland are in line with the findings of a recent study of Polish outward investors, carried out between May and December 2013. The study involved 100 firms registered in Poland and altogether controlling 368 foreign affiliates (with a minimal parent share in the affiliate of at least 10%). Of the 100 Polish parent firms, only 18% simultaneously indicated both over 10% of foreign share in their capital and the existence of another dominant entity in their capital group. Moreover, the analysis of individual cases indicates that some of these dominant entities are in fact Polish-owned entities, established in third countries due to the aforementioned reasons. Hence, most of the analysed firms are genuinely Polish both in terms of financial resources and responsibility for investment decisions.

With regard to the size of Polish multinationals, there is a relatively equal distribution of firm sizes in the study, 29% accounting for firms up to 249, 21% - 250-499, 28% - 500-1999, and 22% - over 2000 employees. The analysed sample is dominated by industrial sectors (61%), whereof 51% of firms belong to manufacturing, 4% to agriculture, forestry and fishing, 2% to mining and quarrying. Service sectors amount to 39% of the sample, whereby wholesale and retail trade and repair of motor vehicles and motor cycles account for 14%, followed by information and communication (8%), and financial and insurance activities (8%). Accordingly, the sample is more skewed towards manufacturing sectors than the total population of Polish outward FDI described earlier.

69% of studied firms control foreign affiliates in only up to 3 countries. 22% hold 4-7 affiliates abroad, while only 9% have more than 8 affiliates. At the same time, with reference to the biggest foreign investments to date, the respondents indicated in 59% of cases that the affiliates are responsible for sales and marketing activities (59% of largest affiliates), followed by manufacturing operations (37%) and service activities (30%).

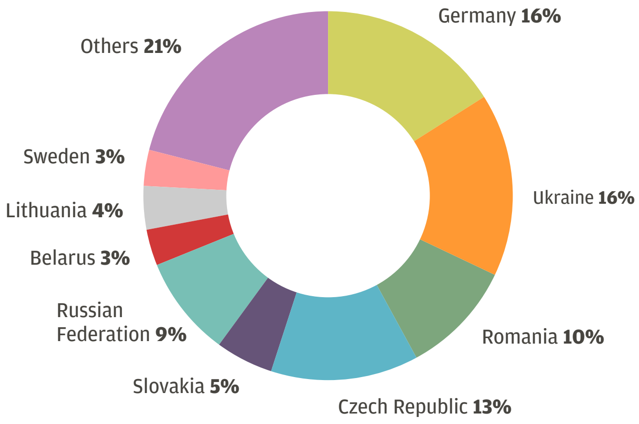
Value-adding activities of major foreign affiliates of Polish firms



Source: survey data.

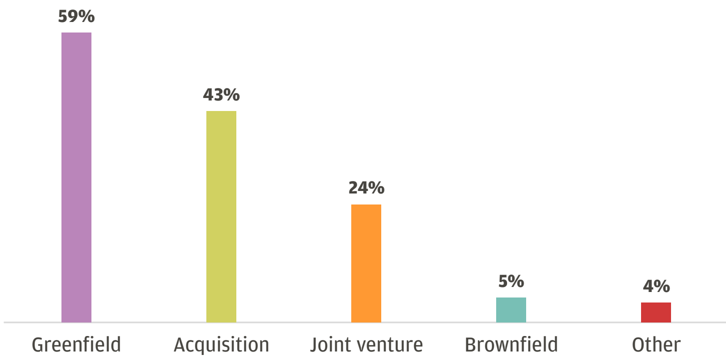
Polish multinationals follow predominantly sequential paths in their foreign expansion. In relation to the first FDI project, exports are the most frequent mode of initial foreign market penetration, with 55% firms preceding the establishment of the affiliate with export activity and 12% with contract manufacturing activities. For subsequent FDI projects, these preceding penetration modes can be observed in 44% and 7% of cases, respectively. At the same time, however, about 37% of first FDI projects and 17% of all subsequent ones occur in the absence of any prior operations in a given host countries. As for their location choices, Polish multinationals locate their major foreign affiliates mostly in Germany (16%), Ukraine (16%), the Czech Republic (13%), Romania (10%) and Russia (9%), reflecting a predominant concentration of key foreign operations on the neighbouring European markets, both economically more and less advanced as compared to Poland.

Host country distribution for major affiliates of Polish outward investors



Source: survey data.

FDI strategies of Polish outward investors



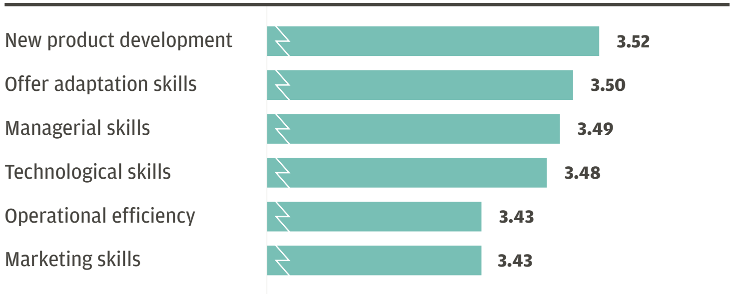
Source: survey data.

With reference to FDI forms used by parent firms, 59% of the firms report experience with wholly-owned greenfield subsidiaries, while 24% have recurred to joint ventures abroad. Notably, 43% of the sample have undertaken foreign acquisitions, whereby 5% can be classified as brownfield investments. The latter are a specific case of acquisitions, whereby substantial resources have to invested in the modernisation of the acquired firm. The clear predominance of greenfield operations is consistent with the focus on sales activities and is another indication of a relatively early stage of foreign expansion. At the same time, the significant share of international acquisitions, a part of which benefited from lower prices during the economic downturn, resembles the trend observed for multinationals from other emerging markets, particularly BRIC countries.

Stuck in the middle?

Given the still limited experience with advanced forms of foreign expansion, a vital question for Polish multinationals, and their CEE peers likewise, relates to the foundations of their international competitiveness. It has been argued that firms from emerging markets have been lagging behind their counterparts from advanced economies in terms of modern technology, managerial skills or marketing abilities, while their key strengths relate to lower production costs and operational efficiency.

Evaluation of intangible resources of Polish outward investors (1-5 scale)



Source: survey data.

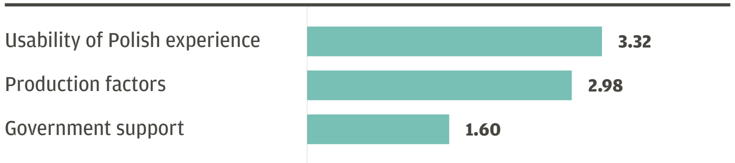
1 - much worse than the key competitor
5 - much better than the key competitor

The specific case of Poland is different, though. The country happens to be classified both as an advanced economy since its EU accession or, on the contrary, as an emerging market depending on the classification.[6] Therefore, a challenge which the economy and its firms are currently facing relates to having a clear source of competitive advantage. The present study indicates that Polish firms are still moderately positive in their evaluation of intangible assets in relation to their key competitors.

Among these resources, which constitute a foundation of international competitiveness of advanced economy firms, the highest average evaluation was awarded to the ability to develop new products (3.52) and the ability to adapt the product offering to market requirements (3.50). Equally important are managerial skills (3.49), as well as technological capabilities (3.48).

This rather conservative self-evaluation of intangible assets is accompanied by an even more refrained stance on the benefits of using production factors of Poland, with an average note of 2.98. Clearly, Poland is not necessarily perceived as a low-cost production basis by the investing firms. A higher note was attributed to the usability of experience gained in the Polish context in other markets, which may be related to the aforementioned focus on neighbouring markets, many of which share a similar institutional heritage to Poland. This ability of doing business in institutionally similar environments has been broadly discussed in other contexts, such as South American emerging markets[7], and may also hold true for the CEE market environment.

Evaluation of the advantages of originating from Poland (1-5 scale)



Source: survey data.

1 - no importance
5 - very high importance

[6] See e.g. MSCI, 2013, Market Classification, Morgan Stanley Capital International, URL: http://www.msci.com/products/indices/market_classification.html [access: 23.08.2013] and World Bank, 2013, New Country Classifications, 07/02/2013, URL: http://data.worldbank.org/news/new-country-classifications [access on 23.08.2013].

[7] Compare with Del Sol, P., Kogan, J., 2007, Regional Competitive Advantage Based on Pioneering Economic Reforms: The Case of Chilean FDI, Journal of International Business Studies, Vol. 38, pp. 901-927.

A strikingly low relevance was attributed to the role of government support in facilitating foreign expansion of firms. A broad array of financial and non-financial support instruments for both exports and outward FDI has been implemented in both advanced and developing countries, including notably China. In fact, the internationalisation of local firms can fulfill a number of strategic objectives of governments and contribute to economic growth. Despite some evidence of diplomatic support for Poland's foreign expansion, as well as the introduction of specific support initiatives, the present findings suggest that in business reality there is still a lot of potential for improvement of the system of internationaliation support measures.

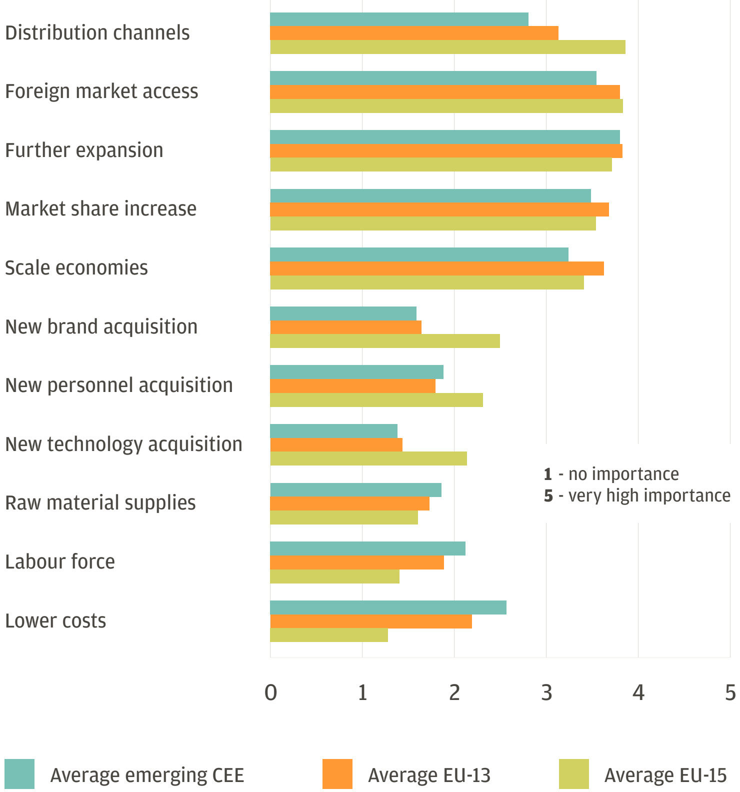
Dedicated strategies for the West and for the East

In general, market-related motives are predominant among Polish outward investors, including access to distribution channels, better access to extant foreign markets, further expansion to new markets and market share increase. Efficiency-related motives were also indicated as important, although this was more related to sales increase (output side) than the supplies of raw materials, labour force, or cost reduction in general (input side). Interestingly, strategic asset-seeking motivations were also relatively important, including the acquisition of new brands, skilled personnel or technologies.

A differentiated analysis of motivations of sample firms to invest in different host countries belonging to the group of EU-15 countries (and other advanced economies), EU-13 countries and non-EU CEE countries (and other emerging markets), respectively, reveals interesting patterns. In regards to the first category of countries, while the above general relevance of motives is similar, the role of strategic asset-seeking motives is far more pronounced. Case-by-case evidence reinforces this trend, notable examples including acquisitions of Rawlplug (UK) by Koelner, of Gram Domestic (Denmark), or of Rohde & Grahl (Germany) by Nowy Styl Group. Conversely, for similarly or less developed CEE countries both from and beyond the EU, relatively more importance was attributed to investments with the motive of obtaining access to cheaper raw materials or labour.

This fact, while it is consistent with the development level of the said economies, demonstrates that there are differences in Polish firm's strategies in relation to locations. Thereby, Poland's location between those two categories of host countries can be regarded as unique and facilitating dual presence strategies.

Investment motives per country category (1-5 scale)



Source: survey data.

Less developed markets, while serving the purpose of sales expansion and better market access, are more related to efficiency-oriented operations. The lower level of various costs as compared to Poland offsets the macroeconomic weaknesses and institutional voids in these markets. In this category of host countries, strategic asset-seeking was, not surprisingly, found to be of lesser importance than in developed countries. However, acquisitions in Eastern markets by Polish firms are also commonplace due to favourable purchase prices, which was particularly visible during the recent economic downturn. Numerous examples include acquisitions of Atlas Baltic (Czech Republic) by Atlas or of Diana Forest (Romania) by Barlinek.[8] Therefore, generalisations as to the preferred market entry modes in Western and Eastern markets should be attempted with caution.

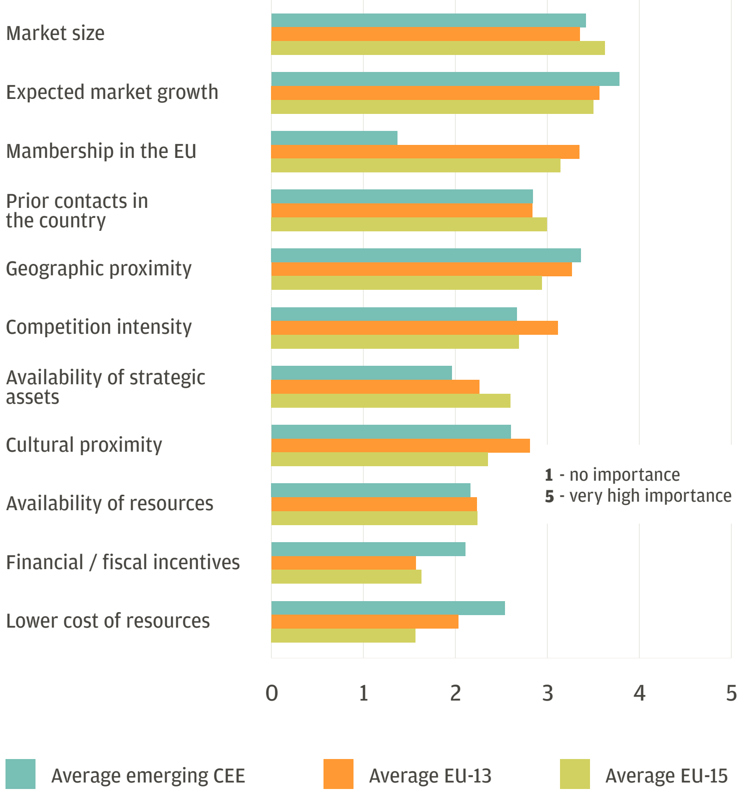
Similar conclusions to the place of different countries in Polish outward investors' international strategy can be drawn by analysing key criteria according to which the surveyed firms selected target markets for their largest foreign investments so far. In all instances, the size and expected growth rate of the host country was taken into account when choosing the investment location. Moreover, the results confirm that Polish firms heavily rely on earlier business ties developed through other market penetration modes, such as export. The attention paid to geographic proximity partly explains the aforementioned geographic concentration on neighbouring markets, which was the most pronounced for Central Eastern European markets, especially those from outside of the EU. A similar finding relates to cultural proximity. The criterion of competition intensity can be interpreted in two ways. For affiliates located in the East, the still lower level of market saturation and competitive rivalry means an opportunity to be leveraged. Conversely, in Western markets the higher level of competition also means a more demanding environment which induces learning and thus enhances the international competitiveness of Polish firms.

As for the role of financial and fiscal incentives in making investment decisions, it was found to be the most important in emerging markets, were foreign investors are frequently attracted by tax discounts or favourable customs regulations in specific sectors.

[8] Gorynia, M., 2010, Zagraniczne inwestycje bezpośrednie jako forma internacjonalizacji polskich przedsiębiorstw - Uwarunkowania i tendencje, in: Umiński, S. (Ed.), Eksport oraz bezpośrednie inwestycje zagraniczne firm województwa pomorskiego, PBS DGA, Sopot, p. 123.

However, similar to the evaluation of Polish support measures, investors were rather reserved.

Location choice criteria per country category (1-5 scale)



Source: survey data.

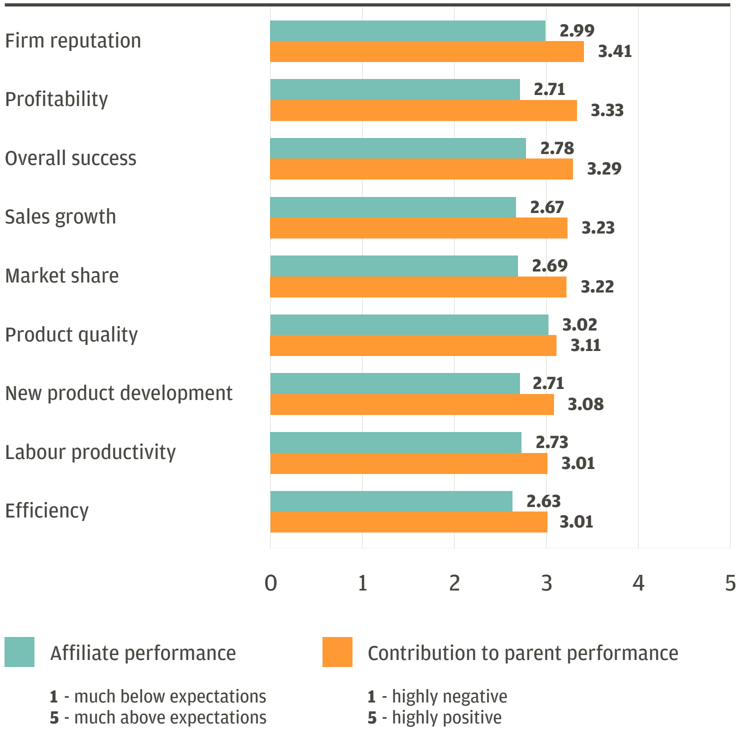
A success story?

While foreign expansion is undertaken to fulfill specific objectives from the perspective of the investor, there is no guarantee that it will eventually turn out to be successful. In fact, business reality provides frequent evidence that divestments are as common as investments. Clearly, there is nothing inevitable about firm internationalisation, unless certain criteria are fulfilled. This question is particularly important in the context of "infant" multinationals, whose experience with international operations is relatively limited and therefore makes these firms exposed to managerial mistakes.

Therefore, the results of the present survey provide a preliminary indication as to the extent to which the biggest Polish investments abroad can be said to be successful. An overall comparison of managerial evaluations of foreign affiliate performance with the extent to which the affiliates were considered to have contributed to the performance of the entire firm, reveals that foreign affiliate performance was rather moderate, i.e. it was on average slightly below the initial objectives. Conversely, the effect of the investment on the whole firm was slightly positive in most cases. Accordingly, while the foreign venture itself might not have met the initial objectives, managers in general perceived it to be beneficial to the whole firm in general. The highest effect of foreign investments, which parent firm managers perceived, was related to firm reputation. In fact, the establishment of foreign affiliates allows the positioning as international groups, thus strengthening the bargaining power in relationships with different stakeholders. The surveyed firms also appreciated the impact of investing abroad on the profitability of the entire firm, although the affiliates' profitability was on average below expectations. A similar situation could be observed for results in terms of sales growth, market share or product quality, although in the case of the latter the improvement of product quality at the level of the foreign affiliate did meet the set objectives. For other performance aspects, such as product innovations, labour productivity or cost efficiency, the effect of foreign investment on the entire firm was regarded as rather meaningless.

The above findings for specific performance dimensions were supported by the overall success evaluation by managers, who saw foreign investments on average as slightly beneficial, although the performance of foreign affiliates was on average regarded to be below initial expectations. This presents a rather ambiguous image of Polish firms' expansion success at its still early stage.

Affiliate performance and its contribution to firm performance (1-5 scale)



Source: survey data.

Policy implications

The still limited resources of Polish firms seem to constrain the scale of their expansion and confine it to geographically proximate markets. Location choices in their foreign expansion are distributed equally between advanced EU countries and less developed, non-EU economies. In the context of this dualism, the results of the present study indicate a differentiated role of these two types of countries in the strategy Polish firms. While it has been argued that Polish firms can more easily exploit their business experience in institutionally less or equally developed markets, the present study supports the existing case-by-case evidence that they increasingly attempt at competing in more challenging, developed markets. However, most foreign investment projects are still of market-seeking nature, which resembles the internationalisation process of firms from other CEE countries. At the same time, while the role of innovativeness and quality in foreign expansion is visibly increasing, it is still evaluated by managers as moderate. At the same time, cost advantages of being a Polish firm are seen as rather meaningless. Unfortunately, the same goes for the perceived support by authorities. Finally, also the financial and non-financial outcomes of investments are evaluated as rather slightly below expectations and with a moderate effect on the entire firm, at best.

The success of foreign expansion by Polish firms is of importance to the development of the home economy. It has been argued that foreign direct investment from middle-income economies can support governments in achieving their strategic goals and increase a country's international competitiveness. Hence, the still limited scale of foreign operations by Polish firms should serve as an impulse for more support programmes, particularly those focused specifically on foreign investments. These support programmes at different levels of government should aim at reducing negative country-of-origin effects that frequently hinder the marketing efforts of Polish firms. Other measures, including inter-governmental relations, should be reinforced to develop effective and sustainable business networks with high-potential countries.

In the case of emerging markets where support measures for foreign expansion are still in their infancy, it is relevant to consider that the adoption of institutional solutions applied in advanced economies might not necessarily be effective if a broader context of the domestic economic policy is not properly taken into account. In fact, the performance of direct support instruments for exporters and outward investors might be doubtful if the fundamental premises of a favourable business environment in the home country are not guaranteed, including lower transaction costs or a high-quality labour market. Polish firms should be supported to compete in foreign markets and also to face foreign competitors in the Polish market. This goal can be reached by fostering entrepreneurship and growth through support for investments, innovations, education and training, as well the establishment of appropriate information systems and promotion of information dissemination. Clearly, while instruments such as subsidies, loans, insurance or information provision, can partly enhance the firm-specific advantages in the short run, they should be combined with decisive activities aimed at a long-term development of Poland's overall competitiveness.[9]

Not least, at the level of policy implementation, an important factor affecting the performance of support instruments is its availability to and awareness by its potential recipients. The present structural dispersion and functional specialization of the Polish system of support measures should be verified in terms of its performance, particularly by analysing if the transaction costs for its end users given the forms and degree of support provided, as well as the costs of coordinating and managing the system by public authorities, outweigh the related benefits.

[9] See Gorynia, M., Nowak, J., Trapczyński, P., Wolniak, R. (in print, 2014), Should Governments Support Outward FDI? The Case of Poland, w: Marinova, S. (Ed.) Institutional Impacts on Firm Internationalization, London and New York: Palgrave Macmillan.

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