Polish Investments on Non-European Markets

Michał Zaremba*

Introduction

Growth in foreign direct investment (FDI) is perhaps the clearest and most significant sign of globalization in recent years, as the average annual growth rate of FDI is twice that of trade. What is significant is that the share of FDI hosted by countries in the developing world increased as they became interesting and important alternatives to traditional host countries. Today, measured as a share in country GDP, FDI flows to developing countries are typically greater than those to the developed world (World Bank 2016).

Developing countries seek FDIs as a potential tool to complement the level of domestic investment as well as a possible efficiency-gain instrument through the transfer of appropriate technology, management knowledge, business culture, access to foreign markets, increasing employment opportunities, and improving living standards. To this end, policy makers have considered various incentives and policies to attract FDI, and to ensure its consistency with the domestic economic development objectives.

Some people view the presence of multinational enterprises (MNEs) in poor countries as a threat to economic development. Others see FDI as a potential source of economic growth. Undoubtedly, non-European markets, mostly represented by developing countries, became an important and attractive area for economic activities for high and medium-developed economies. The “traditional” exporters to Africa, Asia and Latin America (US and Western European companies) are today accompanied by Chinese and Indian firms, which are active mostly in Africa. They are followed by central European investors, including Polish ones.

* Michał Zaremba – MSc, University of Lodz, Faculty of Economics and Sociology, Department of Development Economics.
The aim of the paper is to discuss and present the investment activities of Polish companies on non-European markets as it presents a challenge not only for the companies themselves, but also for the government to support the logistical and financial needs of the potential investors.

Theoretical background of determinants of FDI – chosen aspects

There are many theories which attempt to explain the determinants of FDI. However, the capacity of each to serve as a self-contained general theory, which could explain all types of FDI, has been questioned in the works of various scholars (Agarwal 1980, p. 739–773; Parry 1985, p. 564–569; Itaki 1991, p. 445–460).

Production cycle theory developed by Vernon in 1966 was used to explain certain types of foreign direct investment made by U.S. companies in Western Europe after the Second World War in the manufacturing industry (Vernon 1966, p. 190–207). Vernon believes that there are four stages of production cycle: innovation, growth, maturity and decline. According to Vernon, in the first stage, U.S. transnational companies create new innovative products for local consumption and export the surplus in order to also serve foreign markets. According to production cycle theory, after the Second World War, Europe increased demand for manufactured products like those produced in the USA. Thus, American firms began to export, as they had a technological advantage of over their international competitors.

If, in the first stage of the production cycle, manufacturers have an advantage by possessing new technologies, as the product develops the technology also becomes known. Manufacturers will standardize the product, but there will be companies that will copy it. Thus, European firms started imitating American products that U.S. firms were exporting to these countries. US companies were forced to build production facilities in the local markets to maintain their market shares in those areas.

Dunning is one of the most referenced authors by experts working on FDI. In his works (Dunning 1993), he describes three main types of FDI based on the motive behind the investment from the perspective of the investing firm.

The first type of FDI is called market-seeking FDI, whose aim is to serve local and regional markets. It is also called horizontal FDI, as it involves the replication of production facilities in the host country. Tariff-jumping or export-substituting FDI is a variant of this type of FDI. Because the reason for horizontal FDI is to better serve a local market by local production, market size and market growth of the host economy play important roles. Obstacles to accessing local markets, such as tariffs and transport costs, also encourage this type of FDI.
A second type of FDI is called resource-seeking. This is when firms invest abroad to obtain resources not available in the home country, such as natural resources, raw materials, or low-cost labour. Particularly in the manufacturing sector, when multinationals directly invest in order to export, factor-cost considerations become important. In contrast to horizontal FDI, vertical or export-oriented FDI involves relocating parts of the production chain to the host country. The availability of low-cost labour is a prime driver for export-oriented FDI. Naturally, FDI in the resource sector, such as oil and natural gas, is attracted to countries with plentiful natural endowments.

The third type of FDI, called efficiency-seeking, takes place when the firm can gain from the common governance of geographically dispersed activities in the presence of economies of scale and scope.

The Theory of Exchange Rates on Imperfect Capital Markets is another theory which tried to explain FDI. Initially, the foreign exchange risk was analyzed from the perspective of international trade. Cushman (Cushman 1985, p. 297–308) analyzed the influence of uncertainty as a factor of FDI. In the only empirical analysis made so far, Cushman shows that a real exchange rate increase stimulated FDI made by USD, while foreign currency appreciation reduced American FDI. Cushman concludes that the dollar’s appreciation has led to a reduction in U.S. FDI by 25%.

However, currency risk rate theory cannot explain simultaneous foreign direct investment between countries with different currencies. The sustainers argue that such investments are made at different times, but there are enough cases that contradict these claims.

Internalisation theory tries to explain the growth of transnational companies and their motivations for achieving foreign direct investment. The theory was developed by Buckley and Casson in 1976 and then by Hennart in 1982. However, foundations for the theory were launched by Coase in 1937 in a national context, and by Hymer in 1976 in an international context. Coase presented the theory of transactional costs, while Hymer identified two major determinants of FDI. One of those determinants was the removal of competition. The other was the advantages which some firms possess in a particular activity. Buckley and Casson, who founded the internalisation theory, demonstrated that transnational companies organized their internal activities so as to develop specific advantages, which then were tube exploited.

Internalisation theory is also considered very important by Dunning, who uses it in the eclectic theory, but he also argues that this explains only part of FDI flows. Hennart (Hennart 1982) develops the idea of internalization by developing models between the two types of integration: vertical and horizontal. Hymer is the author of the concept of firm-specific advantages and demonstrates that FDI takes place only if the benefits of exploiting firm-specific advantages outweigh the relative costs of the operations abroad. According to Hymer (Hymer 1976) multina-
ional enterprises appear due to the market imperfections that led to a divergence from perfect competition in the final product market. Hymer has discussed the problem of information costs for foreign firms respected to local firms, different treatment of governments, and currency risk. The result meant the same conclusion: transnational companies face some adjustment costs when investments are made abroad. Hymer recognized that FDI is firm-level strategy decision rather than a capital-market financial decision.

Regardless of the classification of FDI in the literature, there are many determinants often cited in studies. Often it is stated (Billington 1999, p. 65–76, Branard 1997, p. 520–544, Wheeler and Mody 1992, p. 57–76, Kravis and Lipsey 1982, p. 201–223) that market size as measured by GDP or GDP per capita seems to be the most robust FDI determinant in econometric studies. The market-size hypothesis also supports the idea that a large market is required for efficient utilization of resources and exploitation of economies of scale (Charkrabarti 2001, p. 201–223): as the market-size grows to some critical value, FDI will start to increase thereafter with its further expansion. This hypothesis has been quite popular and a variable representing the size of the host country market has come out as an explanatory variable in nearly all empirical studies on the determinants of FDI.

Openness of the economy is often considered to be one of the most important determinants of FDI even though there is mixed evidence concerning the significance of openness, which is measured mostly by the ratio of exports plus imports to GDP, in determining FDI (Charkrabarti 2001, p. 201–223). The maintained hypothesis is: given that most investment projects are directed towards the tradable sector, a country’s degree of openness to international trade should be a relevant factor in the decision. Charkrabarti claims that wage as an indicator of labour cost has been the most contentious of all the potential determinants of FDI. Theoretically, the importance of cheap labour in attracting multinationals is agreed upon by the proponents of the dependency hypothesis as well as those of the modernization hypothesis, though with very different implications. There is, however, no unanimity even among the comparatively small number of studies that have explored the role of wage in affecting FDI: results range from higher host country wages discouraging inbound FDI to them having no significant effect or even a positive association.

The ranking of political risk among FDI determinants remains rather unclear (Demirhan, Masca 2008, p. 360–361). Where the host country owns rich natural resources, no further incentive may be required, as seen in politically unstable countries such as Nigeria and Angola, where high returns in the extractive industries seem to compensate for political instability. In general, as long as the foreign company is confident of being able to operate profitably without excessive risk to its capital and personnel, it will continue to invest. For example, large mining companies overcome some of the political risks by investing in their own infrastructure maintenance and their own security forces. Moreover, these companies
are limited neither by small local markets nor by exchange-rate risks since they tend to sell almost exclusively on the international market at hard currency prices.

Infrastructure covers many dimensions, ranging from roads, ports, railways and telecommunication systems to institutional development (e.g. accounting, legal services, etc.). Poor infrastructure can be seen, however, as both an obstacle and an opportunity for foreign investment. For the majority of low-income countries, it is often cited as one of the major constraints. But foreign investors also point to the potential for attracting significant FDI if host governments permit more substantial foreign participation in the infrastructure sector (Demirhan, Masca 2008, p. 360–361).

The role of growth in attracting FDI has also been the subject of controversy. The growth hypothesis developed by Lim (Lim 1983, p. 207–212) maintains that a rapidly growing economy provides relatively better opportunities for making profits than those growing slowly or not growing at all.

The direction of the effects of the above-mentioned determinants on FDI may be different. A variable may affect FDI both positively and negatively. For example, factors such as labour costs, trade barriers, trade balance, exchange rate and tax have been found to have both negative and positive effects on FDI.

The motives for firms to engage in foreign production can be classified into four groups: natural resources seeking, market seeking, efficiency seeking and strategic asset seeking (Dunning 1993).

Natural resources seeking FDI is justified by the fact that these resources – e.g. minerals, raw materials, and agricultural products – tend to be location specific. The need to guarantee a cheap and safe supply of natural resources justified much of the FDI flows in the 1800s and early 1900s, largely from the most industrialized nations (i.e. Europe, the USA and Japan) to less developed areas of the globe. Market seeking corresponds to FDI that aims at supplying the local market or markets in adjacent territories. It may represent a deeper involvement of the firm, following the success of exports, or the expansion of the firm to a wholly new market. Transportation costs and government regulations are the main reasons behind market seeking FDI. However, Dunning suggested that strategic reasons may also be associated with this type of FDI. Some examples are to follow the firm’s clients in their foreign expansion, the need to adapt products to local conditions and tastes, or the reduction of transaction costs.

Efficiency seeking FDI has two main forms. First, and probably the most frequent type, firms often seek to increase their cost efficiency by transferring production, totally or in part, to locations with low labour costs. This is especially likely to happen in industries where unskilled or semi-skilled labour represents an important part of the production costs. The second type of efficiency seeking FDI corresponds to investment aimed at rationalizing the operations of existing international companies. The target may be the exploitation of comparative advantages in adjacent territories or to exploit economies of scale and scope across borders.
However, prior market seeking FDI or costs reducing FDI is a pre-condition for this variation of efficiency seeking foreign investment.

Finally, strategic asset seeking FDI is probably the fastest growing of the four motives for overseas investment. Firms increasingly use FDI to obtain strategic assets (whether tangible or intangible) that may be critical to their long-term strategy but are not available at home. In contrast to the other motives for FDI, strategic assets seeking investment does not imply the exploitation of an existing ownership advantage of the firm. Instead, FDI may be a vehicle for the firm to build the ownership advantages that will support its long-term expansion at home and abroad, as argued, for example, in the network. Alternatively, strategic asset seeking investment may not involve strengthening the firm’s position, but rather to weaken the competitive position of its competitors.

Institutional and cultural aspects of Foreign Direct Investment outside Europe

In many countries, the institutional system is inefficient (Latin America, Asia) or does not exist at all. All the uncertainty and volatility with regard to property rights, intellectual property, etc., make traders reluctant to engage in long-term projects. The fragility of this trust is particularly evident in countries where corruption, nepotism and so called “bad” capitalism are endemic. The market is inefficient in terms of weakness or lack of necessary financial, social, legal, or political infrastructure.

The development is of fundamental importance and it poses a challenge recognized by all countries. Developing countries are characterized by weak market institutions and laws. A shadow on any development is the lack of structural reforms, massive stratification of income, the fragility of investor confidence as well as corruption, the lack of discipline, poor organization and low or insufficient level of education and knowledge of society. There is no doubt that high institutional quality is essential to a strong state in terms of creating and taking care of the effectiveness of the institution.

The currently dominant view is that institutions are the ultimate determinants of economic performance (Acemoglu et al. 2005, p. 385–472; North, 2005). Economic development changes institutions through a number of channels. First, increased wealth due to growth may create higher demands for higher-quality institutions (e.g., demands for political institutions with greater transparency and accountability). Second, greater wealth also makes better institutions more affordable. Institutions are costly to establish and run, and the higher their quality, the more ‘expensive’ they become. Third, economic development creates new agents of change, demanding new institutions. In the 18th century, the rising industrial
capitalists supported the development of banking against the opposition to it by landlords, while in the late 19th and the early 20th centuries, the growing power of the working class led to the rise of the welfare state and protective labour laws, against the capitalists who thought those institutions would bring about the end of civilization as they knew it.

Today’s rich countries acquired most of the institutions that today’s dominant view considers to be prerequisites of economic development after, not before, their economic development – democracy, modern bureaucracy, limited liability, bankruptcy law, banking, a central bank, securities regulation, and so on (Chang 2002). More specifically, Anglo-American countries themselves did not have most of those institutions in the earlier stages of their development, acquiring most of them only after they became rich (Chang 2005, p. 363–378).

Institutions supporting the market do not have to be public, and do not even have to be formalized. North (1981, p. 201–202) defines an economic institution as a set of rules, compliance procedures and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interests of maximizing the wealth or utility of principals. What is important is that institutions do not need to be ‘designed’, and even if they are, their actual operation may be quite different than intended.

The most important functions of the institution include reducing transaction costs, lowering the cost of entry of new products on the market and facilitating access to information. It is known that the course of the game of supply and demand depends largely on the level of social trust and transparency, which is the result of the quality of the legal system and the morals and mentality of the traders. In other words, the efficiency of markets, and consequently the amount of transaction costs, depends on the institution. Institutions and transaction costs are two sides of market efficiency.

The above-described institutional conditions have a huge impact on the development processes in all countries. This is particularly important in the case of foreign direct investment.

Polish investments in non-European markets

Foreign direct investments that have been made by Polish companies since 2000 show, in general, an upward tendency (Figure 1). The exceptional years were 2012–2013, when an economic downturn and reduction in investments by Polish companies caused a huge withdrawal. 2006 was a record-breaking year, mainly because of a single transaction which remains the biggest Polish foreign investment i.e. the purchase of a refinery in the Lithuanian city of Mažeikiai by Polish giant PKN Orlen (the transaction was priced at ca. €1.86 billion).
The years 2007–2009 were marked in the world economy by global economic crises. Although the value of FDI made by Polish companies was reduced insignificantly in 2007 compared to the previous year, it revived after 2009. The worst period so far were the years 2012 and 2013, when the waves of the global crisis influenced the Polish economy significantly.

The vast majority of companies located their investments in the European Union. Domestic companies were equally willing to invest in the countries of Central and Eastern Europe and the former Soviet Union. That is primarily the result of

1) the geographical proximity (the majority of investments in neighboring countries);

2) the size of the target market and;

3) the degree of maturity of the economy.

Polish direct investments abroad are a direct effect of changes that have occurred in the Polish economy, particularly in the aspect of the level of its globalization. A dynamic increase in these investments points to the growing potential of Polish enterprises which have become active participants of the international system of investment capital turnover. The intensifying trend in the export of Polish capital has also caused changes in the international position of Poland, which is gradually transforming itself from being a recipient of capital in the form of foreign investments towards a more substantial source of this type of capital.

So far, investments outside Europe were made in 25 corporations (of which 15 were companies in Asia, 7 in South and North America, 2 in Australia and 1 in Africa). In 2014, QKR Corporation Limited, an entity belonging to Kulczyk Investments and Qatar Holding, signed with the South African mining conglomerate AngloGold Ashanti an agreement for the acquisition of a 100 percent stake in Anglo-
Gold Ashanti Limited Namibia, which owned pit gold mine in Namibia. In 2013, Group Azoty Police Chemical Plant bought 55% of Senegalese African Investment Group for $28.85 million, thus achieving access to resources in Senegal. The Ebola epidemic stopped the expansion of the Polish company for a while. Attempts to work with Saudi capital are interesting and challenging. The years 2004–2013 produced several Polish-Saudi companies, including POLIMEX ARABIA LTD. (Polimex Mostostal Siedlce SA with several Saudi companies), Elektrobudowa Konin with the Saudi company Al-Alamiyah, and in telecommunications and IT, the company BIATEL ARABIA (involving Biatel SA and Saudi Almashrik Co). In Latin America, the largest Polish investment is the construction of a copper mine in Chile by KGHM. It is Poland’s international flagship investment in recent years (2012–2015), however, it has not yet brought any benefits due to the global crisis on the commodity markets and the drastic fall in copper prices. KGHM’s presence in Chile is fully justified considering Chilean copper resources.

However, not all attempts at capital expansion of Polish companies are successful. Known cases of failure include the case of the Kulczyk investment group’s exploration of gas in Central Asia, as well as the experience of KGHM in Angola and Congo. In the latter case, it invested about $40 million, but the decision was made to withdraw from Africa. The project ended in failure because although they were involved in extracting ore, it turned out that KGHM only had the technology to process it. What is more, some information about international expansion of business located in Poland may be misleading. For instance, recently, the sale of one and a half thousand Ursus tractors to Ethiopia was announced, where an assembly plant will also be built. However, although Ursus is currently based in Lublin, the majority of the capital is Chinese. The internationalization of capital investment, however, is a great opportunity for Polish companies. An example would be the international company Boryszew operating in the automotive industry. In 2015, Boryszew Group signed a contract for the production of parts for Audi in Mexico, which is intended to be foothold for expansion into other countries in the NAFTA zone (Gudowski, Piasecki 2016, 299–304).

In 2014 Polish investors directly invested abroad 5.0 billion PLN – investments in shares and other forms of equity interests amounted to 12.9 billion PLN, positive reinvested income reached PLN 1.5 billion, while investments in debt instruments were negative and amounted to –9.4 billion PLN.

The largest transactions of Polish residents from direct investment abroad took place in Cyprus (PLN 9.6 billion) and France (1.9 billion PLN). Polish direct investors withdrew capital in, among others, Sweden (–9.2 billion PLN) and Luxembourg (–2.0 billion PLN). Polish direct investment abroad is concentrated in such sectors as financial activities and insurance (9.8 billion PLN), professional scientific and technical activities (2.0 billion PLN) and mining (1.3 billion PLN), while the capital withdrawn from entities related to information and communication amounted to –4.7 billion PLN (NBP 2015).
Conclusion

Non-European markets are an important and attractive area of business and their importance will increase. The group of existing “traditional” investors in Africa, Asia and Latin America – American and West European companies – have been joined by Asian corporations, namely China and India, whose presence is particularly evident in Africa. Following them, there are investors from medium-developed countries, including Poland.

Among the many difficulties associated with the expansion of investment in these countries, one of the most important is the long period of “maturity of investments” in markets outside Europe, thus achieving the full economic investment capacity. The reasons for this are various. Regardless of the formal requirements there are also issues of a non-formal nature which must be overcome, regardless of sector and size of capital employed. These local conditions, including the cultural and moral systems, all adds up to what Myrdal terms “soft state”. High costs are therefore a significant barrier for many potential investors.

The nature of capital expansion of Polish companies is varied. These are investments in the capital markets and direct brownfield and greenfield investments. The most promising investments for Polish capital are on the African, Latin American and Asian markets. The situation in these parts of the world is reflected in the attitude of the local governments that are as willing as ever to work with foreign partners. It is also a challenge for the government in the medium-developed countries, whose actions should take into account the needs of potential logistical and financial investors for the successful expansion.

Bibliography

Summary

Foreign direct investment is probably one of the most visible signs of globalization in recent years. Developing countries seek FDIs as a potential tool to complement the level of domestic investment as well as a possible efficiency-gain in-
instrument through the transfer of appropriate technology, management knowledge, business culture, access to foreign markets, increasing employment opportunities, and improving living standards. Undoubtedly, non-European markets, mostly represented by developing countries, are becoming an important and attractive area for economic activities for highly- and medium-developed economies.

The aim of the paper is to discuss and present the investment activities of Polish companies on non-European markets as it poses challenge not only for the companies themselves but also for the government to support the logistical and financial needs of the potential investors.

**Keywords:** foreign direct investment, developing countries, development economics

**Streszczenie**

**Polskie inwestycje na rynkach pozaeuropejskich**

Bezpośrednie inwestycje zagraniczne są prawdopodobnie jednym z najbardziej widocznych znaków globalizacji w ostatnich latach. Kraje rozwijające się ściągają bezpośrednie inwestycje zagraniczne jako potencjalne źródło zwiększających poziom inwestycji krajowych oraz specyficzny instrument zwiększający efektywność poprzez transfery technologii, wiedzy, technik zarządzania, kultury biznesu, dostęp do nowych rynków, zwiększający zatrudnienie i polepszający warunki życia. Niewątpliwie rynki pozaeuropejskie, głównie reprezentowane przez kraje rozwijające się, stają się ważnym i atrakcyjnym obszarem działalności gospodarczej dla krajów wysoko i średnio rozwiniętych.

Celem artykułu jest omówienie aktywności inwestycyjnej polskich przedsiębiorstw na rynkach pozaeuropejskich będącej wyzwaniem nie tylko dla samych przedsiębiorstw, ale także dla rządu mogącego udzielić wsparcia logistycznego i finansowego potencjalnym inwestorom.

**Słowa kluczowe:** bezpośrednie inwestycje zagraniczne, kraje rozwijające się, ekonomia rozwoju

**JEL:** F21, F23, F41, O10