ANNA KRAJEWSKA

Efficiency of Enterprises with Foreign Capital Participation

Foreign capital began to flow into Poland over 20 years ago. For this reason, three stages of the entry of foreign capital into the Polish market are pointed out in literature.[1] Initially, i.e. in the years 1976-1985, there were many legal restrictions (e.g. only foreign investors of Polish origin had the possibility of investing in Poland). The 1985-1989 period can be regarded as the second stage, or a period of a moderate opening up to the inflow of foreign capital. Then it was possible to set up joint companies between foreign capital and state-owned enterprises and these companies could take advantage of tax holidays and customs exemptions. A genuine opening up of the economy to foreign capital (third stage) began at the end of 1989, when the systemic transformation was commenced

From 1989 to end-June 2000, foreign investors located over USD 43 billion in Poland. About 90% of capital flows from OECD countries. The leader is the United States whose investment in Poland totals over USD 6.4 billion. The member countries of the European Union invested over USD 24 million.[2]

A large inflow of foreign capital into Poland causes a fast increase in the number of firms with foreign capital participation (cf. Table no. 1).

[1] J. Misala, Involvement of Foreign Capital in the Polish Economy, 1976-1995, in M. Jarosz (ed.) Foreign Capital in Privatisation, Warsaw: ISP PAN, 1996, pp. 15-16.

[2] Data of the PAIZ (Polish Agency for Foreign Investment).

Table 1. Economic units with foreign capital participation registered in the Regon register

Years	Companies				Foreign small-scale enterprises
	Joint stock		Limited liability		
	Total	with foreign capital participation	Total	with foreign capital participation	
1992	2 624	.	66 426	.	686
1993	3 131	332	79 212	14 835	647
1994	3 897	425	90 146	19 312	587
1995	4 740	553	99 239	23 533	548
1996	5 588	704	109 155	27 918	535
1997	6 378	872	119 053	32 070	518
1998	7 041	1 010	128 332	35 840	505
1999	7 566	.	138 109	.	498

Source: Data from the Statistical Yearbooks of the Central Statistical Office.

Limited liability companies constitute the largest group among firms with foreign capital acting in Poland. The total of 128,332 limited liability companies registered in Poland in 1998 included as many as 35,840 companies with foreign participation (27.9%). This means that one in four companies had foreign shareholders. At the same time, the total of 7,041 joint stock companies included 1,010 companies (14.3%) with foreign participation (one in seven companies had foreign partners). Furthermore nearly 500 foreign small-scale enterprises act in Poland. The first of them were set up already in the 1980s. They could be established by foreign nationals of Polish origin. In 1989 there were 841 such firms. Starting from 1991, their number began to diminish, which was influenced by a change in the legal regulations. The Act on foreign small-scale enterprises is the binding law on firms established until the end of 1988. New permits have not been granted since January 1989. These firms can act until the expiry of their permits or they may transform into capital companies acting under the Act on companies with foreign participation.

The Polish economy has very big expectations concerning foreign capital. It is expected that foreign capital will stimulate the economy by providing funds for investment, giving access to western technology and sales markets, introducing desirable changes in the organisational structure, management, finances and marketing.

Table 2. Economic indices recorded by companies with foreign participation against the background of the economy as a whole

Indices	Total economy				Companies with foreign capital participation			
	1994	1995	1997	1998	1994	1995	1997	1998
Share of costs in revenue	95.9	96.4	96.6	98.3	98.7	89.2	97.6	97.7
Gross profitability rate	3.7	3.8	3.2	1.9	0.6	3.1	2.5	2.4
Net profitability rate	1.5	1.8	1.6	0.5	-0.5	1.4	0.8	0.6
ROE	10.2	3.0	3.8	1.3	-2.3	5.2	3.7	2.3
ROA	1.9	1.9	2.0	0.6	-0.7	9.1	1.2	0.8
Profitability of fixed assets	3.1	2.7	3.1	1.0	-1.5	3.9	2.4	1.4
Index of liquidity (current)	24.1	24.1	19.4	18.8	20.8	9.9	18.4	18.5
Index of liquidity (fast)	86.8	69.6	77.6	75.3	75.5	75.6	74.8	74.9

Source: Wyniki finansowe podmiotów gospodarczych z udziałem kapitału zagranicznego w 1994r. (Financial Results Scored by Economic Units with Foreign Capital Participation in 1994, CSO, Warsaw, 1995; Wyniki finansowe podmiotów gospodarczych z udziałem kapitału zagranicznego w 1995r. (Financial Results Scored by Economic Units with Foreign Capital Participation in 1995, CSO, Warsaw, 1996, pp. 42-43; Działalność gospodarcza spółek z udziałem kapitału zagranicznego w 1997 r. (Economic Activity of Companies with Foreign Capital Participation in 1997), CSO, Warsaw, 1998, p.55.

The comparisons of the basic financial indicators concerning the entire economy and firms with foreign capital participation do not confirm the advantage of firms with foreign participation. In the years 1994-1997, the basic economic indicators such as gross profitability rate, net profitability rate, ROA, ROE were somewhat better for the economy as a whole than for firms with foreign capital. It was not until 1998 that a slight improvement was recorded (cf. table 2). At the same time it follows from the statistical data of the Central Statistical Office that the financial situation of firms with foreign participation is more differentiated than in the other firms acting in Poland. This is indicated by a considerably higher percentage of loss-makers among these firms than among all enterprises. In 1997, 33.7% of all economic units providing balance-sheet data to the CSO (Central Statistical Office) showed a gross loss and 35.7% a net loss. Among firms with foreign participation, the percentage of loss-making firms was considerably higher: 49.5% showed a gross loss and 51.7% a net loss.[3]

Lest the picture of firms with foreign capital should be so one-sidedly negative, it is necessary to underline that firms privatised by means of the capital method with the participation of foreign capital record better results than firms privatised by means of other methods.

Tables 3 and 4 present the economic results recorded in 1998 and 1999 by firms covered by the privatisation process. Companies with foreign capital participation were singled out from companies privatised as a result of individual (capital) privatisation in this specification. The tables also give information on economic results of companies privatised directly and liquidated for the privatisation purpose in which foreign investors have shares.

Table 3. Economic relations in 1998 in economic units under privatisation (in %)

Specification	Cost level indicator	Turnover profitability rate gross	Turnover profitability rate Net
	%		
Total Of which:	99.1	1.3	-0.1
Sole-shareholder companies of the State Treasury established as a result of commercialisation of state-owned enterprises	101.4	-0.8	-1.8
Companies privatised as a result of individual privatisation	95.3	4.9	2.9
Of which with foreign capital participation	95.0	5.1	2.9
Companies included in the NIF Programme	100.7	-0.5	-1.5
Companies established as a result of debt conversion	114.8	-14.8	-15.0
Employee companies	95.5	4.5	2.7
Companies with State Treasury participation established as a result of transfer of assets of directly privatised and state-owned companies to	98.6	2.0	1.0
Of which with foreign capital participation	99.4	0.6	-0.7
State-owned enterprises under direct privatisation	99.5	0.5	-0.9
Stare-owned enterprises under liquidation	127.9	-29.8	-32.4

Source: Statistical Yearbook 1999, CSO, Warsaw 1999, p. 568.

[3] Economic Activity of Companies with Foreign Capital Participation in 1997, CSO, Warsaw, 1998, p. 55 and Economic Activity of Companies with Foreign Capital Participation in 1998, CSO, Warsaw, 1999.

The data point to high efficiency of enterprises privatised as a result of individual (capital) privatisation. The average results of companies with foreign participation did not differ from the average results attained by companies privatised individually and in 1999, the index of net profitability was higher (3.9% compared with 3.6% for all companies privatised individually).

Table 4. Economic relations in 1999 in privatises economic units[a]

Specification	Cost level indicator	Turnover profitability rate gross	Net
	%		
Total Of which:	99.3	0.9	-0.6
Sole-shareholder companies of the State Treasury established as a result of commercialisation of state-owned enterprises	102.8	-2.5	-3.4
Companies privatised as a result of individual privatisation	94.0	6.0	3.6
Of which with foreign capital participation	94.0	6.0	3.9
Companies included in the NIF Programme	103.6	-3.5	-4.4
Companies established as a result of debt conversion	110.4	-10.6	-10.7
Employee companies	96.0	4.0	2.2
Companies with State Treasury participation established as a result of transfer of assets of directly privatised and state-owned companies to	100.5	-0.5	-1.3
Of which with foreign capital participation	98.1	1.9	0.7
State-owned enterprises under direct privatisation	102.2	-2.3	-3.9
Stare-owned enterprises under liquidation	133.0	-36.1	-39.1

[a] Data concern units with workforce exceeding 20 persons and 50 persons in sections "Mining and quarrying" and "Manufacturing".

Source: Small Statistical Yearbook of Poland 2000, CSO, Warsaw 2000, p. 442.

The financial results of firms with foreign participation recorded in the official statistics, which were lower for all the indices shown in Table 2 than for the economy as a whole prompt several hypotheses constituting an attempt to explain this situation:

1. Small firms, often with a tiny share of foreign capital are predominant among firms with foreign capital participation. In 1997, the value of foreign capital exceeded USD 1 million in only 742 firms. The value of their foreign capital accounted for 89% of the total value of foreign capital located in Poland. As of end 1998, the situation did not change markedly. The value of foreign capital exceeded USD 1 million in 960 companies and the share of foreign

capital of these companies in total foreign capital amounted to almost 92%[4]. Thus, small and medium-sized firms are predominant and they have a greater natural propensity to resort to the grey (shadow) sphere. They have considerably greater possibilities of distorting their real results by understating their gross revenues, transferring a part of the costs of owners' consumption into the costs of the firm, etc. The detailed data concerning profitability rates of enterprises grouped according to number of employees and ownership sectors show that the smaller the firms are, the worse the economic results they show. The profitability indicators improve with the size of the firm (this also applies to firms with foreign capital)[5].

2. As it was already mentioned, companies privatised by a capital method have relatively good results against the background of other private firms. This information corresponds well to the first hypothesis. Capital privatisation covers large firms in which the possibilities of "double book-keeping" are considerably limited. In the case of enterprises privatised via the capital method, much weight is attached to the commitments made by strategic investors in the agreements concluded before privatisation. From the conducted researches it follows that apart from the social package (sustaining the level of employment and wages, implementing a social programme), in many of the privatisation agreements foreign investors commit themselves to providing the firm with technical solutions, licenses and technologies (this was indicated by 70.4% of the surveyed firms), increasing the stock capital (48.1%), reinvesting the dividend in the firm (40.7%) and investing in its modernisation (33.3)[6]. Such actions as a rule strengthen the economic position of the firm and are conducive to improvement in its financial results.

3. Weak economic results achieved by some firms may mean that foreign investors are not oriented exclusively at fast, current profits but that they think about development of the firm in a further perspective, they enter currently unprofitable areas or economically weak firms which can turn out profitable only after a thorough restructuring of the assets, production, technology and organisation, as evidenced by the 1998 improvement in the performance of enterprises with foreign participation. This hypothesis is also confirmed by weak economic results of state-owned enterprises covered by direct privatisation into which foreign capital enters. In 1998 companies established from the apport of assets of state-owned companies to companies

---

[4] Ibid, p. 11.

[5] A. Krajewska, Taxation of the Public and Private Sector, Gospodarka Narodowa nos. 7-8, 1994.

[6] S. Krajewski, Effects of the Participation of Foreign Capital in Privatisation, in M. Jarosz (ed.) Foreign Capital in Privatisation, ISP PAN, Warsaw, 1996, p. 109.

with foreign capital participation acted at the threshold of profitability, recording a low gross profitability rate of +0.6% and a negative net profitability rate of -0.7% cf. tables 3 and 4). However, these results are still weaker than the expectations connected with the inflow of foreign capital to Poland.

4. One of the reasons for the relatively weak financial standing of firms with foreign capital participation can be the difference in profitability of sales in Poland and abroad (exports). The national statistics show that the share of export in sales in the recent years is at the level of about 9% whereas firms with foreign capital export on average about 16-17% of their output.[7] The share of exports was higher than the average level in companies with a majority share of foreign capital. This does not apply to companies with an exclusive or almost exclusive participation of foreign capital. A considerable fraction of these companies is located in areas oriented primarily at gaining the Polish market (beverages, tobacco products, paper products, detergents and other household chemicals, computers and office machines).[8]

The outcomes of empirical researches[9] show that in most cases export production does not exert a positive impact on economic results of companies with foreign participation. A mere 21.2% of exporters claimed that export production ensured higher profitability than production sold in Poland. Such an opinion was expressed by 12.5% of exporters privatised via the capital method and 30.4% of exporters privatised via the direct method. At same time, however, the former group had a much higher share of exports in sales (24-26% compared with 13-15% in the latter group).

It is hard to give an unequivocal answer why companies under capital privatisation decide on a relatively high share of exports although exports do not ensure a satisfactory profitability level. The following circumstances have most probably their say in this matter:

- even less profitable exports permit growth of production and cuts in unit costs, which can consequently lead to higher profitability;
- some firms decide on a temporary cut in prices, treating it as an element of a long-term export expansion strategy;

[7] Calculated on the basis of the Statistical Yearbook of the CSO, 1997, pp. 442 and 534 and Economic Activity of Companies with Foreign Capital Participation in 1997, op.cit., p. 23.

[8] S. Krajewski, Exports by Enterprises with Foreign Capital Participation in Z. Wysokińska, J. Witkowska, Export Chances of Polish Enterprises in Foreign Markets, Lodz University Press, Lodz, 1997, p. 145.

[9] Ibid., pp. 152-153.

- foreign investors undertake actions aimed at lowering costs in the purchased enterprises and temporarily export at a loss so as not to lose their markets;
- wishing to reduce the consequences of high taxation in Poland, foreign investors export their consciously underpriced products to firms with which they have capital links in order to transfer some of the profits obtained in Poland.

The last aspect seems to be significant in practice although it is difficult to prove. The opportunities of an elastic price setting are big, especially in the case of firms with foreign capital participation which have co-operation and financial ties with firms possessed abroad by the present owner. Almost two-thirds of the examined firms were in such a situation. It is characteristic that the question of how prices obtained by the firms in foreign markets compared with prices achieved by other exporters was left unanswered by as many as 30% of the companies who said that they lacked such information. They were first of all the largest enterprises after capital privatisation, that is to say enterprises that should have a good database.

Weak results of some of the enterprises may be the outcome of their conscious actions aimed at money laundering. In the recent years Poland became a convenient place for making this kind of transactions.[10] The favourable factors are the loopholes in the law, a large grey sphere (which generates over 20% of GDP), inefficiency of the law enforcement apparatus and a large demand for foreign capital. Firms with foreign capital can be a convenient form for mafia organisations, smugglers and persons acting illegally. It should be gathered that step in step with growth in marketisation of the economy and improvement in the legal regulations, the indicated irregularities will dwindle and foreign capital will act on the same rules as in the market economy.

[10] Articles showing how citizens of the former Soviet Union buy Polish textile firms, conduct suspicious transactions and lead the firms to bankruptcy appear in the press. Cf. V. Krasnowska, Brudne nici (Dirty Threads), Wprost, 24 September 2000.